भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA
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RBI/2013-14/70
DBOD.No.BP.BC.2 /21.06.201/2013-14 July 1, 2013

All Scheduled Commercial Banks
(Excluding Local Area Banks
and Regional Rural Banks)

Madam / Sir,

Master Circular – Basel III Capital Regulations

Please refer to the Master Circular No.DBOD.BP.BC.16/21.06.001/2012-13 dated July 2, 2012, consolidating therein the prudential guidelines issued to banks till that date on Capital Adequacy and Market Discipline - New Capital Adequacy Framework (NCAF).

2. As you are aware, Basel III Capital Regulations is being implemented in India with effect from April 1, 2013 in a phased manner. Accordingly, instructions contained in the aforesaid Master Circular have been suitably updated / amended by incorporating relevant guidelines, issued up to June 30, 2013 and is being issued as Master Circular on 'Basel III Capital Regulations'.

3. The Basel II guidelines as contained in the Master Circular DBOD.No.BP.BC.9/21.06.001/2013-14 dated July 1, 2013 on 'Prudential Guidelines on Capital Adequacy and Market Discipline- New Capital Adequacy Framework (NCAF)' may, however, be referred to during the Basel III transition period for regulatory adjustments / deductions up to March 31, 2017.

Yours faithfully,

(Chandan Sinha)
Principal Chief General Manager

Encl.: As above

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Master Circular on Basel III Capital Regulations

Part A: Guidelines on Minimum Capital Requirement

1. Introduction

1.1 Basel III reforms are the response of Basel Committee on Banking Supervision (BCBS) to improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source, thus reducing the risk of spill over from the financial sector to the real economy. During Pittsburgh summit in September 2009, the G20 leaders committed to strengthen the regulatory system for banks and other financial firms and also act together to raise capital standards, to implement strong international compensation standards aimed at ending practices that lead to excessive risk-taking, to improve the over-the-counter derivatives market and to create more powerful tools to hold large global firms to account for the risks they take. For all these reforms, the leaders set for themselves strict and precise timetables. Consequently, the Basel Committee on Banking Supervision (BCBS) released comprehensive reform package entitled "*Basel III: A global regulatory framework for more resilient banks and banking systems*" (known as Basel III capital regulations) in December 2010.

1.2 Basel III reforms strengthen the bank-level i.e. micro prudential regulation, with the intention to raise the resilience of individual banking institutions in periods of stress. Besides, the reforms have a macro prudential focus also, addressing system wide risks, which can build up across the banking sector, as well as the procyclical amplification of these risks over time. These new global regulatory and supervisory standards mainly seek to raise the quality and level of capital to ensure banks are better able to absorb losses on both a going concern and a gone concern basis, increase the risk coverage of the capital framework, introduce leverage ratio to serve as a backstop to the risk-based capital measure, raise the standards for the supervisory review process (Pillar 2) and public disclosures (Pillar 3) etc. The macro prudential aspects of Basel III are largely enshrined in the capital buffers. Both the buffers i.e. the capital conservation buffer and the countercyclical buffer are intended to protect the banking sector from periods of excess credit growth.

1.3 Reserve Bank issued Guidelines based on the Basel III reforms on capital regulation on May 2, 2012, to the extent applicable to banks operating in India. The Basel III capital regulation has been implemented from April 1, 2013 in India in phases and it will be fully implemented as on March 31, 2018.

1.4 Further, on a review, the parallel run and prudential floor for implementation of Basel II vis-à-vis Basel I have been discontinued[1].

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[1] Please refer to the circular DBOD.BP.BC.No.95/21.06.001/2012-13 dated May 27, 2013 on Prudential Guidelines on Capital Adequacy and Market Discipline New Capital Adequacy Framework (NCAF) - Parallel Run and Prudential Floor.

2. Approach to Implementation and Effective Date

2.1 The Basel III capital regulations continue to be based on three-mutually reinforcing Pillars, viz. minimum capital requirements, supervisory review of capital adequacy, and market discipline of the Basel II capital adequacy framework[2]. Under Pillar 1, the Basel III framework will continue to offer the three distinct options for computing capital requirement for credit risk and three other options for computing capital requirement for operational risk, *albeit* with certain modifications / enhancements. These options for credit and operational risks are based on increasing risk sensitivity and allow banks to select an approach that is most appropriate to the stage of development of bank's operations. The options available for computing capital for credit risk are Standardised Approach, Foundation Internal Rating Based Approach and Advanced Internal Rating Based Approach. The options available for computing capital for operational risk are Basic Indicator Approach (BIA), The Standardised Approach (TSA) and Advanced Measurement Approach (AMA).

2.2 Keeping in view the Reserve Bank's goal to have consistency and harmony with international standards, it was decided in 2007 that all commercial banks in India (excluding Local Area Banks and Regional Rural Banks) should adopt Standardised Approach for credit risk, Basic Indicator Approach for operational risk by March 2009 and banks should continue to apply the Standardised Duration Approach (SDA) for computing capital requirement for market risks.

2.3 Having regard to the necessary upgradation of risk management framework as also capital efficiency likely to accrue to the banks by adoption of the advanced approaches, the following time schedule was laid down for implementation of the advanced approaches for the regulatory capital measurement in July 2009:

S. No.	Approach	The earliest date of making application by banks to the RBI	Likely date of approval by the RBI
a.	Internal Models Approach (IMA) for Market Risk	April 1, 2010	March 31, 2011
b.	The Standardised Approach (TSA) for Operational Risk	April 1, 2010	September 30, 2010
c.	Advanced Measurement Approach (AMA) for Operational Risk	April 1, 2012	March 31, 2014
d.	Internal Ratings-Based (IRB) Approaches for Credit Risk (Foundation- as well as Advanced IRB)	April 1, 2012	March 31, 2014

[2] For reference, please refer to the Master Circular on Prudential Guidelines on Capital Adequacy and Market Discipline - New Capital Adequacy Framework (NCAF) issued vide circular DBOD.No.BP.BC.9/21.06.001/2013-14 dated July 1, 2013.

2.4 Accordingly, banks were advised to undertake an internal assessment of their preparedness for migration to advanced approaches and take a decision with the approval of their Boards, whether they would like to migrate to any of the advanced approaches. Based on bank's internal assessment and its preparation, a bank may choose a suitable date to apply for implementation of advanced approach. Besides, banks, at their discretion, would have the option of adopting the advanced approaches for one or more of the risk categories, as per their preparedness, while continuing with the simpler approaches for other risk categories, and it would not be necessary to adopt the advanced approaches for all the risk categories simultaneously. However, banks should invariably obtain prior approval of the RBI for adopting any of the advanced approaches.

2.5 **Effective Date:** The Basel III capital regulations are being implemented in India with effect from April 1, 2013. Banks have to comply with the regulatory limits and minima as prescribed under Basel III capital regulations, on an ongoing basis. To ensure smooth transition to Basel III, appropriate transitional arrangements have been provided for meeting the minimum Basel III capital ratios, full regulatory adjustments to the components of capital etc. Consequently, Basel III capital regulations would be fully implemented as on March 31, 2018. In view of the gradual phase-in of regulatory adjustments to the Common Equity component of Tier 1 capital under Basel III, certain specific prescriptions of Basel II capital adequacy framework (e.g. rules relating to deductions from regulatory capital, risk weighting of investments in other financial entities etc.) will also continue to apply till March 31, 2017 on the remainder of regulatory adjustments not treated in terms of Basel III rules (refer to paragraph 4.5.2).

3. Scope of Application of Capital Adequacy Framework

3.1 A bank shall comply with the capital adequacy ratio requirements at two levels:

(a) the consolidated ("Group") level[3] capital adequacy ratio requirements, which measure the capital adequacy of a bank based on its capital strength and risk profile after consolidating the assets and liabilities of its subsidiaries / joint ventures / associates etc. except those engaged in insurance and any non-financial activities; and

(b) the standalone ("Solo") level capital adequacy ratio requirements, which measure the capital adequacy of a bank based on its standalone capital strength and risk profile.

Accordingly, overseas operations of a bank through its branches will be covered in both the above scenarios.

3.2 For the purpose of these guidelines, the subsidiary is an enterprise that is controlled by another enterprise (known as the parent). Banks will follow the definition of 'control' as given in the applicable accounting standards.

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[3] In terms of guidelines on preparation of consolidated prudential reports issued vide circular DBOD. No.BP.BC.72/21.04.018/ 2001-02 dated February 25, 2003; a consolidated bank may exclude group companies which are engaged in insurance business and businesses not pertaining to financial services. A consolidated bank should maintain a minimum Capital to Risk-weighted Assets Ratio (CRAR) as applicable to a bank on an ongoing basis.

3.3 Capital Adequacy at Group / Consolidated Level

3.3.1 All banking and other financial subsidiaries except subsidiaries engaged in insurance and any non-financial activities (both regulated and unregulated) should be fully consolidated for the purpose of capital adequacy. This would ensure assessment of capital adequacy at the group level, taking into account the risk profile of assets and liabilities of the consolidated subsidiaries.

3.3.2 The insurance and non-financial subsidiaries / joint ventures / associates etc. of a bank **should not** be consolidated for the purpose of capital adequacy. The equity and other regulatory capital investments in the insurance and non-financial subsidiaries will be deducted from consolidated regulatory capital of the group. Equity and other regulatory capital investments in the unconsolidated insurance and non-financial entities of banks (which also include joint ventures / associates of the parent bank) will be treated in terms of paragraphs 4.4.9 and 5.13.6 respectively.

3.3.3 All regulatory adjustments indicated in paragraph 4.4 are required to be made to the consolidated Common Equity Tier 1 capital of the banking group as indicated therein.

3.3.4 Minority interest (i.e. non-controlling interest) and other capital issued out of consolidated subsidiaries as per paragraph 3.3.1 that is held by third parties will be recognized in the consolidated regulatory capital of the group subject to certain conditions as stipulated in paragraph 4.3.

3.3.5 Banks should ensure that majority owned financial entities that are not consolidated for capital purposes and for which the investment in equity and other instruments eligible for regulatory capital status is deducted, meet their respective regulatory capital requirements. In case of any shortfall in the regulatory capital requirements in the unconsolidated entity, the shortfall shall be fully deducted from the Common Equity Tier 1 capital.

3.4 Capital Adequacy at Solo Level

3.4.1 While assessing the capital adequacy of a bank at solo level, all regulatory adjustments indicated in paragraph 4.4 are required to be made. In addition, investments in the capital instruments of the subsidiaries, which are consolidated in the consolidated financial statements of the group, will also have to be deducted from the corresponding capital instruments issued by the bank.

3.4.2 In case of any shortfall in the regulatory capital requirements in the unconsolidated entity (e.g. insurance subsidiary), the shortfall shall be fully deducted from the Common Equity Tier 1 capital.

4. Composition of Regulatory Capital

4.1 General

Banks are required to maintain a minimum Pillar 1 Capital to Risk-weighted Assets Ratio (CRAR) of 9% on an on-going basis (other than capital conservation buffer and countercyclical capital buffer etc.). The Reserve Bank will take into account the relevant risk factors and the internal capital adequacy assessments of each bank to ensure that the

capital held by a bank is commensurate with the bank's overall risk profile. This would include, among others, the effectiveness of the bank's risk management systems in identifying, assessing / measuring, monitoring and managing various risks including interest rate risk in the banking book, liquidity risk, concentration risk and residual risk. Accordingly, the Reserve Bank will consider prescribing a higher level of minimum capital ratio for each bank under the Pillar 2 framework on the basis of their respective risk profiles and their risk management systems. Further, in terms of the Pillar 2 requirements, banks are expected to operate at a level well above the minimum requirement. A bank should compute Basel III capital ratios in the following manner:

$$\text{Common Equity Tier 1 capital ratio} = \frac{\text{Common Equity Tier 1 Capital}}{\text{Credit Risk RWA* + Market Risk RWA + Operational Risk RWA}}.$$

$$\text{Tier 1 capital ratio} = \frac{\text{Eligible Tier 1 Capital}[4]}{\text{Credit Risk RWA* + Market Risk RWA + Operational Risk RWA}}.$$

$$\text{Total Capital (CRAR}^{\#}\text{)} = \frac{\text{Eligible Total Capital}[5]}{\text{Credit Risk RWA + Market Risk RWA + Operational Risk RWA}}.$$

* RWA = Risk weighted Assets;
# Capital to Risk Weighted Asset Ratio

4.2 Elements of Regulatory Capital and the Criteria for their Inclusion in the Definition of Regulatory Capital

4.2.1 Components of Capital

Total regulatory capital will consist of the sum of the following categories:

(i) Tier 1 Capital (going-concern capital[6])

(a) Common Equity Tier 1

(b) Additional Tier 1

(ii) Tier 2 Capital (gone-concern capital)

4.2.2 Limits and Minima

(i) As a matter of prudence, it has been decided that scheduled commercial banks (excluding LABs and RRBs) operating in India shall maintain a minimum total capital (MTC) of 9% of total risk weighted assets (RWAs) i.e. capital to risk weighted assets (CRAR). This will be further divided into different components as described under paragraphs 4.2.2(ii) to

[4] Tier 1 capital in terms of paragraph 4.2.2(vii)
[5] Total Capital in terms of paragraph 4.2.2(vii)
[6] From regulatory capital perspective, going-concern capital is the capital which can absorb losses without triggering bankruptcy of the bank. Gone-concern capital is the capital which will absorb losses only in a situation of liquidation of the bank.

4.2.2(viii).

(ii) Common Equity Tier 1 (CET1) capital must be at least 5.5% of risk-weighted assets (RWAs) i.e. for credit risk + market risk + operational risk on an ongoing basis.

(iii) Tier 1 capital must be at least 7% of RWAs on an ongoing basis. Thus, within the minimum Tier 1 capital, Additional Tier 1 capital can be admitted maximum at 1.5% of RWAs.

(iv) Total Capital (Tier 1 Capital plus Tier 2 Capital) must be at least 9% of RWAs on an ongoing basis. Thus, within the minimum CRAR of 9%, Tier 2 capital can be admitted maximum up to 2%.

(v) If a bank has complied with the minimum Common Equity Tier 1 and Tier 1 capital ratios, then the excess Additional Tier 1 capital can be admitted for compliance with the minimum CRAR of 9% of RWAs.

(vi) In addition to the minimum Common Equity Tier 1 capital of 5.5% of RWAs, banks are also required to maintain a capital conservation buffer (CCB) of 2.5% of RWAs in the form of Common Equity Tier 1 capital. Details of operational aspects of CCB have been furnished in **paragraph 15**. Thus, with full implementation of capital ratios[7] and CCB the capital requirements are summarised as follows:

	Regulatory Capital	**As % to RWAs**
(i)	Minimum Common Equity Tier 1 Ratio	5.5
(ii)	Capital Conservation Buffer (comprised of Common Equity)	2.5
(iii)	Minimum Common Equity Tier 1 Ratio plus Capital Conservation Buffer [(i)+(ii)]	8.0
(iv)	Additional Tier 1 Capital	1.5
(v)	Minimum Tier 1 Capital Ratio [(i) +(iv)]	7.0
(vi)	Tier 2 Capital	2.0
(vii)	Minimum Total Capital Ratio (MTC) [(v)+(vi)]	9.0
(viii)	Minimum Total Capital Ratio plus Capital Conservation Buffer [(vii)+(ii)]	11.5

(vii) For the purpose of reporting Tier 1 capital and CRAR, any excess Additional Tier 1 (AT1) capital and Tier 2 (T2) capital will be recognised in the same proportion as that applicable towards minimum capital requirements. This would mean that to admit any excess AT1 and T2 capital, the bank should have excess CET1 over and above 8%[8] (5.5%+2.5%). An illustration has been given in **Part A of Annex 14**.

(viii) It would follow from paragraph 4.2.2(vii) that in cases where the a bank does not have minimum Common Equity Tier 1 + capital conservation buffer of 2.5% of RWAs as required but, has excess Additional Tier 1 and / or Tier 2 capital, no such excess capital can be reckoned towards computation and reporting of Tier 1 capital and Total Capital.

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[7]For smooth migration to these capital ratios, transitional arrangements have been provided as detailed in paragraph 4.5.

[8] During the transition period, the excess will be determined with reference to the applicable minimum Common Equity Tier 1 capital and applicable capital conservation buffer and the proportion with reference to the available Common Equity. For instance, as on March 31, 2015, the excess Additional Tier 1 and Tier 2 will be determined with reference to total Common Equity 6.125% (5.5%+0.625%) and the proportion with reference to 5.5% Common Equity Tier 1 capital.

(ix) For the purpose of all prudential exposure limits linked to capital funds, the 'capital funds'[9] will exclude the applicable capital conservation buffer and countercyclical capital buffer as and when activated, but include Additional Tier 1 capital and Tier 2 capital which are supported by proportionate amount of Common Equity Tier 1 capital as indicated in paragraph 4.2.2(vii). Accordingly, capital funds will be defined as [(Common Equity Tier 1 capital) + (Additional Tier 1 capital and Tier 2 capital eligible for computing and reporting CRAR of the bank)]. It may be noted that the term 'Common Equity Tier 1 capital' does not include capital conservation buffer and countercyclical capital buffer.

4.2.3 **Common Equity Tier 1 Capital**

4.2.3.1 **Common Equity – Indian Banks**

A. Elements of Common Equity Tier 1 Capital

Elements of Common Equity component of Tier 1 capital will comprise the following:

(i) Common shares (paid-up equity capital) issued by the bank which meet the criteria for classification as common shares for regulatory purposes as given in **Annex 1**;

(ii) Stock surplus (share premium) resulting from the issue of common shares;

(iii) Statutory reserves;

(iv) Capital reserves representing surplus arising out of sale proceeds of assets;

(v) Other disclosed free reserves, if any;

(vi) Balance in Profit & Loss Account at the end of the previous financial year;

(vii) Banks may reckon the profits in current financial year for CRAR calculation on a quarterly basis provided the incremental provisions made for non-performing assets at the end of any of the four quarters of the previous financial year have not deviated more than 25% from the average of the four quarters. The amount which can be reckoned would be arrived at by using the following formula:

$EP_t = \{NP_t - 0.25*D*t\}$

Where;

EP_t = Eligible profit up to the quarter 't' of the current financial year; t varies from 1 to 4

NP_t = Net profit up to the quarter 't'

D= average annual dividend paid during last three years

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[9]The definition of capital funds as indicated in para 4.2.2(ix) will be reviewed by RBI as and when any changes in the Large Exposure regime is considered by the Basel Committee.

(viii) While calculating capital adequacy at the consolidated level, common shares issued by consolidated subsidiaries of the bank and held by third parties (i.e. minority interest) which meet the criteria for inclusion in Common Equity Tier 1 capital (refer to paragraph 4.3.2); and

(ix) Less: Regulatory adjustments / deductions applied in the calculation of Common Equity Tier 1 capital [i.e. to be deducted from the sum of items (i) to (viii)].

B. ***Criteria for Classification as Common Shares for Regulatory Purposes***

Common Equity is recognised as the highest quality component of capital and is the primary form of funding which ensures that a bank remains solvent. Therefore, under Basel III, common shares to be included in Common Equity Tier 1 capital must meet the criteria as furnished in **Annex 1.**

4.2.3.2 **Common Equity Tier 1 Capital – Foreign Banks' Branches**

A. ***Elements of Common Equity Tier 1 Capital***

Elements of Common Equity Tier 1 capital will remain the same and consist of the following:

(i) Interest-free funds from Head Office kept in a separate account in Indian books specifically for the purpose of meeting the capital adequacy norms;

(ii) Statutory reserves kept in Indian books;

(iii) Remittable surplus retained in Indian books which is not repatriable so long as the bank functions in India;

(iv) Interest-free funds remitted from abroad for the purpose of acquisition of property and held in a separate account in Indian books provided they are non-repatriable and have the ability to absorb losses regardless of their source;

(v) Capital reserve representing surplus arising out of sale of assets in India held in a separate account and which is not eligible for repatriation so long as the bank functions in India; and

(vi) Less: Regulatory adjustments / deductions applied in the calculation of Common Equity Tier 1 capital [i.e. to be deducted from the sum of items (i) to (v)].

B. ***Criteria for Classification as Common Equity for Regulatory Purposes***

The instruments to be included in Common Equity Tier 1 capital must meet the criteria furnished in **Annex 2.**

Notes:

(i) Foreign banks are required to furnish to Reserve Bank, an undertaking to the effect that the bank will not remit abroad the 'capital reserve' and 'remittable surplus retained in India' as long as they function in India to be eligible for including this item under Common Equity Tier 1 capital.

(ii) These funds may be retained in a separate account titled as 'Amount Retained in India for Meeting Capital to Risk-weighted Asset Ratio (CRAR) Requirements' under 'Capital Funds'.

(iii) An auditor's certificate to the effect that these funds represent surplus remittable to Head Office once tax assessments are completed or tax appeals are decided and do not include funds in the nature of provisions towards tax or for any other contingency may also be furnished to Reserve Bank.

(iv) The net credit balance, if any, in the inter-office account with Head Office / overseas branches will not be reckoned as capital funds. However, the debit balance in the Head Office account will have to be set-off against capital subject to the following provisions[10]:

(a) If net overseas placements with Head Office / other overseas branches / other group entities (Placement minus borrowings, excluding Head Office borrowings for Tier I and II capital purposes) exceed 10% of the bank's minimum CRAR requirement, the amount in excess of this limit would be deducted from Tier I capital.

(b) For the purpose of the above prudential cap, the net overseas placement would be the higher of the overseas placements as on date and the average daily outstanding over year to date.

(c) The overall cap on such placements / investments will continue to be guided by the present regulatory and statutory restrictions i.e. net open position limit and the gap limits approved by the Reserve Bank of India, and Section 25 of the Banking Regulation Act, 1949. All such transactions should also be in conformity with other FEMA guidelines.

4.2.4 **Additional Tier 1 Capital**

4.2.4.1 **Additional Tier 1 Capital – Indian Banks**

A. **Elements of Additional Tier 1 Capital**

Additional Tier 1 capital will consist of the sum of the following elements:

(i) Perpetual Non-Cumulative Preference Shares (PNCPS), which comply with the regulatory requirements as specified in **Annex 3**;

(ii) Stock surplus (share premium) resulting from the issue of instruments included in Additional Tier 1 capital;

(iii) Debt capital instruments eligible for inclusion in Additional Tier 1 capital, which comply with the regulatory requirements as specified in **Annex 4**;

(iv) Any other type of instrument generally notified by the Reserve Bank from time to time for inclusion in Additional Tier 1 capital;

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[10] Please refer to the circular DBOD.No.BP.BC.28/21.06.001/2012-13 dated July 9, 2012 on 'Treatment of Head Office Debit Balance - Foreign Banks'.

(v) While calculating capital adequacy at the consolidated level, Additional Tier 1 instruments issued by consolidated subsidiaries of the bank and held by third parties which meet the criteria for inclusion in Additional Tier 1 capital (refer to paragraph 4.3.3); and

(vi) Less: Regulatory adjustments / deductions applied in the calculation of Additional Tier 1 capital [i.e. to be deducted from the sum of items (i) to (v)].

B. ***Criteria for Classification as Additional Tier 1 Capital for Regulatory Purposes***

(i) Under Basel III, the criteria for instruments to be included in Additional Tier 1 capital have been modified to improve their loss absorbency as indicated in **Annex 3, 4 and 16.** Criteria for inclusion of Perpetual Non-Cumulative Preference Shares (PNCPS) in Additional Tier 1 Capital are furnished in **Annex 3**. Criteria for inclusion of Perpetual Debt Instruments (PDI) in Additional Tier 1 Capital are furnished in **Annex 4**. **Annex 16** contains criteria for loss absorption through conversion / write-down / write-off of Additional Tier 1 instruments on breach of the pre-specified trigger and of all non-common equity regulatory capital instruments at the point of non-viability.

(ii) Banks should not issue Additional Tier 1 capital instruments to the retail investors.

4.2.4.2 **Elements and Criteria for Additional Tier 1 Capital – Foreign Banks' Branches**

Various elements and their criteria for inclusion in the Additional Tier 1 capital are as follows:

(i) Head Office borrowings in foreign currency by foreign banks operating in India for inclusion in Additional Tier 1 capital which comply with the regulatory requirements as specified in **Annex 4 and Annex 16**;

(ii) Any other item specifically allowed by the Reserve Bank from time to time for inclusion in Additional Tier 1 capital; and

(iii) Less: Regulatory adjustments / deductions applied in the calculation of Additional Tier 1 capital [i.e. to be deducted from the sum of items (i) to (ii)].

4.2.5 **Elements of Tier 2 Capital**

Under Basel III, there will be a single set of criteria governing all Tier 2 debt capital instruments.

4.2.5.1 **Tier 2 Capital - Indian Banks**

A. **Elements of Tier 2 Capital**

(i) General Provisions and Loss Reserves

a. Provisions or loan-loss reserves held against future, presently unidentified losses, which are freely available to meet losses which subsequently materialize, will qualify for inclusion within Tier 2 capital. Accordingly, General Provisions on Standard Assets, Floating

Provisions[11], Provisions held for Country Exposures, Investment Reserve Account, excess provisions which arise on account of sale of NPAs and 'countercyclical provisioning buffer[12]' will qualify for inclusion in Tier 2 capital. However, these items together will be admitted as Tier 2 capital up to a maximum of 1.25% of the total credit risk-weighted assets under the standardized approach. Under Internal Ratings Based (IRB) approach, where the total expected loss amount is less than total eligible provisions, banks may recognise the difference as Tier 2 capital up to a maximum of 0.6% of credit-risk weighted assets calculated under the IRB approach.

b. Provisions ascribed to identified deterioration of particular assets or loan liabilities, whether individual or grouped should be excluded. Accordingly, for instance, specific provisions on NPAs, both at individual account or at portfolio level, provisions in lieu of diminution in the fair value of assets in the case of restructured advances, provisions against depreciation in the value of investments will be excluded.

(ii) Debt Capital Instruments issued by the banks;

(iii) Preference Share Capital Instruments [Perpetual Cumulative Preference Shares (PCPS) / Redeemable Non-Cumulative Preference Shares (RNCPS) / Redeemable Cumulative Preference Shares (RCPS)] issued by the banks;

(iv) Stock surplus (share premium) resulting from the issue of instruments included in Tier 2 capital;

(v) While calculating capital adequacy at the consolidated level, Tier 2 capital instruments issued by consolidated subsidiaries of the bank and held by third parties which meet the criteria for inclusion in Tier 2 capital (refer to paragraph 4.3.4);

(vi) Revaluation reserves at a discount of 55%[13];

(vii) Any other type of instrument generally notified by the Reserve Bank from time to time for inclusion in Tier 2 capital; and

(viii) Less: Regulatory adjustments / deductions applied in the calculation of Tier 2 capital [i.e. to be deducted from the sum of items (i) to (vii)].

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[11] Banks will continue to have the option to net off such provisions from Gross NPAs to arrive at Net NPA or reckoning it as part of their Tier 2 capital as per circular DBOD.NO.BP.BC 33/21.04.048/2009-10 dated August 27, 2009.

[12] Please refer to circular DBOD.No.BP.BC.87/21.04.048/2010-11 dated April 21, 2011 on provisioning coverage ratio (PCR) for advances.

[13] These reserves often serve as a cushion against unexpected losses, but they are less permanent in nature and cannot be considered as 'Core Capital'. Revaluation reserves arise from revaluation of assets that are undervalued on the bank's books, typically bank premises. The extent to which the revaluation reserves can be relied upon as a cushion for unexpected losses depends mainly upon the level of certainty that can be placed on estimates of the market values of the relevant assets, the subsequent deterioration in values under difficult market conditions or in a forced sale, potential for actual liquidation at those values, tax consequences of revaluation, etc. Therefore, it would be prudent to consider revaluation reserves at a discount of 55% while determining their value for inclusion in Tier 2 capital. Such reserves will have to be reflected on the face of the Balance Sheet as revaluation reserves.

B. ***Criteria for Classification as Tier 2 Capital for Regulatory Purposes***

Under Basel III, the criteria for instruments[14] to be included in Tier 2 capital have been modified to improve their loss absorbency as indicated in **Annex 5, 6 and 16**. Criteria for inclusion of Debt Capital Instruments as Tier 2 capital are furnished in **Annex 5.** Criteria for inclusion of Perpetual Cumulative Preference Shares (PCPS) / Redeemable Non-Cumulative Preference Shares (RNCPS) / Redeemable Cumulative Preference Shares (RCPS) as part of Tier 2 capital are furnished in **Annex 6**. **Annex 16** contains criteria for loss absorption through conversion / write-off of all non-common equity regulatory capital instruments at the point of non-viability.

4.2.5.2 **Tier 2 Capital – Foreign Banks' Branches**

A. **Elements of Tier 2 Capital**

Elements of Tier 2 capital in case of foreign banks' branches will be as under:

(i) General Provisions and Loss Reserves (as detailed in paragraph 4.2.5.1.A.(i) above);

(ii) Head Office (HO) borrowings in foreign currency received as part of Tier 2 debt capital;

(iii) Revaluation reserves at a discount of 55%; and

(iv) Less: Regulatory adjustments / deductions applied in the calculation of Tier 2 capital [i.e. to be deducted from the sum of items (i) and (iii)].

B. **Criteria for Classification as Tier 2 Capital for Regulatory Purposes**

Criteria for inclusion of Head Office (HO) borrowings in foreign currency received as part of Tier 2 debt Capital for foreign banks are furnished in **Annex 5 and Annex 16.**

4.3 Recognition of Minority Interest (i.e. Non-Controlling Interest) and Other Capital Issued out of Consolidated Subsidiaries That is Held by Third Parties

4.3.1 Under Basel III, the minority interest is recognised only in cases where there is considerable explicit or implicit assurance that the minority interest which is supporting the risks of the subsidiary would be available to absorb the losses at the consolidated level. Accordingly, the portion of minority interest which supports risks in a subsidiary that is a bank will be included in group's Common Equity Tier 1. Consequently, minority interest in the subsidiaries which are not banks will not be included in the regulatory capital of the group. In other words, the proportion of surplus capital which is attributable to the minority shareholders would be excluded from the group's Common Equity Tier 1 capital. Further, as opposed to Basel II, a need was felt to extend the minority interest treatment to other

[14] Please also refer circular DBOD.BP.BC.No.75/21.06.001/2010-11 dated January 20, 2011 on 'Regulatory Capital Instruments – Step up Option' doing away with step up option. Banks may also refer to the BCBS Press Release dated September 12, 2010 indicating announcements made by the Group of Governors and Heads of Supervision on higher global minimum capital standards.

components of regulatory capital also (i.e. Additional Tier 1 capital and Tier 2 capital). Therefore, under Basel III, the minority interest in relation to other components of regulatory capital will also be recognised.

4.3.2 Treatment of Minority Interest Corresponding to Common Shares Issued by Consolidated Subsidiaries

Minority interest arising from the issue of common shares by a fully consolidated subsidiary of the bank may receive recognition in Common Equity Tier 1 capital only if: (a) the instrument giving rise to the minority interest would, if issued by the bank, meet all of the criteria for classification as common shares for regulatory capital purposes as stipulated in **Annex 1**; and (b) the subsidiary that issued the instrument is itself a bank[15]. The amount of minority interest meeting the criteria above that will be recognised in consolidated Common Equity Tier 1 capital will be calculated as follows:

(i) Total minority interest meeting the two criteria above minus the amount of the surplus Common Equity Tier 1 capital of the subsidiary attributable to the minority shareholders.

(ii) Surplus Common Equity Tier 1 capital of the subsidiary is calculated as the Common Equity Tier 1 of the subsidiary minus the lower of: (a) the minimum Common Equity Tier 1 capital requirement of the subsidiary plus the capital conservation buffer (i.e. 8.0% of risk weighted assets) and (b) the portion of the consolidated minimum Common Equity Tier 1 capital requirement plus the capital conservation buffer (i.e. 8.0% of consolidated risk weighted assets) that relates to the subsidiary[16].

(iii) The amount of the surplus Common Equity Tier 1 capital that is attributable to the minority shareholders is calculated by multiplying the surplus Common Equity Tier 1 by the percentage of Common Equity Tier 1 that is held by minority shareholders.

4.3.3 Treatment of Minority Interest Corresponding to Tier 1 Qualifying Capital Issued by Consolidated Subsidiaries

Tier 1 capital instruments issued by a fully consolidated subsidiary of the bank to third party investors (including amounts under paragraph 4.3.2) may receive recognition in Tier 1 capital only if the instruments would, if issued by the bank, meet all of the criteria for classification as Tier 1 capital. The amount of this capital that will be recognised in Tier 1 capital will be calculated as follows:

(i) Total Tier 1 capital of the subsidiary issued to third parties minus the amount of the surplus Tier 1 capital of the subsidiary attributable to the third party investors.

(ii) Surplus Tier 1 capital of the subsidiary is calculated as the Tier 1 capital of the subsidiary minus the lower of: (a) the minimum Tier 1 capital requirement of the subsidiary plus the capital conservation buffer (i.e. 9.5% of risk weighted assets) and (b) the portion of the consolidated minimum Tier 1 capital requirement plus the capital conservation buffer (i.e. 9.5% of consolidated risk weighted assets) that relates to the subsidiary.

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[15] For the purposes of this paragraph, All India Financial Institutions, Non-banking Financial Companies regulated by RBI and Primary Dealers will be considered to be a bank.

[16] The ratios used as the basis for computing the surplus (8.0%, 9.5% and 11.5%) in paragraphs 4.3.2, 4.3.3 and 4.3.4 respectively will not be phased-in.

(iii) The amount of the surplus Tier 1 capital that is attributable to the third party investors is calculated by multiplying the surplus Tier 1 capital by the percentage of Tier 1 capital that is held by third party investors.

The amount of this Tier 1 capital that will be recognised in Additional Tier 1 capital will exclude amounts recognised in Common Equity Tier 1 capital under paragraph 4.3.2.

4.3.4 **Treatment of Minority Interest Corresponding to Tier 1 Capital and Tier 2 Capital Qualifying Capital Issued by Consolidated Subsidiaries**

Total capital instruments (i.e. Tier 1 and Tier 2 capital instruments) issued by a fully consolidated subsidiary of the bank to third party investors (including amounts under paragraphs 4.3.2 and 4.3.3) may receive recognition in Total Capital only if the instruments would, if issued by the bank, meet all of the criteria for classification as Tier 1 or Tier 2 capital. The amount of this capital that will be recognised in consolidated Total Capital will be calculated as follows:

(i) Total capital instruments of the subsidiary issued to third parties minus the amount of the surplus Total Capital of the subsidiary attributable to the third party investors.

(ii) Surplus Total Capital of the subsidiary is calculated as the Total Capital of the subsidiary minus the lower of: (a) the minimum Total Capital requirement of the subsidiary plus the capital conservation buffer (i.e. 11.5% of risk weighted assets) and (b) the portion of the consolidated minimum Total Capital requirement plus the capital conservation buffer (i.e. 11.5% of consolidated risk weighted assets) that relates to the subsidiary.

(iii) The amount of the surplus Total Capital that is attributable to the third party investors is calculated by multiplying the surplus Total Capital by the percentage of Total Capital that is held by third party investors.

The amount of this Total Capital that will be recognised in Tier 2 capital will exclude amounts recognised in Common Equity Tier 1 capital under paragraph 4.3.2 and amounts recognised in Additional Tier 1 under paragraph 4.3.3.

4.3.5 An illustration of calculation of minority interest and other capital issued out of consolidated subsidiaries that is held by third parties is furnished in **Annex 17.**

4.4 Regulatory Adjustments / Deductions

The following paragraphs deal with the regulatory adjustments / deductions which will be applied to regulatory capital **both** at solo and consolidated level.

4.4.1 **Goodwill and all Other Intangible Assets**

(i) Goodwill and all other intangible assets should be deducted from Common Equity Tier 1 capital including any goodwill included in the valuation of significant investments in the capital of banking, financial and insurance entities which are outside the scope of regulatory consolidation. In terms of AS 23 – Accounting for investments in associates, goodwill/capital reserve arising on the acquisition of an associate by an investor should be included in the carrying amount of investment in the associate but should be disclosed separately. Therefore, if the acquisition of equity interest in any associate involves payment which can be attributable to

goodwill, this should be deducted from the Common Equity Tier 1 of the bank.

(ii) The full amount of the intangible assets is to be deducted net of any associated deferred tax liabilities which would be extinguished if the intangible assets become impaired or derecognized under the relevant accounting standards. For this purpose, the definition of intangible assets would be in accordance with the Indian accounting standards. Operating losses in the current period and those brought forward from previous periods should also be deducted from Common Equity Tier 1 capital.

(iii) Application of these rules at consolidated level would mean deduction of any goodwill and other intangible assets from the consolidated Common Equity which is attributed to the Balance Sheets of subsidiaries, in addition to deduction of goodwill and other intangible assets which pertain to the solo bank.

4.4.2 **Deferred Tax Assets (DTAs)**

(i) The DTAs computed as under should be deducted from Common Equity Tier 1 capital:

(a) DTA associated with accumulated losses; and

(b) The DTA (excluding DTA associated with accumulated losses), net of DTL. Where the DTL is in excess of the DTA (excluding DTA associated with accumulated losses), the excess shall neither be adjusted against item (a) nor added to Common Equity Tier 1 capital.

(ii) Application of these rules at consolidated level would mean deduction of DTAs from the consolidated Common Equity which is attributed to the subsidiaries, in addition to deduction of DTAs which pertain to the solo bank.

4.4.3 **Cash Flow Hedge Reserve**

(i) The amount of the cash flow hedge reserve which relates to the hedging of items that are not fair valued on the balance sheet (including projected cash flows) should be derecognised in the calculation of Common Equity Tier 1. This means that positive amounts should be deducted and negative amounts should be added back. This treatment specifically identifies the element of the cash flow hedge reserve that is to be derecognised for prudential purposes. It removes the element that gives rise to artificial volatility in Common Equity, as in this case the reserve only reflects one half of the picture (the fair value of the derivative, but not the changes in fair value of the hedged future cash flow).

(ii) Application of these rules at consolidated level would mean derecognition of cash flow hedge reserve from the consolidated Common Equity which is attributed to the subsidiaries, in addition to derecognition of cash flow hedge reserve pertaining to the solo bank.

4.4.4 **Shortfall of the Stock of Provisions to Expected Losses**

The deduction from capital in respect of a shortfall of the stock of provisions to expected losses under the Internal Ratings Based (IRB) approach should be made in

the calculation of Common Equity Tier 1. The full amount is to be deducted and should not be reduced by any tax effects that could be expected to occur if provisions were to rise to the level of expected losses.

4.4.5 **Gain-on-Sale Related to Securitisation Transactions**

(i) As per Basel III rule text, banks are required to derecognise in the calculation of Common Equity Tier 1 capital, any increase in equity capital resulting from a securitisation transaction, such as that associated with expected future margin income (FMI) resulting in a gain-on-sale. However, as per existing guidelines on securitization of standard assets issued by RBI, banks are not permitted to recognise the gain-on-sale in the P&L account including cash profits. Therefore, there is no need for any deduction on account of gain-on-sale on securitization. Banks are allowed to amortise the profit including cash profit over the period of the securities issued by the SPV. However, if a bank is following an accounting practice which in substance results in recognition of realized or unrealized gains at the inception of the securitization transactions, the treatment stipulated as per Basel III rule text as indicated in the beginning of the paragraph would be applicable.

(ii) Application of these rules at consolidated level would mean deduction of gain-on-sale from the consolidated Common Equity which is recognized by the subsidiaries in their P&L and / or equity, in addition to deduction of any gain-on-sale recognised by the bank at the solo level.

4.4.6 **Cumulative Gains and Losses due to Changes in Own Credit Risk on Fair Valued Financial Liabilities**

(i) Banks are required to derecognise in the calculation of Common Equity Tier 1 capital, all unrealised gains and losses which have resulted from changes in the fair value of liabilities that are due to changes in the bank’s own credit risk. In addition, with regard to derivative liabilities, derecognise all accounting valuation adjustments arising from the bank's own credit risk. The offsetting between valuation adjustments arising from the bank's own credit risk and those arising from its counterparties' credit risk is not allowed. If a bank values its derivatives and securities financing transactions (SFTs) liabilities taking into account its own creditworthiness in the form of debit valuation adjustments (DVAs), then the bank is required to deduct all DVAs from its Common Equity Tier 1 capital, irrespective of whether the DVAs arises due to changes in its own credit risk or other market factors. Thus, such deduction also includes the deduction of initial DVA at inception of a new trade. In other words, though a bank will have to recognize a loss reflecting the credit risk of the counterparty (i.e. credit valuation adjustments-CVA), the bank will not be allowed to recognize the corresponding gain due to its own credit risk.

(ii) Application of these rules at consolidated level would mean derecognition of unrealised gains and losses which have resulted from changes in the fair value of liabilities that are due to changes in the subsidiaries’ credit risk, in the calculation of consolidated Common Equity Tier 1 capital, in addition to derecognition of any such unrealised gains and losses attributed to the bank at the solo level.

4.4.7 **Defined Benefit Pension Fund[17] Assets and Liabilities**

(i) Defined benefit pension fund liabilities, as included on the balance sheet, must be fully recognised in the calculation of Common Equity Tier 1 capital (i.e. Common Equity Tier 1 capital cannot be increased through derecognising these liabilities). For each defined benefit pension fund that is an asset on the balance sheet, the asset should be deducted in the calculation of Common Equity Tier 1 net of any associated deferred tax liability which would be extinguished if the asset should become impaired or derecognised under the relevant accounting standards.

(ii) Application of these rules at consolidated level would mean deduction of defined benefit pension fund assets and recognition of defined benefit pension fund liabilities pertaining to subsidiaries in the consolidated Common Equity Tier 1, in addition to those pertaining to the solo bank.

(iii) In terms of circular DBOD.No.BP.BC.80/21.04.018/2010-11dated February 9, 2011, a special dispensation of amortizing the expenditure arising out of second pension option and enhancement of gratuity over a period of 5 years was permitted to public sector banks as also select private sector banks who were parties to 9th bipartite settlement with Indian Banks Association (IBA). Further, in terms of this circular, the unamortised expenditure is not required to be reduced from Tier 1 capital. It is not possible to retain this dispensation under Basel III, as all pension fund liabilities are required to be recognized in the balance sheet under Basel III. Accordingly, from April 1, 2013, banks should deduct the entire amount of unamortized expenditure from common equity Tier 1 capital for the purpose of capital adequacy ratios.

4.4.8 **Investments in Own Shares (Treasury Stock)**

(i) Investment in a bank's own shares is tantamount to repayment of capital and therefore, it is necessary to knock-off such investment from the bank's capital with a view to improving the bank's quality of capital. This deduction would remove the double counting of equity capital which arises from direct holdings, indirect holdings via index funds and potential future holdings as a result of contractual obligations to purchase own shares.

(ii) Banks should not repay their equity capital without specific approval of Reserve Bank of India. Repayment of equity capital can take place by way of share buy-back, investments in own shares (treasury stock) or payment of dividends out of reserves, none of which are permissible. However, banks may end up having indirect investments in their own stock if they invest in / take exposure to mutual funds or index funds / securities which have long position in bank's share. In such cases, banks should look through holdings of index securities to deduct exposures to own shares from their Common Equity Tier 1 capital. Following the same approach outlined above, banks must deduct investments in their own Additional Tier 1 capital in the calculation of their Additional Tier 1 capital and investments in their own Tier 2

[17] It includes other defined employees' funds also.

capital in the calculation of their Tier 2 capital. In this regard, the following rules may be observed:

(a) If the amount of investments made by the mutual funds / index funds / venture capital funds / private equity funds / investment companies in the capital instruments of the investing bank is known; the indirect investment would be equal to bank's investments in such entities multiplied by the percent of investments of these entities in the investing bank's respective capital instruments.

(b) If the amount of investments made by the mutual funds / index funds / venture capital funds / private equity funds / investment companies in the capital instruments of the investing bank is not known but, as per the investment policies / mandate of these entities such investments are permissible; the indirect investment would be equal to bank's investments in these entities multiplied by 10%[18] of investments of such entities in the investing bank's capital instruments. Banks must note that this method does not follow corresponding deduction approach i.e. all deductions will be made from the Common Equity Tier 1 capital even though, the investments of such entities are in the Additional Tier 1 / Tier 2 capital of the investing banks.

(iii) Application of these rules at consolidated level would mean deduction of subsidiaries' investments in their own shares (direct or indirect) in addition to bank's direct or indirect investments in its own shares while computing consolidated Common Equity Tier 1.

4.4.9 Investments in the Capital of Banking, Financial and Insurance Entities[19]

4.4.9.1 Limits on a Bank's Investments in the Capital of Banking, Financial and Insurance Entities

(i) A bank's investment in the capital instruments issued by banking, financial and insurance entities is subject to the following limits:

(a) A bank's investments in the **capital instruments** issued by banking, financial and insurance entities should not exceed 10% of its **capital funds**, but after all deductions mentioned in paragraph 4 (upto paragraph 4.4.8).

(b) Banks should not acquire any fresh stake in a bank's equity shares, if by such acquisition, the investing bank's holding exceeds 5% of the investee bank's equity capital.

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[18] In terms of Securities and Exchange Board of India (Mutual Funds) Regulations 1996, no mutual fund under all its schemes should own more than ten per cent of any company's paid up capital carrying voting rights.

[19] These rules will be applicable to a bank's equity investments in other banks and financial entities, even if such investments are exempted from 'capital market exposure' limit.

(c) Under the provisions of Section 19(2) of the Banking Regulation Act, 1949, a banking company cannot hold shares in any company whether as pledge or mortgagee or absolute owner of an amount exceeding 30% of the paid-up share capital of that company or 30% of its own paid-up share capital and reserves, whichever is less.

(d) Equity investment by a bank in a subsidiary company, financial services company, financial institution, stock and other exchanges should not exceed 10% of the bank's paid-up share capital and reserves.

(e) Equity investment by a bank in companies engaged in non-financial services activities would be subject to a limit of 10% of the investee company's paid up share capital or 10% of the bank's paid up share capital and reserves, whichever is less.

(f) Equity investments in any non-financial services company held by (a) a bank; (b) entities which are bank's subsidiaries, associates or joint ventures or entities directly or indirectly controlled by the bank; and (c) mutual funds managed by AMCs controlled by the bank should in the aggregate not exceed 20% of the investee company's paid up share capital.

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

(ii) An indicative list of institutions which may be deemed to be financial institutions other than banks and insurance companies for capital adequacy purposes is as under:

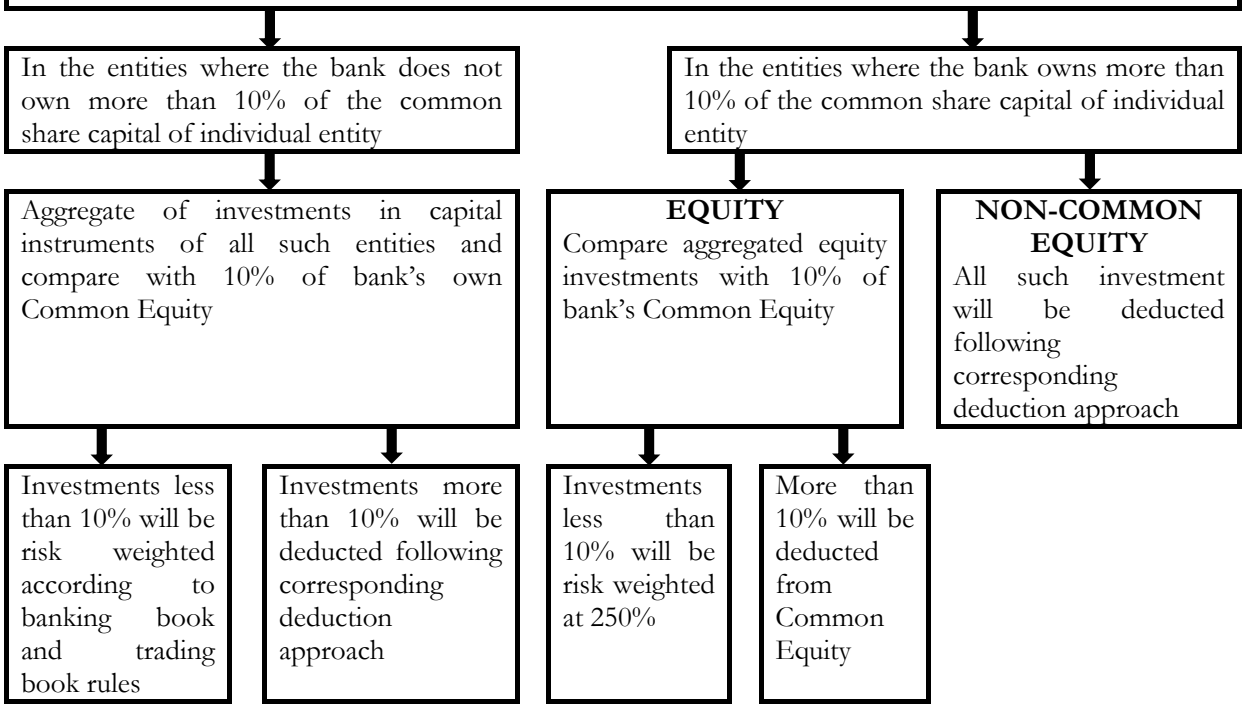
- Asset Management Companies of Mutual Funds / Venture Capital Funds / Private Equity Funds etc;
- Non-Banking Finance Companies;
- Housing Finance Companies;
- Primary Dealers;
- Merchant Banking Companies; and
- Entities engaged in activities which are ancillary to the business of banking under the B.R. Act, 1949.

(iii) Investments made by a banking subsidiary/ associate in the equity or non-equity regulatory capital instruments issued by its parent bank should be deducted from such subsidiary's regulatory capital following corresponding deduction approach, in its capital adequacy assessment on a solo basis. The regulatory treatment of investment by the non-banking financial subsidiaries / associates in the parent bank's regulatory capital would, however, be governed by the applicable regulatory capital norms of the respective regulators of such subsidiaries / associates.

4.4.9.2 **Treatment of a Bank's Investments in the Capital Instruments Issued by Banking, Financial and Insurance Entities within Limits**

The investment of banks in the regulatory capital instruments of other financial entities contributes to the inter-connectedness amongst the financial institutions. In addition, these investments also amount to double counting of capital in the financial system. Therefore, these investments have been subjected to stringent treatment in terms of deduction from respective tiers of regulatory capital. A schematic representation of treatment of banks' investments in capital instruments of financial entities is shown in **Figure 1** below. Accordingly, all investments[20] in the capital instruments issued by banking, financial and insurance entities within the limits mentioned in **paragraph 4.4.9.1** will be subject to the following rules:

Figure 1: Investments in the Capital Instruments of Banking, Financial and Insurance Entities that are outside the scope of regulatory consolidation (i.e. excluding insurance and non-financial subsidiaries)



(A) Reciprocal Cross- Holdings in the Capital of Banking, Financial and Insurance Entities

Reciprocal cross holdings of capital might result in artificially inflating the capital position of banks. Such holdings of capital will be fully deducted. Banks must apply a "corresponding deduction approach" to such investments in the capital of other banks, other financial institutions and insurance entities. This means the deduction should be applied to the same component of capital (Common Equity, Additional Tier 1 and Tier 2 capital) for which the capital would qualify if it was issued by the bank itself. For this purpose, a holding will be

[20] For this purpose, investments held in AFS / HFT category may be reckoned at their market values, whereas, those held in HTM category may be reckoned at values appearing in the Balance sheet of the Bank.

treated as reciprocal cross holding if the investee entity has also invested in the any class of bank's capital instruments which need not necessarily be the same as the bank's holdings.

(B) Investments in the Capital of Banking, Financial and Insurance Entities which are outside the Scope of Regulatory Consolidation and where the Bank does not Own more than 10% of the Issued Common Share Capital of the Entity

(i) The regulatory adjustment described in this section applies to investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation and where the bank does not own more than 10% of the issued common share capital of the entity. In addition:

(a) Investments include direct, indirect[21] and synthetic holdings of capital instruments. For example, banks should look through holdings of index securities to determine their underlying holdings of capital.

(b) Holdings in both the banking book and trading book are to be included. Capital includes common stock (paid-up equity capital) and all other types of cash and synthetic capital instruments (e.g. subordinated debt).

(c) Underwriting positions held for five working days or less can be excluded. Underwriting positions held for longer than five working days must be included.

(d) If the capital instrument of the entity in which the bank has invested does not meet the criteria for Common Equity Tier 1, Additional Tier 1, or Tier 2 capital of the bank, the capital is to be considered common shares for the purposes of this regulatory adjustment[22].

(e) With the prior approval of RBI a bank can temporarily exclude certain investments where these have been made in the context of resolving or providing financial assistance to reorganise a distressed institution.

(ii) If the total of all holdings listed in paragraph (i) above, in aggregate exceed 10% of the bank's Common Equity (after applying all other regulatory adjustments in full listed prior to this one), then the amount above 10% is required to be deducted, applying a corresponding deduction approach. This means the deduction should be applied to the same component of capital for which the capital would qualify if it was issued by the bank itself. Accordingly, the amount to be deducted from common equity should be calculated as the total of all holdings which in aggregate exceed 10% of the bank's common equity (as per above) multiplied by the common equity holdings as a percentage of the total capital holdings. This would result in a Common Equity deduction which corresponds to the proportion of total capital holdings held in Common Equity. Similarly, the amount to be deducted from Additional Tier 1 capital should be calculated as the total of all holdings which in aggregate exceed 10% of the bank's Common Equity (as per above) multiplied by the Additional Tier 1 capital

[21] Indirect holdings are exposures or part of exposures that, if a direct holding loses its value, will result in a loss to the bank substantially equivalent to the loss in the value of direct holding.
[22] If the investment is issued out of a regulated financial entity and not included in regulatory capital in the relevant sector of the financial entity, it is not required to be deducted.

holdings as a percentage of the total capital holdings. The amount to be deducted from Tier 2 capital should be calculated as the total of all holdings which in aggregate exceed 10% of the bank's Common Equity (as per above) multiplied by the Tier 2 capital holdings as a percentage of the total capital holdings. (Please refer to illustration given in **Annex 11).**

(iii) If, under the corresponding deduction approach, a bank is required to make a deduction from a particular tier of capital and it does not have enough of that tier of capital to satisfy that deduction, the shortfall will be deducted from the next higher tier of capital (e.g. if a bank does not have enough Additional Tier 1 capital to satisfy the deduction, the shortfall will be deducted from Common Equity Tier 1 capital).

(iv) Investments below the threshold of 10% of bank's Common Equity, which are not deducted, will be risk weighted. Thus, instruments in the trading book will be treated as per the market risk rules and instruments in the banking book should be treated as per the standardised approach or internal ratings-based approach (as applicable). For the application of risk weighting the amount of the holdings which are required to be risk weighted would be allocated on a pro rata basis between the Banking and Trading Book. However, in certain cases, such investments in both scheduled and non-scheduled commercial banks will be fully deducted from Common Equity Tier 1 capital of investing bank as indicated in paragraphs 5.6, 8.3.5 and 8.4.4.

(v) For the purpose of risk weighting of investments in as indicated in para (iv) above, investments in securities having comparatively higher risk weights will be considered for risk weighting to the extent required to be risk weighted, both in banking and trading books. In other words, investments with comparatively poor ratings (i.e. higher risk weights) should be considered for the purpose of application of risk weighting first and the residual investments should be considered for deduction.

(C) Significant Investments in the Capital of Banking, Financial and Insurance Entities which are outside the Scope of Regulatory Consolidation[23]

(i) The regulatory adjustment described in this section applies to investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation where the bank owns more than 10% of the issued common share capital of the issuing entity or where the entity is an affiliate[24] of the bank. In addition:

[23]Investments in entities that are outside of the scope of regulatory consolidation refers to investments in entities that have not been consolidated at all or have not been consolidated in such a way as to result in their assets being included in the calculation of consolidated risk-weighted assets of the group.

[24]An affiliate of a bank is defined as a company that controls, or is controlled by, or is under common control with, the bank. Control of a company is defined as (1) ownership, control, or holding with power to vote 20% or more of a class of voting securities of the company; or (2) consolidation of the company for financial reporting purposes.

- Investments include direct, indirect[25] and synthetic holdings of capital instruments. For example, banks should look through holdings of index securities to determine their underlying holdings of capital.

- Holdings in both the banking book and trading book are to be included. Capital includes common stock and all other types of cash and synthetic capital instruments (e.g. subordinated debt).

- Underwriting positions held for five working days or less can be excluded. Underwriting positions held for longer than five working days must be included.

- If the capital instrument of the entity in which the bank has invested does not meet the criteria for Common Equity Tier 1, Additional Tier 1, or Tier 2 capital of the bank, the capital is to be considered common shares for the purposes of this regulatory adjustment[26].

- With the prior approval of RBI a bank can temporarily exclude certain investments where these have been made in the context of resolving or providing financial assistance to reorganise a distressed institution.

(ii) **Investments other than Common Shares**

All investments included in para (i) above which are not common shares must be fully deducted following a corresponding deduction approach. This means the deduction should be applied to the same tier of capital for which the capital would qualify if it was issued by the bank itself. If the bank is required to make a deduction from a particular tier of capital and it does not have enough of that tier of capital to satisfy that deduction, the shortfall will be deducted from the next higher tier of capital (e.g. if a bank does not have enough Additional Tier 1 capital to satisfy the deduction, the shortfall will be deducted from Common Equity Tier 1 capital).

(iii) **Investments which are Common Shares**

All investments included in para (i) above which are common shares and which exceed 10% of the bank's Common Equity (after the application of all regulatory adjustments) will be deducted while calculating Common Equity Tier 1 capital. The amount that is not deducted (upto 10% if bank's common equity invested in the equity capital of such entities) in the calculation of Common Equity Tier 1 will be risk weighted at 250% (refer to illustration in **Annex 11**). However, in certain cases, such investments in both scheduled and non-scheduled commercial banks will be fully deducted from Common Equity Tier 1 capital of investing bank as indicated in paragraphs 5.6, 8.3.5 and 8.4.4.

4.4.9.3 With regard to computation of indirect holdings through mutual funds or index funds, of capital of banking, financial and insurance entities which are outside the scope of regulatory consolidation as mentioned in paragraphs 4.4.9.2(B) and 4.4.9.2(C) above, the

[25]Indirect holdings are exposures or part of exposures that, if a direct holding loses its value, will result in a loss to the bank substantially equivalent to the loss in the value of direct holding.

[26]If the investment is issued out of a regulated financial entity and not included in regulatory capital in the relevant sector of the financial entity, it is not required to be deducted.

following rules may be observed:

(i) If the amount of investments made by the mutual funds / index funds / venture capital funds / private equity funds / investment companies in the capital instruments of the financial entities is known; the indirect investment of the bank in such entities would be equal to bank's investments in these entities multiplied by the percent of investments of such entities in the financial entities' capital instruments.

(ii) If the amount of investments made by the mutual funds / index funds / venture capital funds / private equity funds / investment companies in the capital instruments of the investing bank is not known but, as per the investment policies / mandate of these entities such investments are permissible; the indirect investment would be equal to bank's investments in these entities multiplied by maximum permissible limit which these entities are authorized to invest in the financial entities' capital instruments.

(iii) If neither the amount of investments made by the mutual funds / index funds / venture capital funds / private equity funds in the capital instruments of financial entities nor the maximum amount which these entities can invest in financial entities are known but, as per the investment policies / mandate of these entities such investments are permissible; the entire investment of the bank in these entities would be treated as indirect investment in financial entities. Banks must note that this method does not follow corresponding deduction approach i.e. all deductions will be made from the Common Equity Tier 1 capital even though, the investments of such entities are in the Additional Tier 1 / Tier 2 capital of the investing banks.

4.4.9.4 Application of these rules at consolidated level would mean:

(i) Identifying the relevant entities below and above threshold of 10% of common share capital of investee entities, based on aggregate investments of the consolidated group (parent plus consolidated subsidiaries) in common share capital of individual investee entities.

(ii) Applying the rules as stipulated in paragraphs 4.4.9.2(A), 4.4.9.2(B) and 4.4.9.2(C) and segregating investments into those which will be deducted from the consolidated capital and those which will be risk weighted. For this purpose,

- investments of the entire consolidated entity in capital instruments of investee entities will be aggregated into different classes of instruments.

- the consolidated Common Equity of the group will be taken into account.

4.4.9.5 It has come to our notice that certain investors such as Employee Pension Funds have subscribed to regulatory capital issues of commercial banks concerned. These funds enjoy the counter guarantee by the bank concerned in respect of returns. When returns of the investors of the capital issues are counter guaranteed by the bank, such investments will not be considered as regulatory capital for the purpose of capital adequacy.

4.5 Transitional Arrangements

4.5.1 In order to ensure smooth migration to Basel III without aggravating any near term stress, appropriate transitional arrangements have been made. The transitional arrangements for capital ratios begin **as on April 1, 2013**. However, the phasing out of non-Basel III compliant regulatory capital instruments begins **as on January 1, 2013**[27]. Capital ratios and deductions from Common Equity will be fully phased-in and implemented as on March 31, 2018. The phase-in arrangements for banks operating in India are indicated in the following Table:

Table 1: Transitional Arrangements-Scheduled Commercial Banks (excluding LABs and RRBs)

(% of RWAs)

Minimum capital ratios	April 1, 2013	March 31, 2014	March 31, 2015	March 31, 2016	March 31, 2017	March 31, 2018
Minimum Common Equity Tier 1 (CET1)	4.5	5	5.5	5.5	5.5	5.5
Capital conservation buffer (CCB)	-	-	0.625	1.25	1.875	2.5
Minimum CET1+ CCB	4.5	5	6.125	6.75	7.375	8
Minimum Tier 1 capital	6	6.5	7	7	7	7
Minimum Total Capital*	9	9	9	9	9	9
Minimum Total Capital +CCB	9	9	9.625	10.25	10.875	11.5
Phase-in of all deductions from CET1 (in %) #	20	40	60	80	100	100

* The difference between the minimum total capital requirement of 9% and the Tier 1 requirement can be met with Tier 2 and higher forms of capital;

The same transition approach will apply to deductions from Additional Tier 1 and Tier 2 capital.

4.5.2 The regulatory adjustments (i.e. deductions and prudential filters) would be fully deducted from Common Equity Tier 1 only by March 31, 2017. During this transition period, the remainder not deducted from Common Equity Tier 1 / Additional Tier 1 / Tier 2 capital will continue to be subject to treatments given under Basel II capital adequacy framework[28].

To illustrate:

- if a deduction amount is taken off CET1 under the Basel III rules, the treatment for it in 2013 is as follows: 20% of that amount is taken off CET1 and 80% of it is taken off the tier where this deduction used to apply under existing treatment (e.g. in case of DTAs, irrespective of their origin, they are currently deducted from Tier 1 capital. Under new rules, 20% of the eligible deduction will be made to CET1 and 80% will be made to balance Tier 1 capital in the year 2013).

- if the item to be deducted under new rules based on Basel III, is risk weighted under existing framework, the treatment for it in 2013 is as follows: 20% of the amount is taken off CET1, and 80% is subject to the risk weight that applies under existing framework.

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[27] Please refer to paragraph 3 of the DBOD.No.BP.BC.88/21.06.201/2012-13 dated March 28, 2013 on 'Guidelines on Implementation of Basel III Capital Regulations in India - Clarifications'

[28] Master Circular on Prudential Guidelines on Capital Adequacy and Market Discipline - New Capital Adequacy Framework (NCAF) issued vide circular DBOD.No.BP.BC.9/21.06.001/2013-14 dated July 1, 2013.

4.5.3 The treatment of capital issued out of subsidiaries and held by third parties (e.g. minority interest) will also be phased in. Where such capital is eligible for inclusion in one of the three components of capital according to paragraphs 4.3.2, 4.3.3 and 4.3.4, it can be included from April 1, 2013. Where such capital is not eligible for inclusion in one of the three components of capital but is included under the existing guidelines, 20% of this amount should be excluded from the relevant component of capital on April 1, 2013, 40% on March 31, 2014, 60% on March 31, 2015, 80% on March 31, 2016 and reach 100% on March 31, 2017.

4.5.4 Capital instruments which no longer qualify as non-common equity Tier 1 capital or Tier 2 capital (e.g. IPDI and Tier 2 debt instruments with step-ups) will be phased out beginning January 1, 2013. Fixing the base at the nominal amount of such instruments outstanding on January 1, 2013, their recognition will be capped at 90% from January 1, 2013, with the cap reducing by 10 percentage points in each subsequent year[29]. This cap will be applied to Additional Tier 1 and Tier 2 capital instruments separately and refers to the total amount of instruments outstanding which no longer meet the relevant entry criteria. To the extent an instrument is redeemed, or its recognition in capital is amortised, after January 1, 2013, the nominal amount serving as the base is not reduced. In addition, instruments, specifically those with an incentive to be redeemed will be treated as follows:

4.5.4.1 If the non-common equity regulatory capital instrument has been issued prior to September 12, 2010, then the treatment indicated in paragraphs from 4.5.4.1(A) to 4.5.4.1(D) will apply:

(A) If the instrument does not have a call and a step-up and other incentive to redeem - (i) if it meets all the other criteria, including the non-viability criteria, then such instrument will continue to be fully recognised from January 1, 2013; (ii) if the instrument does not meet the other criteria, including the non-viability criteria, then it will be phased out from January 1, 2013.

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[29] The base should only include instruments that will be grandfathered. If an instrument is derecognized on January 1, 2013, it does not count towards the base fixed on January 1, 2013. Also, the base for the transitional arrangements should reflect the outstanding amount which is eligible to be included in the relevant tier of capital under the existing framework applied as on December 31, 2012. Further, for Tier 2 instruments which have begun to amortise before January 1, 2013, the base for grandfathering should take into account the amortised amount, and not the full nominal amount. Thus, individual instruments will continue to be amortised at a rate of 20% per year while the aggregate cap will be reduced at a rate of 10% per year.

To calculate the base in cases of instruments denominated in foreign currency, which no longer qualify for inclusion in the relevant tier of capital (but will be grandfathered) should be included using their value in the reporting currency of the bank as on January 1, 2013. The base will therefore be fixed in the reporting currency of the bank throughout the transitional period. During the transitional period instruments denominated in a foreign currency should be valued as they are reported on the balance sheet of the bank at the relevant reporting date (adjusting for any amortisation in the case of Tier 2 instruments) and, along with all other instruments which no longer meet the criteria for inclusion in the relevant tier of capital, will be subject to the cap.

(B) If the instrument has a call and a step-up and the effective maturity date was prior to September 12, 2010 and the call option was not exercised - (i) if the instrument meets the all other criteria, including the non-viability criteria, then such instrument will continue to be fully recognised from January 1, 2013; (ii) if the instrument does not meet the other criteria, including the non-viability criteria, then it will be phased out from January 1, 2013.

(C) If the instrument has a call and a step-up and the effective maturity date is between September 12, 2010 and December 31, 2012 and the call option is not exercised – (i) if the instrument meets the all other criteria, including the non-viability criteria, then such instrument will continue to be fully recognised from January 1, 2013; (ii) if the instrument does not meet the other criteria, including the non-viability criteria, then it will be fully derecognised from January 1, 2013. However, if such instrument meets all other criteria except the non-viability criteria then it will be phased out from January 1, 2013.

(D) If the instrument has a call and a step-up and the effective maturity date is after January 1, 2013 - (i) the instrument will be phased out from January 1, 2013 till the call option is exercised; (ii) if the call option is not exercised and it meets the all other criteria, including the non-viability criteria, then the instrument will be phased out from January 1, 2013 till the call date and fully recognised after the call date. However, if it does not meet all the criteria including the non-viability criteria, then the instrument will be phased out from January 1, 2013 till the call date and fully derecognised after the call date.

4.5.4.2 If the non-common equity regulatory capital instrument has been issued between September 12, 2010 and December 31, 2012[30], then the treatment indicated in paragraphs from 4.5.4.2(A) to 4.5.4.2(C) will apply:

(A) If such instrument meets all the criteria including non-viability criteria, then it will continue to be fully recognised from January 1, 2013.

(B) If such instrument does not meet all the criteria including non-viability criteria, then it will be fully derecognised from January 1, 2013.

(C) If such instrument meets all the criteria except the non-viability criteria, then it will be phased out from January 1, 2013.

4.5.4.3 Non-common equity regulatory capital instrument issued on or after January 1, 2013 must comply with all the eligibility criteria including the non-viability criteria in order to be an eligible regulatory capital instrument (Additional Tier 1 or Tier 2 capital). Otherwise, such instrument will be fully derecognised as eligible capital instrument.

4.5.4.4 A schematic representation of above mentioned phase-out arrangements has been shown in the **Annex 19**.

4.5.5 Capital instruments which do not meet the criteria for inclusion in Common Equity Tier 1 will be excluded from Common Equity Tier 1 as on April 1, 2013. However, instruments meeting the following two conditions will be phased out over the same horizon

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[30] Please refer circular DBOD.BP.BC.No.75/21.06.001/2010-11 dated January 20, 2011 on 'Regulatory Capital Instruments – Step up Option'. Banks may also refer to the BCBS Press Release dated September 12, 2010 indicating announcements made by the Group of Governors and Heads of Supervision on higher global minimum capital standards

described in paragraph 4.5.4 above: (i) they are treated as equity under the prevailing accounting standards; and (ii) they receive unlimited recognition as part of Tier 1 capital under current laws / regulations.

4.5.6 An illustration of transitional arrangements - Capital instruments which no longer qualify as non-common equity Tier 1 capital or Tier 2 capital is furnished in the **Annex 12.**

5. Capital Charge for Credit Risk

5.1 General

Under the Standardised Approach, the rating assigned by the eligible external credit rating agencies will largely support the measure of credit risk. The Reserve Bank has identified the external credit rating agencies that meet the eligibility criteria specified under the revised Framework. Banks may rely upon the ratings assigned by the external credit rating agencies chosen by the Reserve Bank for assigning risk weights for capital adequacy purposes as per the mapping furnished in these guidelines.

5.2 Claims on Domestic Sovereigns

5.2.1 Both fund based and non-fund based claims on the central government will attract a zero risk weight. Central Government guaranteed claims will attract a zero risk weight.

5.2.2 The Direct loan / credit / overdraft exposure, if any, of banks to the State Governments and the investment in State Government securities will attract zero risk weight. State Government guaranteed claims will attract 20 per cent risk weight.

5.2.3 The risk weight applicable to claims on central government exposures will also apply to the claims on the Reserve Bank of India, DICGC, Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) and Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH)[31]. The claims on ECGC will attract a risk weight of 20 per cent.

5.2.4 The above risk weights for both direct claims and guarantee claims will be applicable as long as they are classified as 'standard' / performing assets. Where these sovereign exposures are classified as non-performing, they would attract risk weights as applicable to NPAs, which are detailed in paragraph 5.12.

5.2.5 The amount outstanding in the account styled as 'Amount receivable from Government of India under Agricultural Debt Waiver Scheme, 2008' shall be treated as a claim on the Government of India and would attract zero risk weight for the purpose of capital adequacy norms. However, the amount outstanding in the accounts covered by the Debt Relief Scheme shall be treated as a claim on the borrower and risk weighted as per the extant norms.

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[31] Please refer to the circular DBOD.No.BP.BC-90/21.04.048/2012-13 dated April 16, 2013 on Advances Guaranteed by 'Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH) - Risk Weights and Provisioning'.

5.3 Claims on Foreign Sovereigns

5.3.1 Claims on foreign sovereigns will attract risk weights as per the rating assigned[32] to those sovereigns / sovereign claims by international rating agencies as follows:

Table 2: Claims on Foreign Sovereigns – Risk Weights

S&P*/ Fitch ratings	AAA to AA	A	BBB	BB to B	Below B	Unrated
Moody's ratings	**Aaa to Aa**	**A**	**Baa**	**Ba to B**	**Below B**	**Unrated**
Risk weight (%)	0	20	50	100	150	100

* Standard & Poor's

5.3.2 Claims denominated in domestic currency of the foreign sovereign met out of the resources in the same currency raised in the jurisdiction[33] of that sovereign will, however, attract a risk weight of zero percent.

5.3.3 However, in case a Host Supervisor requires a more conservative treatment to such claims in the books of the foreign branches of the Indian banks, they should adopt the requirements prescribed by the Host Country supervisors for computing capital adequacy.

5.4 Claims on Public Sector Entities (PSEs)

5.4.1 Claims on domestic public sector entities will be risk weighted in a manner similar to claims on Corporates.

5.4.2 Claims on foreign PSEs will be risk weighted as per the rating assigned by the international rating agencies as under:

Table 3: Claims on Foreign PSEs – Risk Weights

S&P/ Fitch ratings	AAA to AA	A	BBB to BB	Below BB	Unrated
Moody's ratings	**Aaa to Aa**	**A**	**Baa to Ba**	**Below Ba**	**Unrated**
RW (%)	20	50	100	150	100

5.5 Claims on MDBs, BIS and IMF

Claims on the Bank for International Settlements (BIS), the International Monetary Fund (IMF) and the following eligible Multilateral Development Banks (MDBs) evaluated by the BCBS will be treated similar to claims on scheduled banks meeting the minimum capital

[32] For example: The risk weight assigned to an investment in US Treasury Bills by SBI branch in Paris, irrespective of the currency of funding, will be determined by the rating assigned to the Treasury Bills, as indicated in Table 2.

[33] For example: The risk weight assigned to an investment in US Treasury Bills by SBI branch in New York will attract a zero per cent risk weight, irrespective of the rating of the claim, if the investment is funded from out of the USD denominated resources of SBI, New York. In case the SBI, New York, did not have any USD denominated resources, the risk weight will be determined by the rating assigned to the Treasury Bills, as indicated in Table 2 above.

adequacy requirements and assigned a uniform twenty per cent risk weight:

(a) World Bank Group: IBRD and IFC,
(b) Asian Development Bank,
(c) African Development Bank,
(d) European Bank for Reconstruction and Development,
(e) Inter-American Development Bank,
(f) European Investment Bank,
(g) European Investment Fund,
(h) Nordic Investment Bank,
(i) Caribbean Development Bank,
(j) Islamic Development Bank and
(k) Council of Europe Development Bank.

Similarly, claims on the International Finance Facility for Immunization (IFFIm) will also attract a twenty per cent risk weight.

5.6 Claims on Banks (Exposure to capital instruments)

5.6.1 In case of a banks' investment in capital instruments of other banks, the following such **investments** would not be deducted, but would attract appropriate risk weights (refer to the paragraph 4.4.9 above:

(i) Investments in **capital instruments** of banks where the investing bank holds not more than 10% of the issued common shares of the investee banks, subject to the following conditions:

- Aggregate of these investments, together with investments in the capital instruments in insurance and other financial entities, do not exceed 10% of Common Equity of the investing bank; and

- The equity investment in the investee entities is outside the scope of regulatory consolidation.

(ii) **Equity investments** in other banks where the investing bank holds more than 10% of the issued common shares of the investee banks, subject to the following conditions:

- Aggregate of these investments, together with such investments in insurance and other financial entities, do not exceed 10% of Common Equity of the investing bank.

- The equity investment in the investee entities is outside the scope of regulatory consolidation.

Accordingly, the claims on banks incorporated in India and the branches of foreign banks in India, other than those deducted in terms of paragraph 4.4.9 above, will be risk weighted as under:

Table 4: Claims on Banks[34] Incorporated in India and Foreign Bank Branches in India

	Risk Weights (%)					
	All Scheduled Banks (Commercial, Regional Rural Banks, Local Area Banks and Co-Operative Banks)			All Non-Scheduled Banks (Commercial, Regional Rural Banks, Local Area Banks and Co-Operative Banks)		
Level of Common Equity Tier 1 capital (CET1) including applicable capital conservation buffer (CCB) (%) of the investee bank (where applicable)	Investments referred to in paragraph 5.6.1 (i)	Investments referred to in paragraph 5.6.1 (ii)	All other claims	Investments referred to in paragraph 5.6.1 (i)	Investments referred to in paragraph 5.6.1 (ii)	All Other Claims
1	2	3	4	5	6	7
Applicable Minimum CET1 + Applicable CCB and above	125 % or the risk weight as per the rating of the instrument or counterparty, whichever is higher	250	20	125% or the risk weight as per the rating of the instrument or counterparty, whichever is higher	300	100
Applicable Minimum CET1 + CCB = 75% and <100% of applicable CCB[35]	150	300	50	250	350	150
Applicable Minimum CET1 + CCB = 50% and <75% of applicable CCB	250	350	100	350	450	250
Applicable Minimum CET1 + CCB = 0% and <50% of applicable CCB	350	450	150	625	Full deduction*	350
Minimum CET1 less than applicable minimum	625	Full deduction*	625	Full deduction*	Full deduction*	625

* The deduction should be made from Common Equity Tier 1 Capital.

Notes:

(i) In the case of banks where no capital adequacy norms have been prescribed by the RBI, the lending / investing bank may calculate the CRAR of the cooperative bank concerned, notionally, by obtaining necessary information from the investee bank, using the capital adequacy norms as applicable to the

[34] For claims held in AFS and HFT portfolios, please see the paragraphs 8.3.5 and 8.4.4 under 'capital charge for market risk'

[35] For example, as on March 31, 2016, minimum Common Equity Tier 1 of 5.5% and CCB between equal to 75% of 1.25% and less than 1.25%.

commercial banks. In case, it is not found feasible to compute CRAR on such notional basis, the risk weight of 350 or 625 per cent, as per the risk perception of the investing bank, should be applied uniformly to the investing bank's entire exposure.

(ii) In case of banks where capital adequacy norms are not applicable at present, the matter of investments in their capital-eligible instruments would not arise for now. However, this Table above will become applicable to them, if in future they issue any capital instruments where other banks are eligible to invest.

(iii) Till such time the investee banks have not disclosed their Basel III capital ratios publicly, the risk weights / capital charges may be arrived at based on the applicable tables / paragraph as contained in the Master Circular DBOD.No.BP.BC.9/21.06.001/2013-14 dated July 1, 2013 on Prudential Guidelines on Capital Adequacy and Market Discipline - New Capital Adequacy Framework.

5.6.2 The claims on foreign banks will be risk weighted as under as per the ratings assigned by international rating agencies.

Table 5: Claims on Foreign Banks – Risk Weights

S &P / Fitch ratings	**AAA to AA**	**A**	**BBB**	**BB to B**	**Below B**	**Unrated**
Moody's ratings	**Aaa to Aa**	**A**	**Baa**	**Ba to B**	**Below B**	**Unrated**
Risk weight (%)	20	50	50	100	150	50

The exposures of the Indian branches of foreign banks, guaranteed / counter-guaranteed by the overseas Head Offices or the bank's branch in another country would amount to a claim on the parent foreign bank and would also attract the risk weights as per Table 5 above.

5.6.3 However, the claims on a bank which are denominated in 'domestic[36]' foreign currency met out of the resources in the same currency raised in that jurisdiction will be risk weighted at 20 per cent provided the bank complies with the minimum CRAR prescribed by the concerned bank regulator(s).

5.6.4 However, in case a Host Supervisor requires a more conservative treatment for such claims in the books of the foreign branches of the Indian banks, they should adopt the requirements prescribed by the Host supervisor for computing capital adequacy.

5.7 Claims on Primary Dealers

Claims on Primary Dealers shall be risk weighted in a manner similar to claims on corporates.

[36] For example: A Euro denominated claim of SBI branch in Paris on BNP Paribas, Paris which is funded from out of the Euro denominated deposits of SBI, Paris will attract a 20 per cent risk weight irrespective of the rating of the claim, provided BNP Paribas complies with the minimum CRAR stipulated by its regulator/supervisor in France. If BNP Paribas were breaching the minimum CRAR, the risk weight will be as indicated in Table 4 above.

5.8 Claims on Corporates, AFCs and NBFC-IFCs

5.8.1 Claims on corporates[37], exposures on Asset Finance Companies (AFCs) and Non-Banking Finance Companies-Infrastructure Finance Companies (NBFC-IFC)[38], shall be risk weighted as per the ratings assigned by the rating agencies registered with the SEBI and accredited by the Reserve Bank of India. The following table indicates the risk weight applicable to claims on corporates, AFCs and NBFC-IFCs.

Table 6: Part A – Long term Claims on Corporates – Risk Weights

Domestic rating agencies	AAA	AA	A	BBB	BB & below	Unrated
Risk weight (%)	20	30	50	100	150	100

Table 6: Part B - Short Term Claims on Corporates - Risk Weights

CARE	CRISIL	India Ratings and Research Private Limited (India Ratings)	ICRA	Brickwork	SME Rating Agency of India Ltd. (SMERA)	(%)
CARE A1+	CRISIL A1+	IND A1+	ICRA A1+	Brickwork A1+	SMERA A1+	20
CARE A1	CRISIL A1	IND A1	ICRA A1	Brickwork A1	SMERA A1	30
CARE A2	CRISIL A2	IND A2	ICRA A2	Brickwork A2	SMERA A2	50
CARE A3	CRISIL A3	IND A3	ICRA A3	Brickwork A3	SMERA A3	100
CARE A4 & D	CRISIL A4 & D	IND A4 & D	ICRA A4 & D	Brickwork A4 & D	SMERA A4 & D	150
Unrated	Unrated	Unrated	Unrated	Unrated	Unrated	100

Note:

(i) Risk weight on claims on AFCs would continue to be governed by credit rating of the AFCs, except that claims that attract a risk weight of 150 per cent under NCAF shall be reduced to a level of 100 per cent.

(ii) No claim on an unrated corporate may be given a risk weight preferential to that assigned to its sovereign of incorporation.

5.8.2 The Reserve Bank may increase the standard risk weight for unrated claims where a higher risk weight is warranted by the overall default experience. As part of the supervisory review process, the Reserve Bank would also consider whether the credit quality of unrated corporate claims held by individual banks should warrant a standard risk weight higher than 100 per cent.

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[37] Claims on corporates will include all fund based and non-fund based exposures other than those which qualify for inclusion under 'sovereign', 'bank', 'regulatory retail', 'residential mortgage', 'non performing assets', specified category addressed separately in these guidelines.

[38] Circular DBOD.No.BP.BC.74/21.06.001/2009-10 dated February 12, 2010

5.8.3 With a view to reflecting a higher element of inherent risk which may be latent in entities whose obligations have been subjected to re-structuring / re-scheduling either by banks on their own or along with other bankers / creditors, the unrated standard / performing claims on these entities should be assigned a higher risk weight until satisfactory performance under the revised payment schedule has been established for one year from the date when the first payment of interest / principal falls due under the revised schedule. The applicable risk weights will be 125 per cent.

5.8.4 The claims on non-resident corporates will be risk weighted as under as per the ratings assigned by international rating agencies.

Table 7: Claims on Non-Resident Corporates – Risk Weights

S&P/ Fitch Ratings	**AAA to AA**	**A**	**BBB to BB**	**Below BB**	**Unrated**
Moody's ratings	**Aaa to Aa**	**A**	**Baa to Ba**	**Below Ba**	**Unrated**
RW (%)	20	50	100	150	100

5.9 Claims included in the Regulatory Retail Portfolios

5.9.1 Claims (including both fund-based and non-fund based) that meet all the four criteria listed below in paragraph 5.9.3 may be considered as retail claims for regulatory capital purposes and included in a regulatory retail portfolio. Claims included in this portfolio shall be assigned a risk-weight of 75 per cent, except as provided in paragraph 5.12 below for non-performing assets.

5.9.2 The following claims, both fund based and non-fund based, shall be excluded from the regulatory retail portfolio:

(a) Exposures by way of investments in securities (such as bonds and equities), whether listed or not;

(b) Mortgage Loans to the extent that they qualify for treatment as claims secured by residential property[39] or claims secured by commercial real estate[40];

(c) Loans and Advances to bank's own staff which are fully covered by superannuation benefits and / or mortgage of flat/ house;

(d) Consumer Credit, including Personal Loans and credit card receivables;

(e) Capital Market Exposures;

(f) Venture Capital Funds.

[39] Mortgage loans qualifying for treatment as 'claims secured by residential property' are defined in paragraph 5.10.

[40] As defined in paragraph 5.11.1.

5.9.3 Qualifying Criteria

(i) *Orientation Criterion* - The exposure (both fund-based and non fund-based) is to an individual person or persons or to a small business; Person under this clause would mean any legal person capable of entering into contracts and would include but not be restricted to individual, HUF, partnership firm, trust, private limited companies, public limited companies, co-operative societies etc. Small business is one where the total average annual turnover is less than ₹ 50 crore. The turnover criterion will be linked to the average of the last three years in the case of existing entities; projected turnover in the case of new entities; and both actual and projected turnover for entities which are yet to complete three years.

(ii) *Product Criterion* - The exposure (both fund-based and non-fund-based) takes the form of any of the following: revolving credits and lines of credit (including overdrafts), term loans and leases (e.g. installment loans and leases, student and educational loans) and small business facilities and commitments.

(iii) *Granularity Criterion* - Banks must ensure that the regulatory retail portfolio is sufficiently diversified to a degree that reduces the risks in the portfolio, warranting the 75 per cent risk weight. One way of achieving this is that no aggregate exposure to one counterpart should exceed 0.2 per cent of the overall regulatory retail portfolio. '***Aggregate exposure'*** means gross amount (i.e. not taking any benefit for credit risk mitigation into account) of all forms of debt exposures (e.g. loans or commitments) that individually satisfy the three other criteria. In addition, '*one counterpart*' means one or several entities that may be considered as a single beneficiary (e.g. in the case of a small business that is affiliated to another small business, the limit would apply to the bank's aggregated exposure on both businesses). While banks may appropriately use the group exposure concept for computing aggregate exposures, they should evolve adequate systems to ensure strict adherence with this criterion. NPAs under retail loans are to be excluded from the overall regulatory retail portfolio when assessing the granularity criterion for risk-weighting purposes.

(iv) *Low value of individual exposures* - The maximum aggregated retail exposure to one counterpart should not exceed the absolute threshold limit of ₹ 5 crore.

5.9.4 For the purpose of ascertaining compliance with the absolute threshold, exposure would mean sanctioned limit or the actual outstanding, whichever is higher, for all fund based and non-fund based facilities, including all forms of off-balance sheet exposures. In the case of term loans and EMI based facilities, where there is no scope for redrawing any portion of the sanctioned amounts, exposure shall mean the actual outstanding.

5.9.5 The RBI would evaluate at periodic intervals the risk weight assigned to the retail portfolio with reference to the default experience for these exposures. As part of the supervisory review process, the RBI would also consider whether the credit quality of regulatory retail claims held by individual banks should warrant a standard risk weight higher than 75 per cent.

5.10 Claims secured by Residential Property

5.10.1 Lending to individuals meant for acquiring residential property which are fully secured by mortgages on the residential property that is or will be occupied by the borrower, or that is rented, shall be risk weighted as indicated as per Table 7A below, based on Board approved valuation policy. LTV ratio should be computed as a percentage with total outstanding in the account (viz. "principal + accrued interest + other charges pertaining to the loan" without any netting) in the numerator and the realisable value of the residential property mortgaged to the bank in the denominator.

Table 7A: Claims Secured by Residential Property – Risk Weights[41]

Category of Loan	LTV Ratio[42] (%)	Risk Weight (%)
(a) Individual Housing Loans		
(i) Up to Rs. 20 lakh	90	50
(ii) Above Rs. 20 lakh and up to Rs. 75 lakh	80	50
(iii) Above Rs.75 lakh	75	75
(b) Commercial Real Estate – Residential Housing (CRE-RH)	N A	75
(c) Commercial Real Estate (CRE)	N A	100

Notes:

1 - The LTV ratio should not exceed the prescribed ceiling in all fresh cases of sanction. In case the LTV ratio is currently above the ceiling prescribed for any reasons, efforts shall be made to bring it within limits.

2 - Banks' exposures to third dwelling unit onwards to an individual will also be treated as CRE exposures, as indicated in paragraph 2 in Appendix 2 of Circular DBOD.BP.BC.No.42/08.12.015/2009-10 dated September 9, 2009 on 'Guidelines on Classification of Exposures as Commercial Real Estate (CRE) Exposures'.

5.10.2 All other claims secured by residential property would attract the higher of the risk weight applicable to the counterparty or to the purpose for which the bank has extended finance.

5.10.3 Restructured housing loans should be risk weighted with an additional risk weight of 25 per cent to the risk weights prescribed above.

5.10.4 Loans / exposures to intermediaries for on-lending will not be eligible for inclusion under claims secured by residential property but will be treated as claims on corporates or

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[41] Please refer to the circular DBOD.BP.BC.No.104/08.12.015/2012-13 dated June 21, 2013 on Housing Sector: New sub-sector CRE (Residential Housing) within CRE & Rationalisation of provisioning, risk-weight and LTV ratios

[42] Please also refer to the circular DBOD.No.BP.BC.78/08.12.001/2011-12 dated February 3, 2012 on Housing Loans by Commercial Banks – Loan to Value (LTV) Ratio.

claims included in the regulatory retail portfolio as the case may be.

5.10.5 Investments in mortgage backed securities (MBS) backed by exposures as at paragraph 5.10.1 above will be governed by the guidelines pertaining to securitisation exposures (refer to paragraph 5.16 below).

5.11 Claims Classified as Commercial Real Estate Exposure

5.11.1 Commercial Real Estate exposure is defined as per the guidelines issued vide circular DBOD.No.BP.BC.42/08.12.015/2009-10 dated September 9, 2009.

5.11.2 Claims mentioned above will attract a risk weight of 100 per cent.

5.11.3 Investments in mortgage backed securities (MBS) backed by exposures as at paragraph 5.11.1 above will be governed by the guidelines pertaining to securitisation exposures in terms of paragraph 5.16 below.

5.12 Non-Performing Assets (NPAs)

5.12.1 The unsecured portion of NPA (other than a qualifying residential mortgage loan which is addressed in paragraph 5.12.6), net of specific provisions (including partial write-offs), will be risk-weighted as follows:

(i) 150 per cent risk weight when specific provisions are less than 20 per cent of the outstanding amount of the NPA ;

(ii) 100 per cent risk weight when specific provisions are at least 20 per cent of the outstanding amount of the NPA ;

(iii) 50 per cent risk weight when specific provisions are at least 50 per cent of the outstanding amount of the NPA

5.12.2 For the purpose of computing the level of specific provisions in NPAs for deciding the risk-weighting, all funded NPA exposures of a single counterparty (without netting the value of the eligible collateral) should be reckoned in the denominator.

5.12.3 For the purpose of defining the secured portion of the NPA, eligible collateral will be the same as recognised for credit risk mitigation purposes (paragraph 7.3.5). Hence, other forms of collateral like land, buildings, plant, machinery, current assets, etc. will not be reckoned while computing the secured portion of NPAs for capital adequacy purposes.

5.12.4 In addition to the above, where a NPA is fully secured by the following forms of collateral that are not recognised for credit risk mitigation purposes, either independently or along with other eligible collateral a 100 per cent risk weight may apply, net of specific provisions, when provisions reach 15 per cent of the outstanding amount:

(i) Land and building which are valued by an expert valuer and where the valuation is not more than three years old, and

(ii) Plant and machinery in good working condition at a value not higher than the depreciated value as reflected in the audited balance sheet of the borrower, which is not older than eighteen months.

5.12.5 The above collaterals (mentioned in paragraph 5.12.4) will be recognized only where the bank is having clear title to realize the sale proceeds thereof and can appropriate the same towards the amounts due to the bank. The bank's title to the collateral should be

well documented. These forms of collaterals are not recognised anywhere else under the standardised approach.

5.12.6 Claims secured by residential property, as defined in paragraph 5.10.1, which are NPA will be risk weighted at 100 per cent net of specific provisions. If the specific provisions in such loans are at least 20 per cent but less than 50 per cent of the outstanding amount, the risk weight applicable to the loan net of specific provisions will be 75 per cent. If the specific provisions are 50 per cent or more the applicable risk weight will be 50 per cent.

5.13 Specified Categories

5.13.1 Fund based and non-fund based claims on Venture Capital Funds, which are considered as high risk exposures, will attract a higher risk weight of 150 per cent.

5.13.2 Reserve Bank may, in due course, decide to apply a 150 per cent or higher risk weight reflecting the higher risks associated with any other claim that may be identified as a high risk exposure.

5.13.3 Consumer credit, including personal loans and credit card receivables but excluding educational loans, will attract a higher risk weight of 125 per cent or higher, if warranted by the external rating (or, the lack of it) of the counterparty. As gold and gold jewellery are eligible financial collateral, the counterparty exposure in respect of personal loans secured by gold and gold jewellery will be worked out under the comprehensive approach as per paragraph 7.3.4. The 'exposure value after risk mitigation' shall attract the risk weight of 125 per cent.

5.13.4 Advances classified as 'Capital market exposures' will attract a 125 per cent risk weight or risk weight warranted by external rating (or lack of it) of the counterparty, whichever is higher. These risk weights will also be applicable to all banking book exposures, which are exempted from capital market exposure ceilings for direct investments / total capital market exposures[43].

5.13.5 The exposure to **capital instruments** issued by NBFCs which are not deducted and are required to be risk weighted in terms of paragraph 4.4.9.2(B) would be risk weighted at 125% or as per the external ratings, whichever is higher. The exposure to **equity instruments** issued by NBFCs which are not deducted and are required to be risk weighted in terms of paragraph 4.4.9.2(C) would be risk weighted at 250%. The claims (other than in the form of capital instruments of investee companies) on rated as well as unrated 'Non-deposit Taking Systemically Important Non-Banking Financial Companies (NBFC-ND-SI), other than AFCs, NBFC-IFCs and NBFC-IDF, regardless of the amount of claim, shall be uniformly risk weighted at 100% (for risk weighting claims on AFCs, NBFC-IFC and NBFC-IDFs[44], please refer to paragraph 5.8.1).

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[43] The applicable risk weight for banking book exposure / capital charge for market risk exposure for a bank's equity investments in other banks/financial institutions etc. are covered under paragraphs 5 and 8 respectively. These risk weights / capital charge will also apply to exposures which are exempt from 'capital market exposure' limit.

[44] Please refer to circular DBOD.No.BP.BC.74/21.06.001/2009-10 dated February 12, 2010

5.13.6 All investments in the paid-up equity of non-financial entities (other than subsidiaries) which exceed 10% of the issued common share capital of the issuing entity or where the entity is an unconsolidated affiliate as defined in paragraph 4.4.9.2(C)(i) will receive a risk weight of 1111%[45]. Equity investments equal to or below 10% paid-up equity of such investee companies shall be assigned a 125% risk weight or the risk weight as warranted by rating or lack of it, whichever higher.

5.13.7 The exposure to capital instruments issued by financial entities (other than banks and NBFCs) which are not deducted and are required to be risk weighted in terms of paragraph 4.4.9.2(B) would be risk weighted at 125% or as per the external ratings whichever is higher. The exposure to equity instruments issued by financial entities (other than banks and NBFCs) which are not deducted and are required to be risk weighted in terms of paragraph 4.4.9.2(C) would be risk weighted at 250%.

5.13.8 Bank's investments in the non-equity capital eligible instruments of other banks should be risk weighted as prescribed in paragraph 5.6.1.

5.14 Other Assets

5.14.1 Loans and advances to bank's own staff which are fully covered by superannuation benefits and/or mortgage of flat/ house will attract a 20 per cent risk weight. Since flat / house is not an eligible collateral and since banks normally recover the dues by adjusting the superannuation benefits only at the time of cessation from service, the concessional risk weight shall be applied without any adjustment of the outstanding amount. In case a bank is holding eligible collateral in respect of amounts due from a staff member, the outstanding amount in respect of that staff member may be adjusted to the extent permissible, as indicated in paragraph 7 below.

5.14.2 Other loans and advances to bank's own staff will be eligible for inclusion under regulatory retail portfolio and will therefore attract a 75 per cent risk weight.

5.14.3 As indicated in para 5.15.3.4(iii), the deposits kept by banks with the CCPs will attract risk weights appropriate to the nature of the CCPs. In the case of Clearing Corporation of India Limited (CCIL), the risk weight will be 20 per cent and for other CCPs, it will be according to the ratings assigned to these entities.

5.14.4 All other assets will attract a uniform risk weight of 100 per cent.

5.15 Off-Balance Sheet Items

5.15.1 General

(i) The total risk weighted off-balance sheet credit exposure is calculated as the sum of the risk-weighted amount of the market related and non-market related off-balance sheet items. The risk-weighted amount of an off-balance sheet item that gives rise to

[45] Equity investments in non-financial subsidiaries will be deducted from the consolidated / solo bank capital as indicated in paragraphs 3.3.2 /3.4.1.

credit exposure is generally calculated by means of a two-step process:

(a) the notional amount of the transaction is converted into a credit equivalent amount, by multiplying the amount by the specified credit conversion factor or by applying the current exposure method; and

(b) the resulting credit equivalent amount is multiplied by the risk weight applicable to the counterparty or to the purpose for which the bank has extended finance or the type of asset, whichever is higher.

(ii) Where the off-balance sheet item is secured by eligible collateral or guarantee, the credit risk mitigation guidelines detailed in paragraph 7 may be applied.

5.15.2 Non-market-related Off Balance Sheet Items

(i) The credit equivalent amount in relation to a non-market related off-balance sheet item like, direct credit substitutes, trade and performance related contingent items and commitments with certain drawdown, other commitments, etc. will be determined by multiplying the contracted amount of that particular transaction by the relevant credit conversion factor (CCF).

(ii) Where the non-market related off-balance sheet item is an undrawn or partially undrawn fund-based facility[46], the amount of undrawn commitment to be included in calculating the off-balance sheet non-market related credit exposures is the maximum unused portion of the commitment that could be drawn during the remaining period to maturity. Any drawn portion of a commitment forms a part of bank's on-balance sheet credit exposure.

(iii) In the case of irrevocable commitments to provide off-balance sheet facilities, the original maturity will be measured from the commencement of the commitment until the time the associated facility expires. For example an irrevocable commitment with an original maturity of 12 months, to issue a 6 month documentary letter of credit, is deemed to have an original maturity of 18 months. Irrevocable commitments to provide off-balance sheet facilities should be assigned the lower of the two applicable credit conversion factors. For example, an irrevocable commitment with an original maturity of 15 months (50 per cent - CCF) to issue a six month documentary letter of credit (20 per cent - CCF) would attract the lower of the CCF i.e., the CCF applicable

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[46] For example: (a) In the case of a cash credit facility for Rs.100 lakh (which is not unconditionally cancellable) where the drawn portion is Rs. 60 lakh, the undrawn portion of Rs. 40 lakh will attract a CCF of 20 per cent (since the CC facility is subject to review / renewal normally once a year). The credit equivalent amount of Rs. 8 lakh (20% of Rs.40 lakh) will be assigned the appropriate risk weight as applicable to the counterparty / rating to arrive at the risk weighted asset for the undrawn portion. The drawn portion (Rs. 60 lakh) will attract a risk weight as applicable to the counterparty / rating.

(b) A TL of Rs. 700 cr is sanctioned for a large project which can be drawn down in stages over a three year period. The terms of sanction allow draw down in three stages – Rs. 150 cr in Stage I, Rs. 200 cr in Stage II and Rs. 350 cr in Stage III, where the borrower needs the bank's explicit approval for draw down under Stages II and III after completion of certain formalities. If the borrower has drawn already Rs. 50 cr under Stage I, then the undrawn portion would be computed with reference to Stage I alone i.e., it will be Rs.100 cr. If Stage I is scheduled to be completed within one year, the CCF will be 20% and if it is more than one year then the applicable CCF will be 50 per cent.

to the documentary letter of credit viz. 20 per cent.

(iv) The credit conversion factors for non-market related off-balance sheet transactions are as under:

Table 8: Credit Conversion Factors – Non-market related Off-Balance Sheet Items

Sr. No.	Instruments	Credit Conversion Factor (%)
1.	Direct credit substitutes e.g. general guarantees of indebtedness (including standby L/Cs serving as financial guarantees for loans and securities, credit enhancements, liquidity facilities for securitisation transactions), and acceptances (including endorsements with the character of acceptance). (i.e., the risk of loss depends on the credit worthiness of the counterparty or the party against whom a potential claim is acquired)	100
2.	Certain transaction-related contingent items (e.g. performance bonds, bid bonds, warranties, indemnities and standby letters of credit related to particular transaction).	50
3.	Short-term self-liquidating trade letters of credit arising from the movement of goods (e.g. documentary credits collateralised by the underlying shipment) for both issuing bank and confirming bank.	20
4.	Sale and repurchase agreement and asset sales with recourse, where the credit risk remains with the bank. (These items are to be risk weighted according to the type of asset and not according to the type of counterparty with whom the transaction has been entered into.)	100
5.	Forward asset purchases, forward deposits and partly paid shares and securities, which represent commitments with certain drawdown. (These items are to be risk weighted according to the type of asset and not according to the type of counterparty with whom the transaction has been entered into.)	100
6	Lending of banks' securities or posting of securities as collateral by banks, including instances where these arise out of repo style transactions (i.e., repurchase / reverse repurchase and securities lending / securities borrowing transactions)	100
7.	Note issuance facilities and revolving / non-revolving underwriting facilities.	50
8	Commitments with certain drawdown	100
9.	Other commitments (e.g., formal standby facilities and credit lines) with an original maturity of a) up to one year b) over one year Similar commitments that are unconditionally cancellable at any time by the bank without prior notice or that effectively provide for automatic cancellation due to deterioration in a borrower's credit worthiness[47]	 20 50 0
10.	Take-out Finance in the books of taking-over institution	

[47] However, this will be subject to banks demonstrating that they are actually able to cancel any undrawn commitments in case of deterioration in a borrower's credit worthiness failing which the credit conversion factor applicable to such facilities which are not cancellable will apply. Banks' compliance to these guidelines will be assessed under Annual Financial Inspection / Supervisory Review and Evaluation Process under Pillar 2 of RBI.

Sr. No.	Instruments	Credit Conversion Factor (%)
	(i) Unconditional take-out finance	100
	(ii) Conditional take-out finance	50

(v) In regard to non-market related off-balance sheet items, the following transactions with non-bank counterparties will be treated as claims on banks:

- Guarantees issued by banks against the counter guarantees of other banks.
- Rediscounting of documentary bills discounted by other banks and bills discounted by banks which have been accepted by another bank will be treated as a funded claim on a bank.

In all the above cases banks should be fully satisfied that the risk exposure is in fact on the other bank. If they are satisfied that the exposure is on the other bank they may assign these exposures the risk weight applicable to banks as detailed in paragraph 5.6.

(vi) Issue of Irrevocable Payment Commitment by banks to various Stock Exchanges on behalf of Mutual Funds and FIIs is a financial guarantee with a Credit Conversion Factor (CCF) of 100. However, capital will have to be maintained only on exposure which is reckoned as CME, i.e. 50% of the amount, because the rest of the exposure is deemed to have been covered by cash/securities which are admissible risk mitigants as per capital adequacy framework. Thus, capital is to be maintained on the amount taken for CME and the risk weight would be 125% thereon.

(vii) For classification of banks guarantees[48] viz. direct credit substitutes and transaction-related contingent items etc. (Sr. No. 1 and 2 of Table 8 above), the following principles should be kept in view for the application of CCFs:

(a) Financial guarantees are direct credit substitutes wherein a bank irrevocably undertakes to guarantee the repayment of a contractual financial obligation. Financial guarantees essentially carry the same credit risk as a direct extension of credit i.e., the risk of loss is directly linked to the creditworthiness of the counterparty against whom a potential claim is acquired. An indicative list of financial guarantees, attracting a CCF of 100 per cent is as under:

- Guarantees for credit facilities;
- Guarantees in lieu of repayment of financial securities;
- Guarantees in lieu of margin requirements of exchanges;
- Guarantees for mobilisation advance, advance money before the commencement of a project and for money to be received in various stages of project implementation;
- Guarantees towards revenue dues, taxes, duties, levies etc. in favour of Tax/ Customs / Port / Excise Authorities and for disputed liabilities for litigation pending at courts;
- Credit Enhancements;
- Liquidity facilities for securitisation transactions;

[48] Please refer to the circular DBOD.No.BP.BC.89 /21.04.009 /2012-13 dated April 02, 2013 on 'New Capital Adequacy Framework- Non-market related Off Balance Sheet Items- Bank Guarantees'.

- Acceptances (including endorsements with the character of acceptance);
- Deferred payment guarantees.

(b) Performance guarantees are essentially transaction-related contingencies that involve an irrevocable undertaking to pay a third party in the event the counterparty fails to fulfil or perform a contractual non-financial obligation. In such transactions, the risk of loss depends on the event which need not necessarily be related to the creditworthiness of the counterparty involved. An indicative list of performance guarantees, attracting a CCF of 50 per cent is as under:

- Bid bonds;
- Performance bonds and export performance guarantees;
- Guarantees in lieu of security deposits / earnest money deposits (EMD) for participating in tenders;
- Retention money guarantees;
- Warranties, indemnities and standby letters of credit related to particular transaction.

5.15.3 Treatment of Total Counterparty Credit Risk

5.15.3.1 The total capital charge for counterparty credit risk will cover the default risk as well as credit migration risk of the counterparty reflected in mark-to-market losses on the expected counterparty risk (such losses being known as credit value adjustments, CVA). Counterparty risk may arise in the context of OTC derivatives and Securities Financing Transactions. Such instruments generally exhibit the following abstract characteristics:

- The transactions generate a current exposure or market value.
- The transactions have an associated random future market value based on market variables.
- The transactions generate an exchange of payments or an exchange of a financial instrument against payment.
- Collateral may be used to mitigate risk exposure and is inherent in the nature of some transactions.
- Short-term financing may be a primary objective in that the transactions mostly consist of an exchange of one asset for another (cash or securities) for a relatively short period of time, usually for the business purpose of financing. The two sides of the transactions are not the result of separate decisions but form an indivisible whole to accomplish a defined objective.
- Netting may be used to mitigate the risk[49].
- Positions are frequently valued (most commonly on a daily basis), according to market variables.
- Remargining may be employed.

The '**capital charge for default risk'** will be calculated using **Current Exposure Method** as explained in **paragraph 5.15.3.5**. The '**capital charge for CVA risk'** will be calculated as explained in **paragraph 5.15.3.6**. The Current Exposure method is applicable only to OTC derivatives. The counterparty risk on account of Securities Financing Transactions is

[49] Please refer to DBOD.No.BP.BC.48/21.06.001/2010-11 October 1, 2010 on Prudential Norms for Off-Balance Sheet Exposures of Banks – Bilateral netting of counterparty credit exposures. As indicated therein, bilateral netting of mark-to-market (MTM) values arising on account of derivative contracts is not permitted.

covered in **paragraph 7.3.8** of the Master Circular.

5.15.3.2 Exemption from capital requirements for counterparty risk is permitted for foreign exchange (except gold) contracts which have an original maturity of 14 calendar days or less.

5.15.3.3 **Definitions and general terminology**

Counterparty Credit Risk (CCR) is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. An economic loss would occur if the transactions or portfolio of transactions with the counterparty has a positive economic value at the time of default. Unlike a firm's exposure to credit risk through a loan, where the exposure to credit risk is unilateral and only the lending bank faces the risk of loss, CCR creates a bilateral risk of loss: the market value of the transaction can be positive or negative to either counterparty to the transaction. The market value is uncertain and can vary over time with the movement of underlying market factors.

Securities Financing Transactions (SFTs) are transactions such as repurchase agreements, reverse repurchase agreements, security lending and borrowing, collateralised borrowing and lending (CBLO) and margin lending transactions, where the value of the transactions depends on market valuations and the transactions are often subject to margin agreements.

Hedging Set is a group of risk positions from the transactions within a single netting set for which only their balance is relevant for determining the exposure amount or EAD under the CCR standardised method.

Current Exposure is the larger of zero, or the market value of a transaction or portfolio of transactions within a netting set with a counterparty that would be lost upon the default of the counterparty, assuming no recovery on the value of those transactions in bankruptcy. Current exposure is often also called Replacement Cost.

Credit Valuation Adjustment is an adjustment to the mid-market valuation of the portfolio of trades with a counterparty. This adjustment reflects the market value of the credit risk due to any failure to perform on contractual agreements with a counterparty. This adjustment may reflect the market value of the credit risk of the counterparty or the market value of the credit risk of both the bank and the counterparty.

One-Sided Credit Valuation Adjustment is a credit valuation adjustment that reflects the market value of the credit risk of the counterparty to the firm, but does not reflect the market value of the credit risk of the bank to the counterparty.

5.15.3.4 **Treatment of Exposure to Central Counterparties**

Presently, treatment of exposures to Central Counterparties for the purpose of capital adequacy is as under:

(i) The exposures on account of derivatives trading and securities financing transactions (e.g. Collateralised Borrowing and Lending Obligations - CBLOs, Repos) to Central Counter Parties (CCPs) including those attached to stock exchanges for settlement of exchange traded derivatives, will be assigned zero exposure value for counterparty credit risk, as it is presumed that the CCPs' exposures to their counterparties are fully collateralised on a daily basis, thereby providing protection for the CCP's credit risk exposures.

(ii) A CCF of 100% will be applied to the banks securities posted as collaterals with

CCPs and the resultant off-balance sheet exposure will be assigned risk weights appropriate to the nature of the CCPs. In the case of Clearing Corporation of India Limited (CCIL), the risk weight will be 20% and for other CCPs, it will be according to the ratings assigned to these entities.

(iii) The deposits kept by banks with the CCPs will attract risk weights appropriate to the nature of the CCPs. In the case of Clearing Corporation of India Limited (CCIL), the risk weight will be 20% and for other CCPs, it will be according to the ratings assigned to these entities.

When entering into bilateral OTC derivative transactions, banks are required to hold capital to protect against the risk that the counterparty defaults and for credit valuation adjustment (CVA) risk. The CVA charge is introduced as part of the Basel III framework as explained in **paragraphs 5.15.3.5 and 5.15.3.6** below.

5.15.3.5 **Default Risk Capital Charge for CCR**

The exposure amount for the purpose of computing for default risk capital charge for counterparty credit risk will be calculated using the **Current Exposure Method (CEM)** described as under:

(i) The credit equivalent amount of a market related off-balance sheet transaction calculated using the current exposure method is the sum of current credit exposure and potential future credit exposure of these contracts. For this purpose, credit equivalent amount will be adjusted for legally valid eligible financial collaterals in accordance with **paragraph 7.3** – Credit Risk Mitigation Techniques – Collateralised Transactions and the provisions held by the bank for CVA losses.

(ii) The CVA loss will be calculated as a prudent valuation adjustment as per prudent valuation guidance contained in **paragraph 8.8.1**, without taking into account any offsetting debit valuation adjustments (DVA) which have been deducted from capital (please see paragraph 4.4.6). The CVA loss deducted from exposures to determine outstanding EAD is the CVA loss gross of all DVA which have been separately deducted from capital. To the extent DVA has not been separately deducted from a bank's capital, the CVA loss used to determine outstanding EAD will be net of such DVA. Risk Weighted Assets for a given OTC derivative counterparty may be calculated as the applicable risk weight under the Standardised or IRB approach multiplied by the outstanding EAD of the counterparty. This reduction of EAD by CVA losses does not apply to the determination of the CVA risk capital charge as per formula given in **paragraph 5.15.3.6 (ii).**

(iii) While computing the credit exposure banks may exclude 'sold options', provided the entire premium / fee or any other form of income is received / realised.

(iv) Current credit exposure is defined as the sum of the positive mark-to-market value of these contracts. The Current Exposure Method requires periodical calculation of the current credit exposure by marking these contracts to market**,** thus capturing the current credit exposure.

(v) Potential future credit exposure is determined by multiplying the notional principal amount of each of these contracts irrespective of whether the contract has a zero, positive or negative mark-to-market value by the relevant add-on factor indicated below according to the nature and residual maturity of the instrument.

Table 9: Credit Conversion Factors for Market-Related Off-Balance Sheet Items[50]

	Credit Conversion Factors (%)	
	Interest Rate Contracts	**Exchange Rate Contracts and Gold**
One year or less	0.50	2.00
Over one year to five years	1.00	10.00
Over five years	3.00	15.00

(vi) For contracts with multiple exchanges of principal, the add-on factors are to be multiplied by the number of remaining payments in the contract.

(vii) For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be set equal to the time until the next reset date. However, in the case of interest rate contracts which have residual maturities of more than one year and meet the above criteria, the CCF or add-on factor is subject to a floor of 1.0%.

(viii) No potential future credit exposure would be calculated for single currency floating / floating interest rate swaps; the credit exposure on these contracts would be evaluated solely on the basis of their mark-to-market value.

(ix) Potential future exposures should be based on 'effective' rather than 'apparent notional amounts'. In the event that the 'stated notional amount' is leveraged or enhanced by the structure of the transaction, banks must use the 'effective notional amount' when determining potential future exposure. For example, a stated notional amount of USD 1 million with payments based on an internal rate of two times the BPLR / Base Rate would have an effective notional amount of USD 2 million.

5.15.3.6 Capitalisation of mark-to-market counterparty risk losses (CVA capital charge)

(i) In addition to the default risk capital requirement for counterparty credit risk, banks are also required to compute an additional capital charge to cover the risk of mark-to-market losses on the expected counterparty risk (such losses being known as credit value adjustments, CVA) to OTC derivatives. The CVA capital charge will be calculated in the manner indicated below in para (ii). Banks are not required to include in this capital charge (a) transactions with a central counterparty (CCP); and (b) securities financing transactions (SFTs).

[50] Please refer to paragraph 8.6.3 for credit default swaps.

(ii) Banks should use the following formula to calculate a **portfolio capital charge** for CVA risk for their counterparties:

$$K = 2.33 \cdot \sqrt{h} \cdot \sqrt{\left(\sum_i 0.5 \cdot w_i \cdot \left(M_i \cdot EAD_i^{total} - M_i^{hedge} B_i \right) - \sum_{ind} w_{ind} \cdot M_{ind} \cdot B_{ind} \right)^2 + \sum_i 0.75 \cdot w_i^2 \cdot \left(M_i \cdot EAD_i^{total} - M_i^{hedge} B_i \right)^2}$$

Where;

- **h** is the one-year risk horizon (in units of a year), h = 1.

- **w_i** is the weight applicable to counterparty 'i'. Counterparty 'i' should be mapped to one of the seven weights **w_i** based on its external rating, as shown in the **Table** below in the last bullet point.

- **EAD_i^{total}** is the gross exposure at default of counterparty 'i' without taking into account the effect of bilateral netting[51] including the effect of collateral as per the existing Current Exposure Method (CEM) as applicable to the calculation of counterparty risk capital charges for such counterparty by the bank. The exposure should be discounted by applying the factor $(1-\exp(-0.05*M_i))/(0.05*M_i)$.

- **B_i** is the notional of purchased single name CDS hedges (summed if more than one position) referencing counterparty 'i', and used to hedge CVA risk. This notional amount should be discounted by applying the factor $(1-\exp(-0.05*M_i^{hedge}))/(0.05*M_i^{hedge})$.

- **B_{ind}** is the full notional of one or more index CDS of purchased protection, used to hedge CVA risk. This notional amount should be discounted by applying the factor $(1-\exp(-0.05*M_{ind}))/(0.05*M_{ind})$.

- **w_{ind}** is the weight applicable to index hedges. The bank must map indices to one of the seven weights w_i based on the average spread of index 'ind'.

- **M_i** is the effective maturity of the transactions with counterparty 'i'. **M_i** is the notional weighted average maturity of all the contracts with counterparty 'i'.

- **M_i^{hedge}** is the maturity of the hedge instrument with notional B_i (the quantities M_i^{hedge}. B_i are to be summed if these are several positions).

- **M^{ind}** is the maturity of the index hedge 'ind'. In case of more than one index hedge position, it is the notional weighted average maturity.

- For any counterparty that is also a constituent of an index on which a CDS is used for hedging counterparty credit risk, the notional amount attributable to that single name

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[51] Please refer to the circular DBOD.No.BP.BC.48/21.06.001/2010-11 dated October 1, 2010 on bilateral netting of counterparty credit, which states that owing to legal issues bilateral netting of counterparty exposures is not permitted in India. Therefore, each transaction with counterparty becomes its own netting set.

(as per its reference entity weight) may be subtracted from the index CDS notional amount and treated as a single name hedge (Bi) of the individual counterparty with maturity based on the maturity of the index.

- The weights are given in the Table below, which are based on the external rating of the counterparty:

Weights (w_i)

Rating	W_i
AAA	0.7%
AA	0.7%
A	0.8%
BBB	1.0%
BB	2.0%
B and unrated	3.0%
CCC	10.0%[52]

- In cases where the unrated counterparty is a scheduled commercial bank, banks may use the following Table to arrive at the implied ratings of the counterparty-bank and consequently, the W_i

Applicable Risk weight of the Counterparty-bank according to Table 4 of paragraph 5.6	Implied ratings	W_i
20	AAA/AA	0.7%
50	A	0.8%
100	BBB	1%
150	BB	2%
625	CCC	10%

- Banks will have to continuously monitor the capital adequacy position of their counterparty banks so that the effect of any change in the implied ratings is adequately reflected in CVA capital charge calculations.

An illustration of CVA risk capital charge has been furnished in **Annex 13.**

5.15.3.7 **Calculation of the Aggregate CCR and CVA Risk Capital Charges**

The total CCR capital charge for the bank is determined as the sum of the following two components:

i. The sum over all counterparties of the CEM based capital charge determined as per **paragraph 5.15.3.5**; and

ii. The standardised CVA risk capital charge determined as per **paragraph 5.15.3.6**[53]

[52] Please refer to the revised version of Basel III capital rules (bcbs189.doc) issued by the BCBS vide press release on June 1, 2011.

5.15.4 Failed Transactions

(i) With regard to unsettled securities and foreign exchange transactions, banks are exposed to counterparty credit risk from trade date, irrespective of the booking or the accounting of the transaction. Banks are encouraged to develop, implement and improve systems for tracking and monitoring the credit risk exposure arising from unsettled transactions as appropriate for producing management information that facilitates action on a timely basis.

(ii) Banks must closely monitor securities and foreign exchange transactions that have failed, starting from the day they fail for producing management information that facilitates action on a timely basis. Failed transactions give rise to risk of delayed settlement or delivery.

(iii) Failure of transactions settled through a delivery-versus-payment system (DvP), providing simultaneous exchanges of securities for cash, expose banks to a risk of loss on the difference between the transaction valued at the agreed settlement price and the transaction valued at current market price (i.e. positive current exposure). Failed transactions where cash is paid without receipt of the corresponding receivable (securities, foreign currencies, or gold,) or, conversely, deliverables were delivered without receipt of the corresponding cash payment (non-DvP, or free-delivery) expose banks to a risk of loss on the full amount of cash paid or deliverables delivered. Therefore, a capital charge is required for failed transactions and must be calculated as under. The following capital treatment is applicable to all failed transactions, including transactions through recognised clearing houses. Repurchase and reverse-repurchase agreements as well as securities lending and borrowing that have failed to settle are excluded from this capital treatment.

(iv) **For DvP Transactions** – If the payments have not yet taken place five business days after the settlement date, banks are required to calculate a **capital charge** by multiplying the positive current exposure of the transaction by the appropriate factor as under. In order to capture the information, banks will need to upgrade their information systems in order to track the number of days after the agreed settlement date and calculate the corresponding capital charge.

Number of working days after the agreed settlement date	Corresponding risk multiplier (in per cent)
From 5 to 15	9
From 16 to 30	50
From 31 to 45	75
46 or more	100

[53] Please refer to the circular DBOD.No.BP.BC.88/21.06.201/2012-13 dated March 28, 2013 on 'Implementation of Basel III Capital Regulations in India – Clarifications', in terms of which the requirements for CVA risk capital charges would become effective as on January 1, 2014.

(v) For non-DvP transactions (free deliveries) after the first contractual payment / delivery leg, the bank that has made the payment will treat its exposure as a loan if the second leg has not been received by the end of the business day. If the dates when two payment legs are made are the same according to the time zones where each payment is made, it is deemed that they are settled on the same day. For example, if a bank in Tokyo transfers Yen on day X (Japan Standard Time) and receives corresponding US Dollar via CHIPS on day X (US Eastern Standard Time), the settlement is deemed to take place on the same value date. Banks shall compute the capital requirement using the counterparty risk weights prescribed in these guidelines. However, if five business days after the second contractual payment / delivery date the second leg has not yet effectively taken place, the bank that has made the first payment leg will receive a risk weight of 1111% on the full amount of the value transferred plus replacement cost, if any. This treatment will apply until the second payment / delivery leg is effectively made.

5.16 Securitisation Exposures

5.16.1 General

(i) A securitisation transaction, which meets the minimum requirements, as stipulated in circular DBOD.No.BP.BC.60/21.04.048/2005-06 dated February 1, 2006 on 'Guidelines on Securitisation of Standard Assets' and circular DBOD.No.BP.BC.103/ 21.04.177/2011-12 dated May 07, 2012 on 'Revision to the Guidelines on Securitisation Transactions' would qualify for the following prudential treatment of securitisation exposures for capital adequacy purposes. Banks' exposures to a securitisation transaction, referred to as securitisation exposures, can include, but are not restricted to the following: as investor, as credit enhancer, as liquidity provider, as underwriter, as provider of credit risk mitigants. Cash collaterals provided as credit enhancements shall also be treated as securitisation exposures. The terms used in this section with regard to securitisation shall be as defined in the above guidelines. Further, the following definitions shall be applicable:

(a) A 'credit enhancing interest only strip (I/Os)' – an on-balance sheet exposure that is recorded by the originator, which (i) represents a valuation of cash flows related to future margin income to be derived from the underlying exposures, and (ii) is subordinated to the claims of other parties to the transaction in terms of priority of repayment.

(b) 'Implicit support' – the support provided by a bank to a securitisation in excess of its predetermined contractual obligation.

(c) A 'gain-on-sale' – any profit realised at the time of sale of the securitised assets to SPV.

(ii) Banks are required to hold regulatory capital against all of their securitisation exposures, including those arising from the provision of credit risk mitigants to a securitisation transaction, investments in asset-backed securities, retention of a subordinated tranche, and extension of a liquidity facility or credit enhancement, as set forth in the following paragraphs. Repurchased securitisation exposures must be treated as retained securitisation exposures.

(iii) An originator in a securitisation transaction which does not meet the minimum requirements prescribed in the guidelines dated February 01, 2006 and May 07,

2012 and therefore does not qualify for de-recognition shall hold capital against all of the exposures associated with the securitisation transaction as if they had not been securitised[54]. Additionally, the originator shall deduct any 'gain on sale' on such transaction from Tier I capital. This capital would be in addition to the capital which the bank is required to maintain on its other existing exposures to the securitization transaction.

(iv) Operational criteria for Credit Analysis[55]

In addition to the conditions specified in the RBI Guidelines dated February 1, 2006 on Securitisation of standard assets in order to qualify for de-recognition of assets securitised, the bank must have the information specified in paragraphs (a) through (c) below:

(a) As a general rule, a bank must, on an ongoing basis, have a comprehensive understanding of the risk characteristics of its individual securitisation exposures, whether on balance sheet or off balance sheet, as well as the risk characteristics of the pools underlying its securitisation exposures.

(b) Banks must be able to access performance information on the underlying pools on an on-going basis in a timely manner. Such information may include, as appropriate: exposure type; percentage of loans 30, 60 and 90 days past due; default rates; prepayment rates; loans in foreclosure; property type; occupancy; average credit score or other measures of creditworthiness; average loan-to-value ratio; and industry and geographic diversification.

(c) A bank must have a thorough understanding of all structural features of a securitisation transaction that would materially impact the performance of the bank's exposures to the transaction, such as the contractual waterfall and waterfall-related triggers, credit enhancements, liquidity enhancements, market value triggers, and deal-specific definitions of default.

5.16.2 **Treatment of Securitisation Exposures**

(i) Credit enhancements which are first loss positions should be risk weighted at 1111%.

(ii) Any rated securitisation exposure with a long term rating of 'B+ and below' when not held by an originator, and a long term rating of 'BB+ and below' when held by the originator will receive a risk weight of 1111%.

(iii) Any unrated securitisation exposure, except an eligible liquidity facility as specified in **paragraph 5.16.8** should be risk weighted at 1111%. In an unrated and ineligible liquidity facility, both the drawn and undrawn portions (after applying a CCF of 100%) shall receive a risk weight of 1111%.

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[54] For example: If in a securitisation transaction of Rs.100, the pool consists of 80 per cent of AAA securities, 10 per cent of BB securities and 10 per cent of unrated securities and the transaction does not meet the true sale criterion, then the originator will be deemed to be holding all the exposures in that transaction. Consequently, the AAA rated securities will attract a risk weight of 20 per cent and the face value of the BB rated securities and the unrated securities will be deducted. Thus the consequent impact on the capital will be Rs.21.44 (16*9 % + 20).

[55] Master Circular DBOD.No.BP.BC.73/21.06.001/2009-10 dated Feb 8, 2010

(iv) The holdings of securities devolved on the originator through underwriting should be sold to third parties within three-month period following the acquisition. In case of failure to off-load within the stipulated time limit, any holding in excess of 20% of the original amount of issue, including secondary market purchases, shall receive a risk weight of 1111%.

5.16.3 Implicit Support

(i) The originator shall not provide any implicit support to investors in a securitisation transaction.

(ii) When a bank is deemed to have provided implicit support to a securitisation:

a) It must, at a minimum, hold capital against all of the exposures associated with the securitisation transaction as if they had not been securitised.

b) Furthermore, in respect of securitisation transactions where the bank is deemed to have provided implicit support it is required to disclose publicly that (a) it has provided non-contractual support (b) the details of the implicit support and (c) the impact of the implicit support on the bank's regulatory capital.

(iii) Where a securitisation transaction contains a clean-up call and the clean up call can be exercised by the originator in circumstances where exercise of the clean up call effectively provides credit enhancement, the clean up call shall be treated as implicit support and the concerned securitisation transaction will attract the above prescriptions.

5.16.4 Application of External Ratings

The following operational criteria concerning the use of external credit assessments apply:

(i) A bank must apply external credit assessments from eligible external credit rating agencies consistently across a given type of securitisation exposure. Furthermore, a bank cannot use the credit assessments issued by one external credit rating agency for one or more tranches and those of another external credit rating agency for other positions (whether retained or purchased) within the same securitisation structure that may or may not be rated by the first external credit rating agency. Where two or more eligible external credit rating agencies can be used and these assess the credit risk of the same securitisation exposure differently, **paragraph 6.7** will apply.

(ii) If the CRM provider is not recognised as an eligible guarantor as defined in **paragraph 7.5.5**, the covered securitisation exposures should be treated as unrated.

(iii) In the situation where a credit risk mitigant is not obtained by the SPV but rather applied to a specific securitisation exposure within a given structure (e.g. ABS tranche), the bank must treat the exposure as if it is unrated and then use the CRM treatment outlined in **paragraph 7**.

(iv) The other aspects of application of external credit assessments will be as per guidelines given in **paragraph 6**.

(v) A bank is not permitted to use any external credit assessment for risk weighting

purposes where the assessment is at least partly based on unfunded support provided by the bank. For example, if a bank buys an ABS / MBS where it provides an unfunded securitisation exposure extended to the securitisation programme (e.g. liquidity facility or credit enhancement), and that exposure plays a role in determining the credit assessment on the securitised assets/various tranches of the ABS/MBS, the bank must treat the securitised assets/various tranches of the ABS/MBS as if these were not rated. The bank must continue to hold capital against the other securitisation exposures it provides (e.g. against the liquidity facility and/or credit enhancement).[56]

5.16.5 Risk Weighted Securitisation Exposures

(i) Banks shall calculate the risk weighted amount of an on-balance sheet securitisation exposure by multiplying the principal amount (after deduction of specific provisions) of the exposures by the applicable risk weight.

(ii) The risk-weighted asset amount of a securitisation exposure is computed by multiplying the amount of the exposure by the appropriate risk weight determined in accordance with issue specific rating assigned to those exposures by the chosen external credit rating agencies as indicated in the following tables:

Table 10: Securitisation Exposures – Risk Weight Mapping to Long-Term Ratings

Domestic rating agencies	AAA	AA	A	BBB	BB	B and below or unrated
Risk weight for banks other than originators (%)	20	30	50	100	350	1111
Risk weight for originator (%)	20	30	50	100	1111	

(iii) The risk-weighted asset amount of a securitisation exposure in respect of MBS backed by commercial real estate exposure, as defined in paragraph 5.11 above, is computed by multiplying the amount of the exposure by the appropriate risk weight determined in accordance with issue specific rating assigned to those exposures by the chosen external credit rating agencies as indicated in the following tables:

[56] Master Circular DBOD.No.BP.BC.73/21.06.001/2009-10 dated Feb 8, 2010

Table 10-A: Commercial Real Estate Securitisation Exposures – Risk Weight mapping to long-term ratings

Domestic Rating Agencies	AAA	AA	A	BBB	BB	B and below or unrated
Risk weight for banks other than originators (%)	100	100	100	150	400	1111
Risk weight for originator (%)	100	100	100	150	1111	

(iv) Banks are not permitted to invest in unrated securities issued by an SPV as a part of the securitisation transaction. However, securitisation exposures assumed by banks which may become unrated or may be deemed to be unrated, would be treated for capital adequacy purposes in accordance with the provisions of **paragraph 5.16.2.**

(v) There should be transfer of a significant credit risk associated with the securitised exposures to the third parties for recognition of risk transfer. In view of this, the total exposure of banks to the loans securitised in the following forms should not exceed 20% of the total securitised instruments issued:

- Investments in equity / subordinate / senior tranches of securities issued by the SPV including through underwriting commitments
- Credit enhancements including cash and other forms of collaterals including over-collateralisation, but excluding the credit enhancing interest only strip
- Liquidity support.

If a bank exceeds the above limit, the excess amount would be risk weighted at 1111 per cent[57]. Credit exposure on account of interest rate swaps/ currency swaps entered into with the SPV will be excluded from the limit of 20 per cent as this would not be within the control of the bank.

(vi) If an originating bank fails to meet the requirement laid down in the paragraphs 1.1 to 1.7 of Section A / paragraphs 1.1 to 1.6 of Section B of the circular DBOD.No.BP.BC.103/21.04.177/ 2011-12 dated May 07, 2012 on 'Revision to the Guidelines on Securitisation Transactions', it will have to maintain capital for the securitized assets/ assets sold as if these were not securitized/ sold. This capital would be in addition to the capital which the bank is required to maintain on its other existing exposures to the securitisation transaction.

(vii) The investing banks will assign a risk weight of 1111 per cent to the exposures relating to securitization/ or assignment where the requirements in the paragraphs 2.1 to 2.3 of Section A / or paragraphs 2.1 to 2.8 of Section B, respectively, of the circular DBOD.No.BP.BC.103/21.04.177/ 2011-12 dated May 07, 2012 on 'Revision

[57] As per Basel III rules of the Basel Committee, the maximum risk weight for securitization exposures, consistent with minimum 8 per cent capital requirement, is 1250 per cent. Since in India minimum capital requirement is 9 per cent, the risk weight has been capped at 1111 per cent (100/9) so as to ensure that capital charge does not exceed the exposure value.

to the Guidelines on Securitisation Transactions' dated May 07, 2012 are not met. The higher risk weight of 1111 per cent is applicable with effect from October 01, 2012.

(viii) Under the transactions involving transfer of assets through direct assignment of cash flows and the underlying securities, the capital adequacy treatment for direct purchase of corporate loans will be as per the rules applicable to corporate loans directly originated by the banks. Similarly, the capital adequacy treatment for direct purchase of retail loans, will be as per the rules applicable to retail portfolios directly originated by banks except in cases where the individual accounts have been classified as NPA, in which case usual capital adequacy norms as applicable to retail NPAs will apply. No benefit in terms of reduced risk weights will be available to purchased retail loans portfolios based on rating because this is not envisaged under the Basel II Standardized Approach for credit risk.

5.16.6 Off-Balance Sheet Securitisation Exposures

(i) Banks shall calculate the risk weighted amount of a rated off-balance sheet securitisation exposure by multiplying the credit equivalent amount of the exposure by the applicable risk weight. The credit equivalent amount should be arrived at by multiplying the principal amount of the exposure (after deduction of specific provisions) with a 100 per cent CCF, unless otherwise specified.

(ii) If the off-balance sheet exposure is not rated, it must be deducted from capital, except an unrated eligible liquidity facility for which the treatment has been specified separately in **paragraph 5.16.8**.

5.16.7 Recognition of Credit Risk Mitigants (CRMs)

(i) The treatment below applies to a bank that has obtained a credit risk mitigant on a securitisation exposure. Credit risk mitigant include guarantees and eligible collateral as specified in these guidelines. Collateral in this context refers to that used to hedge the credit risk of a securitisation exposure rather than for hedging the credit risk of the underlying exposures of the securitisation transaction.

(ii) When a bank other than the originator provides credit protection to a securitisation exposure, it must calculate a capital requirement on the covered exposure as if it were an investor in that securitisation. If a bank provides protection to an unrated credit enhancement, it must treat the credit protection provided as if it were directly holding the unrated credit enhancement.

(iii) Capital requirements for the guaranteed / protected portion will be calculated according to CRM methodology for the standardised approach as specified in **paragraph 7** below. Eligible collateral is limited to that recognised under these guidelines in **paragraph 7.3.5.** For the purpose of setting regulatory capital against a maturity mismatch between the CRM and the exposure, the capital requirement will be determined in accordance with **paragraph 7.6.** When the exposures being hedged have different maturities, the longest maturity must be used applying the methodology prescribed in **paragraphs 7.6.3 and 7.6.**4.

5.16.8 Liquidity Facilities

(i) A liquidity facility will be considered as an 'eligible' facility only if it satisfies all minimum requirements prescribed in the guidelines issued on February 1, 2006. The rated liquidity facilities will be risk weighted or deducted as per the appropriate risk weight determined in accordance with the specific rating assigned to those exposures by the chosen External Credit Assessment Institutions (ECAIs) as indicated in the tables presented above.

(ii) The unrated eligible liquidity facilities will be exempted from deductions and treated as follows.

(a) The drawn and undrawn portions of an unrated eligible liquidity facility would attract a risk weight equal to the highest risk weight assigned to any of the underlying individual exposures covered by this facility.

(b) The undrawn portion of an unrated eligible liquidity facility will attract a credit conversion factor of 50%.[58]

5.16.9 Re-Securitisation Exposures/ Synthetic Securitisations/ Securitisation with Revolving Structures (with or without early amortization features)

At present, banks in India including their overseas branches, are not permitted to assume exposures relating to re-securitisation / Synthetic Securitisations/ Securitisations with Revolving Structures (with or without early amortization features), as defined in circular DBOD.No.BP.BC.103/21.04.177/ 2011-12 dated May 07, 2012 on 'Revision to the Guidelines on Securitisation Transactions'. However, some of the Indian banks have invested in CDOs and other similar securitization exposures through their overseas branches before issuance of circular RBI/2008-09/302.DBOD.No.BP.BC.89/21.04.141 /2008-09 dated December 1, 2008. Some of these exposures may be in the nature of re-securitisation. For such exposures, the risk weights would be assigned as under:

Table 11: Re-securitisation Exposures – Risk Weight Mapping to Long-Term Ratings

Domestic rating agencies	**AAA**	**AA**	**A**	**BBB**	**BB**	**B and below or unrated**
Risk weight for banks other than originators (%)	40	60	100	200	650	1111
Risk weight for originator (%)	40	60	100	200	1111	

[58] Master Circular DBOD,No.BP:.BC.73 / 21.06.001 / 2009-10 dated Feb 8, 2010

Table 11 A: Commercial Real Estate Re-Securitisation Exposures – Risk Weight Mapping to Long-Term Ratings

Domestic rating agencies	AAA	AA	A	BBB	BB and below or unrated
Risk weight for banks other than originators (%)	200	200	200	400	1111
Risk weight for originator (%)	200	200	200	400	1111

All other regulatory norms would be applicable as prescribed above in this paragraph (paragraph 5.16).

5.17 Capital Adequacy Requirement for Credit Default Swap (CDS) Positions in the Banking Book

5.17.1 Recognition of External / Third-party CDS Hedges

5.17.1.1 In case of Banking Book positions hedged by bought CDS positions, no exposure will be reckoned against the reference entity / underlying asset in respect of the hedged exposure, and exposure will be deemed to have been substituted by the protection seller, if the following conditions are satisfied:

(a) Operational requirements mentioned in paragraph 4 of circular DBOD.BP.BC.No.61/21.06.203/2011-12 dated November 30, 2011 on Prudential Guidelines on Credit Default Swaps (CDS) are met (refer to **Annex 7** of these guidelines);

(b) The risk weight applicable to the protection seller under the Standardised Approach for credit risk is lower than that of the underlying asset; and

(c) There is no maturity mismatch between the underlying asset and the reference / deliverable obligation. If this condition is not satisfied, then the amount of credit protection to be recognised should be computed as indicated in paragraph 5.17.1.3 (ii) below.

5.17.1.2 If the conditions 5.17.1.1 (a) and (b) above are not satisfied or the bank breaches any of these conditions subsequently, the bank shall reckon the exposure on the underlying asset; and the CDS position will be transferred to Trading Book where it will be subject to specific risk, counterparty credit risk and general market risk (wherever applicable) capital requirements as applicable to Trading Book.

5.17.1.3 The unprotected portion of the underlying exposure should be risk-weighted as applicable under the Standardised Approach for credit risk. The amount of credit protection shall be adjusted if there are any mismatches between the underlying asset/ obligation and the reference / deliverable asset / obligation with regard to asset or maturity. These are dealt with in detail in the following paragraphs.

(i) ***Asset Mismatches:*** Asset mismatch will arise if the underlying asset is different from

the reference asset or deliverable obligation. Protection will be reckoned as available by the protection buyer only if the mismatched assets meet the requirements that (1) the reference obligation or deliverable obligation ranks pari passu with or is junior to the underlying obligation, and (2) the underlying obligation and reference obligation or deliverable obligation share the same obligor (i.e. the same legal entity) and legally enforceable cross-default or cross-acceleration clauses are in place..

(ii) ***Maturity Mismatches:*** The protection buyer would be eligible to reckon the amount of protection if the maturity of the credit derivative contract were to be equal or more than the maturity of the underlying asset. If, however, the maturity of the CDS contract is less than the maturity of the underlying asset, then it would be construed as a maturity mismatch. In case of maturity mismatch the amount of protection will be determined in the following manner:

a. If the residual maturity of the credit derivative product is less than **three months** no protection will be recognized.

b. If the residual maturity of the credit derivative contract is **three months** or more protection proportional to the period for which it is available will be recognised.

When there is a maturity mismatch the following adjustment will be applied.

$$Pa = P \times (t - 0.25) \div (T - 0.25)$$

Where:
Pa = value of the credit protection adjusted for maturity mismatch

P = credit protection

t = min (T, residual maturity of the credit protection arrangement) expressed in years

T = min (5, residual maturity of the underlying exposure) expressed in years

Example: Suppose the underlying asset is a corporate bond of Face Value of Rs.100 where the residual maturity is of 5 years and the residual maturity of the CDS is 4 years. The amount of credit protection is computed as under:
$100 * \{(4 - 0.25) \div (5 - 0.25)\} = 100*(3.75 \div 4.75) = 78.95$

c. Once the residual maturity of the CDS contract reaches **three months**, protection ceases to be recognised.

5.17.2 **Internal Hedges**

Banks can use CDS contracts to hedge against the credit risk in their existing corporate bonds portfolios. A bank can hedge a Banking Book credit risk exposure either by an internal hedge (the protection purchased from the trading desk of the bank and held in the Trading Book) or an external hedge (protection purchased from an eligible third party protection provider). When a bank hedges a Banking Book credit risk exposure (corporate bonds) using a CDS booked in its Trading Book (i.e. using an internal hedge), the Banking Book exposure is not deemed to be hedged for capital purposes unless the bank transfers the credit risk from the Trading Book to an eligible third party protection provider through a CDS meeting

the requirements of **paragraph 5.17** vis-à-vis the Banking Book exposure. Where such third party protection is purchased and is recognised as a hedge of a Banking Book exposure for regulatory capital purposes, no capital is required to be maintained on internal and external CDS hedge. In such cases, the external CDS will act as indirect hedge for the Banking Book exposure and the capital adequacy in terms of **paragraph 5.17**, as applicable for external/ third party hedges, will be applicable.

6. External Credit Assessments

6.1 Eligible Credit Rating Agencies

6.1.1 Reserve Bank has undertaken the detailed process of identifying the eligible credit rating agencies, whose ratings may be used by banks for assigning risk weights for credit risk. In line with the provisions of the Revised Framework[59], where the facility provided by the bank possesses rating assigned by an eligible credit rating agency, the risk weight of the claim will be based on this rating.

6.1.2 In accordance with the principles laid down in the Revised Framework, the Reserve Bank of India has decided that banks may use the ratings of the following domestic credit rating agencies (arranged in alphabetical order) for the purposes of risk weighting their claims for capital adequacy purposes:

(a) Brickwork Ratings India Pvt. Limited (Brickwork);
(b) Credit Analysis and Research Limited;
(c) CRISIL Limited;
(d) ICRA Limited;
(e) India Ratings and Research Private Limited (India Ratings); and
(f) SME Rating Agency of India Ltd. (SMERA)

6.1.2.1 The Reserve Bank of India has decided that banks may use the ratings of the following international credit rating agencies (arranged in alphabetical order) for the purposes of risk weighting their claims for capital adequacy purposes where specified:

a. Fitch;
b. Moody's; and
c. Standard & Poor's

6.2 Scope of Application of External Ratings

6.2.1 Banks should use the chosen credit rating agencies and their ratings consistently for each type of claim, for both risk weighting and risk management purposes. Banks will not be allowed to "cherry pick" the assessments provided by different credit rating agencies and to arbitrarily change the use of credit rating agencies. If a bank has decided to use the ratings of some of the chosen credit rating agencies for a given type of claim, it can use only the

[59] Please refer to the Document 'International Convergence of Capital Measurement and Capital Standards' (June 2006) released by the Basel Committee on Banking Supervision.

ratings of those credit rating agencies, despite the fact that some of these claims may be rated by other chosen credit rating agencies whose ratings the bank has decided not to use. Banks shall not use one agency's rating for one corporate bond, while using another agency's rating for another exposure to the same counterparty, unless the respective exposures are rated by only one of the chosen credit rating agencies, whose ratings the bank has decided to use. External assessments for one entity within a corporate group cannot be used to risk weight other entities within the same group.

6.2.2 Banks must disclose the names of the credit rating agencies that they use for the risk weighting of their assets, the risk weights associated with the particular rating grades as determined by Reserve Bank through the mapping process for each eligible credit rating agency as well as the aggregated risk weighted assets as required vide **Table DF-4 of Annex 18**.

6.2.3 To be eligible for risk-weighting purposes, the external credit assessment must take into account and reflect the entire amount of credit risk exposure the bank has with regard to all payments owed to it. For example, if a bank is owed both principal and interest, the assessment must fully take into account and reflect the credit risk associated with timely repayment of both principal and interest.

6.2.4 To be eligible for risk weighting purposes, the rating should be in force and confirmed from the monthly bulletin of the concerned rating agency. The rating agency should have reviewed the rating at least once during the previous 15 months.

6.2.5 An eligible credit assessment must be publicly available. In other words, a rating must be published in an accessible form and included in the external credit rating agency's transition matrix. Consequently, ratings that are made available only to the parties to a transaction do not satisfy this requirement.

6.2.6 For assets in the bank's portfolio that have contractual maturity less than or equal to one year, short term ratings accorded by the chosen credit rating agencies would be relevant. For other assets which have a contractual maturity of more than one year, long term ratings accorded by the chosen credit rating agencies would be relevant.

6.2.7 Cash credit exposures tend to be generally rolled over and also tend to be drawn on an average for a major portion of the sanctioned limits. Hence, even though a cash credit exposure may be sanctioned for period of one year or less, these exposures should be reckoned as long term exposures and accordingly the long term ratings accorded by the chosen credit rating agencies will be relevant. Similarly, banks may use long-term ratings of a counterparty as a proxy for an unrated short- term exposure on the same counterparty subject to strict compliance with the requirements for use of multiple rating assessments and applicability of issue rating to issuer / other claims as indicated in **paragraphs 6.4, 6.5, 6.7 and 6.8** below.

6.3 Mapping Process

The Revised Framework recommends development of a mapping process to assign the ratings issued by eligible credit rating agencies to the risk weights available under the Standardised risk weighting framework. The mapping process is required to result in a risk

weight assignment consistent with that of the level of credit risk. A mapping of the credit ratings awarded by the chosen domestic credit rating agencies has been furnished below in **paragraphs 6.4.1 and 6.5.4**, which should be used by banks in assigning risk weights to the various exposures.

6.4 Long Term Ratings

6.4.1 On the basis of the above factors as well as the data made available by the rating agencies, the ratings issued by the chosen domestic credit rating agencies have been mapped to the appropriate risk weights applicable as per the Standardised approach under the Revised Framework. The rating-risk weight mapping furnished in the Table 12 below shall be adopted by all banks in India:

Table 12: Risk Weight Mapping of Long Term Ratings of the chosen Domestic Rating Agencies

CARE	CRISIL	India Ratings and Research Private Limited (India Ratings)	ICRA	Brickwork	SME Rating Agency of India Ltd. (SMERA)	Standardised approach risk weights (in per cent)
CARE AAA	CRISIL AAA	IND AAA	ICRA AAA	Brickwork AAA	SMERA AAA	20
CARE AA	CRISIL AA	IND AA	ICRA AA	Brickwork AA	SMERA AA	30
CARE A	CRISIL A	IND A	ICRA A	Brickwork A	SMERA A	50
CARE BBB	CRISIL BBB	IND BBB	ICRA BBB	Brickwork BBB	SMERA BBB	100
CARE BB, CARE B, CARE C & CARE D	CRISIL BB, CRISIL B, CRISIL C & CRISIL D	IND BB, IND B, IND C & IND D	ICRA BB, ICRA B, ICRA C & ICRA D	Brickwork BB, Brickwork B, Brickwork C & Brickwork D	SMERA BB, SMERA B, SMERA C & SMERA D	150
Unrated	Unrated	Unrated	Unrated	Unrated	Unrated	100

6.4.2 Where "+" or "-" notation is attached to the rating, the corresponding main rating category risk weight should be used. For example, A+ or A- would be considered to be in the A rating category and assigned 50 per cent risk weight.

6.4.3 If an issuer has a long-term exposure with an external long term rating that warrants a risk weight of 150 per cent, all unrated claims on the same counter-party, whether short-term or long-term, should also receive a 150 per cent risk weight, unless the bank uses recognised credit risk mitigation techniques for such claims.

6.5 Short Term Ratings

6.5.1 For risk-weighting purposes, short-term ratings are deemed to be issue-specific. They can only be used to derive risk weights for claims arising from the rated facility. They cannot be generalised to other short-term claims. In no event can a short-term rating be used to support a risk weight for an unrated long-term claim. Short-term assessments may only be used for short-term claims against banks and corporates.

6.5.2 Notwithstanding the above restriction on using an issue specific short term rating for other short term exposures, the following broad principles will apply. The unrated short term claim on counterparty will attract a risk weight of at least one level higher than the risk weight applicable to the rated short term claim on that counter-party. If a short-term rated facility to counterparty attracts a 20 per cent or a 50 per cent risk-weight, unrated short-term claims to the same counter-party cannot attract a risk weight lower than 30 per cent or 100 per cent respectively.

6.5.3 Similarly, if an issuer has a short-term exposure with an external short term rating that warrants a risk weight of 150 per cent, all unrated claims on the same counter-party, whether long-term or short-term, should also receive a 150 per cent risk weight, unless the bank uses recognised credit risk mitigation techniques for such claims.

6.5.4 In respect of the issue specific short term ratings the following risk weight mapping shall be adopted by banks:

Table 13: Risk Weight Mapping of Short Term Ratings of Domestic Rating Agencies

CARE	CRISIL	India Ratings and Research Private Limited (India Ratings)	ICRA	Brickwork	SME Rating Agency of India Ltd. (SMERA)	Standardised approach risk weights (in per cent)
CARE A1+	CRISIL A1+	IND A1+	ICRA A1+	Brickwork A1+	SMERA A1+	20
CARE A1	CRISIL A1	IND A1	ICRA A1	Brickwork A1	SMERA A1	30
CARE A2	CRISIL A2	IND A2	ICRA A2	Brickwork A2	SMERA A2	50
CARE A3	CRISIL A3	IND A3	ICRA A3	Brickwork A3	SMERA A3	100
CARE A4 & D	CRISIL A4 & D	IND A4 & D	ICRA A4 & D	Brickwork A4 & D	SMERA A4 & D	150
Unrated	Unrated	Unrated	Unrated	Unrated	Unrated	100

6.5.5 Where "+" or "-" notation is attached to the rating, the corresponding main rating category risk weight should be used for A2 and below, unless specified otherwise. For example, A2+ or A2- would be considered to be in the A2 rating category and assigned 50 per cent risk weight.

6.5.6 The above risk weight mapping of both long term and short term ratings of the chosen domestic rating agencies would be reviewed annually by the Reserve Bank.

6.6 Use of Unsolicited Ratings

A rating would be treated as solicited only if the issuer of the instrument has requested the credit rating agency for the rating and has accepted the rating assigned by the agency. As a general rule, banks should use only **solicited rating from the chosen credit rating agencies.** No ratings issued by the credit rating agencies on an unsolicited basis should be considered for risk weight calculation as per the Standardised Approach.

6.7 Use of Multiple Rating Assessments

Banks shall be guided by the following in respect of exposures / obligors having multiple

ratings from the chosen credit rating agencies chosen by the bank for the purpose of risk weight calculation:

(i) If there is only one rating by a chosen credit rating agency for a particular claim, that rating would be used to determine the risk weight of the claim.

(ii) If there are two ratings accorded by chosen credit rating agencies that map into different risk weights, the higher risk weight should be applied.

(iii) If there are three or more ratings accorded by chosen credit rating agencies with different risk weights, the ratings corresponding to the two lowest risk weights should be referred to and the higher of those two risk weights should be applied. i.e., the second lowest risk weight.

6.8 Applicability of 'Issue Rating' to issuer/ other claims

6.8.1 Where a bank invests in a particular issue that has an issue specific rating by a chosen credit rating agency the risk weight of the claim will be based on this assessment. Where the bank's claim is not an investment in a specific assessed issue, the following general principles will apply:

(i) In circumstances where the borrower has a specific assessment for an issued debt - but the bank's claim is not an investment in this particular debt - the rating applicable to the specific debt (where the rating maps into a risk weight lower than that which applies to an unrated claim) may be applied to the bank's unassessed claim only if this claim ranks *pari passu* or senior to the specific rated debt in all respects and the maturity of the unassessed claim is not later than the maturity of the rated claim,[60] except where the rated claim is a short term obligation as specified in paragraph 6.5.2. If not, the rating applicable to the specific debt cannot be used and the unassessed claim will receive the risk weight for unrated claims.

(ii) In circumstances where the borrower has an issuer assessment, this assessment typically applies to senior unsecured claims on that issuer. Consequently, only senior claims on that issuer will benefit from a high quality issuer assessment. Other unassessed claims of a highly assessed issuer will be treated as unrated. If either the issuer or a single issue has a low quality assessment (mapping into a risk weight equal to or higher than that which applies to unrated claims), an unassessed claim on the same counterparty that ranks pari-passu or is subordinated to either the senior unsecured issuer assessment or the exposure assessment will be assigned the same risk weight as is applicable to the low quality assessment.

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[60] In a case where a short term claim on a counterparty is rated as A1+ and a long term claim on the same counterparty is rated as AAA, then a bank may assign a 30 per cent risk weight to an unrated short term claim and 20 per cent risk weight to an unrated long term claim on that counterparty where the seniority of the claim ranks pari-passu with the rated claims and the maturity of the unrated claim is not later than the rated claim. In a similar case where a short term claim is rated A1+ and a long term claim is rated A, the bank may assign 50 per cent risk weight to an unrated short term or long term claim .

(iii) Where a bank intends to extend an issuer or an issue specific rating assigned by a chosen credit rating agency to any other exposure which the bank has on the same counterparty and which meets the above criterion, it should be extended to the entire amount of credit risk exposure the bank has with regard to that exposure i.e., both principal and interest.

(iv) With a view to avoiding any double counting of credit enhancement factors, no recognition of credit risk mitigation techniques should be taken into account if the credit enhancement is already reflected in the issue specific rating accorded by a chosen credit rating agency relied upon by the bank.

(v) Where unrated exposures are risk weighted based on the rating of an equivalent exposure to that borrower, the general rule is that foreign currency ratings would be used only for exposures in foreign currency.

6.8.2 If the conditions indicated in **paragraph 6.8.1** above are not satisfied, the rating applicable to the specific debt cannot be used and the claims on NABARD/SIDBI/NHB[61] on account of deposits placed in lieu of shortfall in achievement of priority sector lending targets/sub-targets shall be risk weighted as applicable for unrated claims, i.e. 100%.

7. Credit Risk Mitigation

7.1 General Principles

7.1.1 Banks use a number of techniques to mitigate the credit risks to which they are exposed. For example, exposures may be collateralised in whole or in part by cash or securities, deposits from the same counterparty, guarantee of a third party, etc. The revised approach to credit risk mitigation allows a wider range of credit risk mitigants to be recognised for regulatory capital purposes than is permitted under the 1988 Framework provided these techniques meet the requirements for legal certainty as described in **paragraph 7.2** below. Credit risk mitigation approach as detailed in this section is applicable to the banking book exposures. This will also be applicable for calculation of the counterparty risk charges for OTC derivatives and repo-style transactions booked in the trading book.

7.1.2 The general principles applicable to use of credit risk mitigation techniques are as under:

(i) No transaction in which Credit Risk Mitigation (CRM) techniques are used should receive a higher capital requirement than an otherwise identical transaction where such techniques are not used.

(ii) The effects of CRM will **not** be double counted. Therefore, no additional supervisory recognition of CRM for regulatory capital purposes will be granted

[61] Please refer to the circular DBOD.BP.BC.No.103/21.06.001/2012-13 dated June 20, 2013 on 'Risk Weights on Deposits Placed with NABARD / SIDBI / NHB in lieu of Shortfall in Achievement of Priority Sector Lending Targets / Sub-targets'.

on claims for which an issue-specific rating is used that already reflects that CRM.

(iii) Principal-only ratings will not be allowed within the CRM framework.

(iv) While the use of CRM techniques reduces or transfers credit risk, it simultaneously may increase other risks (residual risks). Residual risks include legal, operational, liquidity and market risks. Therefore, it is imperative that banks employ robust procedures and processes to control these risks, including strategy; consideration of the underlying credit; valuation; policies and procedures; systems; control of roll-off risks; and management of concentration risk arising from the bank's use of CRM techniques and its interaction with the bank's overall credit risk profile. Where these risks are not adequately controlled, Reserve Bank may impose additional capital charges or take other supervisory actions. The disclosure requirements prescribed in **Table DF-5 of Annex 18** must also be observed for banks to obtain capital relief in respect of any CRM techniques.

7.2 Legal Certainty

In order for banks to obtain capital relief for any use of CRM techniques, the following minimum standards for legal documentation must be met. All documentation used in collateralised transactions and guarantees must be binding on all parties and legally enforceable in all relevant jurisdictions. Banks must have conducted sufficient legal review, which should be well documented, to verify this requirement. Such verification should have a well-founded legal basis for reaching the conclusion about the binding nature and enforceability of the documents. Banks should also undertake such further review as necessary to ensure continuing enforceability.

7.3 Credit Risk Mitigation Techniques - Collateralised Transactions

7.3.1 A Collateralised Transaction is one in which:

(i) banks have a credit exposure and that credit exposure is hedged in whole or in part by collateral posted by a counterparty or by a third party on behalf of the counterparty. Here, "counterparty" is used to denote a party to whom a bank has an on- or off-balance sheet credit exposure.

(ii) banks have a specific lien on the collateral and the requirements of legal certainty are met.

7.3.2 Overall framework and minimum conditions

The framework allows banks to adopt either the simple approach, which, similar to the 1988 Accord, substitutes the risk weighting of the collateral for the risk weighting of the counterparty for the collateralised portion of the exposure (generally subject to a 20 per cent floor), or the comprehensive approach, which allows fuller offset of collateral against exposures, by effectively reducing the exposure amount by the value ascribed to the collateral. Banks in India shall adopt the Comprehensive Approach, which allows fuller offset

of collateral against exposures, by effectively reducing the exposure amount by the value ascribed to the collateral. Under this approach, banks, which take eligible financial collateral (e.g., cash or securities, more specifically defined below), are allowed to reduce their credit exposure to a counterparty when calculating their capital requirements to take account of the risk mitigating effect of the collateral. Credit risk mitigation is allowed only on an account-by-account basis, even within regulatory retail portfolio. However, before capital relief will be granted the standards set out below must be met:

(i) In addition to the general requirements for legal certainty, the legal mechanism by which collateral is pledged or transferred must ensure that the bank has the right to liquidate or take legal possession of it, in a timely manner, in the event of the default, insolvency or bankruptcy (or one or more otherwise-defined credit events set out in the transaction documentation) of the counterparty (and, where applicable, of the custodian holding the collateral). Furthermore banks must take all steps necessary to fulfill those requirements under the law applicable to the bank's interest in the collateral for obtaining and maintaining an enforceable security interest, e.g. by registering it with a registrar.

(ii) In order for collateral to provide protection, the credit quality of the counterparty and the value of the collateral must not have a material positive correlation. For example, securities issued by the counterparty - or by any related group entity - would provide little protection and so would be ineligible.

(iii) Banks must have clear and robust procedures for the timely liquidation of collateral to ensure that any legal conditions required for declaring the default of the counterparty and liquidating the collateral are observed, and that collateral can be liquidated promptly.

(iv) Where the collateral is held by a custodian, banks must take reasonable steps to ensure that the custodian segregates the collateral from its own assets.

(v) Banks must ensure that sufficient resources are devoted to the orderly operation of margin agreements with OTC derivative and securities-financing counterparties banks, as measured by the timeliness and accuracy of its outgoing calls and response time to incoming calls. Banks must have collateral management policies in place to control, monitor and report the following to the Board or one of its Committees:

- the risk to which margin agreements exposes them (such as the volatility and liquidity of the securities exchanged as collateral),
- the concentration risk to particular types of collateral,
- the reuse of collateral (both cash and non-cash) including the potential liquidity shortfalls resulting from the reuse of collateral received from counterparties, and
- the surrender of rights on collateral posted to counterparties.

7.3.3 A capital requirement will be applied to a bank on either side of the collateralised transaction: for example, both repos and reverse repos will be subject to capital requirements. Likewise, both sides of securities lending and borrowing transactions will be subject to explicit capital charges, as will the posting of securities in connection with a derivative exposure or other borrowing.

7.3.4 The Comprehensive Approach

(i) In the comprehensive approach, when taking collateral, banks will need to calculate their adjusted exposure to a counterparty for capital adequacy purposes in order to take account of the effects of that collateral. Banks are required to adjust both the amount of the exposure to the counterparty and the value of any collateral received in support of that counterparty to take account of possible future fluctuations in the value of either, occasioned by market movements. These adjustments are referred to as 'haircuts'. The application of haircuts will produce volatility adjusted amounts for both exposure and collateral. The volatility adjusted amount for the exposure will be higher than the exposure and the volatility adjusted amount for the collateral will be lower than the collateral, unless either side of the transaction is cash. In other words, the 'haircut' for the exposure will be a premium factor and the 'haircut' for the collateral will be a discount factor. It may be noted that the purpose underlying the application of haircut is to capture the market-related volatility inherent in the value of exposures as well as of the eligible financial collaterals. Since the value of credit exposures acquired by banks in the course of their banking operations, would not be subject to market volatility, (since the loan disbursal / investment would be a "cash" transaction) though the value of eligible financial collateral would be, the haircut stipulated in **Table-14** (paragraph 7.3.7) would apply in respect of credit transactions only to the eligible collateral but not to the credit exposure of the bank. On the other hand, exposures of banks, arising out of repo-style transactions would require upward adjustment for volatility, as the value of security sold/lent/pledged in the repo transaction, would be subject to market volatility. Hence, such exposures shall attract haircut.

(ii) Additionally where the exposure and collateral are held in different currencies an additional downwards adjustment must be made to the volatility adjusted collateral amount to take account of possible future fluctuations in exchange rates.

(iii) Where the volatility-adjusted exposure amount is greater than the volatility-adjusted collateral amount (including any further adjustment for foreign exchange risk), banks shall calculate their risk-weighted assets as the difference between the two multiplied by the risk weight of the counterparty. The framework for performing calculations of capital requirement is indicated in **paragraph 7.3.6**.

7.3.5 Eligible Financial Collateral

The following collateral instruments are eligible for recognition in the comprehensive approach:

(i) Cash (as well as certificates of deposit or comparable instruments, including fixed deposit receipts, issued by the lending bank) on deposit with the bank which is incurring the counterparty exposure.

(ii) Gold: Gold would include both bullion and jewellery. However, the value of the collateralised jewellery should be arrived at after notionally converting these to 99.99 purity.

(iii) Securities issued by Central and State Governments

(iv) Kisan Vikas Patra and National Savings Certificates provided no lock-in period is operational and if they can be encashed within the holding period.

(v) Life insurance policies with a declared surrender value of an insurance company which is regulated by an insurance sector regulator.

(vi) Debt securities rated by a chosen Credit Rating Agency in respect of which banks should be sufficiently confident about the market liquidity[62] where these are either:

(a) Attracting 100 per cent or lesser risk weight i.e., rated at least BBB(-) when issued by public sector entities and other entities (including banks and Primary Dealers); or

(b) Attracting 100 per cent or lesser risk weight i.e., rated at least CARE A3/ CRISIL A3/ India Ratings and Research Private Limited (India Ratings) A3/ICRA A3/Brickwork A3/ SMERA A3 for short-term debt instruments.

(vii) Debt Securities not rated by a chosen Credit Rating Agency in respect of which banks should be sufficiently confident about the market liquidity where these are:

(a) issued by a bank; and

(b) listed on a recognised exchange; and

(c) classified as senior debt; and

(d) all rated issues of the same seniority by the issuing bank are rated at least BBB(-) or CARE A3/ CRISIL A3/ India Ratings and Research Private Limited (India Ratings) A3/ICRA A3/Brickwork A3/SMERA A3 by a chosen Credit Rating Agency; and

(e) the bank holding the securities as collateral has no information to suggest that the issue justifies a rating below BBB(-) or CARE A3/ CRISIL A3/ India Ratings and Research Private Limited (India Ratings) A3/ICRA A3/Brickwork A3/SMERA A3 (as applicable) and;

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[62] A debenture would meet the test of liquidity if it is traded on a recognised stock exchange(s) on at least 90 per cent of the trading days during the preceding 365 days. Further, liquidity can be evidenced in the trading during the previous one month in the recognised stock exchange if there are a minimum of 25 trades of marketable lots in securities of each issuer.

(f) Banks should be sufficiently confident about the market liquidity of the security.

(viii) Units of Mutual Funds regulated by the securities regulator of the jurisdiction of the bank's operation mutual funds where:

(a) a price for the units is publicly quoted daily i.e., where the daily NAV is available in public domain; and

(b) Mutual fund is limited to investing in the instruments listed in this paragraph.

(ix) Re-securitisations, irrespective of any credit ratings, are not eligible financial collateral.

7.3.6 Calculation of capital requirement

For a collateralised transaction, the exposure amount after risk mitigation is calculated as follows:

$$E^* = \max \{0, [E \times (1 + H_e) - C \times (1 - H_c - H_{fx})]\}$$

where:

E^* = the exposure value after risk mitigation

E = current value of the exposure for which the collateral qualifies as a risk mitigant

H_e = haircut appropriate to the exposure

C = the current value of the collateral received

H_c = haircut appropriate to the collateral

H_{fx} = haircut appropriate for currency mismatch between the collateral and exposure

The exposure amount after risk mitigation (i.e., E*) will be multiplied by the risk weight of the counterparty to obtain the risk-weighted asset amount for the collateralised transaction. Illustrative examples calculating the effect of Credit Risk Mitigation is furnished in **Annex 8.**

7.3.7 Haircuts

(i) In principle, banks have two ways of calculating the haircuts: (i) standard supervisory haircuts, using parameters set by the Basel Committee, and (ii) own-estimate haircuts, using banks' own internal estimates of market price volatility. Banks in India shall use only the standard supervisory haircuts for both the exposure as well as the collateral.

(ii) The Standard Supervisory Haircuts (assuming daily mark-to-market, daily re-margining and a 10 business-day holding period)[63], expressed as percentages, would be as furnished in Table 14.

(iii) The ratings indicated in Table 14 represent the ratings assigned by the domestic

[63] Holding period will be the time normally required by the bank to realise the value of the collateral.

rating agencies. In the case of exposures toward debt securities issued by foreign Central Governments and foreign corporates, the haircut may be based on ratings of the international rating agencies, as indicated in Table 15.

(iv) Sovereign will include Reserve Bank of India, DICGC and CGTMSE, CRGFTLIH which are eligible for zero per cent risk weight.

(v) Banks may apply a zero haircut for eligible collateral where it is a National Savings Certificate, Kisan Vikas Patras, surrender value of insurance policies and banks' own deposits.

(vi) The standard supervisory haircut for currency risk where exposure and collateral are denominated in different currencies is eight per cent (also based on a 10-business day holding period and daily mark-to-market).

Table 14: Standard Supervisory Haircuts for Sovereign and other securities which constitute Exposure and Collateral

Sl. No.		Issue Rating for Debt securities	Residual Maturity (in years)	Haircut (in percentage)
A	**Securities issued / guaranteed by the Government of India and issued by the State Governments (Sovereign securities)**			
	I	Rating not applicable – as Government securities are not currently rated in India	≤ 1 year	0.5
			> 1 year and ≤ 5 years	2
			> 5 years	4
	Domestic debt securities other than those indicated at Item No. A above including the securities guaranteed by Indian State Governments			
	Ii	AAA to AA A1	≤ 1 year	1
			> 1 year and ≤ 5 years	4
			> 5 years	8
	Iii	A to BBB A2, A3 and unrated bank securities as specified in paragraph 7.3.5 (vii) of the circular	≤ 1 year	2
			> 1 year and ≤ years	6
			> 5 years	12
	Iv	Units of Mutual Funds		Highest haircut applicable to any of the above securities, in which the eligible mutual fund {cf. paragraph 7.3.5 (viii)} can invest
C	**Cash in the same currency**			0
D	**Gold**			15
	Securitisation Exposures[64]			
			≤ 1 year	2

[64]Including those backed by securities issued by foreign sovereigns and foreign corporates.

	Ii	AAA to AA	> 1 year and ≤ 5 years	8
			> 5 years	16
	Iii	A to BBB and unrated bank securities as specified in paragraph 7.3.5 (vii) of the circular	≤ 1 year	4
			> 1 year and ≤ years	12
			> 5 years	24

Table 15: Standard Supervisory Haircut for Exposures and Collaterals which are obligations of foreign central sovereigns / foreign corporates

Issue rating for debt securities as assigned by international rating agencies	**Residual Maturity**	**Sovereigns** (%)	**Other Issues (%)**
AAA to AA / A1	**<** = 1 year	0.5	1
	> 1 year and < or = 5 years	2	4
	> 5 years	4	8
A to BBB / A2 / A3 and Unrated Bank Securities	< = 1 year	1	2
	> 1 year and < or = 5 years	3	6
	> 5 years	6	12

(vii) For transactions in which banks' exposures are unrated or bank lends non-eligible instruments (i.e. non-investment grade corporate securities), the haircut to be applied on a exposure should be 25 per cent. (Since, at present, the repos are allowed only in the case of Government securities, banks are not likely to have any exposure which will attract the provisions of this clause. However, this would be relevant, if in future, repos/security lending transactions are permitted in the case of unrated corporate securities).

(viii) Where the collateral is a basket of assets, the haircut on the basket will be,

$$H = \sum_i a_i H_i$$

where a_i is the weight of the asset (as measured by the amount/value of the asset in units of currency) in the basket and H_i the haircut applicable to that asset.

(ix) Adjustment for different holding periods:

For some transactions, depending on the nature and frequency of the revaluation and remargining provisions, different holding periods (other than 10 business-days) are appropriate. The framework for collateral haircuts distinguishes between repo-style transactions (i.e. repo/reverse repos and securities lending/borrowing), "other capital-market-driven transactions" (i.e. OTC derivatives transactions and margin lending) and secured lending. In capital-market-driven transactions and repo-style transactions, the documentation contains remargining clauses; in secured lending transactions, it generally does not. In view of different holding periods, in the case of these transactions, the minimum holding period shall be taken as indicated below:

Transaction type	Minimum holding Period	Condition
Repo-style transaction	five business days	daily remargining
Other capital market transactions	ten business days	daily remargining
Secured lending	twenty business days	daily revaluation

The haircut for the transactions with other than 10 business-days minimum holding period, as indicated above, will have to be adjusted by scaling up/down the haircut for 10 business–days indicated in the Table 14, as per the formula given in paragraph 7.3.7 (xi) below.

(x) Adjustment for non-daily mark-to-market or remargining:

In case a transaction has margining frequency different from daily margining assumed, the applicable haircut for the transaction will also need to be adjusted by using the formula given in paragraph 7.3.7 (xi) below.

(xi) Formula for adjustment for different holding periods and / or non-daily mark-to-market or remargining:

Adjustment for the variation in holding period and margining / mark-to-market, as indicated in paragraph (ix) and (x) above will be done as per the following formula:

$$H = H_{10}\sqrt{\frac{N_R + (T_M - 1)}{10}}$$

where:

H = haircut

H_{10} = 10-business-day standard supervisory haircut for instrument

N_R = actual number of business days between remargining for capital market transactions or revaluation for secured transactions.

T_M = minimum holding period for the type of transaction

7.3.8 Capital Adequacy Framework for Repo-/Reverse Repo-style transactions.

The repo-style transactions also attract capital charge for Counterparty credit risk (CCR), in addition to the credit risk and market risk. The CCR is defined as the risk of default by the counterparty in a repo-style transaction, resulting in non-delivery of the security lent/pledged/sold or non-repayment of the cash.

A. Treatment in the books of the borrower of funds:

(i) Where a bank has borrowed funds by selling / lending or posting, as collateral, of securities, the ‘Exposure’ will be an off-balance sheet exposure equal to the 'market value' of the securities sold/lent as scaled up after applying appropriate haircut. For the purpose, the haircut as per Table 14 would be used as the basis which should be applied by using the formula in paragraph 7.3.7 (xi), to reflect minimum (prescribed) holding period of five business-days for repo-style transactions and the variations, if any, in the frequency of re-margining, from the daily margining assumed for the standard

supervisory haircut. The 'off-balance sheet exposure' will be converted into 'on-balance sheet' equivalent by applying a credit conversion factor of 100 per cent, as per item 5 in **Table 8** (paragraph 5.15).

(ii) The amount of money received will be treated as collateral for the securities lent/sold/pledged. Since the collateral is cash, the haircut for it would be zero.

(iii) The credit equivalent amount arrived at (i) above, net of amount of cash collateral, will attract a risk weight as applicable to the counterparty.

(iv) As the securities will come back to the books of the borrowing bank after the repo period, it will continue to maintain the capital for the credit risk in the securities in the cases where the securities involved in repo are held under HTM category, and capital for market risk in cases where the securities are held under AFS/HFT categories. The capital charge for credit risk / specific risk would be determined according to the credit rating of the issuer of the security. In the case of Government securities, the capital charge for credit / specific risk will be 'zero'.

B. Treatment in the books of the lender of funds:

(i) The amount lent will be treated as on-balance sheet/funded exposure on the counter party, collateralised by the securities accepted under the repo.

(ii) The exposure, being cash, will receive a zero haircut.

(iii) The collateral will be adjusted downwards/marked down as per applicable haircut.

(iv) The amount of exposure reduced by the adjusted amount of collateral, will receive a risk weight as applicable to the counterparty, as it is an on- balance sheet exposure.

(v) The lending bank will not maintain any capital charge for the security received by it as collateral during the repo period, since such collateral does not enter its balance sheet but is only held as a bailee.

7.4 Credit Risk Mitigation Techniques – On-Balance Sheet Netting

On-balance sheet netting is confined to loans/advances and deposits, where banks have legally enforceable netting arrangements, involving specific lien with proof of documentation. They may calculate capital requirements on the basis of net credit exposures subject to the following conditions:

Where a bank,

(a) has a well-founded legal basis for concluding that the netting or offsetting agreement is enforceable in each relevant jurisdiction regardless of whether the counterparty is insolvent or bankrupt;

(b) is able at any time to determine the loans/advances and deposits with the same counterparty that are subject to the netting agreement; and

(c) monitors and controls the relevant exposures on a net basis,

it may use the net exposure of loans/advances and deposits as the basis for its capital adequacy calculation in accordance with the formula in **paragraph 7.3.6**. Loans/advances are treated as exposure and deposits as collateral. The haircuts will be zero except when a currency mismatch exists. All the requirements contained in **paragraph 7.3.6 and 7.6** will also apply.

7.5 Credit Risk Mitigation Techniques - Guarantees

7.5.1 Where guarantees are direct, explicit, irrevocable and unconditional banks may take account of such credit protection in calculating capital requirements.

7.5.2 A range of guarantors are recognised. As under the 1988 Accord, a substitution approach will be applied. Thus only guarantees issued by entities with a lower risk weight than the counterparty will lead to reduced capital charges since the protected portion of the counterparty exposure is assigned the risk weight of the guarantor, whereas the uncovered portion retains the risk weight of the underlying counterparty.

7.5.3 Detailed operational requirements for guarantees eligible for being treated as a CRM are as under:

7.5.4 Operational requirements for guarantees

(i) A guarantee (counter-guarantee) must represent a direct claim on the protection provider and must be explicitly referenced to specific exposures or a pool of exposures, so that the extent of the cover is clearly defined and incontrovertible. The guarantee must be irrevocable; there must be no clause in the contract that would allow the protection provider unilaterally to cancel the cover or that would increase the effective cost of cover as a result of deteriorating credit quality in the guaranteed exposure. The guarantee must also be unconditional; there should be no clause in the guarantee outside the direct control of the bank that could prevent the protection provider from being obliged to pay out in a timely manner in the event that the original counterparty fails to make the payment(s) due.

(ii) All exposures will be risk weighted after taking into account risk mitigation available in the form of guarantees. When a guaranteed exposure is classified as non-performing, the guarantee will cease to be a credit risk mitigant and no adjustment would be permissible on account of credit risk mitigation in the form of guarantees. The entire outstanding, net of specific provision and net of realisable value of eligible collaterals / credit risk mitigants, will attract the appropriate risk weight.

7.5.5 Additional operational requirements for guarantees

In addition to the legal certainty requirements in **paragraph 7.2** above, in order for a guarantee to be recognised, the following conditions must be satisfied:

(i) On the qualifying default/non-payment of the counterparty, the bank is able in a timely manner to pursue the guarantor for any monies outstanding under the documentation governing the transaction. The guarantor may make one lump sum payment of all monies under such documentation to the bank, or the guarantor may assume the future payment obligations of the counterparty covered by the guarantee. The bank must have the right to receive any such payments from the guarantor without first having to take legal actions in order to pursue the counterparty for payment.

(ii) The guarantee is an explicitly documented obligation assumed by the guarantor.

(iii) Except as noted in the following sentence, the guarantee covers all types of payments the underlying obligor is expected to make under the documentation governing the transaction, for example notional amount, margin payments etc. Where a guarantee covers payment of principal only, interests and other uncovered payments should be treated as an unsecured amount in accordance with paragraph

7.5.6 Range of Eligible Guarantors (Counter-Guarantors)

Credit protection given by the following entities will be recognised:

(i) Sovereigns, sovereign entities (including BIS, IMF, European Central Bank and European Community as well as those MDBs referred to in **paragraph 5.5**, ECGC and CGTSI, CRGFTLIH), banks and primary dealers with a lower risk weight than the counterparty;

(ii) Other entities that are externally rated except when credit protection is provided to a securitisation exposure. This would include credit protection provided by parent, subsidiary and affiliate companies when they have a lower risk weight than the obligor.

(iii) When credit protection is provided to a securitisation exposure, other entities that currently are externally rated BBB- or better and that were externally rated A- or better at the time the credit protection was provided. This would include credit protection provided by parent, subsidiary and affiliate companies when they have a lower risk weight than the obligor.

7.5.7 Risk Weights

The protected portion is assigned the risk weight of the protection provider. Exposures covered by State Government guarantees will attract a risk weight of 20 per cent. The uncovered portion of the exposure is assigned the risk weight of the underlying counterparty.

7.5.8 Proportional Cover

Where the amount guaranteed, or against which credit protection is held, is less than the amount of the exposure, and the secured and unsecured portions are of equal seniority, i.e. the bank and the guarantor share losses on a pro-rata basis capital relief will be afforded on a proportional basis: i.e. the protected portion of the exposure will receive the treatment applicable to eligible guarantees, with the remainder treated as unsecured.

7.5.9 Currency Mismatches

Where the credit protection is denominated in a currency different from that in which the exposure is denominated – i.e. there is a currency mismatch – the amount of the exposure deemed to be protected will be reduced by the application of a haircut H_{FX}, i.e.,

$$G_A = G \times (1 - H_{FX})$$

where:

G = nominal amount of the credit protection

H_{FX} = haircut appropriate for currency mismatch between the credit protection and underlying obligation.

Banks using the supervisory haircuts will apply a haircut of eight per cent for currency mismatch.

7.5.10 Sovereign Guarantees and Counter-Guarantees

A claim may be covered by a guarantee that is indirectly counter-guaranteed by a sovereign. Such a claim may be treated as covered by a sovereign guarantee provided that:

(i) the sovereign counter-guarantee covers all credit risk elements of the claim;

(ii) both the original guarantee and the counter-guarantee meet all operational requirements for guarantees, except that the counter-guarantee need not be direct and explicit to the original claim; and

(iii) the cover should be robust and no historical evidence suggests that the coverage of the counter-guarantee is less than effectively equivalent to that of a direct sovereign guarantee.

7.6 Maturity Mismatch

7.6.1 For the purposes of calculating risk-weighted assets, a maturity mismatch occurs when the residual maturity of collateral is less than that of the underlying exposure. Where there is a maturity mismatch and the CRM has an original maturity of less than one year, the CRM is not recognised for capital purposes. In other cases where there is a maturity mismatch, partial recognition is given to the CRM for regulatory capital purposes as detailed below in paragraphs 7.6.2 to 7.6.4. In case of loans collateralised by the bank's own deposits, even if the tenor of such deposits is less than three months or deposits have maturity mismatch vis-à-vis the tenor of the loan, the provisions of paragraph 7.6.1 regarding derecognition of collateral would not be attracted provided an explicit consent of the depositor has been obtained from the depositor (i.e. borrower) for adjusting the maturity proceeds of such deposits against the outstanding loan or for renewal of such deposits till the full repayment of the underlying loan.

7.6.2 Definition of Maturity

The maturity of the underlying exposure and the maturity of the collateral should both be defined conservatively. The effective maturity of the underlying should be gauged as the

longest possible remaining time before the counterparty is scheduled to fulfil its obligation, taking into account any applicable grace period. For the collateral, embedded options which may reduce the term of the collateral should be taken into account so that the shortest possible effective maturity is used. The maturity relevant here is the residual maturity.

7.6.3 Risk Weights for Maturity Mismatches

As outlined in paragraph 7.6.1, collateral with maturity mismatches are only recognised when their original maturities are greater than or equal to one year. As a result, the maturity of collateral for exposures with original maturities of less than one year must be matched to be recognised. In all cases, collateral with maturity mismatches will no longer be recognised when they have a residual maturity of three months or less.

7.6.4 When there is a maturity mismatch with recognised credit risk mitigants (collateral, on-balance sheet netting and guarantees) the following adjustment will be applied:

$$Pa = P \times (t - 0.25) \div (T - 0.25)$$

where:

Pa = value of the credit protection adjusted for maturity mismatch

P = credit protection (e.g. collateral amount, guarantee amount) adjusted for any haircuts

t = min (T, residual maturity of the credit protection arrangement) expressed in years

T = min (5, residual maturity of the exposure) expressed in years

7.7 Treatment of pools of CRM Techniques

In the case where a bank has multiple CRM techniques covering a single exposure (e.g. a bank has both collateral and guarantee partially covering an exposure), the bank will be required to subdivide the exposure into portions covered by each type of CRM technique (e.g. portion covered by collateral, portion covered by guarantee) and the risk-weighted assets of each portion must be calculated separately. When credit protection provided by a single protection provider has differing maturities, they must be subdivided into separate protection as well.

8. Capital Charge for Market Risk

8.1 Introduction

Market risk is defined as the risk of losses in on-balance sheet and off-balance sheet positions arising from movements in market prices. The market risk positions subject to capital charge requirement are:

(i) The risks pertaining to interest rate related instruments and equities in the trading book; and

(ii) Foreign exchange risk (including open position in precious metals) throughout the bank (both banking and trading books).

8.2 Scope and Coverage of Capital Charge for Market Risks

8.2.1 These guidelines seek to address the issues involved in computing capital charges for interest rate related instruments in the trading book, equities in the trading book and foreign exchange risk (including gold and other precious metals) in both trading and banking books. Trading book for the purpose of capital adequacy will include:

(i) Securities included under the Held for Trading category
(ii) Securities included under the Available for Sale category
(iii) Open gold position limits
(iv) Open foreign exchange position limits
(v) Trading positions in derivatives, and
(vi) Derivatives entered into for hedging trading book exposures.

8.2.2 Banks are required to manage the market risks in their books on an ongoing basis and ensure that the capital requirements for market risks are being maintained on a continuous basis, i.e. at the close of each business day. Banks are also required to maintain strict risk management systems to monitor and control intra-day exposures to market risks.

8.2.3 Capital for market risk would not be relevant for securities, which have already matured and remain unpaid. These securities will attract capital only for credit risk. On completion of 90 days delinquency, these will be treated on par with NPAs for deciding the appropriate risk weights for credit risk.

8.3 Measurement of Capital Charge for Interest Rate Risk

8.3.1 This section describes the framework for measuring the risk of holding or taking positions in debt securities and other interest rate related instruments in the trading book.

8.3.2 The capital charge for interest rate related instruments would apply to current market value of these items in bank's trading book. Since banks are required to maintain capital for market risks on an ongoing basis, they are required to mark to market their trading positions on a daily basis. The current market value will be determined as per extant RBI guidelines on valuation of investments.

8.3.3 The minimum capital requirement is expressed in terms of two separately calculated charges, (i) "**specific risk**" charge for each security, which is designed to protect against an adverse movement in the price of an individual security owing to factors related to the individual issuer, both for short (short position is not allowed in India except in derivatives and Central Government Securities) and long positions, and (ii) "**general market risk**" charge towards interest rate risk in the portfolio, where long and short positions (which is not allowed in India except in derivatives and Central Government Securities) in different securities or instruments can be offset.

8.3.4 For the debt securities held under AFS category, in view of the possible longer holding period and attendant higher specific risk, the banks shall hold total capital charge for market risk equal to greater of (a) or (b) below:

(a) Specific risk capital charge, computed notionally for the AFS securities treating them as held under HFT category (as computed according to Table 16: Part A / C / E(i) / F / G / H, as applicable) plus the General Market Risk Capital Charge.

(b) Alternative total capital charge for the AFS category computed notionally treating them as held in the banking book (as computed in accordance with Table 16: Part B / D / E(ii) / F / G / I, as applicable)

A. Specific Risk

8.3.5 The capital charge for specific risk is designed to protect against an adverse movement in the price of an individual security owing to factors related to the individual issuer. The specific risk charges for various kinds of exposures would be applied as detailed below:

Sr. No.	Nature of debt securities / issuer	Table to be followed
a.	Central, State and Foreign Central Governments' Bonds: (i) Held in HFT category (ii) Held in AFS category	 Table 16 – Part A Table 16 – Part B
b.	Banks' Bonds: (i) Held in HFT category (ii) Held in AFS category	 Table 16 – Part C Table 16 – Part D
c.	Corporate Bonds (other than Bank Bonds): (i) Held in HFT category (ii) Held in AFS category	 Table 16 – Part E(i) Table 16 – Part E(ii)
d.	Securitiesd Debt Instruments Held in HFT and AFS categories	 Table 16 – Part F
e.	Re-securitiesd Debt Instruments Held in HFT and AFS categories	 Table 16 – Part G
f.	Non-common Equity Capital Instruments issued by Financial Entities other than Banks (i) Held in HFT category (ii) Held in AFS category	 Table 16 – Part H Table 16 – Part I
g.	Equity Investments in Banks Held in HFT and AFS Categories	 Table 19 – Part A
h.	Equity Investments in Financial Entities (other than Banks) Held in HFT and AFS Categories	 Table 19 – Part B
i.	Equity Investments in Non-financial (commercial) Entities	Table 19 – Part C

Table 16 – Part A: Specific Risk Capital Charge for Sovereign securities issued by Indian and foreign sovereigns – Held by banks under the HFT Category

Sr. No.	Nature of Investment	Residual Maturity	Specific risk capital (as % of exposure)
A.	**Indian Central Government and State Governments**		
1.	Investment in Central and State Government Securities	All	0.00
2.	Investments in other approved securities guaranteed by Central Government	All	0.00
3.	Investments in other approved securities guaranteed by State Government	6 months or less	0.28
		More than 6 months and up to and including 24 months	1.13
		More than 24 months	1.80
4.	Investment in other securities where payment of interest and repayment of principal are guaranteed by Central Government	All	0.00
5.	Investments in other securities where payment of interest and repayment of principal are guaranteed by State Government.	6 months or less	0.28
		More than 6 months and up to and including 24 months	1.13
		More than 24 months	1.80
B.	**Foreign Central Governments**		
1.	AAA to AA	All	0.00
2.	A to BBB	6 months or less	0.28
		More than 6 months and up to and including 24 months	1.13
		More than 24 months	1.80
3.	BB to B	All	9.00
4.	Below B	All	13.50
5.	Unrated	All	13.50

Table 16 – Part B: Alternative Total Capital Charge for securities issued by Indian and foreign sovereigns - Held by banks under the AFS Category

Sr. No.	Nature of Investment	Residual Maturity	Specific risk capital (as % of exposure)
A.	**Indian Central Government and State Governments**		
1.	Investment in Central and State Government Securities	All	0.00
2.	Investments in other approved securities guaranteed by Central Government	All	0.00
3.	Investments in other approved securities guaranteed by State Government	All	1.80
4.	Investment in other securities where payment of interest and repayment of principal are guaranteed by Central Government	All	0.00
5.	Investments in other securities where payment of interest and repayment of principal are guaranteed by State Government.	All	1.80
B.	**Foreign Central Governments**		
1.	AAA to AA	All	0.00
2.	A	All	1.80
3.	BBB	All	4.50
4.	BB to B	All	9.00
5.	Below B	All	13.50
	Unrated	All	9.00

Table 16 - Part C: Specific risk capital charge for bonds issued by banks – Held by banks under the HFT category

	Residual maturity	Specific risk capital charge (%)			
		All Scheduled Banks (Commercial, Regional Rural Banks, Local Area Banks and Co-Operative Banks)		All Non-Scheduled Banks (Commercial, Regional Rural Banks, Local Area Banks and Co-Operative Banks)	
Level of Common Equity Tier 1 capital (CET1) including applicable capital conservation buffer (CCB) (%) of the investee bank (where applicable)		Investments in capital instruments (other than equity[#]) referred to in para 5.6.1(i)	All other claims	Investments in capital instruments (other than equity[#]) referred to in para 5.6.1(i)	All other Claims
1	2	3	4	5	6
Applicable Minimum CET1 + Applicable CCB and above	≤6 months	1.75	0.28	1.75	1.75
	> 6 months and ≤ 24 months	7.06	1.13	7.06	7.06
	>24 months	11.25	1.8	11.25	11.25
Applicable Minimum CET1 + CCB = 75% and <100% of applicable CCB	All Maturities	13.5	4.5	22.5	13.5
Applicable Minimum CET1 + CCB = 50% and <75% of applicable CCB	All Maturities	22.5	9	31.5	22.5
Applicable Minimum CET1 + CCB = 0% and <50% of applicable CCB	All Maturities	31.5	13.5	56.25	31.5
Minimum CET1 less than applicable minimum	All Maturities	56.25	56.25	Full deduction*	56.25

* The deduction should be made from Common Equity Tier 1 Capital.

refer to para 8.4.4 below for specific risk capital charge on equity instruments.

Notes:

(i) In case of banks where no capital adequacy norms have been prescribed by the RBI, the lending / investing bank may calculate the applicable Common Equity Tier 1 and capital conservation buffer of the bank concerned, notionally, by obtaining necessary information from the investee bank and using the capital adequacy norms as applicable to the commercial banks. In case, it is not found feasible to compute applicable Common Equity Tier 1 and capital conservation buffer on such notional basis, the specific risk capital charge of 31.5% or 56.25

%, as per the risk perception of the investing bank, should be applied uniformly to the investing bank's entire exposure.

(ii) In case of banks where capital adequacy norms are not applicable at present, the matter of investments in their capital-eligible instruments would not arise for now. However, this Table above will become applicable to them, if in future they issue any capital instruments where other banks are eligible to invest.

(iii) The existing specific risk capital charges up to 9% have been scaled up to reflect the application of specific risk charge corresponding to risk weight of 125% instead of 100%. For instance the existing specific risk charge for exposure to capital instrument issued by scheduled banks with applicable Common Equity Tier 1 and capital conservation buffer more than 9% and instrument having a residual maturity of less than 6 month is 1.4%. This is scaled up as under:

1.4*125% =1.75

(iv) Till such time the investee banks have not disclosed their Basel III capital ratios publicly, the risk weights / capital charges may be arrived at based on the tables/paragraph as contained in the Master Circular DBOD.No.BP.BC.9/21.06.001/2013-14 dated July 1, 2013 on Prudential Guidelines on Capital Adequacy and Market Discipline - New Capital Adequacy Framework.

Table 16 - Part D: Alternative Total Capital Charge for bonds issued by banks – Held by banks under AFS category (subject to the conditions stipulated in paragraph 8.3.4)

	Specific risk capital charge (%)			
	All Scheduled Banks (Commercial, Regional Rural Banks, Local Area Banks and Co-Operative Banks)		All Non-Scheduled Banks (Commercial, Regional Rural Banks, Local Area Banks and Co-Operative Banks)	
Level of Common Equity Tier 1 capital (CET1) including applicable capital conservation buffer (CCB) (%) of the investee bank (where applicable))	Investments in capital instruments (other than equity[#]) referred to in para 5.6.1(i)	All other claims	Investments in capital instruments (other than equity[#]) referred to in para 5.6.1(i)	All other claims
1	2	3	4	5
Applicable Minimum CET1 + Applicable CCB and above	11.25	1.8	11.25	11.25
Applicable Minimum CET1 + CCB = 75% and <100% of applicable CCB	13.5	4.5	22.5	13.5
Applicable Minimum CET1 + CCB = 50% and <75% of applicable CCB	22.5	9	31.5	22.5
Applicable Minimum CET1 + CCB = 0% and <50% of applicable CCB	31.5	13.5	56.25	31.5
Minimum CET1 less than applicable minimum	56.25	56.25	Full deduction*	56.25

***** deduction should be made from Common Equity Tier 1 capital

refer to para 8.4.4 below for specific risk capital charge on equity instruments

Notes:

(i) In the case of banks where no capital adequacy norms have been prescribed by the RBI, the lending / investing bank may calculate the applicable Common Equity Tier 1 and capital conservation buffer of the bank concerned, notionally, by obtaining necessary information from the investee bank and using the capital adequacy norms as applicable to the commercial banks. In case, it is not found feasible to compute applicable Common Equity Tier 1 and capital conservation buffer on such notional basis, the specific risk capital charge of 31.5% or 56.25 %, as per the risk perception of the investing bank, should be applied uniformly to the investing bank's entire exposure.

(ii) In case of banks where capital adequacy norms are not applicable at present, the matter of investments in their capital-eligible instruments would not arise for now. However, the Table above will become applicable to them, if in future they issue any capital instruments where other banks are eligible to invest.

(iii) Till such time the investee banks have not disclosed their Basel III capital ratios publicly, the risk weights / capital charges may be arrived at based on the applicable tables / paragraph as contained in the Master Circular DBOD.No.BP.BC.9/21.06.001/2013-14 dated July 1, 2013 on Prudential Guidelines on Capital Adequacy and Market Discipline - New Capital Adequacy Framework.

Table 16 – Part E (i)[65]: Specific Risk Capital Charge for Corporate Bonds (Other than bank bonds) – Held by banks under HFT Category

* Rating by the ECAI	Residual maturity	Specific Risk Capital Charge (in %)
AAA to BBB	6 months or less	0.28
	Greater than 6 months and up to and including 24 months	1.14
	Exceeding 24 months	1.80
BB and below	All maturities	13.5
Unrated (if permitted)	All maturities	9

* These ratings indicate the ratings assigned by Indian rating agencies/ECAIs or foreign rating agencies. In the case of foreign ECAIs, the rating symbols used here correspond to Standard and Poor. The modifiers "+" or "-" have been subsumed with the main rating category.

[65] Master Circular DBOD.No.BP.BC.73/21.06.001/2009-10 dated Feb 8, 2010

Table 16 – Part E (ii): Alternative Total Capital Charge for Corporate Bonds (Other than bank bonds) – Held by banks under AFS Category

* Rating by the ECAI	Total Capital Charge (in per cent)
AAA	1.8
AA	2.7
A	4.5
BBB	9.0
BB and below	13.5
Unrated	9.0

***** These ratings indicate the ratings assigned by Indian rating agencies/ECAIs or foreign rating agencies. In the case of foreign ECAIs, the rating symbols used here correspond to Standard and Poor. The modifiers "+" or "-" have been subsumed with the main rating category.

Table 16 – Part F: Specific Risk Capital Charge for Securitised Debt Instruments (SDIs) – Held by banks under HFT and AFS Category

* Rating by the ECAI	Specific Risk Capital Charge	
	Securitisation Exposures (in %)	Securitisation Exposures (SDIs) relating to Commercial Real Estate Exposures (in %)
AAA	1.8	9.0
AA	2.7	9.0
A	4.5	9.0
BBB	9.0	9.0
BB	31.5 (100.0 in the case of originators)	31.5 (100.0 in the case of originators)
B and below or unrated	100.0	100.0

***** These ratings indicate the ratings assigned by Indian rating agencies/ECAIs or foreign rating agencies. In the case of foreign ECAIs, the rating symbols used here correspond to Standard and Poor. The modifiers "+" or "-"have been subsumed with the main rating category.

Table 16 – Part G: Specific Risk Capital Charge for Re-securitised Debt Instruments (RSDIs) – Held by banks under HFT and AFS Category

* Rating by the ECAI	Specific Risk Capital Charge	
	Re-Securitisation Exposures (in %)	Re-Securitisation Exposures (RSDIs) relating to Commercial Real Estate Exposures (in %)
AAA	3.6	18
AA	5.4	18
A	9.0	18
BBB	18	18
BB	63 (100 in the case of originators)	63 (100 in the case of originators)
B and below or unrated	100	100

* These ratings indicate the ratings assigned by Indian rating agencies/ECAIs or foreign rating agencies. In the case of foreign ECAIs, the rating symbols used here correspond to Standard and

Poor. The modifiers "+" or "-"have been subsumed with the main rating category.

Table 16 - Part H: Specific risk capital charge for non-common equity capital instruments issued by financial entities other than bank – Held by banks under the HFT category

	Residual maturity	Specific risk capital charge (%)
		Investments in non-common equity capital instruments of financial entities other than banks referred to in paragraph 5.6.1(i)*
1	2	3
Specific risk charge	≤6 months	1.75
	> 6 months and ≤ 24 months	7.06
	>24 months	11.25

* Investments falling under para 5.6.1 (ii) will be deducted following corresponding deduction approach

Table 16 - Part I: Alternative Total Capital Charge for non-common equity capital instruments issued financial entities other than banks - Held by banks under the AFS category

	Specific risk capital charge (%)
	Investments in non- common equity capital instruments of financial entities other than banks referred to in para 5.6.1(i)
1	2
Specific risk charge	11.25

8.3.6 Banks shall, in addition to computing the counterparty credit risk (CCR) charge for OTC derivatives, as part of capital for credit risk as per the Standardised Approach covered in **paragraph 5** above, also compute the specific risk charge for OTC derivatives in the trading book as required in terms of **Annex 9**.

B. **General Market Risk**

8.3.7 The capital requirements for general market risk are designed to capture the risk of loss arising from changes in market interest rates. The capital charge is the sum of four components:

(i) the net short (short position is not allowed in India except in derivatives and Central Government Securities) or long position in the whole trading book;

(ii) a small proportion of the matched positions in each time-band (the "vertical disallowance");

(iii) a larger proportion of the matched positions across different time-bands (the "horizontal disallowance"), and

(iv) a net charge for positions in options, where appropriate.

8.3.8 Separate maturity ladders should be used for each currency and capital charges should be calculated for each currency separately and then summed with no offsetting between positions of opposite sign. In the case of those currencies in which business is

insignificant (where the turnover in the respective currency is less than 5 per cent of overall foreign exchange turnover), separate calculations for each currency are not required. The bank may, instead, slot within each appropriate time-band, the net long or short position for each currency. However, these individual net positions are to be summed within each time-band, irrespective of whether they are long or short positions, to produce a gross position figure. The gross positions in each time-band will be subject to the assumed change in yield set out in Table-18 with no further offsets.

8.3.9 The Basel Committee has suggested two broad methodologies for computation of capital charge for market risks. One is the standardised method and the other is the banks' internal risk management models method. As banks in India are still in a nascent stage of developing internal risk management models, it has been decided that, to start with, banks may adopt the standardised method. Under the standardised method there are two principal methods of measuring market risk, a "maturity" method and a "duration" method. As "duration" method is a more accurate method of measuring interest rate risk, it has been decided to adopt standardised duration method to arrive at the capital charge. Accordingly, banks are required to measure the general market risk charge by calculating the price sensitivity (modified duration) of each position separately. Under this method, the mechanics are as follows:

(i) first calculate the price sensitivity (modified duration) of each instrument;

(ii) next apply the assumed change in yield to the modified duration of each instrument between 0.6 and 1.0 percentage points depending on the maturity of the instrument (see **Table 17)**;

(iii) slot the resulting capital charge measures into a maturity ladder with the fifteen time bands as set out in **Table 17**;

(iv) subject long and short positions (short position is not allowed in India except in derivatives and Central Government Securities) in each time band to a 5 per cent vertical disallowance designed to capture basis risk; and

(v) carry forward the net positions in each time-band for horizontal offsetting subject to the disallowances set out in **Table 18**.

Table 17 - Duration Method – Time Bands and Assumed changes in Yield

Time Bands	Assumed Change in Yield		Time Bands	Assumed Change in Yield
Zone 1			**Zone 3**	
1 month or less	1.00		3.6 to 4.3 years	0.75
1 to 3 months	1.00		4.3 to 5.7 years	0.70
3 to 6 months	1.00		5.7 to 7.3 years	0.65
6 to 12 months	1.00		7.3 to 9.3 years	0.60
Zone 2			9.3 to 10.6 years	0.60
1.0 to 1.9 years	0.90		10.6 to 12 years	0.60
1.9 to 2.8 years	0.80		12 to 20 years	0.60
2.8 to 3.6 years	0.75		over 20 years	0.60

Table 18 - Horizontal Disallowances

Zones	Time band	Within the zones	Between adjacent zones	Between zones 1 and 3
Zone 1	1 month or less	40%	40%	100%
	1 to 3 months			
	3 to 6 months			
	6 to 12 months			
Zone 2	1.0 to 1.9 years	30%		
	1.9 to 2.8 years			
	2.8 to 3.6 years			
Zone 3	3.6 to 4.3 years	30%	40%	
	4.3 to 5.7 years			
	5.7 to 7.3 years			
	7.3 to 9.3 years			
	9.3 to 10.6 years			
	10.6 to 12 years			
	12 to 20 years			
	over 20 years			

8.3.10 The measurement system should include all interest rate derivatives and off balance-sheet instruments in the trading book which react to changes in interest rates, (e.g. forward rate agreements (FRAs), other forward contracts, bond futures, interest rate and cross-currency swaps and forward foreign exchange positions). Options can be treated in a variety of ways as described in **Annex 9**.

8.4 Measurement of Capital Charge for Equity Risk

8.4.1 The capital charge for equities would apply on their current market value in bank's trading book. Minimum capital requirement to cover the risk of holding or taking positions in equities in the trading book is set out below. This is applied to all instruments that exhibit market behaviour similar to equities but not to non-convertible preference shares (which are covered by the interest rate risk requirements described earlier). The instruments covered include equity shares, whether voting or non-voting, convertible securities that behave like equities, for example: units of mutual funds, and commitments to buy or sell equity.

Specific and General Market Risk

8.4.2 Capital charge for specific risk (akin to credit risk) will be 11.25 per cent or capital charge in accordance with the risk warranted by external rating (or lack of it) of the counterparty, whichever is higher and specific risk is computed on banks' gross equity positions (i.e. the sum of all long equity positions and of all short equity positions - short equity position is, however, not allowed for banks in India). In addition, the general market risk charge will also be 9 per cent on the gross equity positions. These capital charges will also be applicable to all trading book exposures, which are exempted from capital market exposure ceilings for direct investments.

8.4.3 Specific Risk Capital Charge for banks' investment in Security Receipts will be 13.5 per cent (equivalent to 150 per cent risk weight). Since the Security Receipts are by and large illiquid and not traded in the secondary market, there will be no General Market Risk Capital Charge on them. (vide mailbox clarification dated January 18, 2010)

8.4.4 The specific risk charge for bank's investments in the equity of other banks / other financial entities / non-financial entities will be as under:

Table 19 – Part A: Specific risk charge for bank's investments in the equity of other banks held in HFT and AFS portfolios

Level of Common Equity Tier 1 capital (CET1) including applicable capital conservation buffer (CCB) (%) of the investee bank (where applicable)	All Scheduled Banks (Commercial, Regional Rural Banks, Local Area Banks and Co-Operative Banks)		All Non-scheduled Banks (Commercial, Local Area Banks and Co-Operative Banks) (in %)	
	Equity investments in other banks referred to in:		Equity investments in other banks referred to in:	
	para 5.6.1(i)	para 5.6.1(ii)	para 5.6.1(i)	para 5.6.1(ii)
Applicable Minimum CET1 + Applicable CCB and above	11.25	22.5	11.25	27
Applicable Minimum CET1 + CCB = 75% and <100% of applicable CCB	13.5	27	22.5	31.5
Applicable Minimum CET1 + CCB = 50% and <75% of applicable CCB	22.5	31.5	31.5	40.5
Applicable Minimum CET1 + CCB = 0% and <50% of applicable CCB	31.5	40.5	56.25	Full deduction*
Minimum CET1 less than applicable minimum	50	Full deduction*	Full deduction*	Full deduction*

* Full deduction should be made from Common Equity Tier 1 capital

Notes:
Till such time the investee banks have not disclosed their Basel III capital ratios publicly, the risk weights / capital charges may be arrived at based on the tables/paragraph as contained in the Master Circular DBOD.No.BP.BC.9/21.06.001/2013-14 dated July 1, 2013 on Prudential Guidelines on Capital Adequacy and Market Discipline - New Capital Adequacy Framework.

Table 19 – Part B: Specific risk charge for bank's investments in the equity of financial entities other than banks

	Equity investments in financial entities other than banks referred to in:	
	para 5.6.1(i)	para 5.6.1(ii)
Specific risk charge (%)	11.25	22.5

Table 19 – Part C: Specific risk charge for bank's investments in the equity of non-financial (commercial) entities

	Equity investments in non-financial entities	
	where a bank does not own more than 10% of the equity capital of investee companies	which are more than 10% of the equity capital of investee companies or which are affiliates of the bank (these exposures need not attract general market risk charge)
Specific risk charge (%)	11.25	100

8.5 Measurement of Capital Charge for Foreign Exchange Risk

The bank's net open position in each currency should be calculated by summing:

- The net spot position (i.e. all asset items less all liability items, including accrued interest, denominated in the currency in question);
- The net forward position (i.e. all amounts to be received less all amounts to be paid under forward foreign exchange transactions, including currency futures and the principal on currency swaps not included in the spot position);
- Guarantees (and similar instruments) that are certain to be called and are likely to be irrecoverable;
- Net future income/expenses not yet accrued but already fully hedged (at the discretion of the reporting bank);
- Depending on particular accounting conventions in different countries, any other item representing a profit or loss in foreign currencies;
- The net delta-based equivalent of the total book of foreign currency options

Foreign exchange open positions and gold open positions are at present risk-weighted at 100 per cent. Thus, capital charge for market risks in foreign exchange and gold open position is 9 per cent. These open positions, **limits or actual whichever is higher,** would continue to attract capital charge at 9 per cent. This capital charge is in addition to the capital charge for credit risk on the on-balance sheet and off-balance sheet items pertaining to foreign exchange and gold transactions.

8.6 Measurement of Capital Charge for Credit Default Swap (CDS) in the Trading Book

8.6.1 General Market Risk

A credit default swap does not normally create a position for general market risk for either the protection buyer or protection seller. However, the present value of premium payable / receivable is sensitive to changes in the interest rates. In order to measure the interest rate risk in premium receivable / payable, the present value of the premium can be treated as a notional position in Government securities of relevant maturity. These positions will attract appropriate capital charge for general market risk. The protection buyer / seller will treat the

present value of the premium payable / receivable equivalent to a short / long notional position in Government securities of relevant maturity.

8.6.2 **Specific Risk for Exposure to Reference Entity**

A CDS creates a notional long / short position for specific risk in the reference asset / obligation for protection seller / protection buyer. For calculating specific risk capital charge, the notional amount of the CDS and its maturity should be used. The specific risk capital charge for CDS positions will be as per Tables below.

Table 20: Specific Risk Capital Charges for bought and sold CDS positions in the Trading Book : Exposures to entities other than Commercial Real Estate Companies / NBFC-ND-SI

Upto 90 days			After 90 days	
Ratings by the ECAI*	**Residual Maturity of the instrument**	**Capital charge**	**Ratings by the ECAI***	**Capital charge**
AAA to BBB	6 months or less	0.28 %	AAA	1.8 %
	Greater than 6 months and up to and including 24 months	1.14%	AA	2.7%
	Exceeding 24 months	1.80%	A	4.5%
			BBB	9.0%
BB and below	All maturities	13.5%	BB and below	13.5%
Unrated (if permitted)	All maturities	9.0%	Unrated (if permitted)	9.0%

* These ratings indicate the ratings assigned by Indian rating agencies / ECAIs or foreign rating agencies. In the case of foreign ECAIs, the rating symbols used here correspond to Standard and Poor. The modifiers "+" or "-" have been subsumed within the main category.

Table 21: Specific Risk Capital Charges for bought and sold CDS positions in the Trading Book : Exposures to Commercial Real Estate Companies / NBFC-ND-SI#

Ratings by the ECAI*	Residual Maturity of the instrument	Capital charge
AAA to BBB	6 months or less	1.4%
	Greater than 6 months and up to and including 24 months	7.7%
	Exceeding 24 months	9.0%
BB and below	All maturities	9.0%
Unrated (if permitted)	All maturities	9.0%

The above table will be applicable for exposures up to 90 days. Capital charge for exposures to Commercial Real Estate Companies / NBFC-ND-SI beyond 90 days shall be taken at 9.0%, regardless of rating of the reference / deliverable obligation.

* These ratings indicate the ratings assigned by Indian rating agencies / ECAIs or foreign rating agencies. In the case of foreign ECAIs, the rating symbols used here correspond to

Standard and Poor. The modifiers "+" or "-" have been subsumed within the main category.

8.6.2.1 ***Specific Risk Capital Charges for Positions Hedged by CDS[66]***

(i) Banks may fully offset the specific risk capital charges when the values of two legs (i.e. long and short in CDS positions) always move in the opposite direction and broadly to the same extent. This would be the case when the two legs consist of **completely identical CDS**. In these cases, no specific risk capital requirement applies to both sides of the CDS positions.

(ii) Banks may offset 80 per cent of the specific risk capital charges when the value of two legs (i.e. long and short) always moves in the opposite direction but not broadly to the same extent. This would be the case when a long cash position is hedged by a credit default swap and there is an exact match in terms of the reference / deliverable obligation, and the maturity of both the reference / deliverable obligation and the CDS. In addition, key features of the CDS (e.g. credit event definitions, settlement mechanisms) should not cause the price movement of the CDS to materially deviate from the price movements of the cash position. To the extent that the transaction transfers risk, an 80% specific risk offset will be applied to the side of the transaction with the higher capital charge, while the specific risk requirement on the other side will be zero.

(iii) Banks may offset partially the specific risk capital charges when the value of the two legs (i.e. long and short) usually moves in the opposite direction. This would be the case in the following situations:

(a) The position is captured in paragraph 8.6.2.1(ii) but there is an asset mismatch between the cash position and the CDS. However, the underlying asset is included in the (reference / deliverable) obligations in the CDS documentation and meets the requirements in paragraph 5.17.1.3(i) above.

(b) The position is captured in paragraph 8.6.2.1(ii) but there is maturity mismatch between credit protection and the underlying asset. However, the underlying asset is included in the (reference/ deliverable) obligations in the CDS documentation.

(c) In each of the cases in paragraph (a) and (b) above, rather than applying specific risk capital requirements on each side of the transaction (i.e. the credit protection and the underlying asset), only higher of the two capital requirements will apply.

8.6.2.2 ***Specific Risk Charge in CDS Positions which are not meant for Hedging***

In cases not captured in paragraph 8.6.2.1, a specific risk capital charge will be assessed against both sides of the positions.

8.6.3 **Capital Charge for Counterparty Credit Risk**

The credit exposure for the purpose of counterparty credit risk on account of CDS transactions in the Trading Book will be calculated according to the Current Exposure Method[67].

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[66] Please refer to paragraph 6.2 of Annex 7 of these guidelines for details.

[67] A CDS contract, which is required to be marked-to-market, creates bilateral exposure for the parties

8.6.3.1 **Protection Seller**

A protection seller will have exposure to the protection buyer only if the fee/premia is outstanding. In such cases, the counterparty credit risk charge for all single name long CDS positions in the Trading Book will be calculated as the sum of the current marked-to-market value, if positive (zero, if marked-to-market value is negative) and the potential future exposure add-on factors based on table given below. However, the add-on will be capped to the amount of unpaid premia.

Table 22: Add-on Factors for Protection Sellers	
	(As % of Notional Principal of CDS)
Type of Reference Obligation	**Add-on Factor**
Obligations rated BBB- and above	10%
Below BBB- and unrated	20%

8.6.3.2 **Protection Buyer**

A CDS contract creates a counterparty exposure on the protection seller on account of the credit event payment. The counterparty credit risk charge for all short CDS positions in the Trading Book will be calculated as the sum of the current marked-to-market value, if positive (zero, if marked-to-market value is negative) and the potential future exposure add-on factors based on table given below:

Table 23: Add-on Factors for Protection Buyers	
	(As % of Notional Principal of CDS)
Type of Reference Obligation	**Add-on Factor**
Obligations rated BBB- and above	10%
Below BBB- and unrated	20%

8.6.3.3 **Capital Charge for Counterparty Risk for Collateralised Transactions in CDS**

As mentioned in paragraph 3.3 of the circular IDMD.PCD.No.5053/14.03.04/2010-11 dated May 23, 2011, collaterals and margins would be maintained by the individual market participants. The counterparty exposure for CDS traded in the OTC market will be calculated

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to the contract. The mark-to-market value of a CDS contract is the difference between the default-adjusted present value of protection payment (called “protection leg” / “credit leg”) and the present value of premium payable called (“premium leg”). If the value of credit leg is less than the value of the premium leg, then the marked-to-market value for the protection seller in positive. Therefore, the protection seller will have exposure to the counterparty (protection buyer) if the value of premium leg is more than the value of credit leg. In case, no premium is outstanding, the value of premium leg will be zero and the mark-to-market value of the CDS contract will always be negative for the protection seller and therefore, protection seller will not have any exposure to the protection buyer. In no case, the protection seller’s exposure on protection buyer can exceed the amount of the premium unpaid. For the purpose of capital adequacy as well as exposure norms, the measure of counterparty exposures in case of CDS transaction held in Trading Book is the Potential Future Exposure (PFE) which is measured and recognised as per Current Exposure Method.

as per the Current Exposure Method. Under this method, the calculation of the counterparty credit risk charge for an individual contract, taking into account the collateral, will be as follows:

Counterparty risk capital charge = [(RC + add-on) – CA] x r x 9%

where:

RC = the replacement cost,

add-on = the amount for potential future exposure calculated according to paragraph 5.17.3 above.

CA = the volatility adjusted amount of eligible collateral under the comprehensive approach prescribed in paragraph 7.3 on "Credit Risk Mitigation Techniques - Collateralised Transactions" of these guidelines, or zero if no eligible collateral is applied to the transaction, and

r = the risk weight of the counterparty.

8.6.4 **Treatment of Exposures below Materiality Thresholds of CDS**

Materiality thresholds on payments below which no payment is made in the event of loss are equivalent to retained first loss positions and should be assigned risk weight of 1111 per cent for capital adequacy purpose by the protection buyer.

8.7 Aggregation of the capital charge for Market Risks

As explained earlier capital charges for specific risk and general market risk are to be computed separately before aggregation. For computing the total capital charge for market risks, the calculations may be plotted in the following table

Proforma

(□ in crore)

Risk Category	Capital charge
I. **Interest Rate (a+b)**	
a. General market risk	
i) Net position (parallel shift) ii) Horizontal disallowance (curvature) iii) Vertical disallowance (basis) iv) Options	
b. Specific risk	
II. **Equity (a+b)**	
a. General market risk	
b. Specific risk	
III. **Foreign Exchange and Gold**	
IV. **Total capital charge for market risks** (I+II+III)	

8.8 Treatment for Illiquid Positions

8.8.1 Prudent Valuation Guidance

(i) This section provides banks with guidance on prudent valuation for positions that are accounted for at fair value. This guidance would be applicable to all positions

enumerated in **paragraph 8.2.1** above. It is especially important for positions without actual market prices or observable inputs to valuation, as well as less liquid positions which raise supervisory concerns about prudent valuation. The valuation guidance set forth below is not intended to require banks to change valuation procedures for financial reporting purposes.

(ii) A framework for prudent valuation practices should at a minimum include the following:

8.8.1.1 *Systems and Controls*:

Banks must establish and maintain adequate systems and controls sufficient to give management and supervisors the confidence that their valuation estimates are prudent and reliable. These systems must be integrated with other risk management systems within the organisation (such as credit analysis). Such systems must include:

(i) Documented policies and procedures for the process of valuation. This includes clearly defined responsibilities of the various areas involved in the determination of the valuation, sources of market information and review of their appropriateness, guidelines for the use of unobservable inputs reflecting the bank's assumptions of what market participants would use in pricing the position, frequency of independent valuation, timing of closing prices, procedures for adjusting valuations, end of the month and ad-hoc verification procedures; and

(ii) Clear and independent (i.e. independent of front office) reporting lines for the department accountable for the valuation process.

8.8.1.2 *Valuation Methodologies*:

Marking to Market

(i) Marking-to-market is at least the daily valuation of positions at readily available close out prices in orderly transactions that are sourced independently. Examples of readily available close out prices include exchange prices, screen prices, or quotes from several independent reputable brokers.

(ii) Banks must mark-to-market as much as possible. The more prudent side of bid/offer should be used unless the institution is a significant market maker in a particular position type and it can close out at mid-market. Banks should maximise the use of relevant observable inputs and minimise the use of unobservable inputs when estimating fair value using a valuation technique. However, observable inputs or transactions may not be relevant, such as in a forced liquidation or distressed sale, or transactions may not be observable, such as when markets are inactive. In such cases, the observable data should be considered, but may not be determinative.

Marking to Model

(iii) Marking-to model is defined as any valuation which has to be benchmarked, extrapolated or otherwise calculated from a market input. Where marking-to-market is not possible, banks should follow the guidelines on valuation of investments contained in Master Circular DBOD No.BP.BC.3/21.04.141/2009-10 dated July 1, 2009, as amended from time to time on prudential norms for classification, valuation and operation of investment portfolio by banks. For investment and derivative positions other than those covered in the Master Circular, the valuation model used by banks must be demonstrated to be prudent. When marking to valuation model

other than that prescribed in RBI / FIMMDA guidelines, an extra degree of conservatism is appropriate. RBI will consider the following in assessing whether a mark-to-model valuation is prudent:

• Senior management should be aware of the elements of the trading book or of other fair-valued positions which are subject to mark to model and should understand the materiality of the uncertainty this creates in the reporting of the risk/performance of the business.

• Market inputs should be sourced, to the extent possible, in line with market prices (as discussed above). The appropriateness of the market inputs for the particular position being valued should be reviewed regularly.

• Where available, generally accepted valuation methodologies for particular products should be used as far as possible.

• Where the model is developed by the institution itself, it should be based on appropriate assumptions, which have been assessed and challenged by suitably qualified parties independent of the development process. The model should be developed or approved independently of the front office. It should be independently tested. This includes validating the mathematics, the assumptions and the software implementation.

• There should be formal change control procedures in place and a secure copy of the model should be held and periodically used to check valuations.

• Risk management should be aware of the weaknesses of the models used and how best to reflect those in the valuation output.

• The model should be subject to periodic review to determine the accuracy of its performance (e.g. assessing continued appropriateness of the assumptions, analysis of P&L versus risk factors, comparison of actual close out values to model outputs).

• Valuation adjustments should be made as appropriate, for example, to cover the uncertainty of the model valuation (see also valuation adjustments in paragraphs 8.8.1.2 (vi), (vii) and 8.8.2.1 to 8.8.2.4.)

Independent Price Verification

(iv) Independent price verification is distinct from daily mark-to-market. It is the process by which market prices or model inputs are regularly verified for accuracy. While daily marking-to-market may be performed by dealers, verification of market prices or model inputs should be performed by a unit independent of the dealing room, at least monthly (or, depending on the nature of the market/trading activity, more frequently). It need not be performed as frequently as daily mark-to-market, since the objective, i.e. independent, marking of positions should reveal any error or bias in pricing, which should result in the elimination of inaccurate daily marks.

(v) Independent price verification entails a higher standard of accuracy in that the market prices or model inputs are used to determine profit and loss figures, whereas daily marks are used primarily for management reporting in between reporting dates. For independent price verification, where pricing sources are more subjective, e.g. only

one available broker quote, prudent measures such as valuation adjustments may be appropriate.

Valuation Adjustments

(vi) As part of their procedures for marking to market, banks must establish and maintain procedures for considering valuation adjustments. RBI would particularly expect banks using third-party valuations to consider whether valuation adjustments are necessary. Such considerations are also necessary when marking to model.

(vii) At a minimum, banks should consider the following valuation adjustments while valuing their derivatives portfolios:

- incurred CVA losses[68],
- closeout costs,
- operational risks,
- early termination, investing and funding costs, and
- future administrative costs and,
- where appropriate, model risk.

Banks may follow any recognised method/model to compute the above adjustments except provisions against incurred CVA losses. However, banks may use the following formula to calculate incurred CVA loss on derivatives transactions:

$$\mathbf{ICVAL_t = Max\ [0,\{(EE_t * RP_t) - (EE_0 * RP_0)\}]}$$

Where;

$ICVAL_t$ = Cumulative Incurred CVA loss at time 't'.

EE_t = Value of counterparty exposure projected after one year from 't' and discounted back to 't' using CEM and a risk free discount rate for one year

EE_0 = Counterparty exposure estimated at time '0' using CEM

RP_t = Credit spread of the counterparty as reflected in the CDS or bond prices.

In cases where market based credit spreads are not available, risk premium applicable to the counterparty according to its credit grade as per the internal credit rating system of the bank used for pricing/loan approval purposes at time 't' may be used.

RP_0 = Credit spread of the counterparty as reflected in the CDS or bond prices.

In cases where market based credit spreads are not available, risk premium applicable to the counterparty according to its credit grade as per the internal credit rating system of the bank used for pricing / loan approval purposes at time '0' i.e. the date of the transaction.

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[68] Provisions against incurred CVA losses are akin to specific provisions required on impaired assets and depreciation in case of investments held in the trading book. These provisions will be in addition to the general provisions @ 0.4% required on the positive MTM values. The provisions against incurred CVA losses may be netted off from the exposure value while calculating capital charge for default risk under the Current Exposure Method as required in terms of paragraph 5.15.3.5 (ii).

Note: Some of other terms used above are explained below:

Close-out costs
Close-out costs adjustment factors in the cost of eliminating the market risk of the portfolio.

Investing and Funding costs
The "investing and funding costs adjustment" relating to the cost of funding and investing cash flow mismatches at rates different from the rate which models typically assume.

Administrative costs adjustment
Administrative costs adjustment relates to the costs that will be incurred to administer the portfolio"

8.8.2 Adjustment to the current valuation of less liquid positions for regulatory capital purposes:

8.8.2.1 Banks must establish and maintain procedures for judging the necessity of and calculating an adjustment to the current valuation of less liquid positions for regulatory capital purposes. This adjustment may be in addition to any changes to the value of the position required for financial reporting purposes and should be designed to reflect the illiquidity of the position. An adjustment to a position's valuation to reflect current illiquidity should be considered whether the position is marked to market using market prices or observable inputs, third-party valuations or marked to model.

8.8.2.2 Bearing in mind that the assumptions made about liquidity in the market risk capital charge may not be consistent with the bank's ability to sell or hedge out less liquid positions where appropriate, banks must take an adjustment to the current valuation of these positions, and review their continued appropriateness on an on-going basis. Reduced liquidity may have arisen from market events. Additionally, close-out prices for concentrated positions and/or stale positions should be considered in establishing the adjustment. RBI has not prescribed any particularly methodology for calculating the amount of valuation adjustment on account of illiquid positions. Banks must consider all relevant factors when determining the appropriateness of the adjustment for less liquid positions. These factors may include, but are not limited to, the amount of time it would take to hedge out the position/risks within the position, the average volatility of bid/offer spreads, the availability of independent market quotes (number and identity of market makers), the average and volatility of trading volumes (including trading volumes during periods of market stress), market concentrations, the aging of positions, the extent to which valuation relies on marking-to-model, and the impact of other model risks not included in paragraph 8.8.2.2. The valuation adjustment on account of illiquidity should be considered irrespective of whether the guidelines issued by FIMMDA have taken into account the illiquidity premium or not, while fixing YTM/spreads for the purpose of valuation.

8.8.2.3 For complex products including, but not limited to, securitisation exposures, banks must explicitly assess the need for valuation adjustments to reflect two forms of model risk:

(i) the model risk associated with using a possibly incorrect valuation methodology; and

(ii) the risk associated with using unobservable (and possibly incorrect) calibration parameters in the valuation model.

8.8.2.4 The adjustment to the current valuation of less liquid positions made under paragraph 8.8.2.2 will not be debited to P&L Account, but will be deducted from Common Equity Tier 1 capital while computing CRAR of the bank. The adjustment may exceed those valuation adjustments made under financial reporting/accounting standards and paragraphs 8.8.1.2 (vi) and (vii).

8.8.2.5 In calculating the eligible capital for market risk, it will be necessary first to calculate the banks' minimum capital requirement for credit and operational risk and only afterwards its market risk requirement to establish how much components of capital is available to support market risk as described in **Part B of the Annex 14**.

9. Capital Charge for Operational Risk

9.1 Definition of Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputational risk. Legal risk includes, but is not limited to, exposure to fines, penalties, or punitive damages resulting from supervisory actions, as well as private settlements.

9.2 The Measurement Methodologies

9.2.1 The New Capital Adequacy Framework outlines three methods for calculating operational risk capital charges in a continuum of increasing sophistication and risk sensitivity: (i) the Basic Indicator Approach (BIA); (ii) the Standardised Approach (TSA); and (iii) Advanced Measurement Approaches (AMA).

9.2.2 Banks are encouraged to move along the spectrum of available approaches as they develop more sophisticated operational risk measurement systems and practices.

9.2.3 The New Capital Adequacy Framework provides that internationally active banks and banks with significant operational risk exposures are expected to use an approach that is more sophisticated than the Basic Indicator Approach and that is appropriate for the risk profile of the institution. However, to begin with, banks in India shall compute the capital requirements for operational risk under the Basic Indicator Approach. Reserve Bank will review the capital requirement produced by the Basic Indicator Approach for general credibility, especially in relation to a bank's peers and in the event that credibility is lacking, appropriate supervisory action under Pillar 2 will be considered.

9.3 The Basic Indicator Approach

9.3.1 Under the Basic Indicator Approach, banks must hold capital for operational risk equal to the average over the previous three years of a fixed percentage (denoted as alpha) of positive annual gross income. Figures for any year in which annual gross income is negative or zero should be excluded from both the numerator and denominator when calculating the average. If negative gross income distorts a bank's Pillar 1 capital charge, Reserve Bank will consider appropriate supervisory action under Pillar 2. The charge may be expressed as follows:

$$\mathbf{KBIA = [\sum (GI_{1...n} \times \alpha)]/n}$$

Where:

KBIA = the capital charge under the Basic Indicator Approach
GI = annual gross income, where positive, over the previous three years
n = number of the previous three years for which gross income is positive
α = 15 per cent, which is set by the BCBS , relating the industry wide level of required capital to the industry wide level of the indicator.

9.3.2 Gross income is defined as "Net interest income" plus "net non-interest income". It is intended that this measure should:

(i) be gross of any provisions (e.g. for unpaid interest) and write-offs made during the year;

(ii) be gross of operating expenses, including fees paid to outsourcing service providers, *in addition to fees paid for services that are outsourced, fees received by banks that provide outsourcing services shall be included in the definition of gross income;*

(iii) exclude reversal during the year in respect of provisions and write-offs made during the previous year(s);

(iv) exclude income recognised from the disposal of items of movable and immovable property;

(v) exclude realised profits/losses from the sale of securities in the *"held to maturity" category*;

(vi) exclude income from legal settlements in favour of the bank;

(vii) exclude other extraordinary or irregular items of income and expenditure; and

(viii) exclude income derived from insurance activities (i.e. income derived by writing insurance policies) and insurance claims in favour of the bank.

9.3.3 Banks are advised to compute capital charge for operational risk under the Basic Indicator Approach as follows:

(a) Average of [Gross Income * alpha] for each of the last three financial years, excluding years of negative or zero gross income

(b) Gross income = *Net profit (+) Provisions & contingencies* ***(+)*** *operating expenses (Schedule 16) (–) items (iii) to (viii) of paragraph 9.3.2.*

(c) Alpha = 15 per cent

9.3.4 As a point of entry for capital calculation, no specific criteria for use of the Basic Indicator Approach are set out in these guidelines. Nevertheless, banks using this approach are encouraged to comply with the Basel Committee's guidance on '*Sound Practices for the Management and Supervision of Operational Ris*k', February 2003 and the 'Guidance Note on Management of Operational Risk', issued by the Reserve Bank of India in October, 2005.

Part B: Supervisory Review and Evaluation Process (SREP)

10. Introduction to the SREP under Pillar 2

10.1 The New Capital Adequacy Framework (NCAF), based on the Basel II Framework evolved by the Basel Committee on Banking Supervision, was adapted for India vide Circular DBOD.No.BP.BC.90/20.06.001/ 2006-07 dated April 27, 2007. In terms of paragraph 2.4 (iii)(c) of the Annex to the aforesaid circular banks were required to have a Board-approved policy on Internal Capital Adequacy Assessment Process (ICAAP) and to assess the capital requirement as per ICAAP. It is presumed that banks would have formulated the policy and also undertaken the capital adequacy assessment accordingly.

10.2 The Capital Adequacy Framework rests on three components or three Pillars. Pillar 1 is the Minimum Capital Ratio while Pillar 2 and Pillar 3 are the Supervisory Review Process (SRP) and Market Discipline, respectively. The guidelines in regard to the SRP and the ICAAP are furnished in this Section. An illustrative outline of the format of the ICAAP document, to be submitted to the RBI, by banks, is furnished at **Annex 15**.

10.3 The objective of the SRP is to ensure that banks have adequate capital to support all the risks in their business as also to encourage them to develop and use better risk management techniques for monitoring and managing their risks. This in turn would require a well-defined internal assessment process within banks through which they assure the RBI that adequate capital is indeed held towards the various risks to which they are exposed. The process of assurance could also involve an active dialogue between the bank and the RBI so that, when warranted, appropriate intervention could be made to either reduce the risk exposure of the bank or augment / restore its capital. Thus, ICAAP is an important component of the SRP.

10.4 The main aspects to be addressed under the SRP, and therefore, under the ICAAP, would include:

(a) the risks that are not fully captured by the minimum capital ratio prescribed under Pillar 1;

(b) the risks that are not at all taken into account by the Pillar 1; and

(c) the factors external to the bank.

Since the capital adequacy ratio prescribed by the RBI under the Pillar 1 of the Framework is only the regulatory **minimum** level, addressing only the three specified risks (viz., credit, market and operational risks), holding additional capital might be necessary for banks, on account of both – the possibility of some under-estimation of risks under the Pillar 1 and the actual risk exposure of a bank vis-à-vis the quality of its risk management architecture. **Illustratively**, some of the risks that the banks are generally exposed to but which are not captured or not fully captured in the regulatory CRAR would include:

(a) Interest rate risk in the banking book;
(b) Credit concentration risk;
(c) Liquidity risk;
(d) Settlement risk;

(e) Reputational risk;
(f) Strategic risk;
(g) Risk of under-estimation of credit risk under the Standardised approach;
(h) Model risk i.e., the risk of under-estimation of credit risk under the IRB approaches;
(i) Risk of weakness in the credit-risk mitigants;
(j) Residual risk of securitisation, etc.

It is, therefore, only appropriate that the banks make their own assessment of their various risk exposures, through a well-defined internal process, and maintain an adequate capital cushion for such risks.

10.5 It is recognised that there is no one single approach for conducting the ICAAP and the market consensus in regard to the best practice for undertaking ICAAP is yet to emerge. The methodologies and techniques are still evolving particularly in regard to measurement of non-quantifiable risks, such as reputational and strategic risks. These guidelines, therefore, seek to provide only broad principles to be followed by banks in developing their ICAAP.

10.6 Banks were advised to develop and put in place, with the approval of their Boards, an ICAAP commensurate with their size, level of complexity, risk profile and scope of operations. The ICAAP, which would be in addition to a bank's calculation of regulatory capital requirements under Pillar 1, was to be operationalised with effect from March 31, 2008 by the foreign banks and the Indian banks with operational presence outside India, and from March 31, 2009 by all other commercial banks, excluding the Local Area Banks and Regional Rural banks.

10.7 The ICAAP document should, *inter alia*, include the capital adequacy assessment and projections of capital requirement for the ensuing year, along with the plans and strategies for meeting the capital requirement. An illustrative outline of a format of the ICAAP document is furnished at **Annex 15**, for guidance of the banks though the ICAAP documents of the banks could vary in length and format, in tune with their size, level of complexity, risk profile and scope of operations.

11. Need for Improved Risk Management[69]

11.1 While financial institutions have faced difficulties over the years for a multitude of reasons, the major causes of serious banking problems continue to be lax credit standards for borrowers and counterparties, poor portfolio risk management, and a lack of attention to changes in economic or other circumstances that can lead to a deterioration in the credit standing of a bank's counterparties. This experience is common in both advanced and developing countries.

11.2 The financial market crisis of 2007-08 has underscored the critical importance of effective credit risk management to the long-term success of any banking organisation and

[69] Master Circular DBOD.No.BP.BC.73/21.06.001/2009-10 dated Feb 8, 2010

as a key component to financial stability. It has provided a stark reminder of the need for banks to effectively identify, measure, monitor and control credit risk, as well as to understand how credit risk interacts with other types of risk (including market, liquidity and reputational risk). The essential elements of a comprehensive credit risk management programme include (i) establishing an appropriate credit risk environment; (ii) operating under a sound credit granting process; (iii) maintaining an appropriate credit administration, measurement and monitoring process; and (iv) ensuring adequate controls over credit risk as elaborated in our Guidance note on Credit Risk issued on October 12, 2002[70].

11.3 The recent crisis has emphasised the importance of effective capital planning and longer-term capital maintenance. A bank's ability to withstand uncertain market conditions is bolstered by maintaining a strong capital position that accounts for potential changes in the bank's strategy and volatility in market conditions over time. Banks should focus on effective and efficient capital planning, as well as long-term capital maintenance. An effective capital planning process requires a bank to assess both the risks to which it is exposed and the risk management processes in place to manage and mitigate those risks; evaluate its capital adequacy relative to its risks; and consider the potential impact on earnings and capital from economic downturns. A bank's capital planning process should incorporate rigorous, forward looking stress testing, as discussed below in paragraph 12.9.

11.4 Rapid growth in any business activity can present banks with significant risk management challenges. This was the case with the expanded use of the "originate-to-distribute" business model, off-balance sheet vehicles, liquidity facilities and credit derivatives. The originate-to-distribute model and securitisation can enhance credit intermediation and bank profitability, as well as more widely diversify risk. Managing the associated risks, however, poses significant challenges. Indeed, these activities create exposures within business lines, across the firm and across risk factors that can be difficult to identify, measure, manage, mitigate and control. This is especially true in an environment of declining market liquidity, asset prices and risk appetite. The inability to properly identify and measure such risks may lead to unintended risk exposures and concentrations, which in turn can lead to concurrent losses arising in several businesses and risk dimensions due to a common set of factors. Strong demand for structured products created incentives for banks using the originate-to-distribute model to originate loans, such as subprime mortgages, using unsound and unsafe underwriting standards. At the same time, many investors relied solely on the ratings of the credit rating agencies (CRAs) when determining whether to invest in structured credit products. Many investors conducted little or no independent due diligence on the structured products they purchased. Furthermore, many banks had insufficient risk management processes in place to address the risks associated with exposures held on their balance sheet, as well as those associated with off-balance sheet entities, such as asset backed commercial paper (ABCP) conduits and structured investment vehicles (SIVs).

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[70] Guidance Notes on Management of Credit Risk and Market Risk issued vide circular DBOD.No.BP.520/21.04.103/2002-03 dated October 12, 2002.

11.5 Innovation has increased the complexity and potential illiquidity of structured credit products. This, in turn, can make such products more difficult to value and hedge, and may lead to inadvertent increases in overall risk. Further, the increased growth of complex investor-specific products may result in thin markets that are illiquid, which can expose a bank to large losses in times of stress if the associated risks are not well understood and managed in a timely and effective manner.

12. Guidelines for the SREP of the RBI and the ICAAP of Banks

12.1 Background

12.1.1 The Basel capital adequacy framework rests on the following three mutually-reinforcing pillars:

> Pillar 1: Minimum Capital Requirements - which prescribes a risk-sensitive calculation of capital requirements that, for the first time, explicitly includes operational risk in addition to market and credit risk.
>
> Pillar 2: Supervisory Review Process (SRP) - which envisages the establishment of suitable risk management systems in banks and their review by the supervisory authority.
>
> Pillar 3: Market Discipline - which seeks to achieve increased transparency through expanded disclosure requirements for banks.

12.1.2. The Basel Committee also lays down the following four key principles in regard to the SRP envisaged under Pillar 2:

> **Principle 1:** Banks should have a process for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital levels.
>
> **Principle 2:** Supervisors should review and evaluate banks' internal capital adequacy assessments and strategies, as well as their ability to monitor and ensure their compliance with the regulatory capital ratios. Supervisors should take appropriate supervisory action if they are not satisfied with the result of this process.
>
> **Principle 3:** Supervisors should expect banks to operate above the minimum regulatory capital ratios and should have the ability to require banks to hold capital in excess of the minimum.
>
> **Principle 4:** Supervisors should seek to intervene at an early stage to prevent capital from falling below the minimum levels required to support the risk characteristics of a particular bank and should require rapid remedial action if capital is not maintained or restored.

12.1.3 It would be seen that the principles 1 and 3 relate to the supervisory expectations from banks while the principles 2 and 4 deal with the role of the supervisors under Pillar 2. Pillar 2 (Supervisory Review Process - SRP) requires banks to implement an internal process, called the Internal Capital Adequacy Assessment Process (ICAAP), for assessing their capital adequacy in relation to their risk profiles as well as a strategy for maintaining their capital levels. Pillar 2 also requires the supervisory authorities to subject all banks to an evaluation process, hereafter called Supervisory Review and Evaluation Process (SREP),

and to initiate such supervisory measures on that basis, as might be considered necessary. An analysis of the foregoing principles indicates that the following broad responsibilities have been cast on banks and the supervisors:

Banks' responsibilities:

(a) Banks should have in place a process for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital levels (Principle 1)

(b) Banks should operate above the minimum regulatory capital ratios *(Principle 3)*

Supervisors' responsibilities

(a) Supervisors should review and evaluate a bank's ICAAP. (Principle 2)

(b) Supervisors should take appropriate action if they are not satisfied with the results of this process. (Principle 2)

(c) Supervisors should review and evaluate a bank's compliance with the regulatory capital ratios. (Principle 2)

(d) Supervisors should have the ability to require banks to hold capital in excess of the minimum. (Principle 3)

(e) Supervisors should seek to intervene at an early stage to prevent capital from falling below the minimum levels. (Principle 4)

(f) Supervisors should require rapid remedial action if capital is not maintained or restored. (Principle 4)

12.1.4 Thus, the ICAAP and SREP are the two important components of Pillar 2 and could be broadly defined as follows:

The ICAAP comprises a bank's procedures and measures designed to ensure the following:

(a) An appropriate identification and measurement of risks;

(b) An appropriate level of internal capital in relation to the bank's risk profile; and

(c) Application and further development of suitable risk management systems in the bank.

The SREP consists of a review and evaluation process adopted by the supervisor, which covers all the processes and measures defined in the principles listed above. Essentially, these include the review and evaluation of the bank's ICAAP, conducting an independent assessment of the bank's risk profile, and if necessary, taking appropriate prudential measures and other supervisory actions.

12.1.5 These guidelines seek to provide broad guidance to banks by outlining the manner in which the SREP would be carried out by the RBI, the expected scope and design of their ICAAP, and the expectations of the RBI from banks in regard to implementation of the

ICAAP.

12.2 Conduct of the SREP by the RBI

12.2.1 Capital helps protect individual banks from insolvency, thereby promoting safety and soundness in the overall banking system. Minimum regulatory capital requirements under Pillar 1 establish a threshold below which a sound bank's regulatory capital must not fall. Regulatory capital ratios permit some comparative analysis of capital adequacy across regulated banking entities because they are based on certain common methodology / assumptions. However, supervisors need to perform a more comprehensive assessment of capital adequacy that considers risks specific to a bank, conducting analyses that go beyond minimum regulatory capital requirements.

12.2.2 The RBI generally expects banks to hold capital above their minimum regulatory capital levels, commensurate with their individual risk profiles, to account for all material risks. Under the SREP, the RBI will assess the overall capital adequacy of a bank through a comprehensive evaluation that takes into account all relevant available information. In determining the extent to which banks should hold capital in excess of the regulatory minimum, the RBI would take into account the combined implications of a bank's compliance with regulatory minimum capital requirements, the quality and results of a bank's ICAAP, and supervisory assessment of the bank's risk management processes, control systems and other relevant information relating to the bank's risk profile and capital position.

12.2.3 The SREP of banks would, thus, be conducted by the RBI periodically, generally, along with the RBI's Annual Financial Inspection (AFI) of banks and in the light of the data in the off-site returns received from banks in the RBI, in conjunction with the ICAAP document, which is required to be submitted every year by banks to the RBI (refer to paragraph 12.3.3.7 below). Through the SREP, the RBI would evaluate the adequacy and efficacy of the ICAAP of banks and the capital requirements derived by them therefrom. While in the course of evaluation, there would be no attempt to reconcile the difference between the regulatory minimum CRAR and the outcome of the ICAAP of a bank (as the risks covered under the two processes are different), banks would be expected to demonstrate to the RBI that the ICAAP adopted by them is fully responsive to their size, level of complexity, scope and scale of operations and the resultant risk profile / exposures, and adequately captures their capital requirements. Such an evaluation of the effectiveness of the ICAAP would help the RBI in understanding the capital management processes and strategies adopted by banks. If considered necessary, the SREP could also involve a dialogue between the bank's top management and the RBI from time to time. In addition to the periodic reviews, independent external experts may also be commissioned by the RBI, if deemed necessary, to perform *ad hoc* reviews and comment on specific aspects of the ICAAP process of a bank; the nature and extent of such a review shall be determined by the RBI.

12.2.4 Pillar 1 capital requirements will include a buffer for uncertainties surrounding the Pillar 1 regime that affect the banking population as a whole. Bank-specific uncertainties will be treated under Pillar 2[71]. It is anticipated that such buffers under Pillar 1 will be set to

[71] Annex 3 of the Guidelines on Implementation of Basel III Capital Regulations in India issued vide circular DBOD.No.BP.BC.98/21.06.201/2011-2012 dated May 2, 2012.

provide reasonable assurance that a bank with good internal systems and controls, a well-diversified risk profile and a business profile well covered by the Pillar 1 regime, and which operates with capital equal to Pillar 1 requirements, will meet the minimum goals for soundness embodied in Pillar 1. However, RBI may require particular banks to operate with a buffer, over and above the Pillar 1 standard. Banks should maintain this buffer for a combination of the following:

(a) Pillar 1 minimums are anticipated to be set to achieve a level of bank creditworthiness in markets that is below the level of creditworthiness sought by many banks for their own reasons. For example, most international banks appear to prefer to be highly rated by internationally recognised rating agencies. Thus, banks are likely to choose to operate above Pillar 1 minimums for competitive reasons.

(b) In the normal course of business, the type and volume of activities will change, as will the different risk exposures, causing fluctuations in the overall capital ratio.

(c) It may be costly for banks to raise additional capital, especially if this needs to be done quickly or at a time when market conditions are unfavourable.

(d) For banks to fall below minimum regulatory capital requirements is a serious matter. It may place banks in breach of the provisions of the Banking Regulation Act and / or attract prompt corrective action on the part of RBI.

(e) There may be risks, either specific to individual banks, or more generally to an economy at large, that are not taken into account in Pillar 1.[72]

Under the SREP, the RBI would make an assessment as to whether the bank maintains adequate capital cushion to take care of the above situations. Such a cushion should be in addition to the capital conservation buffer and countercyclical capital buffer, if any, required to be maintained by the bank according to the applicable guidelines. Such cushion would generally be reflected in more than minimum capital adequacy ratio maintained by the bank after taking into account capital conservation buffer and countercyclical capital buffer.

Under the SREP, RBI would also seek to determine whether a bank's overall capital remains adequate as the underlying conditions change. Generally, material increases in risk that are not otherwise mitigated should be accompanied by commensurate increases in capital. Conversely, reductions in overall capital (to a level still above regulatory minima) may be appropriate if the RBI's supervisory assessment leads it to a conclusion that risk has materially declined or that it has been appropriately mitigated. Based on such an assessment, the RBI could consider initiating appropriate supervisory measures to address its supervisory concerns. The measures could include requiring a modification or enhancement of the risk management and internal control processes of a bank, a reduction in risk exposures, or any other action as deemed necessary to address the identified supervisory concerns. These measures could also include the stipulation of a bank-specific additional capital requirement over and above what has been determined under Pillar 1.

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[72] If a bank has identified some capital add-on to take care of an identified Pillar 2 risk or inadequately capitalised Pillar 1 risk, that add-on can be translated into risk weighted assets as indicated in this paragraph below, which should be added to the total risk weighted assets of the bank. No additional Pillar 2 buffer need be maintained for such identified risks.

12.2.5 As and when the advanced approaches envisaged in the Basel capital adequacy framework are permitted to be adopted in India, the SREP would also assess the ongoing compliance by banks with the eligibility criteria for adopting the advanced approaches.

12.3 The Structural Aspects of the ICAAP

12.3.1 This section outlines the broad parameters of the ICAAP that banks are required to comply with in designing and implementing their ICAAP.

12.3.2 Every bank to have an ICAAP

Reckoning that the Basel II framework is applicable to all commercial banks (except the Local Area Banks and the Regional Rural Banks), both at the solo level (global position) as well as at the consolidated level, the ICAAP should be prepared, on a solo basis, at every tier for each banking entity within the banking group, as also at the level of the consolidated bank (i.e., a group of entities where the licensed bank is the controlling entity). This requirement would also apply to the foreign banks which have a branch presence in India and their ICAAP should cover their Indian operations only.

12.3.3 ICAAP to encompass firm-wide risk profile [73]

12.3.3.1 General firm-wide risk management principles:

Senior management should understand the importance of taking an integrated, firm-wide perspective of a bank's risk exposure, in order to support its ability to identify and react to emerging and growing risks in a timely and effective manner. The purpose of this guidance is the need to enhance firm-wide oversight, risk management and controls around banks' capital markets activities, including securitisation, off-balance sheet exposures, structured credit and complex trading activities.

A sound risk management system should have the following key features:

- Active board and senior management oversight;
- Appropriate policies, procedures and limits;
- Comprehensive and timely identification, measurement, mitigation, controlling, monitoring and reporting of risks;
- Appropriate management information systems (MIS) at the business and firm-wide level; and
- Comprehensive internal controls.

12.3.3.2 Board and Senior Management Oversight:

The ultimate responsibility for designing and implementation of the ICAAP lies with the bank's board of directors of the bank and with the Chief Executive Officer in the case of the foreign banks with branch presence in India**.** It is the responsibility of the board of directors and senior management to define the institution's risk appetite and to ensure that the bank's

[73] Master Circular DBOD.No.BP.BC.73/21.06.001/2009-10 dated Feb 8, 2010

risk management framework includes detailed policies that set specific firm-wide prudential limits on the bank's activities, which are consistent with its risk taking appetite and capacity. In order to determine the overall risk appetite, the board and senior management must first have an understanding of risk exposures on a firm-wide basis. To achieve this understanding, the appropriate members of senior management must bring together the perspectives of the key business and control functions. In order to develop an integrated firm-wide perspective on risk, senior management must overcome organisational silos between business lines and share information on market developments, risks and risk mitigation techniques. As the banking industry is exhibiting the tendency to move increasingly towards market-based intermediation, there is a greater probability that many areas of a bank may be exposed to a common set of products, risk factors or counterparties. Senior management should establish a risk management process that is not limited to credit, market, liquidity and operational risks, but incorporates all material risks. This includes reputational, legal and strategic risks, as well as risks that do not appear to be significant in isolation, but when combined with other risks could lead to material losses.

The Board of Directors and senior management should possess sufficient knowledge of all major business lines to ensure that appropriate policies, controls and risk monitoring systems are effective. They should have the necessary expertise to understand the capital markets activities in which the bank is involved – such as securitisation and off-balance sheet activities – and the associated risks. The board and senior management should remain informed on an on-going basis about these risks as financial markets, risk management practices and the bank's activities evolve. In addition, the board and senior management should ensure that accountability and lines of authority are clearly delineated. With respect to new or complex products and activities, senior management should understand the underlying assumptions regarding business models, valuation and risk management practices. In addition, senior management should evaluate the potential risk exposure if those assumptions fail. Before embarking on new activities or introducing products new to the institution, the board and senior management should identify and review the changes in firm-wide risks arising from these potential new products or activities and ensure that the infrastructure and internal controls necessary to manage the related risks are in place. In this review, a bank should also consider the possible difficulty in valuing the new products and how they might perform in a stressed economic environment. The Board should ensure that the senior management of the bank:

(i) establishes a risk framework in order to assess and appropriately manage the various risk exposures of the bank;

(ii) develops a system to monitor the bank's risk exposures and to relate them to the bank's capital and reserve funds;

(iii) establishes a method to monitor the bank's compliance with internal policies, particularly in regard to risk management; and

(iv) effectively communicates all relevant policies and procedures throughout the bank.

A bank's risk function and its chief risk officer (CRO) or equivalent position should be independent of the individual business lines and report directly to the chief executive officer

(CEO) / Managing Director and the institution's board of directors. In addition, the risk function should highlight to senior management and the board risk management concerns, such as risk concentrations and violations of risk appetite limits.

12.3.3.4 Policies, procedures, limits and controls:

The structure, design and contents of a bank's ICAAP should be approved by the Board of Directors to ensure that the ICAAP forms an integral part of the management process and decision making culture of the bank. Firm-wide risk management programmes should include detailed policies that set specific firm-wide prudential limits on the principal risks relevant to a bank's activities. A bank's policies and procedures should provide specific guidance for the implementation of broad business strategies and should establish, where appropriate, internal limits for the various types of risk to which the bank may be exposed. These limits should consider the bank's role in the financial system and be defined in relation to the bank's capital, total assets, earnings or, where adequate measures exist, its overall risk level.

A bank's policies, procedures and limits should:

- Provide for adequate and timely identification, measurement, monitoring, control and mitigation of the risks posed by its lending, investing, trading, securitisation, off-balance sheet, fiduciary and other significant activities at the business line and firm-wide levels;

- Ensure that the economic substance of a bank's risk exposures, including reputational risk and valuation uncertainty, are fully recognised and incorporated into the bank's risk management processes;

- Be consistent with the bank's stated goals and objectives, as well as its overall financial strength;

- Clearly delineate accountability and lines of authority across the bank's various business activities, and ensure there is a clear separation between business lines and the risk function;

- Escalate and address breaches of internal position limits;

- Provide for the review of new businesses and products by bringing together all relevant risk management, control and business lines to ensure that the bank is able to manage and control the activity prior to it being initiated; and

- Include a schedule and process for reviewing the policies, procedures and limits and for updating them as appropriate.

12.3.3.5 Identifying, measuring, monitoring and reporting of risk:

(i) A bank's MIS should provide the board and senior management in a clear and concise manner with timely and relevant information concerning their institutions' risk profile. This information should include all risk exposures, including those that are off-balance sheet. Management should understand the assumptions behind and limitations inherent in specific risk measures.

(ii) The key elements necessary for the aggregation of risks are an appropriate infrastructure and MIS that (i) allow for the aggregation of exposures and risk measures across business lines and (ii) support customised identification of concentrations and emerging risks. MIS developed to achieve this objective should support the ability to evaluate the impact of various types of economic and financial shocks that affect the whole of the financial institution. Further, a bank's systems should be flexible enough to incorporate hedging and other risk mitigation actions to be carried out on a firm-wide basis while taking into account the various related basis risks.

(iii) To enable proactive management of risk, the board and senior management need to ensure that MIS is capable of providing regular, accurate and timely information on the bank's aggregate risk profile, as well as the main assumptions used for risk aggregation. MIS should be adaptable and responsive to changes in the bank's underlying risk assumptions and should incorporate multiple perspectives of risk exposure to account for uncertainties in risk measurement. In addition, it should be sufficiently flexible so that the institution can generate forward-looking bank-wide scenario analyses that capture management's interpretation of evolving market conditions and stressed conditions. Third-party inputs or other tools used within MIS (e.g. credit ratings, risk measures, models) should be subject to initial and ongoing validation.

(iv) A bank's MIS should be capable of capturing limit breaches and there should be procedures in place to promptly report such breaches to senior management, as well as to ensure that appropriate follow-up actions are taken. For instance, similar exposures should be aggregated across business platforms (including the banking and trading books) to determine whether there is a concentration or a breach of an internal position limit.

12.3.3.6 Internal controls:

Risk management processes should be frequently monitored and tested by independent control areas and internal, as well as external, auditors. The aim is to ensure that the information on which decisions are based is accurate so that processes fully reflect management policies and that regular reporting, including the reporting of limit breaches and other exception-based reporting, is undertaken effectively. The risk management function of banks must be independent of the business lines in order to ensure an adequate separation of duties and to avoid conflicts of interest.

Since a sound risk management process provides the basis for ensuring that a bank maintains adequate capital, the board of directors of a bank shall set the tolerance level for risk.

12.3.3.7 Submission of the outcome of the ICAAP to the Board and the RBI

As the ICAAP is an ongoing process, a written record on the outcome of the ICAAP should to be periodically submitted by banks to their board of directors. Such written record of the internal assessment of its capital adequacy should include, *inter alia*, the risks identified, the manner in which those risks are monitored and managed, the impact of the bank's changing

risk profile on the bank's capital position, details of stress tests/scenario analysis conducted and the resultant capital requirements. The reports shall be sufficiently detailed to allow the Board of Directors to evaluate the level and trend of material risk exposures, whether the bank maintains adequate capital against the risk exposures and in case of additional capital being needed, the plan for augmenting capital. The board of directors would be expected make timely adjustments to the strategic plan, as necessary.

Based on the outcome of the ICAAP as submitted to and approved by the Board, the ICAAP Document, in the format furnished at **Annex 15**, should be furnished to the RBI (i.e., to the CGM-in-Charge, Department of Banking Supervision, Central Office, Reserve Bank of India, World Trade Centre, Centre I, Colaba, Cuffe Parade, Mumbai – 400 005). The document should reach the RBI latest by end of the first quarter (i.e. April-June) of the relevant financial year.

12.4 Review of the ICAAP Outcomes

The board of directors shall, at least once a year, assess and document whether the processes relating the ICAAP implemented by the bank successfully achieve the objectives envisaged by the board. The senior management should also receive and review the reports regularly to evaluate the sensitivity of the key assumptions and to assess the validity of the bank's estimated future capital requirements. In the light of such an assessment, appropriate changes in the ICAAP should be instituted to ensure that the underlying objectives are effectively achieved.

12.5 ICAAP to be an Integral part of the Management and Decision-making Culture

The ICAAP should from an integral part of the management and decision-making culture of a bank. This integration could range from using the ICAAP to internally allocate capital to various business units, to having it play a role in the individual credit decision process and pricing of products or more general business decisions such as expansion plans and budgets. The integration would also mean that ICAAP should enable the bank management to assess, on an ongoing basis, the risks that are inherent in their activities and material to the institution.

12.6 The Principle of Proportionality

The implementation of ICAAP should be guided by the principle of proportionality. Though banks are encouraged to migrate to and adopt progressively sophisticated approaches in designing their ICAAP, the RBI would expect the degree of sophistication adopted in the ICAAP in regard to risk measurement and management to be commensurate with the nature, scope, scale and the degree of complexity in the bank's business operations. The following paragraphs **illustratively** enumerate the broad approach which could be considered by banks with varying levels of complexity in their operations, in formulating their ICAAP.

(A) In relation to a bank that defines its activities and risk management practices as **simple**, in carrying out its ICAAP, that bank could:

(a) identify and consider that bank's largest losses over the last 3 to 5 years and whether those losses are likely to recur;

(b) prepare a short list of the most significant risks to which that bank is exposed;

(c) consider how that bank would act, and the amount of capital that would be absorbed in the event that each of the risks identified were to materialise;

(d) consider how that bank's capital requirement might alter under the scenarios in (c) and how its capital requirement might alter in line with its business plans for the next 3 to 5 years; and

(e) document the ranges of capital required in the scenarios identified above and form an overall view on the amount and quality of capital which that bank should hold, ensuring that its senior management is involved in arriving at that view.

(B) In relation to a bank that define its activities and risk management practices as **moderately complex**, in carrying out its ICAAP, that bank could:

(a) having consulted the operational management in each major business line, prepare a comprehensive list of the major risks to which the business is exposed;

(b) estimate, with the aid of historical data, where available, the range and distribution of possible losses which might arise from each of those risks and consider using shock stress tests to provide risk estimates;

(c) consider the extent to which that bank's capital requirement adequately captures the risks identified in (a) and (b) above;

(d) for areas in which the capital requirement is either inadequate or does not address a risk, estimate the additional capital needed to protect that bank and its customers, in addition to any other risk mitigation action that bank plans to take;

(e) consider the risk that the bank's own analyses of capital adequacy may be inaccurate and that it may suffer from management weaknesses which affect the effectiveness of its risk management and mitigation;

(f) project that bank's business activities forward in detail for one year and in less detail for the next 3 to 5 years, and estimate how that bank's capital and capital requirement would alter, assuming that business develops as expected;

(g) assume that business does not develop as expected and consider how that bank's capital and capital requirement would alter and what that bank's reaction to a range of adverse economic scenarios might be;

(h) document the results obtained from the analyses in (b), (d), (f), and (g) above in a detailed report for that bank's top management / board of directors; and

(i) ensure that systems and processes are in place to review the accuracy of the estimates made in (b), (d), (f) and (g) (i.e., systems for back testing) vis-à-vis the performance / actuals.

(C) In relation to a bank that define its activities and risk management practices as **complex**, in carrying out its ICAAP, that bank could follow a proportional approach to that

bank's ICAAP which should cover the issues identified at (a) to (d) in paragraph (B) above, but is likely also to involve the use of models, most of which will be integrated into its day-to-day management and operations.

Models of the kind referred to above may be linked so as to generate an overall estimate of the amount of capital that a bank considers appropriate to hold for its business needs. A bank may also link such models to generate information on the economic capital considered desirable for that bank. A model which a bank uses to generate its target amount of economic capital is known as an economic capital model (ECM). Economic capital is the target amount of capital which optimises the return for a bank's stakeholders for a desired level of risk. For example, a bank is likely to use value-at-risk (VaR) models for market risk, advanced modelling approaches for credit risk and, possibly, advanced measurement approaches for operational risk. A bank might also use economic scenario generators to model stochastically its business forecasts and risks. However, banks would need prior approval of the RBI for migrating to the advanced approaches envisaged in the Basel II Framework.

Such a bank is also likely to be part of a group and to be operating internationally. There is likely to be centralised control over the models used throughout the group, the assumptions made and their overall calibration.

12.7 Regular Independent Review and Validation

The ICAAP should be subject to regular and independent review through an internal or external audit process, separately from the SREP conducted by the RBI, to ensure that the ICAAP is comprehensive and proportionate to the nature, scope, scale and level of complexity of the bank's activities so that it accurately reflects the major sources of risk that the bank is exposed to. A bank shall ensure appropriate and effective internal control structures, particularly in regard to the risk management processes, in order to monitor the bank's continued compliance with internal policies and procedures. As a minimum, a bank shall conduct periodic reviews of its risk management processes, which should ensure:

(a) the integrity, accuracy, and reasonableness of the processes;

(b) the appropriateness of the bank's capital assessment process based on the nature, scope, scale and complexity of the bank's activities;

(c) the timely identification of any concentration risk;

(d) the accuracy and completeness of any data inputs into the bank's capital assessment process;

(e) the reasonableness and validity of any assumptions and scenarios used in the capital assessment process; and

(f) that the bank conducts appropriate stress testing;

12.8 ICAAP to be a Forward-looking Process

The ICAAP should be forward looking in nature, and thus, should take into account the expected / estimated future developments such as strategic plans, macro-economic factors,

etc., including the likely future constraints in the availability and use of capital. As a minimum, the management of a bank shall develop and maintain an appropriate strategy that would ensure that the bank maintains adequate capital commensurate with the nature, scope, scale, complexity and risks inherent in the bank's on-balance-sheet and off-balance-sheet activities, and should demonstrate as to how the strategy dovetails with the macro-economic factors.

Thus, banks shall have an explicit, Board-approved capital plan which should spell out the institution's objectives in regard to level of capital, the time horizon for achieving those objectives, and in broad terms, the capital planning process and the allocate responsibilities for that process. The plan shall outline:

12.9 ICAAP to be a Risk-based Process

The adequacy of a bank's capital is a function of its risk profile. Banks shall, therefore, set their capital targets which are consistent with their risk profile and operating environment. As a minimum, a bank shall have in place a sound ICAAP, which shall include all **material** risk exposures incurred by the bank. There are some types of risks (such as reputation risk and strategic risk) which are less readily quantifiable; for such risks, the focus of the ICAAP should be more on qualitative assessment, risk management and mitigation than on quantification of such risks. Banks' ICAAP document shall clearly indicate for which risks a quantitative measure is considered warranted, and for which risks a qualitative measure is considered to be the correct approach.

12.10 ICAAP to Include Stress Tests and Scenario Analyses

As part of the ICAAP, the management of a bank shall, as a minimum, conduct relevant stress tests periodically, particularly in respect of the bank's material risk exposures, in order to evaluate the potential vulnerability of the bank to some unlikely but plausible events or movements in the market conditions that could have an adverse impact on the bank. The use of stress testing framework can provide a bank's management a better understanding of the bank's likely exposure in extreme circumstances. In this context, the attention is also invited to the RBI circular DBOD.No.BP.BC.101/21.04.103/2006-07 dated June 26, 2007 on stress testing wherein the banks were advised to put in place appropriate stress testing policies and stress test frameworks, incorporating "sensitivity tests" and "scenario tests", for the various risk factors, by September 30, 2007, on a trial / pilot basis and to operationalise formal stress testing frameworks from March 31, 2008. The banks are urged to take necessary measures for implementing an appropriate formal stress testing framework by the date specified which would also meet the stress testing requirements under the ICAAP of the banks.

12.11 Use of Capital Models for ICAAP

While the RBI does not expect the banks to use complex and sophisticated econometric models for internal assessment of their capital requirements, and there is no RBI-mandated requirement for adopting such models, the banks, with international presence, were required, in terms of paragraph 17 of our Circular DBOD.No.BP(SC).BC. 98 / 21.04.103 / 99 dated October 7, 1999, to develop suitable methodologies, by March 31, 2001, for estimating and maintaining economic capital. However, some of the banks, which have relatively complex operations and are adequately equipped in this regard, may like to place reliance

on such models as part of their ICAAP. While there is no single prescribed approach as to how a bank should develop its capital model, a bank adopting a model-based approach to its ICAAP shall be able to, *inter alia,* demonstrate:

(a) Well documented model specifications, including the methodology / mechanics and the assumptions underpinning the working of the model;

(b) The extent of reliance on the historical data in the model and the system of back testing to be carried out to assess the validity of the outputs of the model vis-à-vis the actual outcomes;

(c) A robust system for independent validation of the model inputs and outputs;

(d) A system of stress testing the model to establish that the model remains valid even under extreme conditions / assumptions;

(e) The level of confidence assigned to the model outputs and its linkage to the bank's business strategy;

(f) The adequacy of the requisite skills and resources within the banks to operate, maintain and develop the model.

13. Select Operational Aspects of the ICAAP

This Section outlines in somewhat greater detail the scope of the risk universe expected to be normally captured by the banks in their ICAAP.

13.1 Identifying and Measuring Material Risks in ICAAP

(i) The first objective of an ICAAP is to identify all material risks. Risks that can be reliably measured and quantified should be treated as rigorously as data and methods allow. The appropriate means and methods to measure and quantify those material risks are likely to vary across banks.

(ii) Some of the risks to which banks are exposed include credit risk, market risk, operational risk, interest rate risk in the banking book, credit concentration risk and liquidity risk (as briefly outlined below). The RBI has issued guidelines to the banks on asset liability management, management of country risk, credit risk, operational risk, etc., from time to time. A bank's risk management processes, including its ICAAP, should, therefore, be consistent with this existing body of guidance. However, certain other risks, such as reputational risk and business or strategic risk, may be equally important for a bank and, in such cases, should be given same consideration as the more formally defined risk types. For example, a bank may be engaged in businesses for which periodic fluctuations in activity levels, combined with relatively high fixed costs, have the potential to create unanticipated losses that must be supported by adequate capital. Additionally, a bank might be involved in strategic activities (such as expanding business lines or engaging in acquisitions) that introduce significant elements of risk and for which additional capital would be appropriate.

(iii) Additionally, if banks employ risk mitigation techniques, they should understand the risk to be mitigated and the potential effects of that mitigation, reckoning its enforceability and effectiveness, on the risk profile of the bank.

13.2 Credit Risk[74]

13.2.1 Banks should have methodologies that enable them to assess the credit risk involved in exposures to individual borrowers or counterparties as well as at the portfolio level. Banks should be particularly attentive to identifying credit risk concentrations and ensuring that their effects are adequately assessed. This should include consideration of various types of dependence among exposures, incorporating the credit risk effects of extreme outcomes, stress events, and shocks to the assumptions made about the portfolio and exposure behaviour. Banks should also carefully assess concentrations in counterparty credit exposures, including counterparty credit risk exposures emanating from trading in less liquid markets, and determine the effect that these might have on the bank's capital adequacy.

13.2.2 Banks should assess exposures, regardless of whether they are rated or unrated[75], and determine whether the risk weights applied to such exposures, under the Standardised Approach, are appropriate for their inherent risk. In those instances where a bank determines that the inherent risk of such an exposure, particularly if it is unrated, is significantly higher than that implied by the risk weight to which it is assigned, the bank should consider the higher degree of credit risk in the evaluation of its overall capital adequacy. For more sophisticated banks, the credit review assessment of capital adequacy, at a minimum, should cover four areas: risk rating systems, portfolio analysis/aggregation, securitisation/complex credit derivatives, and large exposures and risk concentrations.

13.2.3 *Counterparty credit risk (CCR)*

(i) The bank must have counterparty credit risk management policies, processes and systems that are conceptually sound and implemented with integrity relative to the sophistication and complexity of a bank's holdings of exposures that give rise to counterparty credit risk (CCR). A sound counterparty credit risk management framework shall include the identification, measurement, management, approval and internal reporting of CCR.

(ii) The bank's risk management policies must take account of the market, liquidity, legal and operational risks that can be associated with CCR and, to the extent practicable, interrelationships among those risks. The bank must not undertake business with a counterparty without assessing its creditworthiness and must take due account of both settlement and pre-settlement credit risk. These risks must be managed as comprehensively as practicable at the counterparty level (aggregating counterparty exposures with other credit exposures) and at the enterprise-wide level.

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[74] Annex 3 of the Guidelines on Implementation of Basel III Capital Regulations in India issued vide circular DBOD.No.BP.BC.98/21.06.201/2011-2012 dated May 2, 2012.

[75] In such cases it would be in order for banks to derive notional external ratings of the unrated exposure by mapping their internal credit risk ratings / grades of the exposure used for pricing purposes with the external ratings scale.

(iii)The Board of directors and senior management must be actively involved in the CCR control process and must regard this as an essential aspect of the business to which significant resources need to be devoted. The daily reports prepared on a firm's exposures to CCR must be reviewed by a level of management with sufficient seniority and authority to enforce both reductions of positions taken by individual credit managers or traders and reductions in the bank's overall CCR exposure.

(iv) The bank's CCR management system must be used in conjunction with internal credit and trading limits.

(v) The measurement of CCR must include monitoring daily and intra-day usage of credit lines. The bank must measure current exposure gross and net of collateral held where such measures are appropriate and meaningful (e.g. OTC derivatives, margin lending, etc.). Measuring and monitoring peak exposure or potential future exposure (PFE), both the portfolio and counterparty levels is one element of a robust limit monitoring system. Banks must take account of large or concentrated positions, including concentrations by groups of related counterparties, by industry, by market, customer investment strategies, etc.

(vi) The bank must have an appropriate stress testing methodology in place to assess the impact on the counterparty credit risk of abnormal volatilities in market variables driving the counterparty exposures and changes in the creditworthiness of the counterparty. The results of this stress testing must be reviewed periodically by senior management and must be reflected in the CCR policies and limits set by management and the board of directors. Where stress tests reveal particular vulnerability to a given set of circumstances, management should explicitly consider appropriate risk management strategies (e.g. by hedging against that outcome, or reducing the size of the firm's exposures).

(vii) The bank must have a routine in place for ensuring compliance with a documented set of internal policies, controls and procedures concerning the operation of the CCR management system. The firm's CCR management system must be well documented, for example, through a risk management manual that describes the basic principles of the risk management system and that provides an explanation of the empirical techniques used to measure CCR.

(viii) The bank must conduct an independent review of the CCR management system regularly through its own internal auditing process. This review must include both the activities of the business credit and trading units and of the independent CCR control unit. A review of the overall CCR management process must take place at regular intervals (ideally not less than once a year) and must specifically address, at a minimum:

- the adequacy of the documentation of the CCR management system and process;
- the organisation of the collateral management unit;
- the organisation of the CCR control unit;
- the integration of CCR measures into daily risk management;
- the approval process for risk pricing models and valuation systems used by front and back- office personnel;

- the validation of any significant change in the CCR measurement process;
- the scope of counterparty credit risks captured by the risk measurement model;
- the integrity of the management information system;
- the accuracy and completeness of CCR data;
- the accurate reflection of legal terms in collateral and netting agreements into exposure measurements; the verification of the consistency, timeliness and reliability of data sources used to run internal models, including the independence of such data sources;
- the accuracy and appropriateness of volatility and correlation assumptions;
- the accuracy of valuation and risk transformation calculations; and
- the verification of the model's accuracy through frequent back-testing.

(ix) Banks should make an assessment as part of their ICAAP as to whether the bank's evaluation of the risks contained in the transactions that give rise to CCR and the bank's assessment of whether the Current Exposure Method (CEM) captures those risks appropriately and satisfactorily. In cases where, under SREP, it is determined that CEM does not capture the risk inherent in the bank's relevant transactions (as could be the case with structured, more complex OTC derivatives), RBI may require the bank to apply the CEM on a transaction-by-transaction basis (i.e. no netting will be recognized even if it is permissible legally).

13.3 Market Risk: A bank should be able to identify risks in trading activities resulting from a movement in market prices. This determination should consider factors such as illiquidity of instruments, concentrated positions, one-way markets, non-linear/deep out-of-the money positions, and the potential for significant shifts in correlations. Exercises that incorporate extreme events and shocks should also be tailored to capture key portfolio vulnerabilities to the relevant market developments.

13.4 Operational Risk: A bank should be able to assess the potential risks resulting from inadequate or failed internal processes, people, and systems, as well as from events external to the bank. This assessment should include the effects of extreme events and shocks relating to operational risk. Events could include a sudden increase in failed processes across business units or a significant incidence of failed internal controls.

13.5 Interest Rate Risk in the Banking Book (IRRBB): A bank should identify the risks associated with the changing interest rates on its on-balance sheet and off-balance sheet exposures in the banking book from both, a short-term and long-term perspective. This might include the impact of changes due to parallel shocks, yield curve twists, yield curve inversions, changes in the relationships of rates (basis risk), and other relevant scenarios. The bank should be able to support its assumptions about the behavioral characteristics of its non-maturity deposits and other assets and liabilities, especially those exposures

characterised by embedded optionality. Given the uncertainty in such assumptions, stress testing and scenario analysis should be used in the analysis of interest rate risks. While there could be several approaches to measurement of IRRBB, an illustrative approach for measurement of IRRBB is furnished at **Annex 10.** The banks would, however, be free to adopt any other variant of these approaches or entirely different methodology for computing / quantifying the IRRBB provided the technique is based on objective, verifiable and transparent methodology and criteria.

13.6 Credit Concentration Risk: A risk concentration is any single exposure or a group of exposures with the potential to produce losses large enough (relative to a bank's capital, total assets, or overall risk level) to threaten a bank's health or ability to maintain its core operations. Risk concentrations have arguably been the single most important cause of major problems in banks. Concentration risk resulting from concentrated portfolios could be significant for most of the banks.

The following **qualitative criteria** could be adopted by banks to demonstrate that the credit concentration risk is being adequately addressed:

(a) While assessing the exposure to concentration risk, a bank should keep in view that the calculations of Basel capital adequacy framework are based on the assumption that a bank is well diversified.

(b) While the banks' single borrower exposures, the group borrower exposures and capital market exposures are regulated by the exposure norms prescribed by the RBI, there could be concentrations in these portfolios as well. In assessing the degree of credit concentration, therefore, a bank shall consider not only the foregoing exposures but also consider the degree of credit concentration in a particular economic sector or geographical area. Banks with operational concentration in a few geographical regions, by virtue of the pattern of their branch network, shall also consider the impact of adverse economic developments in that region, and their impact on the asset quality.

(c) The performance of specialised portfolios may, in some instances, also depend on key individuals / employees of the bank. Such a situation could exacerbate the concentration risk because the skills of those individuals, in part, limit the risk arising from a concentrated portfolio. The impact of such key employees / individuals on the concentration risk is likely to be correspondingly greater in smaller banks. In developing its stress tests and scenario analyses, a bank shall, therefore, also consider the impact of losing key personnel on its ability to operate normally, as well as the direct impact on its revenues.

As regards the **quantitative criteria** to be used to ensure that credit concentration risk is being adequately addressed, the credit concentration risk calculations shall be performed at the counterparty level (i.e., large exposures), at the portfolio level (i.e., sectoral and geographical concentrations) and at the asset class level (i.e., liability and assets concentrations). In this regard, a reference is invited to paragraph 3.2.2 (c) of the Annex to our Circular DBOD.No.BP.(SC).BC.98/ 21.04.103/ 99 dated October 7, 1999 regarding Risk Management System in Banks in terms of which certain prudential limits have been stipulated in regard to 'substantial exposures' of banks. As a prudent practice, banks may like to ensure that their aggregate exposure (including non-funded exposures) to all 'large

borrowers' does not exceed at any time, 800 per cent of their 'capital funds' (as defined for the purpose of extant exposure norms of the RBI). The 'large borrower' for this purpose could be taken to mean as one to whom the bank's aggregate exposure (funded as well as non-funded) exceeds 10 per cent of the bank's capital funds. The banks would also be well advised to pay special attention to their industry-wise exposures where their exposure to a particular industry exceeds 10 per cent of their aggregate credit exposure (including investment exposure) to the industrial sector as a whole.

There could be several approaches to the measurement of credit concentration the banks' portfolio. One of the approaches commonly used for the purpose involves computation of Herfindahl-Hirshman Index (HHI). It may please be noted that the HHI as a measure of concentration risk is only one of the possible methods and the banks would be free to adopt any other appropriate method for the purpose, which has objective and transparent criteria for such measurement.

Risk concentrations should be analysed on both solo and consolidated basis.[76] Risk concentrations should be viewed in the context of a single or a set of closely related risk-drivers that may have different impacts on a bank. These concentrations should be integrated when assessing a bank's overall risk exposure. A bank should consider concentrations that are based on common or correlated risk factors that reflect more subtle or more situation-specific factors than traditional concentrations, such as correlations between market, credit risks and liquidity risk.

The growth of market-based intermediation has increased the possibility that different areas of a bank are exposed to a common set of products, risk factors or counterparties. This has created new challenges for risk aggregation and concentration management. Through its risk management processes and MIS, a bank should be able to identify and aggregate similar risk exposures across the firm, including across legal entities, asset types (e.g. loans, derivatives and structured products), risk areas (e.g. the trading book) and geographic regions. In addition to the situations described in para 13.6 (b) above, risk concentrations can arise include:

- exposures to a single counterparty, or group of connected counterparties ;
- exposures to both regulated and non-regulated financial institutions such as hedge funds and private equity firms;
- trading exposures/market risk;
    - exposures to counterparties (e.g. hedge funds and hedge counterparties) through the execution or processing of transactions (either product or service);
    - funding sources;
    - assets that are held in the banking book or trading book, such as loans, derivatives and structured products; and
    - off-balance sheet exposures, including guarantees, liquidity lines and other commitments.

[76] Master Circular DBOD.No.BP.BC.73/21.06.001/2009-10 dated Feb 8, 2010

Risk concentrations can also arise through a combination of exposures across these broad categories. A bank should have an understanding of its firm-wide risk concentrations resulting from similar exposures across its different business lines. Examples of such business lines include subprime exposure in lending books; counterparty exposures; conduit exposures and SIVs; contractual and non-contractual exposures; trading activities; and underwriting pipelines. While risk concentrations often arise due to direct exposures to borrowers and obligors, a bank may also incur a concentration to a particular asset type indirectly through investments backed by such assets (e.g. collateralised debt obligations – CDOs), as well as exposure to protection providers guaranteeing the performance of the specific asset type (e.g. monoline insurers). In this context, it may be noted that while banks in India are presently not allowed to pursue most of such business lines/assume most of such exposures without RBI's permission, their foreign branches may have such exposures booked before issuance of circular DBOD.No.BP.BC.89/21.04.141/2008-09 dated December 1, 2008. A bank should have in place adequate, systematic procedures for identifying high correlation between the creditworthiness of a protection provider and the obligors of the underlying exposures due to their performance being dependent on common factors beyond systematic risk (i.e. "wrong way risk").

Procedures should be in place to communicate risk concentrations to the board of directors and senior management in a manner that clearly indicates where in the organisation each segment of a risk concentration resides. A bank should have credible risk mitigation strategies in place that have senior management approval. This may include altering business strategies, reducing limits or increasing capital buffers in line with the desired risk profile. While it implements risk mitigation strategies, the bank should be aware of possible concentrations that might arise as a result of employing risk mitigation techniques.

Banks should employ a number of techniques, as appropriate, to measure risk concentrations. These techniques include shocks to various risk factors; use of business level and firm-wide scenarios; and the use of integrated stress testing and economic capital models. Identified concentrations should be measured in a number of ways, including for example consideration of gross versus net exposures, use of notional amounts, and analysis of exposures with and without counterparty hedges. A bank should establish internal position limits for concentrations to which it may be exposed. When conducting periodic stress tests a bank should incorporate all major risk concentrations and identify and respond to potential changes in market conditions that could adversely impact their performance and capital adequacy.

The assessment of such risks under a bank's ICAAP and the supervisory review process should not be a mechanical process, but one in which each bank determines, depending on its business model, its own specific vulnerabilities. An appropriate level of capital for risk concentrations should be incorporated in a bank's ICAAP, as well as in Pillar 2 assessments. Each bank should discuss such issues with its supervisor.

A bank should have in place effective internal policies, systems and controls to identify, measure, monitor, manage, control and mitigate its risk concentrations in a timely manner. Not only should normal market conditions be considered, but also the potential build-up of concentrations under stressed market conditions, economic downturns and periods of

general market illiquidity. In addition, the bank should assess scenarios that consider possible concentrations arising from contractual and non-contractual contingent claims. The scenarios should also combine the potential build-up of pipeline exposures together with the loss of market liquidity and a significant decline in asset values.

13.7 Liquidity Risk: A bank should understand the risks resulting from its inability to meet its obligations as they come due, because of difficulty in liquidating assets (market liquidity risk) or in obtaining adequate funding (funding liquidity risk). This assessment should include analysis of sources and uses of funds, an understanding of the funding markets in which the bank operates, and an assessment of the efficacy of a contingency funding plan for events that could arise.

The recent financial market crisis underscores the importance of assessing the potential impact of liquidity risk on capital adequacy in a bank's ICAAP[77]. Senior management should consider the relationship between liquidity and capital since liquidity risk can impact capital adequacy which, in turn, can aggravate a bank's liquidity profile.

In September 2008, the Basel Committee on Banking Supervision published Principles for Sound Liquidity Risk Management and Supervision, which stresses that banks need to have strong liquidity cushions in order to weather prolonged periods of financial market stress and illiquidity. The standards address many of the shortcomings experienced by the banking sector during the market turmoil that began in mid-2007, including those related to stress testing practices contingency funding plans, management of on- and off-balance sheet activity and contingent commitments.

This liquidity guidance outlines requirements for sound practices for the liquidity risk management of banks. The fundamental principle is that a bank should both assiduously manage its liquidity risk and also maintain sufficient liquidity to withstand a range of stress events. Liquidity is a critical element of a bank's resilience to stress, and as such, a bank should maintain a liquidity cushion, made up of unencumbered, high quality liquid assets, to protect against liquidity stress events, including potential losses of unsecured and typically available secured funding sources.

A key element in the management of liquidity risk is the need for strong governance of liquidity risk, including the setting of a liquidity risk tolerance by the board. The risk tolerance should be communicated throughout the bank and reflected in the strategy and policies that senior management set to manage liquidity risk. Another facet of liquidity risk management is that a bank should appropriately price the costs, benefits and risks of liquidity into the internal pricing, performance measurement, and new product approval process of all significant business activities.

A bank is expected to be able to thoroughly identify, measure and control liquidity risks, especially with regard to complex products and contingent commitments (both contractual and non-contractual). This process should involve the ability to project cash flows arising from assets, liabilities and off-balance sheet items over various time horizons, and should ensure diversification in both the tenor and source of funding. A bank should utilise early

[77] Master Circular DBOD.No.BP.BC.73/21.06.001/2009-10 dated Feb 8, 2010

warning indicators to identify the emergence of increased risk or vulnerabilities in its liquidity position or funding needs. It should have the ability to control liquidity risk exposure and funding needs, regardless of its organisation structure, within and across legal entities, business lines, and currencies, taking into account any legal, regulatory and operational limitations to the transferability of liquidity.

A bank's failure to effectively manage intraday liquidity could leave it unable to meet its payment obligations at the time expected, which could lead to liquidity dislocations that cascade quickly across many systems and institutions. As such, the bank's management of intraday liquidity risks should be considered as a crucial part of liquidity risk management. It should also actively manage its collateral positions and have the ability to calculate all of its collateral positions.

While banks typically manage liquidity under "normal" circumstances, they should also be prepared to manage liquidity under "stressed" conditions. A bank should perform stress tests or scenario analyses on a regular basis in order to identify and quantify their exposures to possible future liquidity stresses, analysing possible impacts on the institutions' cash flows, liquidity positions, profitability, and solvency. The results of these stress tests should be discussed thoroughly by management, and based on this discussion, should form the basis for taking remedial or mitigating actions to limit the bank's exposures, build up a liquidity cushion, and adjust its liquidity profile to fit its risk tolerance. The results of stress tests should also play a key role in shaping the bank's contingency funding planning, which should outline policies for managing a range of stress events and clearly sets out strategies for addressing liquidity shortfalls in emergency situations.

As public disclosure increases certainty in the market, improves transparency, facilitates valuation, and strengthens market discipline, it is important that banks publicly disclose information on a regular basis that enables market participants to make informed decisions about the soundness of their liquidity risk management framework and liquidity position.

13.8 Off-Balance Sheet Exposures and Securitisation Risk

Banks' use of securitisation has grown dramatically over the last several years. It has been used as an alternative source of funding and as a mechanism to transfer risk to investors. While the risks associated with securitisation are not new to banks, the recent financial turmoil highlighted unexpected aspects of credit risk, concentration risk, market risk, liquidity risk, legal risk and reputational risk, which banks failed to adequately address. For instance, a number of banks that were not contractually obligated to support sponsored securitisation structures were unwilling to allow those structures to fail due to concerns about reputational risk and future access to capital markets. The support of these structures exposed the banks to additional and unexpected credit, market and liquidity risk as they brought assets onto their balance sheets, which put significant pressure on their financial profile and capital ratios.

Weaknesses in banks' risk management of securitisation and off-balance sheet exposures resulted in large unexpected losses during the financial crisis. To help mitigate these risks, a bank's on- and off-balance sheet securitisation activities should be included in its risk management disciplines, such as product approval, risk concentration limits, and estimates of market, credit and operational risk.

In light of the wide range of risks arising from securitisation activities, which can be compounded by rapid innovation in securitisation techniques and instruments, minimum capital requirements calculated under Pillar 1 are often insufficient. All risks arising from securitisation, particularly those that are not fully captured under Pillar 1, should be addressed in a bank's ICAAP. These risks include:

- Credit, market, liquidity and reputational risk of each exposure;
- Potential delinquencies and losses on the underlying securitised exposures;
- Exposures from credit lines or liquidity facilities to special purpose entities;
- Exposures from guarantees provided by monolines and other third parties.

Securitisation exposures should be included in the bank's MIS to help ensure that senior management understands the implications of such exposures for liquidity, earnings, risk concentration and capital. More specifically, a bank should have the necessary processes in place to capture in a timely manner, updated information on securitisation transactions including market data, if available, and updated performance data from the securitisation trustee or servicer.

13.9 Reputational Risk and Implicit Support[78]

13.9.1 Provision of Implicit Support for Securitization Transactions

(i) Provision of implicit support to a transaction, whether contractual (i.e. credit enhancements provided at the inception of a securitised transaction) or non-contractual (implicit support) can take numerous forms. For instance, contractual support can include over collateralisation, credit derivatives, spread accounts, contractual recourse obligations, subordinated notes, credit risk mitigants provided to a specific tranche, the subordination of fee or interest income or the deferral of margin income, and clean-up calls that exceed 10 percent of the initial issuance. Examples of implicit support include the purchase of deteriorating credit risk exposures from the underlying pool, the sale of discounted credit risk exposures into the pool of securitised credit risk exposures, the purchase of underlying exposures at above market price or an increase in the first loss position according to the deterioration of the underlying exposures.

(ii) The provision of implicit (or non-contractual) support, as opposed to contractual credit support (i.e. credit enhancements), raises significant supervisory concerns. For traditional securitisation structures the provision of implicit support undermines the clean break criteria, which when satisfied would allow banks to exclude the securitised assets from regulatory capital calculations. For synthetic securitisation structures, it negates the significance of risk transference. By providing implicit support, banks signal to the market that the risk is still with the bank and has not in effect been transferred. The institution's capital calculation therefore understates the true risk. Accordingly, national supervisors are

[78] Annex 3 of the Guidelines on Implementation of Basel III Capital Regulations in India issued vide circular DBOD.No.BP.BC.98/21.06.201/2011-2012 dated May 2, 2012.

expected to take appropriate action when a banking organisation provides implicit support.

(iii) When a bank has been found to provide implicit support to a securitisation, it will be required to hold capital against all of the underlying exposures associated with the structure as if they had not been securitised. It will also be required to disclose publicly that it was found to have provided non-contractual support, as well as the resulting increase in the capital charge (as noted above). The aim is to require banks to hold capital against exposures for which they assume the credit risk, and to discourage them from providing non-contractual support.

(iv) If a bank is found to have provided implicit support on more than one occasion, the bank is required to disclose its transgression publicly and the Reserve Bank will take appropriate action that may include, but is not limited to, one or more of the following:

- The bank may be prevented from gaining favourable capital treatment on securitised assets for a period of time to be determined by the Reserve Bank;

- The bank may be required to hold capital against all securitised assets as though the bank had created a commitment to them, by applying a conversion factor to the risk weight of the underlying assets;

- For purposes of capital calculations, the bank may be required to treat all securitised assets as if they remained on the balance sheet; and

- The bank may be required by the Reserve Bank to hold regulatory capital in excess of the minimum risk-based capital ratios.

(v) During the SREP, Reserve Bank will determine implicit support and may take appropriate supervisory action to mitigate the effects. Pending any investigation, the bank may be prohibited from any capital relief for planned securitisation transactions (moratorium). The action of Reserve Bank will be aimed at changing the bank’s behaviour with regard to the provision of implicit support, and to correct market perception as to the willingness of the bank to provide future recourse beyond contractual obligations.

13.9.2 **Reputational Risk on Account of Implicit Support**

(i) Reputational risk can be defined as the risk arising from negative perception on the part of customers, counterparties, shareholders, investors, debt-holders, market analysts, other relevant parties or regulators that can adversely affect a bank's ability to maintain existing, or establish new, business relationships and continued access to sources of funding (e.g. through the interbank or securitisation markets). Reputational risk is multidimensional and reflects the perception of other market participants. Furthermore, it exists throughout the organisation and exposure to reputational risk is essentially a function of the adequacy of the bank's internal risk management processes, as well as the manner and efficiency with which management responds to external influences on bank-related transactions.

(ii) Reputational risk can lead to the provision of implicit support, which may give rise to credit, liquidity, market and legal risk - all of which can have a negative impact on a bank's earnings, liquidity and capital position. A bank should identify potential sources of

reputational risk to which it is exposed. These include the bank's business lines, liabilities, affiliated operations, off-balance sheet vehicles and the markets in which it operates. The risks that arise should be incorporated into the bank's risk management processes and appropriately addressed in its ICAAP and liquidity contingency plans.

(iii) Prior to the 2007 upheaval, many banks failed to recognise the reputational risk associated with their off-balance sheet vehicles. In stressed conditions some firms went beyond their contractual obligations to support their sponsored securitisations and off balance sheet vehicles. A bank should incorporate the exposures that could give rise to reputational risk into its assessments of whether the requirements under the securitisation framework have been met and the potential adverse impact of providing implicit support.

(iv) Reputational risk may arise, for example, from a bank's sponsorship of securitisation structures such as ABCP conduits and SIVs, as well as from the sale of credit exposures to securitisation trusts. It may also arise from a bank's involvement in asset or funds management, particularly when financial instruments are issued by owned or sponsored entities and are distributed to the customers of the sponsoring bank. In the event that the instruments were not correctly priced or the main risk drivers not adequately disclosed, a sponsor may feel some responsibility to its customers, or be economically compelled, to cover any losses. Reputational risk also arises when a bank sponsors activities such as money market mutual funds, in-house hedge funds and real estate investment trusts. In these cases, a bank may decide to support the value of shares / units held by investors even though is not contractually required to provide the support.

(v) The financial market crisis has provided several examples of banks providing financial support that exceeded their contractual obligations. In order to preserve their reputation, some banks felt compelled to provide liquidity support to their SIVs, which was beyond their contractual obligations. In other cases, banks purchased ABCP issued by vehicles they sponsored in order to maintain market liquidity. As a result, these banks assumed additional liquidity and credit risks, and also put pressure on capital ratios.

(vi) Reputational risk also may affect a bank's liabilities, since market confidence and a bank's ability to fund its business are closely related to its reputation. For instance, to avoid damaging its reputation, a bank may call its liabilities even though this might negatively affect its liquidity profile. This is particularly true for liabilities that are components of regulatory capital, such as hybrid / subordinated debt. In such cases, a bank's capital position is likely to suffer.

(vii) Bank management should have appropriate policies in place to identify sources of reputational risk when entering new markets, products or lines of activities. In addition, a bank's stress testing procedures should take account of reputational risk so management has a firm understanding of the consequences and second round effects of reputational risk.

(viii) Once a bank identifies potential exposures arising from reputational concerns, it should measure the amount of support it might have to provide (including implicit support of securitisations) or losses it might experience under adverse market conditions. In particular, in order to avoid reputational damages and to maintain market confidence, a bank should develop methodologies to measure as precisely as possible the effect of reputational risk in

terms of other risk types (eg credit, liquidity, market or operational risk) to which it may be exposed. This could be accomplished by including reputational risk scenarios in regular stress tests. For instance, non-contractual off-balance sheet exposures could be included in the stress tests to determine the effect on a bank's credit, market and liquidity risk profiles. Methodologies also could include comparing the actual amount of exposure carried on the balance sheet versus the maximum exposure amount held off-balance sheet, that is, the potential amount to which the bank could be exposed.

(ix) A bank should pay particular attention to the effects of reputational risk on its overall liquidity position, taking into account both possible increases in the asset side of the balance sheet and possible restrictions on funding, should the loss of reputation result in various counterparties' loss of confidence.

(x) In contrast to contractual credit exposures, such as guarantees, implicit support is a more subtle form of exposure. Implicit support arises when a bank provides post-sale support to a securitisation transaction in excess of any contractual obligation. Implicit support may include any letter of comfort provided by the originator in respect of the present or future liabilities of the SPV. Such non-contractual support exposes a bank to the risk of loss, such as loss arising from deterioration in the credit quality of the securitisation's underlying assets.

(xi) By providing implicit support, a bank signals to the market that all of the risks inherent in the securitised assets are still held by the organisation and, in effect, had not been transferred. Since the risk arising from the potential provision of implicit support is not captured ex ante under Pillar 1, it must be considered as part of the Pillar 2 process. In addition, the processes for approving new products or strategic initiatives should consider the potential provision of implicit support and should be incorporated in a bank's ICAAP.

13.10 Risk Evaluation and Management

A bank should conduct analyses of the underlying risks when investing in the structured products (permitted by RBI) and must not solely rely on the external credit ratings assigned to securitisation exposures by the credit rating agencies. A bank should be aware that external ratings are a useful starting point for credit analysis, but are no substitute for full and proper understanding of the underlying risk, especially where ratings for certain asset classes have a short history or have been shown to be volatile. Moreover, a bank also should conduct credit analysis of the securitisation exposure at acquisition and on an ongoing basis. It should also have in place the necessary quantitative tools, valuation models and stress tests of sufficient sophistication to reliably assess all relevant risks.

When assessing securitisation exposures, a bank should ensure that it fully understands the credit quality and risk characteristics of the underlying exposures in structured credit transactions, including any risk concentrations. In addition, a bank should review the maturity of the exposures underlying structured credit transactions relative to the issued liabilities in order to assess potential maturity mismatches.

A bank should track credit risk in securitisation exposures at the transaction level and across securitisations exposures within each business line and across business lines. It should produce reliable measures of aggregate risk. A bank also should track all meaningful concentrations in securitisation exposures, such as name, product or sector concentrations,

and feed this information to firm-wide risk aggregation systems that track, for example, credit exposure to a particular obligor.

A bank's own assessment of risk needs to be based on a comprehensive understanding of the structure of the securitisation transaction. It should identify the various types of triggers, credit events and other legal provisions that may affect the performance of its on- and off-balance sheet exposures and integrate these triggers and provisions into its funding/liquidity, credit and balance sheet management. The impact of the events or triggers on a bank's liquidity and capital position should also be considered.

Banks globally, either underestimated or did not anticipate that a market-wide disruption could prevent them from securitising warehoused or pipeline exposures and did not anticipate the effect this could have on liquidity, earnings and capital adequacy. As part of its risk management processes, a bank should consider and, where appropriate, mark-to-market warehoused positions, as well as those in the pipeline, regardless of the probability of securitising the exposures. It should consider scenarios which may prevent it from securitising its assets as part of its stress testing and identify the potential effect of such exposures on its liquidity, earnings and capital adequacy.

A bank should develop prudent contingency plans specifying how it would respond to funding, capital and other pressures that arise when access to securitisation markets is reduced. The contingency plans should also address how the bank would address valuation challenges for potentially illiquid positions held for sale or for trading. The risk measures, stress testing results and contingency plans should be incorporated into the bank's risk management processes and its ICAAP, and should result in an appropriate level of capital under Pillar 2 in excess of the minimum requirements.

A bank that employs risk mitigation techniques should fully understand the risks to be mitigated, the potential effects of that mitigation and whether or not the mitigation is fully effective. This is to help ensure that the bank does not understate the true risk in its assessment of capital. In particular, it should consider whether it would provide support to the securitisation structures in stressed scenarios due to the reliance on securitisation as a funding tool.

13.11 Valuation Practices

The characteristics of complex structured products, including securitisation transactions, make their valuation inherently difficult due, in part, to the absence of active and liquid markets, the complexity and uniqueness of the cash waterfalls, and the links between valuations and underlying risk factors. As mentioned earlier, banks in India are presently not allowed to assume such exposures without RBI's permission. However, their foreign branches may have such exposures booked before issuance of circular DBOD.No. BP.BC.89/21.04.141/2008-09 dated December 1, 2008. The absence of a transparent price from a liquid market means that the valuation must rely on models or proxy-pricing methodologies, as well as on expert judgment. The outputs of such models and processes are highly sensitive to the inputs and parameter assumptions adopted, which may themselves be subject to estimation error and uncertainty. Moreover, calibration of the valuation methodologies is often complicated by the lack of readily available benchmarks. Therefore, a bank is expected to have adequate governance structures and control

processes for fair valuing exposures for risk management and financial reporting purposes. The valuation governance structures and related processes should be embedded in the overall governance structure of the bank, and consistent for both risk management and reporting purposes. The governance structures and processes are expected to explicitly cover the role of the board and senior management. In addition, the board should receive reports from senior management on the valuation oversight and valuation model performance issues that are brought to senior management for resolution, as well as all significant changes to valuation policies.

A bank should also have clear and robust governance structures for the production, assignment and verification of financial instrument valuations. Policies should ensure that the approvals of all valuation methodologies are well documented. In addition, policies and procedures should set forth the range of acceptable practices for the initial pricing, marking-to-market/model, valuation adjustments and periodic independent revaluation. New product approval processes should include all internal stakeholders relevant to risk measurement, risk control, and the assignment and verification of valuations of financial instruments.

A bank's control processes for measuring and reporting valuations should be consistently applied across the firm and integrated with risk measurement and management processes. In particular, valuation controls should be applied consistently across similar instruments (risks) and consistent across business lines (books). These controls should be subject to internal audit. Regardless of the booking location of a new product, reviews and approval of valuation methodologies must be guided by a minimum set of considerations. Furthermore, the valuation/new product approval process should be supported by a transparent, well-documented inventory of acceptable valuation methodologies that are specific to products and businesses.

In order to establish and verify valuations for instruments and transactions in which it engages, a bank must have adequate capacity, including during periods of stress. This capacity should be commensurate with the importance, riskiness and size of these exposures in the context of the business profile of the institution. In addition, for those exposures that represent material risk, a bank is expected to have the capacity to produce valuations using alternative methods in the event that primary inputs and approaches become unreliable, unavailable or not relevant due to market discontinuities or illiquidity. A bank must test and review the performance of its models under stress conditions so that it understands the limitations of the models under stress conditions.

The relevance and reliability of valuations is directly related to the quality and reliability of the inputs. A bank is expected to apply the accounting guidance provided to determine the relevant market information and other factors likely to have a material effect on an instrument's fair value when selecting the appropriate inputs to use in the valuation process. Where values are determined to be in an active market, a bank should maximise the use of relevant observable inputs and minimise the use of unobservable inputs when estimating fair value using a valuation technique. However, where a market is deemed inactive, observable inputs or transactions may not be relevant, such as in a forced liquidation or distress sale, or transactions may not be observable, such as when markets are inactive. In such cases, accounting fair value guidance provides assistance on what should be considered, but may not be determinative. In assessing whether a source is reliable and relevant, a bank should

consider, among other things:

- the frequency and availability of the prices/quotes;
- whether those prices represent actual regularly occurring transactions on an arm's length basis;
- the breadth of the distribution of the data and whether it is generally available to the relevant participants in the market;
- the timeliness of the information relative to the frequency of valuations;
- the number of independent sources that produce the quotes/prices;
- whether the quotes/prices are supported by actual transactions;
- the maturity of the market; and
- the similarity between the financial instrument sold in a transaction and the instrument held by the institution.

A bank's external reporting should provide timely, relevant, reliable and decision useful information that promotes transparency. Senior management should consider whether disclosures around valuation uncertainty can be made more meaningful. For instance, the bank may describe the modelling techniques and the instruments to which they are applied; the sensitivity of fair values to modelling inputs and assumptions; and the impact of stress scenarios on valuations. A bank should regularly review its disclosure policies to ensure that the information disclosed continues to be relevant to its business model and products and to current market conditions.

13.12 Sound Stress Testing Practices

Stress testing is an important tool that is used by banks as part of their internal risk management that alerts bank management to adverse unexpected outcomes related to a broad variety of risks, and provides an indication to banks of how much capital might be needed to absorb losses should large shocks occur. Moreover, stress testing supplements other risk management approaches and measures. It plays a particularly important role in:

- providing forward looking assessments of risk,
- overcoming limitations of models and historical data,
- supporting internal and external communication,
- feeding into capital and liquidity planning procedures,
- informing the setting of a banks' risk tolerance,
- addressing existing or potential, firm-wide risk concentrations, and
- facilitating the development of risk mitigation or contingency plans across a range of stressed conditions.

Stress testing is especially important after long periods of benign risk, when the fading

memory of negative economic conditions can lead to complacency and the underpricing of risk, and when innovation leads to the rapid growth of new products for which there is limited or no loss data.

It should be recognised that improvements in stress testing alone cannot address all risk management weaknesses, but as part of a comprehensive approach, stress testing has a leading role to play in strengthening bank corporate governance and the resilience of individual banks and the financial system.

Stress testing should form an integral part of the overall governance and risk management culture of the bank. Board and senior management involvement in setting stress testing objectives, defining scenarios, discussing the results of stress tests, assessing potential actions and decision making is critical in ensuring the appropriate use of stress testing in banks' risk governance and capital planning. Senior management should take an active interest in the development in, and operation of, stress testing. The results of stress tests should contribute to strategic decision making and foster internal debate regarding assumptions, such as the cost, risk and speed with which new capital could be raised or that positions could be hedged or sold. Board and senior management involvement in the stress testing program is essential for its effective operation.

A bank's capital planning process should incorporate rigorous; forward looking stress testing that identifies possible events or changes in market conditions that could adversely impact the bank. Banks, under their ICAAPs should examine future capital resources and capital requirements under adverse scenarios. In particular, the results of forward-looking stress testing should be considered when evaluating the adequacy of a bank's capital buffer. Capital adequacy should be assessed under stressed conditions against a variety of capital ratios, including regulatory ratios, as well as ratios based on the bank's internal definition of capital resources. In addition, the possibility that a crisis impairs the ability of even very healthy banks to raise funds at reasonable cost should be considered.

A bank should develop methodologies to measure the effect of reputational risk in terms of other risk types, namely credit, liquidity, market and other risks that they may be exposed to in order to avoid reputational damages and in order to maintain market confidence. This could be done by including reputational risk scenarios in regular stress tests. For instance, including non-contractual off-balance sheet exposures in the stress tests to determine the effect on a bank's credit, market and liquidity risk profiles.

A bank should carefully assess the risks with respect to commitments to off-balance sheet vehicles and third-party firms related to structured credit securities and the possibility that assets will need to be taken on balance sheet for reputational reasons. Therefore, in its stress testing programme, a bank should include scenarios assessing the size and soundness of such vehicles and firms relative to its own financial, liquidity and regulatory capital positions. This analysis should include structural, solvency, liquidity and other risk issues, including the effects of covenants and triggers.

13.13 Sound Compensation Practices

Risk management must be embedded in the culture of a bank. It should be a critical focus of the CEO/Managing Director, Chief Risk Officer (CRO), senior management, trading desk

and other business line heads and employees in making strategic and day-to-day decisions. For a broad and deep risk management culture to develop and be maintained over time, compensation policies must not be unduly linked to short-term accounting profit generation. Compensation policies should be linked to longer-term capital preservation and the financial strength of the firm, and should consider risk-adjusted performance measures. In addition, a bank should provide adequate disclosure regarding its compensation policies to stakeholders. Each bank's board of directors and senior management have the responsibility to mitigate the risks arising from remuneration policies in order to ensure effective firm-wide risk management.

Compensation practices at large financial institutions are one factor among many that contributed to the financial crisis that began in 2007. High short-term profits led to generous bonus payments to employees without adequate regard to the longer-term risks they imposed on their firms. These incentives amplified the excessive risk-taking that has threatened the global financial system and left firms with fewer resources to absorb losses as risks materialised. The lack of attention to risk also contributed to the large, in some cases extreme absolute level of compensation in the industry. As a result, to improve compensation practices and strengthen supervision in this area, particularly for systemically important firms, the Financial Stability Board (formerly the Financial Stability Forum) published its Principles for Sound Compensation Practices in April 2009.

A bank's board of directors must actively oversee the compensation system's design and operation, which should not be controlled primarily by the chief executive officer and management team. Relevant board members and employees must have independence and expertise in risk management and compensation. In addition, the board of directors must monitor and review the compensation system to ensure the system includes adequate controls and operates as intended. The practical operation of the system should be regularly reviewed to ensure compliance with policies and procedures. Compensation outcomes, risk measurements, and risk outcomes should be regularly reviewed for consistency with intentions.

Staff that are engaged in the financial and risk control areas must be independent, have appropriate authority, and be compensated in a manner that is independent of the business areas they oversee and commensurate with their key role in the firm. Effective independence and appropriate authority of such staff is necessary to preserve the integrity of financial and risk management's influence on incentive compensation.

Compensation must be adjusted for all types of risk so that remuneration is balanced between the profit earned and the degree of risk assumed in generating the profit. In general, both quantitative measures and human judgment should play a role in determining the appropriate risk adjustments, including those that are difficult to measure such as liquidity risk and reputation risk.

Compensation outcomes must be symmetric with risk outcomes and compensation systems should link the size of the bonus pool to the overall performance of the firm. Employees' incentive payments should be linked to the contribution of the individual and business to the firm's overall performance.

Compensation payout schedules must be sensitive to the time horizon of risks. Profits and losses of different activities of a financial firm are realised over different periods of time. Variable compensation payments should be deferred accordingly. Payments should not be finalised over short periods where risks are realised over long periods. Management should question payouts for income that cannot be realised or whose likelihood of realisation remains uncertain at the time of payout.

The mix of cash, equity and other forms of compensation must be consistent with risk alignment. The mix will vary depending on the employee's position and role. The firm should be able to explain the rationale for its mix.

RBI will review compensation practices in a rigorous and sustained manner and deficiencies, if any, will be addressed promptly with the appropriate supervisory action.

13.14 The risk factors discussed above should not be considered an exhaustive list of those affecting any given bank. All relevant factors that present a material source of risk to capital should be incorporated in a well-developed ICAAP. Furthermore, banks should be mindful of the capital adequacy effects of concentrations that may arise within each risk type.

13.15 Quantitative and Qualitative Approaches in ICAAP

(a) All measurements of risk incorporate both quantitative and qualitative elements, but to the extent possible, a quantitative approach should form the foundation of a bank's measurement framework. In some cases, quantitative tools can include the use of large historical databases; when data are more scarce, a bank may choose to rely more heavily on the use of stress testing and scenario analyses. Banks should understand when measuring risks that measurement error always exists, and in many cases the error is itself difficult to quantify. In general, an increase in uncertainty related to modeling and business complexity should result in a larger capital cushion.

(b) Quantitative approaches that focus on most likely outcomes for budgeting, forecasting, or performance measurement purposes may not be fully applicable for capital adequacy because the ICAAP should also take less likely events into account. Stress testing and scenario analysis can be effective in gauging the consequences of outcomes that are unlikely but would have a considerable impact on safety and soundness.

(c) To the extent that risks cannot be reliably measured with quantitative tools – for example, where measurements of risk are based on scarce data or unproven quantitative methods – qualitative tools, including experience and judgment, may be more heavily utilised. Banks should be cognisant that qualitative approaches have their own inherent biases and assumptions that affect risk assessment; accordingly, banks should recognise the biases and assumptions embedded in, and the limitations of, the qualitative approaches used.

13.16 Risk Aggregation and Diversification Effects

(a) An effective ICAAP should assess the risks across the entire bank. A bank choosing to conduct risk aggregation among various risk types or business lines should understand the challenges in such aggregation. In addition, when aggregating risks, banks should be ensure that any potential concentrations across more than one risk dimension are addressed, recognising that losses could arise in several risk dimensions at the same time, stemming from the same event or a common set of factors. For example, a localised natural disaster could generate losses from credit, market, and operational risks at the same time.

(b) In considering the possible effects of diversification, management should be systematic and rigorous in documenting decisions, and in identifying assumptions used in each level of risk aggregation. Assumptions about diversification should be supported by analysis and evidence. The bank should have systems capable of aggregating risks based on the bank's selected framework. For example, a bank calculating correlations within or among risk types should consider data quality and consistency, and the volatility of correlations over time and under stressed market conditions.

Part C: Market Discipline

14. Guidelines for Market Discipline

14.1 General

14.1.1 The purpose of Market discipline is to complement the minimum capital requirements (detailed under Pillar 1) and the supervisory review process (detailed under Pillar 2). The aim is to encourage market discipline by developing a set of disclosure requirements which will allow market participants to assess key pieces of information on the scope of application, capital, risk exposures, risk assessment processes and hence, the capital adequacy of the institution.

14.1.2 In principle, banks' disclosures should be consistent with how senior management and the Board of Directors assess and manage the risks of the bank. Under Pillar 1, banks use specified approaches / methodologies for measuring the various risks they face and the resulting capital requirements. It is believed that providing disclosures that are based on a common framework is an effective means of informing the market about a bank's exposure to those risks and provides a consistent and comprehensive disclosure framework that enhances comparability.

14.2 Achieving Appropriate Disclosure

14.2.1 Market discipline can contribute to a safe and sound banking environment. Hence, non-compliance with the prescribed disclosure requirements would attract a penalty, including financial penalty. However, it is not intended that direct additional capital requirements would be a response to non-disclosure, except as indicated below.

14.2.2 In addition to the general intervention measures, the Basel Capital Adequacy Framework also anticipates a role for specific measures. Where disclosure is a qualifying criterion under Pillar 1 to obtain lower risk weightings and/or to apply specific methodologies, there would be a direct sanction (not being allowed to apply the lower risk weighting or the specific methodology).

14.3 Interaction with Accounting Disclosures

It is recognised that the Pillar 3 disclosure framework does not conflict with requirements under accounting standards, which are broader in scope. The BCBS has taken considerable efforts to see that the narrower focus of Pillar 3, which is aimed at disclosure of bank capital adequacy, does not conflict with the broader accounting requirements. The Reserve Bank will consider future modifications to the Market Discipline disclosures as necessary in light of its ongoing monitoring of this area and industry developments.

14.4 Validation

The disclosures in this manner should be subjected to adequate validation. For example, since information in the annual financial statements would generally be audited, the additional material published with such statements must be consistent with the audited statements. In addition, supplementary material (such as Management's Discussion and Analysis) that is published should also be subjected to sufficient scrutiny (e.g. internal control assessments, etc.) to satisfy the validation issue. If material is not published under a

validation regime, for instance in a stand-alone report or as a section on a website, then management should ensure that appropriate verification of the information takes place, in accordance with the general disclosure principle set out below. In the light of the above, Pillar 3 disclosures will not be required to be audited by an external auditor, unless specified.

14.5 Materiality

A bank should decide which disclosures are relevant for it based on the materiality concept. Information would be regarded as material if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions. This definition is consistent with International Accounting Standards and with the national accounting framework. The Reserve Bank recognises the need for a qualitative judgment of whether, in light of the particular circumstances, a user of financial information would consider the item to be material (user test). The Reserve Bank does not consider it necessary to set specific thresholds for disclosure as the user test is a useful benchmark for achieving sufficient disclosure. However, with a view to facilitate smooth transition to greater disclosures as well as to promote greater comparability among the banks' Pillar 3 disclosures, the materiality thresholds have been prescribed for certain limited disclosures. Notwithstanding the above, banks are encouraged to apply the user test to these specific disclosures and where considered necessary make disclosures below the specified thresholds also.

14.6 Proprietary and Confidential Information

Proprietary information encompasses information (for example on products or systems), that if shared with competitors would render a bank's investment in these products/systems less valuable, and hence would undermine its competitive position. Information about customers is often confidential, in that it is provided under the terms of a legal agreement or counterparty relationship. This has an impact on what banks should reveal in terms of information about their customer base, as well as details on their internal arrangements, for instance methodologies used, parameter estimates, data etc. The Reserve Bank believes that the requirements set out below strike an appropriate balance between the need for meaningful disclosure and the protection of proprietary and confidential information.

14.7 General Disclosure Principle

Banks should have a formal disclosure policy approved by the Board of directors that addresses the bank's approach for determining what disclosures it will make and the internal controls over the disclosure process. In addition, banks should implement a process for assessing the appropriateness of their disclosures, including validation and frequency.

14.8 Implementation Date

As indicated in the Guidelines on Composition of Capital Disclosure Requirements issued vide circular DBOD.No.BP.BC.98/21.06.201/2012-13 dated May 28, 2013, Pillar 3 disclosures as introduced under Basel III would become effective from July 1, 2013. Therefore, the first set of disclosures as required by these guidelines should be made by banks as on September 30, 2013 (with the exception of the Post March 31, 2017 template

described in paragraph 14.12).

14.9 Scope and Frequency of Disclosures

14.9.1 Pillar 3 applies at the top consolidated level of the banking group to which the Capital Adequacy Framework applies. Disclosures related to individual banks within the groups would not generally be required to be made by the parent bank. An exception to this arises in the disclosure of capital ratios by the top consolidated entity where an analysis of significant bank subsidiaries within the group is appropriate, in order to recognise the need for these subsidiaries to comply with the Framework and other applicable limitations on the transfer of funds or capital within the group. Pillar 3 disclosures will be required to be made by the individual banks on a stand-alone basis when they are not the top consolidated entity in the banking group.

14.9.2 Banks are required to make Pillar 3 disclosures[79] at least on a half yearly basis, irrespective of whether financial statements are audited, with the exception of following disclosures:

(i) Table DF-2: Capital Adequacy;

(ii) Table DF-3: Credit Risk: General Disclosures for All Banks; and

(iii) Table DF-4: Credit Risk: Disclosures for Portfolios Subject to the Standardised Approach.

The disclosures as indicated at (i), (ii) and (iii) above will be made at least on a quarterly basis by banks.

14.9.3 All disclosures must either be included in a bank's published financial results / statements or, at a minimum, must be disclosed on bank's website. If a bank finds it operationally inconvenient to make these disclosures along with published financial results / statements, the bank must provide in these financial results / statements, a direct link to where the Pillar 3 disclosures can be found on the bank's website. The Pillar 3 disclosures should be made concurrent with publication of financial results / statements[80].

14.9.4 However, banks may note that in the case of main features template (as indicated in paragraph 14.14.7) and provision of the full terms and conditions of capital instruments (as indicated in paragraph 14.14.8), banks are required to update these disclosures concurrently whenever a new capital instrument is issued and included in capital or whenever there is a redemption, conversion / write-down or other material change in the nature of an existing capital instrument.

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[79] Please refer to Annex 18 for detailed Pillar 3 disclosure templates.

[80] It may be noted that Pillar 3 disclosures are required to be made by all banks including those which are not listed on stock exchanges and / or not required to publish financial results / statement. Therefore, such banks are also required to make Pillar 3 disclosures at least on their websites within reasonable period.

14.10 Regulatory Disclosure Section

14.10.1 Banks are required to make disclosures in the format as specified in **Annex 18** of this Master Circular. Banks have to maintain a 'Regulatory Disclosures Section' on their websites, where all the information relating to disclosures will be made available to the market participants. The direct link to this page should be prominently provided on the home page of a bank's website and it should be easily accessible. This requirement is essentially to ensure that the relevance / benefit of Pillar 3 disclosures is not diminished by the challenge of finding the disclosure in the first place.

14.10.2 An archive for at least three years of all templates relating to prior reporting periods should be made available by banks on their websites.

14.11 Pillar 3 under Basel III Framework[81]

14.11.1 The Basel Committee on Banking Supervision (BCBS) has released the rules text on 'composition of capital disclosure requirements'[82]. Accordingly, Pillar 3 disclosure requirements as introduced under Basel III along with previous disclosure requirements with suitable modifications / enhancements are detailed in the subsequent paragraphs.

14.11.2 In order to ensure comparability of the capital adequacy of banks across jurisdictions, it is important to disclose details of items of regulatory capital and various regulatory adjustments to it. Further, to improve consistency and ease of use of disclosures relating to the composition of capital and to mitigate the risk of inconsistent reporting format undermining the objective of enhanced disclosures, banks across Basel member jurisdictions are required to publish their capital positions according to common templates. The disclosure requirements are set out in the form of following templates:

(i) Post March 31, 2017 Disclosure Template

A common template which will be used by banks to report the details of their regulatory capital after March 31, 2017 i.e. after the transition period for the phasing-in of deductions is over. It is designed to meet the Basel III requirement to disclose all regulatory adjustments. The template enhances consistency and comparability in the disclosure of the elements of capital between banks and across jurisdictions.

(ii) Template during the Transitional Period

During the transition period of phasing-in of regulatory adjustments under Basel III in India i.e. from April 1, 2013 to March 31, 2017, banks will use a modified version of the post March 31, 2017 template. This template is designed to meet the Basel III requirement for banks to disclose the components of capital which will benefit from the transitional arrangements.

(iii) Reconciliation Requirements

In order to meet the reconciliation requirements as envisaged under Basel III, a three-step approach has been devised. This step-by-step approach to reconciliation ensures that the

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[81] Pillar 3 requirements as introduced vide circular DBOD.No.BP.BC.98/21.06.201/2012-13 dated May 28, 2013 on Guidelines on Composition of Capital Disclosure Requirements. These guidelines would become effective from July 1, 2013. Therefore, the first set of disclosures as required by these guidelines will be made by banks as on September 30, 2013. The new disclosure requirements are in addition to the Pillar 3 guidance contained in NCAF.

[82] The rules text is at http://www.bis.org/publ/bcbs221.htm

Basel III requirement to provide a full reconciliation of all regulatory capital elements back to the published financial statements is met in a consistent manner.

(iv) Main Features Template

A common template has been designed to capture the main features of all regulatory capital instruments issued by a bank at one place. This disclosure requirement is intended to meet the Basel III requirement to provide a description of the main features of capital instruments.

(v) Other Disclosure Requirements

This disclosure enables banks in meeting the Basel III requirement to provide the full terms and conditions of capital instruments on their websites.

(vi) Pillar 3 disclosure requirements also include certain aspects that are not specifically required to compute capital requirements under Pillar 1[83]. It may be noted that beyond disclosure requirements as set forth in these guidelines, banks are responsible for conveying their actual risk profile to market participants. The information banks disclose must be adequate to fulfill this objective. In addition to the specific disclosure requirements as set out in the guidelines, banks operating in India should also make additional disclosures in the following areas:

(i) Securitisation exposures in the trading book;
(ii) Sponsorship of off-balance sheet vehicles;
(iii) Valuation with regard to securitisation exposures; and
(iv) Pipeline and warehousing risks with regard to securitisation exposures.

14.12 Post March 31, 2017 Disclosure Template

14.12.1 The common template which banks should use is set out in **Table DF-11, Part I of Annex 18**, along with explanations. The template is designed to capture the capital positions of banks after the transition period for phasing-in of deductions is over as on March 31, 2017. This template has to be used by banks for all reporting periods after March 31, 2017.

14.12.2 It may be noted that banks should not add or delete any rows / columns from the common reporting template. This is essential to ensure that there is no divergence in reporting templates across banks and across jurisdictions which could undermine the objectives of consistency and comparability of a bank's regulatory capital. The template will retain the same row numbering used in its first column such that market participants can easily map the Indian version of templates to the common version designed by the Basel Committee.

14.12.3 The Basel Committee has suggested that in cases where the national implementation of Basel III rules[84] applies a more conservative definition of an element (e.g. components and criteria of regulatory capital, regulatory adjustments etc.), national authorities may choose between one of two approaches listed below for the purpose of disclosure:

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[83] Master Circular DBOD.No.BP.BC.73/21.06.001/2009-10 dated Feb 8, 2010

[84] As defined in the DBOD.No.BP.BC.98/21.06.201/2011-12 dated May 2, 2012 on Guidelines on Implementation of Basel III Capital Regulations in India.

Approach 1: In the national version of the template, banks are required to maintain the same definitions[85] of all rows. Further, banks will have to report the impact of the more conservative national definition in the rows exclusively designated for national specific adjustments.

Approach 2: In the national version of the template, banks are required to use the definitions of elements as implemented in that jurisdiction[86], clearly labelling them as being different from the Basel III minimum definition[87], and banks are required to separately disclose the impact of each of these different definitions in the notes to the template.

14.12.4 The aim of both the approaches is to provide all the information necessary to enable market participants to calculate the capital of banks on a common basis. In the Indian context, Approach 2 appears to be more practical and less burdensome for banks than the Approach 1. Under the Approach 2, banks have to furnish data based on the definition of capital / regulatory adjustments as implemented in India. The difference with the Basel III minimum can be separately disclosed and explained in notes to the templates. This way of disclosure will be more relevant and comprehensible to a larger number of users of disclosures more specifically, the domestic users. At the same time, information provided in the notes to the templates to indicate differences from Basel III minimum will help facilitate cross-jurisdictional comparison of banks' capital, should users desire. Accordingly, the disclosure templates have been customised, keeping in view the consistency and comparability of disclosures.

14.13 Template during the Transitional Period

14.13.1 The transitional arrangements (refer to paragraph 4.5) create an additional layer of complexity in the composition of capital during the period from April 1, 2013 to March 31, 2017, especially due to pre-Basel III treatments[88] (based on Basel II framework) of the residual regulatory adjustments. This necessitates setting out detailed disclosure requirements during this period in a manner which is comprehensible and beneficial for all users of the disclosures.

14.13.2 Accordingly, banks will be required to use a modified version of the Post March 31, 2017 disclosure template (set out in paragraph 14.12 above). This modified template captures the existing treatments for the regulatory adjustments during the transition period. The Post March 31, 2017 template is modified in two ways:

(i) an additional column is inserted to indicate the amount of regulatory adjustments which will be subject to the existing treatment; and

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[85] Basel III: A global regulatory framework for more resilient banks and banking systems, December 2010 (rev June 2011)

[86] As defined in the DBOD.No.BP.BC.98/21.06.201/2011-12 dated May 2, 2012 on Guidelines on Implementation of Basel III Capital Regulations in India.

[87] Basel III: A global regulatory framework for more resilient banks and banking systems, December 2010 (rev June 2011)

[88] Existing treatment means treatment based on guidelines applicable before April 1, 2013. Please refer to Master Circular DBOD.No.BP.BC.9/21.06.001/2013-14 dated July 1, 2013.

(ii) additional rows are inserted in four separate places to indicate where the adjustment amount reported in the additional column actually affects capital during the transition period.

14.13.3 The common template which banks must use during the transition period is set out in **Table DF-11, Part II of Annex 18**. If a bank decides to make full transition to Basel III capital regulations before March 31, 2017, such bank may begin disclosure as set out in **Table DF-11, Part I of Annex 18**. However, the bank should clearly state the reasons for using **Table DF-11, Part I** (i.e. Post March 31, 2017 template) in the disclosure.

14.14 Reconciliation Requirements

14.14.1 Banks will be required to disclose a full reconciliation of all regulatory capital elements back to the balance sheet in the audited (or unaudited) financial statements. This requirement aims to address disconnect, if any, present in a bank's disclosure between the numbers used for the calculation of regulatory capital and the numbers used in the balance sheet.

14.14.2 Banks will have to follow a three step approach to show the link between their balance sheet and the numbers which are used in the composition of capital disclosure template set out in **Annex 18** (**Table DF-11, Part I / Part II**, whichever applicable). The three steps are explained below and also illustrated in **Table DF-12 of Annex 18**:

Step 1: banks are required to disclose the reported balance sheet under the regulatory scope of consolidation[89] (**Table DF-12 of Annex 18**);

Step 2: banks will have to expand the lines of the balance sheet under regulatory scope of consolidation (**Table DF-12 of Annex 18**) to display all components which are used in the composition of capital disclosure template (**Table DF-11 Part I / Part II of Annex 18**); and

Step 3: finally, banks will have to map each of the components that are disclosed in Step 2 to the composition of capital disclosure template set out in **Table DF-11 Part I / Part II of Annex 18** whichever, applicable.

14.14.3 *Step 1: Disclose the reported balance sheet under the regulatory scope of consolidation*

(i) The scope of consolidation for accounting purposes is often different from that applied for the regulatory purposes. Usually, there will be difference between the financial statements of a bank specifically, the bank's balance sheet in published financial statements and the balance sheet considered for the calculation of regulatory capital. Therefore, the reconciliation process involves disclosing how the balance sheet changes when the regulatory scope of consolidation is applied for the purpose of calculation of regulatory capital on a consolidated basis.

(ii) Accordingly, banks are required to disclose the list of the legal entities which have been included within accounting scope of consolidation but excluded from the regulatory scope of consolidation. This is intended to enable market participants and supervisors to

[89] Regulatory scope of consolidation is explained in paragraph 3 of this Master Circular.

investigate the risks posed by unconsolidated entities (e.g. unconsolidated subsidiaries). Similarly, banks are required to list the legal entities which have been included in the regulatory consolidation but not in the accounting scope of consolidation. Finally, it is possible that some entities are included in both the regulatory scope of consolidation and accounting scope of consolidation, but the method of consolidation differs between these two scopes. In such cases, banks are required to list these legal entities and explain the differences in the consolidation methods.

(iii) If the scope of regulatory consolidation and accounting consolidation is identical for a particular banking group, it would not be required to undertake Step 1. The banking group would state that there is no difference between the regulatory consolidation and the accounting consolidation and move to Step 2.

(iv) In addition to the above requirements, banks must disclose for each legal entity, its total balance sheet assets, total balance sheet equity (as stated on the accounting balance sheet of the legal entity), method of consolidation and a description of the principle activities of the entity. These disclosures are required to be made as indicated in the revised templates namely **Table DF-1: Scope of Application of Annex 18.**

*14.14.4 Step 2: Expand the lines of the regulatory balance sheet to display all of the components used in the definition of capital disclosure template (**Table DF-11 Part I / Part II of Annex 18**)*

(i) Many of the elements used in the calculation of regulatory capital may not be readily identified from the face of the balance sheet. This requires that banks should expand the rows of the balance sheet under regulatory scope of consolidation such that all the components used in the definition of capital disclosure template (**Table DF-11 Part I / Part II of Annex 18***)* are displayed separately.

(ii) For example, paid-up share capital may be reported as one line on the balance sheet. However, some elements of this may meet the requirements for inclusion in Common Equity Tier 1 (CET1) capital and other elements may only meet the requirements for Additional Tier 1 (AT1) or Tier 2 (T2) capital, or may not meet the requirements for inclusion in regulatory capital at all. Therefore, if a bank has some amount of paid-up capital which goes into the calculation of CET1 and some amount which goes into the calculation of AT1, it should expand the 'paid-up share capital' line of the balance sheet in the following way:

Paid-up share capital		Ref
of which amount eligible for CET1		e
of which amount eligible for AT1		f

(ii) In addition, as illustrated above, each element of the expanded balance sheet must be given a reference number / letter for use in Step 3.

(iv) Another example is regulatory adjustments of the deduction of intangible assets. *Firstly,* there could be a possibility that the intangible assets may not be readily identifiable in the balance sheet. There is a possibility that the amount on the balance sheet may combine goodwill and other intangibles. *Secondly,* the amount to be deducted is net of any related deferred tax liability. This deferred tax liability is likely to be reported in combination with other deferred tax liabilities which have no relation to goodwill or intangibles. Therefore, the bank should expand the balance sheet in the following way:

Goodwill and intangible assets		Ref
of which goodwill		a
of which other intangibles		b

Current and deferred tax liabilities (DTLs)		Ref
of which DTLs related to goodwill		c
of which DTLs related to other intangible assets		d

(v) Banks will need to expand elements of the balance sheet only to the extent required to reach the components which are used in the definition of capital disclosure template. For example, if entire paid-up capital of the bank met the requirements to be included in CET1, the bank would not need to expand this line.

14.14.5 *Step 3: Map each of the components that are disclosed in Step 2 to the composition of capital disclosure templates*

(i) When reporting the disclosure template (i.e. ***Table DF-11 Part I / Part II of Annex 18***), a bank is required to use the reference numbers / letters from Step 2 to show the source of every input.

(ii) For example, if the composition of capital disclosure template (**Part I / Part II**) includes the line 'goodwill net of related deferred tax liability', then next to this item the bank should put 'a - c'. This is required to illustrate that how these components of the balance sheet under the regulatory scope of consolidation have been used to calculate this item in the disclosure template.

14.14.6 The three step approach is flexible and offers the following benefits:

(i) the level of disclosure is proportionate, varying with the complexity of the balance sheet of the reporting bank (i.e. banks are not subject to a fixed template. A bank may skip a step if there is no further information added by that step);

(ii) supervisors and market participants can trace the origin of the elements of the regulatory capital back to their exact location on the balance sheet under the regulatory scope of consolidation; and

(iii) the approach is flexible enough to be used under any accounting standards. Banks are required to map all the components of the regulatory capital disclosure templates back to the balance sheet under the regulatory scope of consolidation, regardless of where the accounting standards require the source to be reported on the balance sheet.

14.14.7 **Main Features Template**

14.14.7.1 Banks are required to complete a 'main features template' to ensure consistency and comparability of disclosures of the main features of capital instruments. Banks are required to disclose a description of the main features of capital instruments issued by them. Besides, banks will also be required to make available the full terms and conditions of their capital instruments (paragraph 14.14.8 below). The requirement of separately disclosing main features of capital instruments is intended to provide an overview of the capital structure of a bank. Many times, it may not be possible for the users to extract

key features of capital instruments with ease from the full disclosure of terms and conditions of capital instruments made by banks.

14.14.7.2 This template represents the minimum level of summary disclosure which banks are required to report in respect of **each** regulatory capital instrument issued. The main feature disclosure template is set out in **Table DF-13 of Annex 18** along with a description of each of the items to be reported. Some of the key aspects of the 'Main Features Template' are as under:

(i) it is designed to be completed by banks from when the Basel III capital regulations come into effect i.e. as on April 1, 2013. Therefore, it includes disclosure relating to instruments which are subject to the transitional arrangements.

(ii) banks are required to report each capital instrument (including common shares) in a separate column of the template, such that the completed template would provide a 'main features report' that summarises all of the regulatory capital instruments of the banking group.

14.14.7.3 Banks are required to keep the completed main features report up-to-date. Banks should ensure that the report is updated and made publicly available, whenever a bank issues or repays a capital instrument and whenever there is redemption, conversion / write-down or other material change in the nature of an existing capital instrument.

14.14.8 **Other Disclosure Requirements**

In addition to the disclosure requirements set out in above paragraphs, banks are required to make the following disclosure in respect of the composition of capital:

(i) Full Terms and Conditions: banks are required to make available on their websites[90] the full terms and conditions of all instruments included in regulatory capital. The requirement for banks to make available the full terms and conditions of instruments on their websites will allow supervisors and market participants to investigate the specific features of individual capital instruments.

(ii) Banks are required to keep the terms and conditions of all capital instruments up-to-date **(Table DF-14 of Annex 18)**. Whenever there is a change in the terms and conditions of a capital instrument, banks should update them promptly and make publicly available such updated disclosure.

14.15 The Disclosure Templates

All Pillar 3 disclosure templates as set out in these guidelines are furnished in tabular form in **Annex 18**. Additional relevant definitions and explanations are also provided for the Pillar 3 disclosures.

[90] Please refer to paragraph 14.10 of this Master Circular.

Part D: Capital Conservation Buffer Framework[91]

15. Capital Conservation Buffer

15.1 Objective

15.1.1 The capital conservation buffer (CCB) is designed to ensure that banks build up capital buffers during normal times (i.e. outside periods of stress) which can be drawn down as losses are incurred during a stressed period. The requirement is based on simple capital conservation rules designed to avoid breaches of minimum capital requirements.

15.1.2 Outside the period of stress, banks should hold buffers of capital above the regulatory minimum. When buffers have been drawn down, one way banks should look to rebuild them is through reducing discretionary distributions of earnings. This could include reducing dividend payments, share buybacks and staff bonus payments. Banks may also choose to raise new capital from the market as an alternative to conserving internally generated capital. However, if a bank decides to make payments in excess of the constraints imposed as explained above, the bank, with the prior approval of RBI, would have to use the option of raising capital from the market equal to the amount above the constraint which it wishes to distribute.

15.1.3 In the absence of raising capital from the market, the share of earnings retained by banks for the purpose of rebuilding their capital buffers should increase the nearer their actual capital levels are to the minimum capital requirement. It will not be appropriate for banks which have depleted their capital buffers to use future predictions of recovery as justification for maintaining generous distributions to shareholders, other capital providers and employees. It is also not acceptable for banks which have depleted their capital buffers to try and use the distribution of capital as a way to signal their financial strength. Not only is this irresponsible from the perspective of an individual bank, putting shareholders' interests above depositors, it may also encourage other banks to follow suit. As a consequence, banks in aggregate can end up increasing distributions at the exact point in time when they should be conserving earnings.

15.1.4 The capital conservation buffer can be drawn down only when a bank faces a systemic or idiosyncratic stress. A bank should not choose in normal times to operate in the buffer range simply to compete with other banks and win market share. This aspect would be specifically looked into by Reserve Bank of India during the Supervisory Review and Evaluation Process. If, at any time, a bank is found to have allowed its capital conservation buffer to fall in normal times, particularly by increasing its risk weighted assets without a commensurate increase in the Common Equity Tier 1 Ratio (although adhering to the restrictions on distributions), this would be viewed seriously. In addition, such a bank will be required to bring the buffer to the desired level within a time limit prescribed by Reserve Bank of India. The banks which draw down their capital conservation buffer during a stressed period should also have a definite plan to replenish the buffer as part of its Internal

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[91] Annex 4 of Guidelines on Implementation of Basel III Capital Regulations in India issued vide circular DBOD.No.BP.BC.98/21.06.201/2011-12 dated May 2, 2012.

Capital Adequacy Assessment Process and strive to bring the buffer to the desired level within a time limit agreed to with Reserve Bank of India during the Supervisory Review and Evaluation Process.

15.1.5 The framework of capital conservation buffer will strengthen the ability of banks to withstand adverse economic environment conditions, will help increase banking sector resilience both going into a downturn, and provide the mechanism for rebuilding capital during the early stages of economic recovery. Thus, by retaining a greater proportion of earnings during a downturn, banks will be able to help ensure that capital remains available to support the ongoing business operations / lending activities during the period of stress. Therefore, this framework is expected to help reduce pro-cyclicality.

15.2 The Framework

15.2.1 Banks are required to maintain a capital conservation buffer of 2.5%, comprised of Common Equity Tier 1 capital, above the regulatory minimum capital requirement[92]of 9%. Banks should not distribute capital (i.e. pay dividends or bonuses in any form) in case capital level falls within this range. However, they will be able to conduct business as normal when their capital levels fall into the conservation range as they experience losses. Therefore, the constraints imposed are related to the distributions only and are not related to the operations of banks. The distribution constraints imposed on banks when their capital levels fall into the range increase as the banks' capital levels approach the minimum requirements. The **Table 24** below shows the minimum capital conservation ratios a bank must meet at various levels of the Common Equity Tier 1 capital ratios.

Table 24: Minimum capital conservation standards for individual bank

Common Equity Tier 1 Ratio after including the current periods retained earnings	Minimum Capital Conservation Ratios (expressed as a percentage of earnings)
5.5% - 6.125%	100%
>6.125% - 6.75%	80%
>6.75% - 7.375%	60%
>7.375% - 8.0%	40%
>8.0%	0%

For example, a bank with a Common Equity Tier 1 capital ratio in the range of 6.125% to 6.75% is required to conserve 80% of its earnings in the subsequent financial year (i.e. payout no more than 20% in terms of dividends, share buybacks and discretionary bonus payments is allowed).

15.2.2 Basel III minimum capital conservation standards apply with reference to the applicable minimum CET1 capital and applicable CCB. Therefore, during the Basel III transition period, banks may refer to the **Table 25** for meeting the minimum capital

[92]Common Equity Tier 1 must first be used to meet the minimum capital requirements (including the 7% Tier 1 and 9% Total capital requirements, if necessary), before the remainder can contribute to the capital conservation buffer requirement.

conservation ratios at various levels of the Common Equity Tier 1 capital ratios:

Table 25: Minimum capital conservation standards for individual bank			
Common Equity Tier 1 Ratio after including the current periods retained earnings			Minimum Capital Conservation Ratios (expressed as % of earnings)
As on March 31, 2015	As on March 31, 2016	As on March 31, 2017	
5.5% - 5.65625%	5.5% - 5.8125%	5.5% - 5.96875%	100%
>5.65625% - 5.8125%	>5.8125% - 6.125%	>5.96875% - 6.4375%	80%
>5.8125% - 5.96875%	>6.125% - 6.4375%	>6.4375% - 6.90625%	60%
>5.96875% - 6.125%	>6.4375% - 6.75%	>6.90625% - 7.375%	40%
>6.125%	>6.75%	>7.375%	0%

15.2.3 The Common Equity Tier 1 ratio includes amounts used to meet the minimum Common Equity Tier 1 capital requirement of 5.5%, but excludes any additional Common Equity Tier 1 needed to meet the 7% Tier 1 and 9% Total Capital requirements. For example, a bank maintains Common Equity Tier 1 capital of 9% and has no Additional Tier 1 or Tier 2 capital. Therefore, the bank would meet all minimum capital requirements, but would have a zero conservation buffer and therefore, the bank would be subjected to 100% constraint on distributions of capital by way of dividends, share-buybacks and discretionary bonuses.

15.2.4 The following represents other key aspects of the capital conservation buffer requirements:

(i) **Elements subject to the restriction on distributions**: Dividends and share buybacks, discretionary payments on other Tier 1 capital instruments and discretionary bonus payments to staff would constitute items considered to be distributions. Payments which do not result in depletion of Common Equity Tier 1 capital, (for example include certain scrip dividends[93]) are not considered distributions.

(ii) **Definition of earnings**: Earnings are defined as distributable profits before the deduction of elements subject to the restriction on distributions mentioned at (i) above. Earnings are calculated after the tax which would have been reported had none of the distributable items been paid. As such, any tax impact of making such distributions are reversed out. If a bank does not have positive earnings and has a Common Equity Tier 1 ratio less than 8%, it should not make positive net distributions.

(iii) **Solo or consolidated application**: Capital conservation buffer is applicable both at the solo level (global position) as well as at the consolidated level, i.e. restrictions would be imposed on distributions at the level of both the solo bank and the

[93]A scrip dividend is a scrip issue made in lieu of a cash dividend. The term 'scrip dividends' also includes bonus shares.

consolidated group. In all cases where the bank is the parent of the group, it would mean that distributions by the bank can be made only in accordance with the lower of its Common Equity Tier 1 Ratio at solo level or consolidated level[94]. For example, if a bank's Common Equity Tier 1 ratio at solo level is 6.8% and that at consolidated level is 7.4%. It will be subject to a capital conservation requirement of 60% consistent with the Common Equity Tier 1 range of >6.75% - 7.375% as per Table 24 in paragraph 15.2.1 above. Suppose, a bank's Common Equity Tier 1 ratio at solo level is 6.6% and that at consolidated level is 6%. It will be subject to a capital conservation requirement of 100% consistent with the Common Equity Tier 1 range of >5.5% - 6.125% as per Table 24 on minimum capital conservation standards for individual bank.

15.3 Banks which already meet the minimum ratio requirement during the transition period as indicated in paragraph 4.5, but remain below the target of 8% Common Equity Tier 1 capital ratio (minimum of 5.5% plus conservation buffer of 2.5%) should maintain prudent earnings retention policies with a view to meeting the conservation buffer as soon as possible. However, RBI may consider accelerating the build-up of the capital conservation buffer and shorten the transition periods, if the situation warrants so.

[94] If a subsidiary is a bank, it will naturally be subject to the provisions of capita conservation buffer. If it is not a bank, even then the parent bank should not allow the subsidiary to distribute dividend which are inconsistent with the position of CCB at the consolidated level.

Part E: Leverage Ratio Framework[95]

16. Leverage Ratio

16.1 Rationale and Objective

One of the underlying features of the crisis was the build-up of excessive on- and off-balance sheet leverage in the banking system. In many cases, banks built up excessive leverage while still showing strong risk based capital ratios. During the most severe part of the crisis, the banking sector was forced by the market to reduce its leverage in a manner that amplified downward pressure on asset prices, further exacerbating the positive feedback loop between losses, declines in bank capital, and contraction in credit availability. Therefore, under Basel III, a simple, transparent, non-risk based leverage ratio has been introduced. The leverage ratio is calibrated to act as a credible supplementary measure to the risk based capital requirements. The leverage ratio is intended to achieve the following objectives:

(a) constrain the build-up of leverage in the banking sector, helping avoid destabilising deleveraging processes which can damage the broader financial system and the economy; and

(b) reinforce the risk based requirements with a simple, non-risk based "backstop" measure.

16.2 Definition and Calculation of the Leverage Ratio

16.2.1 The provisions relating to leverage ratio contained in the Basel III document[96] are intended to serve as the basis for testing the leverage ratio during the parallel run period. The Basel Committee will test a minimum Tier 1 leverage ratio of 3% during the parallel run period from January 1, 2013 to January 1, 2017. Additional transitional arrangements are set out in paragraph 16.5 below.

16.2.2 During the period of parallel run, banks should strive to maintain their existing level of leverage ratio but, in no case the leverage ratio should fall below 4.5%. A bank whose leverage ratio is below 4.5% may endeavor to bring it above 4.5% as early as possible. Final leverage ratio requirement would be prescribed by RBI after the parallel run taking into account the prescriptions given by the Basel Committee.

16.2.3 The leverage ratio shall be maintained on a quarterly basis. The basis of calculation at the end of each quarter is *"the average of the month-end leverage ratio over the quarter based on the definitions of capital (**the capital measure**) and total exposure (**the exposure measure**) specified in paragraphs 16.3 and 16.4, respectively*".

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[95] Annex 5 of Guidelines on Implementation of Basel III Capital Regulations in India issued vide circular DBOD.No.BP.BC.98/21.06.201/2011-12 dated May 2, 2012.

[96] Basel III: A global regulatory framework for more resilient banks and banking systems, December 2010 (rev June 2011).

16.3 Capital Measure

(a) The capital measure for the leverage ratio should be based on the new definition of Tier 1 capital as set out in paragraph 4.2[97]

(b) Items that are deducted completely from capital do not contribute to leverage, and should therefore also be deducted from the measure of exposure. That is, the capital and exposure should be measured consistently and should avoid double counting. This means that deductions from Tier 1 capital (as set out in paragraph 4.4) should also be made from the exposure measure.

(c) According to the treatment outlined in paragraph 4.4.9.2(C) where a financial entity is included in the accounting consolidation but not in the regulatory consolidation, the investments in the capital of these entities are required to be deducted to the extent that that they exceed 10% of the bank's common equity. To ensure that the capital and exposure are measured consistently for the purposes of the leverage ratio, the assets of such entities included in the accounting consolidation should be excluded from the exposure measure in proportion to the capital that is excluded under paragraph 4.4.9.2(C).

(d) For example, assume that total assets consolidated by the bank in respect of the subsidiaries which are included in the accounting consolidation but not in the regulatory consolidation (e.g. insurance companies) are Rs.1200 crore. Further assume that the total equity investment of a bank in such subsidiaries is 15% of the bank's common equity. In this case, investment equal to 10% of the bank's equity will be risk weighted at 250% and the remaining 5% will be deducted from common equity. Of the consolidated assets of Rs.1200 crore, Rs.400 crore {1200*(5%/15%)} will be excluded from the exposure measure.

16.4 Exposure Measure

16.4.1 General Measurement Principles

The exposure measure for the leverage ratio should generally follow the accounting measure of exposure. In order to measure the exposure consistently with financial accounts, the following should be applied by banks:

(a) on-balance sheet, non-derivative exposures will be net of specific provisions and valuation adjustments (e.g. prudent valuation adjustments for AFS and HFT positions, credit valuation adjustments);

(b) physical or financial collateral, guarantees or credit risk mitigation purchased is not allowed to reduce on-balance sheet exposures; and

(c) netting of loans and deposits is not allowed.

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[97] The Tier 1 capital does not include capital conservation buffer and countercyclical capital buffer for the purpose of leverage ratio.

16.4.2 **On-Balance Sheet Items**

Banks should include all items of assets reported in their accounting balance sheet for the purposes of calculation of the leverage ratio. In addition, the exposure measure should include the following treatments for Securities Financing Transactions (e.g. repo and reverse repo agreements, CBLO) and derivatives.

(i) ***Repurchase agreements and securities finance***

Securities Financing Transactions (SFTs) are a form of secured funding and therefore, an important source of balance sheet leverage that should be included in the leverage ratio. Therefore, banks should calculate SFT for the purposes of the leverage ratio by applying:

(a) the accounting measure of exposure; and

(b) without netting various long and short positions with the same counterparty.

(ii) ***Derivatives***

Derivatives create two types of exposure: an "on-balance sheet" present value reflecting the fair value of the contract (often zero at outset but subsequently positive or negative depending on the performance of the contract), and a notional economic exposure representing the underlying economic interest of the contract. Banks should calculate exposure in respect of derivatives, including where a bank sells protection using a credit derivative, for the purposes of the leverage ratio by applying:

(a) the accounting measure of exposure (positive MTM value) plus an add-on for potential future exposure calculated according to the Current Exposure Method; and

(b) without netting the MTM values and PFEs in respect of various long and short positions with the same counterparty.

(iii) ***Other Off-Balance Sheet Items***

Banks should calculate the off balance sheet items enumerated in paragraph 5.15.2 for the purposes of the leverage ratio by applying a uniform 100% credit conversion factor (CCF). However, for any commitments that are unconditionally cancellable at any time by the bank without prior notice, a CCF of 10% may be applied.

16.5 Transitional Arrangements

16.5.1 The transition period for the leverage ratio has begun on January 1, 2011. The Basel Committee will use the transition period to monitor banks' leverage data on a semi-annual basis in order to assess whether the proposed design and calibration of the minimum Tier 1 leverage ratio of 3% is appropriate over a full credit cycle and for different types of business models. This assessment will include consideration of whether a wider definition of exposures and an offsetting adjustment

in the calibration would better achieve the objectives of the leverage ratio. The Committee also will closely monitor accounting standards and practices to address any differences in national accounting frameworks that are material to the definition and calculation of the leverage ratio. The transition period will comprise of a supervisory monitoring period and a parallel run period:

16.5.2 The supervisory monitoring period has commenced January 1, 2011. The supervisory monitoring process will focus on developing templates to track in a consistent manner the underlying components of the agreed definition and resulting ratio. The BCBS would be undertaking the parallel run between January 1, 2013 and January 1, 2017. During this period, the leverage ratio and its components will be tracked, including its behaviour relative to the risk based requirement. Based on the results of the parallel run period, any final adjustments to the definition and calibration of the leverage ratio will be carried out in the first half of 2017, with a view to migrating to a Pillar 1 treatment on January 1, 2018 based on appropriate review and calibration.

16.5.3 Banks are required to calculate their leverage ratio using the definitions of capital and total exposure as defined under this guidelines and their risk based capital requirement. Bank level disclosure of the leverage ratio and its components will start from April 1, 2015. However, banks should report their Tier 1 leverage ratio to the RBI (Department of Banking Operations and Development) along with detailed calculations of capital and exposure measures on a quarterly basis from the quarter ending June 30, 2013.

Annex 1
[cf. para 4.2.3.1]

Criteria for Classification as Common Shares (Paid-up Equity Capital) for Regulatory Purposes – Indian Banks

1. All common shares should ideally be the voting shares. However, in rare cases, where banks need to issue non-voting common shares as part of Common Equity Tier 1 capital, they must be identical to voting common shares of the issuing bank in all respects except the absence of voting rights. Limit on voting rights will be applicable based on the provisions of respective statutes governing individual banks {i.e. Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 / 1980 in case of nationalized banks; SBI Act, 1955 in case of State Bank of India; State Bank of India (Subsidiary Banks) Act, 1959 in case of associate banks of State Bank of India; Banking Regulation Act, 1949 in case of Private Sector Banks, etc.}

2. Represents the most subordinated claim in liquidation of the bank.

3. Entitled to a claim on the residual assets which is proportional to its share of paid up capital, after all senior claims have been repaid in liquidation (i.e. has an unlimited and variable claim, not a fixed or capped claim).

4. Principal is perpetual and never repaid outside of liquidation (except discretionary repurchases / buy backs or other means of effectively reducing capital in a discretionary manner that is allowable under relevant law as well as guidelines, if any, issued by RBI in the matter).

5. The bank does nothing to create an expectation at issuance that the instrument will be bought back, redeemed or cancelled nor do the statutory or contractual terms provide any feature which might give rise to such an expectation.

6. Distributions are paid out of distributable items (retained earnings included). The level of distributions is not in any way tied or linked to the amount paid up at issuance and is not subject to a contractual cap (except to the extent that a bank is unable to pay distributions that exceed the level of distributable items).

7. There are no circumstances under which the distributions are obligatory. Non-payment is therefore not an event of default.

8. Distributions are paid only after all legal and contractual obligations have been met and payments on more senior capital instruments have been made. This means that there are no preferential distributions, including in respect of other elements classified as the highest quality issued capital.

9. It is the paid up capital that takes the first and proportionately greatest share of any losses as they occur[98]. Within the highest quality capital, each

[98] In cases where capital instruments have a permanent write-down feature, this criterion is still deemed to be met by common shares.

instrument absorbs losses on a going concern basis proportionately and *pari passu* with all the others.

10. The paid up amount is classified as equity capital (i.e. not recognised as a liability) for determining balance sheet insolvency.

11. The paid up amount is classified as equity under the relevant accounting standards.

12. It is directly issued and paid up and the bank cannot directly or indirectly have funded the purchase of the instrument[99]. Banks should also not extend loans against their own shares.

13. The paid up amount is neither secured nor covered by a guarantee of the issuer or related entity[100]nor subject to any other arrangement that legally or economically enhances the seniority of the claim.

14. Paid up capital is only issued with the approval of the owners of the issuing bank, either given directly by the owners or, if permitted by applicable law, given by the Board of Directors or by other persons duly authorised by the owners.

15. Paid up capital is clearly and separately disclosed in the bank's balance sheet.

[99]Banks should not grant advances against its own shares as this would be construed as indirect funding of its own capital.

[100] A related entity can include a parent company, a sister company, a subsidiary or any other affiliate. A holding company is a related entity irrespective of whether it forms part of the consolidated banking group.

Annex 2
[cf. para 4.2.3.2]

Criteria for Classification as Common Equity for Regulatory Purposes – Foreign Banks

1. Represents the most subordinated claim in liquidation of the Indian operations of the bank.

2. Entitled to a claim on the residual assets which is proportional to its share of paid up capital, after all senior claims have been repaid in liquidation (i.e. has an unlimited and variable claim, not a fixed or capped claim).

3. Principal is perpetual and never repaid outside of liquidation (except with the approval of RBI).

4. Distributions to the Head Office of the bank are paid out of distributable items (retained earnings included). The level of distributions is not in any way tied or linked to the amount paid up at issuance and is not subject to a contractual cap (except to the extent that a bank is unable to pay distributions that exceed the level of distributable items).

5. Distributions to the Head Office of the bank are paid only after all legal and contractual obligations have been met and payments on more senior capital instruments have been made. This means that there are no preferential distributions, including in respect of other elements classified as the highest quality issued capital.

6. This capital takes the first and proportionately greatest share of any losses as they occur[101].

7. It is clearly and separately disclosed in the bank's balance sheet.

[101] In cases where capital instruments have a permanent write-down feature, this criterion is still deemed to be met by common shares.

Annex 3
[cf. para 4.2.4.1]

Criteria for Inclusion of Perpetual Non-cumulative Preference Shares (PNCPS) in Additional Tier 1 Capital

The PNCPS will be issued by Indian banks, subject to extant legal provisions only in Indian rupees and should meet the following terms and conditions to qualify for inclusion in Additional Tier 1 Capital for capital adequacy purposes:

1. Terms of Issue of Instruments

1.1 Paid up Status

The instruments should be issued by the bank (i.e. not by any 'SPV' etc. set up by the bank for this purpose) and fully paid up.

1.2 Amount

The amount of PNCPS to be raised may be decided by the Board of Directors of banks.

1.3 Limits

While complying with minimum Tier 1 of 7% of risk weighted assets, a bank cannot admit, Perpetual Non-Cumulative Preference Shares (PNCPS) together with Perpetual Debt Instruments (PDI) in Additional Tier 1 Capital, more than 1.5% of risk weighted assets. However, once this minimum total Tier 1 capital has been complied with, any additional PNCPS and PDI issued by the bank can be included in Total Tier 1 capital reported. Excess PNCPS and PDI can be reckoned to comply with Tier 2 capital if the latter is less than 2% of RWAs. This limit will work in the same way as illustrated in **Part A of Annex 14**.

1.4 Maturity Period

The PNCPS shall be perpetual i.e. there is no maturity date and there are no step-ups or other incentives to redeem.

1.5 Rate of Dividend

The rate of dividend payable to the investors may be either a fixed rate or a floating rate referenced to a market determined rupee interest benchmark rate

1.6 Optionality

PNCPS shall not be issued with a 'put option'. However, banks may issue the instruments with a call option at a particular date subject to following conditions:

(a) The call option on the instrument is permissible after the instrument has run for at least ten years;

(b) To exercise a call option a bank must receive prior approval of RBI(Department of Banking Operations and Development); and

(c) A bank must not do anything which creates an expectation that the call will be exercised[102]; and

(d) Banks must not exercise a call unless:

(i) They replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank[103]; or

(ii) The bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.[104]

The use of tax event and regulatory event calls may be permitted. However, exercise of the calls on account of these events is subject to the requirements set out in points (b) to (d) of criterion 1.6. RBI will permit the bank to exercise the call only if the RBI is convinced that the bank was not in a position to anticipate these events at the time of issuance of PNCPS.

To illustrate, if there is a change in tax treatment which makes the capital instrument with tax deductible coupons into an instrument with non-tax deductible coupons, then the bank would have the option (not obligation) to repurchase the instrument. In such a situation, a bank may be allowed to replace the capital instrument with another capital instrument that perhaps does have tax deductible coupons. Similarly, if there is a downgrade of the instrument in regulatory classification (e.g. if it is decided by the RBI to exclude an instrument from regulatory capital) the bank has the option to call the instrument and replace it with an instrument with a better regulatory classification, or a lower coupon with the same regulatory classification with prior approval of RBI. However, banks may not create an expectation / signal an early redemption / maturity of the regulatory capital instrument.

1.7 Repurchase / Buy-back / Redemption

(i) Principal of the instruments may be repaid (e.g. through repurchase or redemption) only with prior approval of RBI and banks should not assume or create market expectations that supervisory approval will be given (this repurchase / buy-back /redemption of the principal is in a situation other than in the event of exercise of call option by the bank. One of the major differences is that in the case of the former, the option to offer the instrument for repayment on announcement of the decision to repurchase / buy-back /redeem the instrument, would lie with the investors whereas, in case of the latter, it lies with the bank).

(ii) Banks may repurchase / buy-back / redeem the instruments only if:

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[102] If a bank were to call a capital instrument and replace it with an instrument that is more costly (e.g. has a higher credit spread) this might create an expectation that the bank will exercise calls on its other capital instruments. Therefore, bank may not be permitted to call an instrument if the bank intends to replace it with an instrument issued at a higher credit spread. This is applicable in cases of all Additional Tier 1 and Tier 2 instruments.

[103] Replacement issues can be concurrent with but not after the instrument is called.

[104] Here, minimum refers to Common Equity Tier 1 of 8% of RWAs (including capital conservation buffer of 2.5% of RWAs) and Total Capital of 11.5% of RWAs including any additional capital requirement identified under Pillar 2.

(a) They replace such instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank; or

(b) The bank demonstrates that its capital position is well above the minimum capital requirements after the repurchase / buy-back / redemption.

1.8 Dividend Discretion

(i) The bank must have full discretion at all times to cancel distributions/payments;[105]

(ii) Cancellation of discretionary payments must not be an event of default;

(iii) Banks must have full access to cancelled payments to meet obligations as they fall due;

(iv) Cancellation of distributions/payments must not impose restrictions on the bank except in relation to distributions to common stakeholders; and

(v) dividends must be paid out of distributable items.

(vii) The dividend shall not be cumulative. i.e., dividend missed in a year will not be paid in future years, even if adequate profit is available and the level of CRAR conforms to the regulatory minimum. When dividend is paid at a rate lesser than the prescribed rate, the unpaid amount will not be paid in future years, even if adequate profit is available and the level of CRAR conforms to the regulatory minimum.

(viii) The instrument cannot have a credit sensitive coupon feature, i.e. a dividend that is reset periodically based in whole or in part on the banks' credit standing. For this purpose, any reference rate including a broad index which is sensitive to changes to the bank's own creditworthiness and / or to changes in the credit worthiness of the wider banking sector will be treated as a credit sensitive reference rate. Banks desirous of offering floating reference rate may take prior approval of the RBI (DBOD) as regard permissibility of such reference rates.

(ix) In general, it may be in order for banks to have dividend stopper arrangement that stop dividend payments on common shares in the event the holders of AT1 instruments are not paid dividend/coupon. However, dividend stoppers must not impede the full discretion that bank must have at all times to cancel distributions/payments on the Additional Tier 1 instrument, nor must they act in a way that could hinder the re-capitalisation of the bank. For example, it would not be permitted for a stopper on an Additional Tier 1 instrument to:

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[105] Consequence of full discretion at all times to cancel distributions / payments is that "dividend pushers" are prohibited. An instrument with a dividend pusher obliges the issuing bank to make a dividend/coupon payment on the instrument if it has made a payment on another (typically more junior) capital instrument or share. This obligation is inconsistent with the requirement for full discretion at all times. Furthermore, the term "cancel distributions/payments" means extinguish these payments. It does not permit features that require the bank to make distributions/payments in kind.

- attempt to stop payment on another instrument where the payments on this other instrument were not also fully discretionary;

- prevent distributions to shareholders for a period that extends beyond the point in time that dividends/coupons on the Additional Tier 1 instrument are resumed;

- impede the normal operation of the bank or any restructuring activity (including acquisitions/disposals).

A stopper may act to prohibit actions that are equivalent to the payment of a dividend, such as the bank undertaking discretionary share buybacks, **if otherwise permitted**.

1.9 Treatment in Insolvency

The instrument cannot contribute to liabilities exceeding assets if such a balance sheet test forms part of a requirement to prove insolvency under any law or otherwise.

1.10 Loss Absorption Features

PNCPS should have principal loss absorption through either (i) conversion to common shares at an objective pre-specified trigger point or (ii) a write-down mechanism which allocates losses to the instrument at a pre-specified trigger point. The write-down will have the following effects:

(a) Reduce the claim of the instrument in liquidation;
(b) Reduce the amount re-paid when a call is exercised; and
(c) Partially or fully reduce dividend payments on the instrument.

Various criteria for loss absorption through conversion / write-down / write-off on breach of pre-specified trigger and at the point of non-viability are furnished in **Annex 16.**

1.11 Prohibition on Purchase / Funding of PNCPS

Neither the bank nor a related party over which the bank exercises control or significant influence (as defined under relevant Accounting Standards) should purchase PNCPS, nor can the bank directly or indirectly should fund the purchase of the instrument. Banks should also not grant advances against the security of PNCPS issued by them.

1.12 Re-capitalisation

The instrument cannot have any features that hinder re-capitalisation, such as provisions which require the issuer to compensate investors if a new instrument is issued at a lower price during a specified time frame.

1.13 Reporting of Non-payment of Dividends

All instances of non-payment of dividends should be notified by the issuing banks to the Chief General Managers-in-Charge of Department of Banking Operations and

Development and Department of Banking Supervision of the Reserve Bank of India, Mumbai.

1.14 Seniority of Claim

The claims of the investors in instruments shall be

(i) Superior to the claims of investors in equity shares;

(ii) Subordinated to the claims of PDIs, all Tier 2 regulatory capital instruments, depositors and general creditors of the bank; and

(iii) is neither secured nor covered by a guarantee of the issuer nor related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis bank creditors.

1.15 Investment in Instruments Raised in Indian Rupees by Foreign Entities/NRIs

(i) Investment by FIIs and NRIs shall be within an overall limit of 49% and 24% of the issue respectively, subject to the investment by each FII not exceeding 10% of the issue, and investment by each NRI not exceeding 5% of the issue. Investment by FIIs in these instruments shall be outside the ECB limit for rupee-denominated corporate debt, as fixed by Government of India from time to time. The overall non-resident holding of Preference Shares and equity shares in public sector banks will be subject to the statutory / regulatory limit.

(ii) Banks should comply with the terms and conditions, if any, stipulated by SEBI / other regulatory authorities in regard to issue of the instruments.

1.16 Compliance with Reserve Requirements

(i) The funds collected by various branches of the bank or other banks for the issue and held pending finalisation of allotment of the Additional Tier 1 Preference Shares will have to be taken into account for the purpose of calculating reserve requirements.

(ii) However, the total amount raised by the bank by issue of PNCPS shall not be reckoned as liability for calculation of net demand and time liabilities for the purpose of reserve requirements and, as such, will not attract CRR / SLR requirements.

1.17 Reporting of Issuances

(i) Banks issuing PNCPS shall submit a report to the Chief General Manager-in-charge, Department of Banking Operations and Development, Reserve Bank of India, Mumbai giving details of the debt raised, including the terms of issue specified at above **paragraphs**, together with a copy of the offer document soon after the issue is completed.

(ii) The issue-wise details of amount raised as PNCPS qualifying for Additional Tier 1 capital by the bank from FIIs / NRIs are required to be reported within 30 days of the issue to the Chief General Manager, Reserve Bank of India, Foreign Exchange Department, Foreign Investment Division, Central Office, Mumbai 400 001 in the **proforma** given at the end of this **Annex**. The details

of the secondary market sales / purchases by FIIs and the NRIs in these instruments on the floor of the stock exchange shall be reported by the custodians and designated banks, respectively, to the Reserve Bank of India through the soft copy of the LEC Returns, on a daily basis, as prescribed in Schedule 2 and 3 of the FEMA Notification No.20 dated 3rd May 2000, as amended from time to time.

1.18 Investment in Additional Tier 1 Capital Instruments PNCPS Issued by Other Banks/ FIs

(i) A bank's investment in PNCPS issued by other banks and financial institutions will be reckoned along with the investment in other instruments eligible for capital status while computing compliance with the overall ceiling of 10% of investing banks' capital funds as prescribed vide circular DBOD.BP.BC.No.3/ 21.01.002/ 2004-05 dated July 6, 2004.

(ii)Bank's investments in PNCPS issued by other banks / financial institutions will attract risk weight as provided in paragraphs 5.6. and 8.3.5 of the Master Circular on Basel III Capital Regulations, whichever applicable for capital adequacy purposes.

(iii) A bank's investments in the PNCPS of other banks will be treated as exposure to capital market and be reckoned for the purpose of compliance with the prudential ceiling for capital market exposure as fixed by RBI.

1.19 Classification in the Balance Sheet

PNCPS will be classified as capital and shown under 'Schedule I - Capital' of the Balance sheet.

Reporting Format

Details of Investments by FIIs and NRIs in Perpetual Non-Cumulative Preference Shares qualifying as Additional Tier 1 capital

(a) Name of the bank:

(b) Total issue size / amount raised (in Rupees) :

(c) Date of issue :

FIIs			NRIs		
No of FIIs	Amount raised		No. of NRIs	Amount raised	
	in Rupees	as a percentageof the total issue size		in Rupees	as a percentageof the total issue size

It is certified that

(i) the aggregate investment by all FIIs does not exceed 49 % of the issue size and investment by no individual FII exceeds 10 % of the issue size.

(ii) It is certified that the aggregate investment by all NRIs does not exceed 24 % of the issue size and investment by no individual NRI exceeds 5 % of the issue size

Authorised Signatory

Date

Seal of the bank

Annex 4
(cf. para 4.2.4)

Criteria for Inclusion of Perpetual Debt Instruments (PDI) in Additional Tier 1 Capital

The Perpetual Debt Instruments that may be issued as bonds or debentures by Indian banks should meet the following terms and conditions to qualify for inclusion in Additional Tier 1 Capital for capital adequacy purposes:

1. Terms of Issue of Instruments Denominated in Indian Rupees

1.1 Paid-in Status

The instruments should be issued by the bank (i.e. not by any 'SPV' etc. set up by the bank for this purpose) and fully paid-in.

1.2 Amount

The amount of PDI to be raised may be decided by the Board of Directors of banks.

1.3 Limits

While complying with minimum Tier 1 of 7% of risk weighted assets, a bank cannot admit, Perpetual Debt Instruments (PDI) together with Perpetual Non-Cumulative Preference Shares (PNCPS) in Additional Tier 1 Capital, more than 1.5% of risk weighted assets. However, once this minimum total Tier 1 capital has been complied with, any additional PNCPS and PDI issued by the bank can be included in Total Tier 1 capital reported. Excess PNCPS and PDI can be reckoned to comply with Tier 2 capital if the latter is less than 2% of RWAs. This limit will work in the same way as illustrated in **Annex 14**.

1.4 Maturity Period

The PDIs shall be perpetual i.e. there is no maturity date and there are no step-ups or other incentives to redeem.

1.5 Rate of Interest

The interest payable to the investors may be either at a fixed rate or at a floating rate referenced to a market determined rupee interest benchmark rate.

1.6 Optionality

PDIs shall not have any 'put option'. However, banks may issue the instruments with a call option at a particular date subject to following conditions:

a. The call option on the instrument is permissible after the instrument has run for at least ten years;

b. To exercise a call option a bank must receive prior approval of RBI(Department of Banking Operations and Development);

c. A bank must not do anything which creates an expectation that the call will be exercised; and

d. Banks must not exercise a call unless:

(i) They replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank[106]; or

(ii) The bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.[107]

The use of tax event and regulatory event calls may be permitted. However, exercise of the calls on account of these events is subject to the requirements set out in points (b) to (d) of criterion 1.6. RBI will permit the bank to exercise the call only if the RBI is convinced that the bank was not in a position to anticipate these events at the time of issuance of PDIs.

To illustrate, if there is a change in tax treatment which makes the capital instrument with tax deductible coupons into an instrument with non-tax deductible coupons, then the bank would have the option (not obligation) to repurchase the instrument. In such a situation, a bank may be allowed to replace the capital instrument with another capital instrument that perhaps does have tax deductible coupons. Similarly, if there is a downgrade of the instrument in regulatory classification (e.g. if it is decided by the RBI to exclude an instrument from regulatory capital) the bank has the option to call the instrument and replace it with an instrument with a better regulatory classification, or a lower coupon with the same regulatory classification with prior approval of RBI. However, banks may not create an expectation / signal an early redemption / maturity of the regulatory capital instrument.

1.7 Repurchase / Buy-back / Redemption

(i) Principal of the instruments may be repaid (e.g. through repurchase or redemption) only with prior approval of RBI and banks should not assume or create market expectations that supervisory approval will be given (this repurchase / buy-back /redemption of the principal is in a situation other than in the event of exercise of call option by the bank. One of the major differences is that in the case of the former, the option to offer the instrument for repayment on announcement of the decision to repurchase / buy-back /redeem the instrument, would lie with the investors whereas, in case of the latter, it lies with the bank).

(ii) Banks may repurchase / buy-back / redemption only if:

(a) They replace the such instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank; or

(b) The bank demonstrates that its capital position is well above the minimum capital requirements after the repurchase / buy-back / redemption.

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[106] Replacement issues can be concurrent with but not after the instrument is called.

[107] Minimum refers to Common Equity Tier 1 of 8% of RWAs (including capital conservation buffer of 2.5% of RWAs) and Total capital of 11.5% of RWAs including additional capital requirements identified under Pillar 2.

1.8 Coupon Discretion

(a) The bank must have full discretion at all times to cancel distributions/payments[108]

(b) Cancellation of discretionary payments must not be an event of default

(c) Banks must have full access to cancelled payments to meet obligations as they fall due

(d) Cancellation of distributions/payments must not impose restrictions on the bank except in relation to distributions to common stakeholders.

(e) coupons must be paid out of distributable items.

(f) the interest shall not be cumulative.

(g) The instrument cannot have a credit sensitive coupon feature, i.e. a dividend that is reset periodically based in whole or in part on the banks' credit standing. For this purpose, any reference rate including a broad index which is sensitive to changes to the bank's own creditworthiness and / or to changes in the credit worthiness of the wider banking sector will be treated as a credit sensitive reference rate. Banks desirous of offering floating reference rate may take prior approval of the RBI (DBOD) as regard permissibility of such reference rates.

(h) In general, it may be in order for banks to have dividend stopper arrangement that stop dividend payments on common shares in the event the holders of AT1 instruments are not paid dividend/coupon. However, dividend stoppers must not impede the full discretion that bank must have at all times to cancel distributions/payments on the Additional Tier 1 instrument, nor must they act in a way that could hinder the re-capitalisation of the bank. For example, it would not be permitted for a stopper on an Additional Tier 1 instrument to:

- attempt to stop payment on another instrument where the payments on this other instrument were not also fully discretionary;
- prevent distributions to shareholders for a period that extends beyond the point in time that dividends/coupons on the Additional Tier 1 instrument are resumed;
- impede the normal operation of the bank or any restructuring activity (including acquisitions/disposals).

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[108] Consequence of full discretion at all times to cancel distributions/payments is that "dividend pushers" are prohibited. An instrument with a dividend pusher obliges the issuing bank to make a dividend/coupon payment on the instrument if it has made a payment on another (typically more junior) capital instrument or share. This obligation is inconsistent with the requirement for full discretion at all times. Furthermore, the term "cancel distributions/payments" means extinguish these payments. It does not permit features that require the bank to make distributions/payments in kind.

A stopper may act to prohibit actions that are equivalent to the payment of a dividend, such as the bank undertaking discretionary share buybacks, **if otherwise permitted**.

1.9 Treatment in Insolvency

The instrument cannot contribute to liabilities exceeding assets if such a balance sheet test forms part of a requirement to prove insolvency under any law or otherwise.

1.10 Loss Absorption Features

PDIs may be classified as liabilities for accounting purposes (not for the purpose of insolvency as indicated in paragraph 1.9 above). In such cases, these instruments must have principal loss absorption through either (i) conversion to common shares at an objective pre-specified trigger point or (ii) a write-down mechanism which allocates losses to the instrument at a pre-specified trigger point. The write-down will have the following effects:

(a) Reduce the claim of the instrument in liquidation;
(b) Reduce the amount re-paid when a call is exercised; and
(c) Partially or fully reduce coupon payments on the instrument.

Various criteria for loss absorption through conversion / write-down / write-off on breach of pre-specified trigger and at the point of non-viability are furnished in **Annex 16.**

1.11 Prohibition on Purchase / Funding of Instruments

Neither the bank nor a related party over which the bank exercises control or significant influence (as defined under relevant Accounting Standards) should purchase the instrument, nor can the bank directly or indirectly fund the purchase of the instrument. Banks should also not grant advances against the security of the debt instruments issued by them.

1.12 Re-capitalisation

The instrument cannot have any features that hinder re-capitalisation, such as provisions which require the issuer to compensate investors if a new instrument is issued at a lower price during a specified time frame.

1.13 Reporting of Non-payment of Coupons

All instances of non-payment of coupon should be notified by the issuing banks to the Chief General Managers-in-Charge of Department of Banking Operations and Development and Department of Banking Supervision of the Reserve Bank of India, Mumbai.

1.14 Seniority of Claim

The claims of the investors in instruments shall be

(i) superior to the claims of investors in equity shares and perpetual non-cumulative preference shares;

(ii) subordinated to the claims of depositors, general creditors and subordinated debt of the bank;

(iii) is neither secured nor covered by a guarantee of the issuer nor related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis bank creditors.

1.15 Investment in Instruments Raised in Indian Rupees by Foreign Entities/NRIs

(i) Investment by FIIs in instruments raised in Indian Rupees shall be outside the ECB limit for rupee denominated corporate debt, as fixed by the Govt. of India from time to time, for investment by FIIs in corporate debt instruments. Investment in these instruments by FIIs and NRIs shall be within an overall limit of 49% and 24% of the issue, respectively, subject to the investment by each FII not exceeding 10% of the issue and investment by each NRI not exceeding 5% of the issue.

(ii) Banks should comply with the terms and conditions, if any, stipulated by SEBI / other regulatory authorities in regard to issue of the instruments.

1.16 Terms of Issue of Instruments Denominated in Foreign Currency

Banks may augment their capital funds through the issue of PDIs in foreign currency without seeking the prior approval of the Reserve Bank of India, subject to compliance with the requirements mentioned below:

(i) Instruments issued in foreign currency should comply with all terms and conditions as applicable to the instruments issued in Indian Rupees.

(ii) Not more than 49% of the eligible amount can be issued in foreign currency.

(iii) Instruments issued in foreign currency shall be outside the existing limit for foreign currency borrowings by Authorised Dealers, stipulated in terms of Master Circular No. RBI/2006-07/24 dated July 1, 2006 on Risk Management and Inter-Bank Dealings as updated from time to time.

1.17 Compliance with Reserve Requirements

The total amount raised by a bank through debt instruments shall not be reckoned as liability for calculation of net demand and time liabilities for the purpose of reserve requirements and, as such, will not attract CRR / SLR requirements.

1.18 Reporting of Issuances

Banks issuing PDIs shall submit a report to the Chief General Manager-in-charge, Department of Banking Operations and Development, Reserve Bank of India, Mumbai giving details of the debt raised, including the terms of issue specified at **paragraph 1** above, together with a copy of the offer document soon after the issue is completed.

1.19 Investment in Additional Tier 1 Debt Capital Instruments PDIs Issued by Other Banks/ FIs

(i) A bank's investment in debt instruments issued by other banks and financial institutions will be reckoned along with the investment in other instruments eligible for capital status while computing compliance with the overall ceiling of 10% for cross holding of capital among banks/FIs prescribed vide circular DBOD.BP.BC.No.3/ 21.01.002/ 2004-05 dated July 6, 2004 and also subject to cross holding limits.

(ii) Bank's investments in debt instruments issued by other banks will attract risk weight for capital adequacy purposes, as prescribed in paragraphs 5.6 and 8.3.5 of the Master Circular on Basel III Capital Regulations, whichever applicable.

1.20 Classification in the Balance Sheet

The amount raised by way of issue of debt capital instrument may be classified under 'Schedule 4 – Borrowings' in the Balance Sheet.[109]

1.21 Raising of Instruments for Inclusion as Additional Tier 1 Capital by Foreign Banks in India

Foreign banks in India may raise Head Office (HO) borrowings in foreign currency for inclusion as Additional Tier 1 capital subject to the same terms and conditions as mentioned in items 1.1 to 1.18 above for Indian banks. In addition, the following terms and conditions would also be applicable:

a) *Maturity period:* If the amount of Additional Tier 1 capital raised as Head Office borrowings shall be retained in India on a perpetual basis.
b) *Rate of interest:* Rate of interest on Additional Tier 1 capital raised as HO borrowings should not exceed the on-going market rate. Interest should be paid at half yearly rests.
c) *Withholding tax:* Interest payments to the HO will be subject to applicable withholding tax.
d) *Documentation:* The foreign bank raising Additional Tier 1 capital as HO borrowings should obtain a letter from its HO agreeing to give the loan for supplementing the capital base for the Indian operations of the foreign bank. The loan documentation should confirm that the loan given by HO shall be eligible for the same level of seniority of claim as the investors in debt capital instruments issued by Indian banks. The loan agreement will be governed by and construed in accordance with the Indian law.
e) *Disclosure:* The total eligible amount of HO borrowings shall be disclosed in the balance sheet under the head 'Additional Tier 1 capital raised in the form of Head Office borrowings in foreign currency'.
f) *Hedging:* The total eligible amount of HO borrowing should remain fully swapped in Indian Rupees with the bank at all times.
g) *Reporting and certification :* Details regarding the total amount of Additional Tier 1 capital raised as HO borrowings, along with a certification to the effect that the borrowing is in accordance with these guidelines, should be advised to the Chief General Managers-in-Charge of the Department of Banking Operations and Development (International Banking Division), Department of External Investments and Operations and Foreign Exchange Department (Forex Markets Division), Reserve Bank of India, Mumbai.

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[109] Please refer to circular DBOD.No.BP.BC.81/21.01.002/2009-10 dated March 30, 2010

Annex 5
(cf. para 4.2.5)

Criteria for Inclusion of Debt Capital Instruments as Tier 2 Capital

The Tier 2 debt capital instruments that may be issued as bonds / debentures by Indian banks should meet the following terms and conditions to qualify for inclusion as Tier 2 Capital for capital adequacy purposes[110]:

1. Terms of Issue of Instruments Denominated in Indian Rupees

1.1 Paid-in Status

The instruments should be issued by the bank (i.e. not by any 'SPV' etc. set up by the bank for this purpose) and fully paid-in.

1.2 Amount

The amount of these debt instruments to be raised may be decided by the Board of Directors of banks.

1.3 Maturity Period

The debt instruments should have a minimum maturity of 10 years and there are no step-ups or other incentives to redeem.

1.4 Discount

The debt instruments shall be subjected to a progressive discount for capital adequacy purposes. As they approach maturity these instruments should be subjected to progressive discount as indicated in the table below for being eligible for inclusion in Tier 2 capital.

Remaining Maturity of Instruments	Rate of Discount (%)
Less than one year	100
One year and more but less than two years	80
Two years and more but less than three years	60
Three years and more but less than four years	40
Four years and more but less than five years	20

1.5 Rate of Interest

(i) The interest payable to the investors may be either at a fixed rate or at a floating rate referenced to a market determined rupee interest benchmark rate.

(ii) The instrument cannot have a credit sensitive coupon feature, i.e. a coupon that is reset periodically based in whole or in part on the banks'

[110] The criteria relating to loss absorbency through conversion / write-down / write-off at the point of non-viability are furnished in Annex 16.

credit standing. Banks desirous of offering floating reference rate may take prior approval of the RBI (DBOD) as regard permissibility of such reference rates.

1.6 Optionality

The debt instruments shall not have any 'put option'. However, it may be callable at the initiative of the issuer only after a minimum of five years:

(a) To exercise a call option a bank must receive prior approval of RBI (Department of Banking Operations and Development); and

(b) A bank must not do anything which creates an expectation that the call will be exercised; and

(c) Banks must not exercise a call unless:

(i) They replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank[111]; or

(ii) The bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.[112]

The use of tax event and regulatory event calls may be permitted. However, exercise of the calls on account of these events is subject to the requirements set out in points (a) to (c) of criterion 1.6. RBI will permit the bank to exercise the call only if the RBI is convinced that the bank was not in a position to anticipate these events at the time of issuance of these instruments as explained in case of Additional Tier 1 instruments.

1.7 Treatment in Bankruptcy / Liquidation

The investor must have no rights to accelerate the repayment of future scheduled payments (coupon or principal) except in bankruptcy and liquidation.

1.8 Prohibition on Purchase / Funding of Instruments

Neither the bank nor a related party over which the bank exercises control or significant influence (as defined under relevant Accounting Standards) should purchase the instrument, nor can the bank directly or indirectly should fund the purchase of the instrument. Banks should also not grant advances against the security of the debt instruments issued by them.

1.9 Reporting of Non-payment of Coupons

All instances of non-payment of coupon should be notified by the issuing banks to the Chief General Managers-in-Charge of Department of Banking Operations and Development and Department of Banking Supervision of the Reserve Bank of India, Mumbai.

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[111] Replacement issues can be concurrent with but not after the instrument is called.

[112] Minimum refers to Common Equity ratio of 8% of RWAs (including capital conservation buffer of 2.5% of RWAs) and Total capital ratio of 11.5% of RWAs including any additional capital requirement identified under Pillar 2.

1.10 Seniority of Claim

The claims of the investors in instruments shall be

(i) senior to the claims of investors in instruments eligible for inclusion in Tier 1 capital;

(ii) subordinate to the claims of all depositors and general creditors of the bank; and

(iii) is neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis bank creditors.

1.11 Investment in Instruments Raised in Indian Rupees by Foreign Entities/NRIs

(i) Investment by FIIs in Tier 2 instruments raised in Indian Rupees shall be outside the limit for investment in corporate debt instruments, as fixed by the Govt. of India from time to time. However, investment by FIIs in these instruments will be subject to a separate ceiling of USD 500 million. In addition, NRIs shall also be eligible to invest in these instruments as per existing policy.

(ii) Banks should comply with the terms and conditions, if any, stipulated by SEBI / other regulatory authorities in regard to issue of the instruments.

1.12 Terms of Issue of Tier 2 Debt Capital Instruments in Foreign Currency

Banks may issue Tier 2 Debt Instruments in Foreign Currency without seeking the prior approval of the Reserve Bank of India, subject to compliance with the requirements mentioned below:

(i) Tier 2 Instruments issued in foreign currency should comply with all terms and conditions applicable to instruments issued in Indian Rupees.

(ii) The total amount of Tier 2 Instruments issued in foreign currency shall not exceed 25% of the unimpaired Tier 1 capital. This eligible amount will be computed with reference to the amount of Tier 1 capital as on March 31 of the previous financial year, after deduction of goodwill and other intangible assets but before the deduction of investments, as per paragraph 4.4.9 of the Master Circular on Basel III capital regulations.

(iii) This will be in addition to the existing limit for foreign currency borrowings by Authorised Dealers stipulated in terms of Master Circular No. 14/2010-11 dated July 1, 2010 on Risk Management and Inter-Bank Dealings as updated from time to time.

1.13 Compliance with Reserve Requirements

(i) The funds collected by various branches of the bank or other banks for the issue and held pending finalisation of allotment of the Tier 2 Capital instruments will have to be taken into account for the purpose of calculating reserve requirements.

(ii) The total amount raised by a bank through Tier 2 instruments shall be reckoned as liability for the calculation of net demand and time liabilities for the purpose of reserve requirements and, as such, will attract CRR/SLR requirements.

1.14 Reporting of Issuances

Banks issuing debt instruments shall submit a report to the Chief General Manager-in-charge, Department of Banking Operations and Development, Reserve Bank of India, Mumbai giving details of the debt raised, including the terms of issue specified at para 1 above, together with a copy of the offer document soon after the issue is completed.

1.15 Investment in Tier 2 Debt Capital Instruments Issued by Other Banks/ FIs

(i) A bank's investment in Tier 2 debt instruments issued by other banks and financial institutions will be reckoned along with the investment in other instruments eligible for capital status while computing compliance with the overall ceiling of 10% for cross holding of capital among banks/FIs prescribed vide circular DBOD.BP.BC.No.3/ 21.01.002/ 2004-05 dated 6th July 2004 and also subject to cross holding limits.

(ii) Bank's investments in Tier 2 instruments issued by other banks/ financial institutions will attract risk weight as per paragraphs 5.6 and 8.3.5 of the Master Circular on Basel III Capital Regulations, whichever applicable for capital adequacy purposes.

1.16 Classification in the Balance Sheet

The amount raised by way of issue of Tier 2 debt capital instrument may be classified under 'Schedule 4 – Borrowings' in the Balance Sheet.

1.17 Debt Capital Instruments to Retail Investors[113,114]

With a view to enhancing investor education relating to risk characteristics of regulatory capital requirements, banks issuing subordinated debt to retail investors should adhere to the following conditions:

(a) For floating rate instruments, banks should not use its Fixed Deposit rate as benchmark.

(b) The requirement for specific sign-off as quoted below, from the investors for having understood the features and risks of the instrument may be

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[113] Please refer to circular DBOD.BP.BC.No.69 / 21.01.002/ 2009-10 dated January 13, 2010.

[114] Please also refer to the circular DBOD.BP.BC.No.72/21.01.002/2012-13 dated January 24, 2013 on 'Retail Issue of Subordinated Debt for Raising Tier 2 Capital', in terms of which banks were advised that with a view to deepening the corporate bond market in India through enhanced retail participation, banks, while issuing subordinated debt for raising Tier 2 capital, are encouraged to consider the option of raising such funds through public issue to retail investors. However, while doing so banks are advised to adhere to the conditions prescribed in circular dated January 13, 2010 so as to ensure that the investor is aware of the risk characteristics of regulatory capital instruments.

incorporated in the common application form of the proposed debt issue.

> ***"By making this application, I / We acknowledge that I/We have understood the terms and conditions of the Issue of [insert the name of the instruments being issued] of [Name of The Bank] as disclosed in the Draft Shelf Prospectus, Shelf Prospectus and Tranche Document ".***

(c) All the publicity material, application form and other communication with the investor should clearly state in bold letters (**with font size 14**) how a subordinated bond is different from fixed deposit particularly that it is not covered by deposit insurance.

1.18 Raising of Instruments for Inclusion as Tier 2 Capital by Foreign Banks in India

Foreign banks in India may raise Head Office (HO) borrowings in foreign currency for inclusion as Tier 2 capital subject to the same terms and conditions as mentioned in items 1.1 to 1.17 above for Indian banks. In addition, the following terms and conditions would also be applicable:

(a) *Maturity period:* If the amount of Tier 2 debt capital raised as HO borrowings is in tranches, each tranche shall be retained in India for a minimum period of ten years.

(b) *Rate of interest:* Rate of interest on Tier 2 capital raised as HO borrowings should not exceed the on-going market rate. Interest should be paid at half yearly rests.

(c) *Withholding tax:* Interest payments to the HO will be subject to applicable withholding tax.

(d) *Documentation:* The foreign bank raising Tier 2 debt capital as HO borrowings should obtain a letter from its HO agreeing to give the loan for supplementing the capital base for the Indian operations of the foreign bank. The loan documentation should confirm that the loan given by HO shall be eligible for the same level of seniority of claim as the investors in debt capital instruments issued by Indian banks. The loan agreement will be governed by and construed in accordance with the Indian law.

(e) *Disclosure:* The total eligible amount of HO borrowings shall be disclosed in the balance sheet under the head 'Tier 2 debt capital raised in the form of Head Office borrowings in foreign currency'.

(f) *Hedging:* The total eligible amount of HO borrowing should remain fully swapped in Indian Rupees with the bank at all times.

(g) *Reporting and certification:* Details regarding the total amount of Tier 2 debt capital raised as HO borrowings, along with a certification to the effect that the borrowing is in accordance with these guidelines, should be advised to the Chief General Managers-in-Charge of the Department of Banking Operations and Development (International Banking Division), Department of External Investments and Operations and Foreign Exchange Department (Forex Markets Division), Reserve Bank of India, Mumbai.

(h) *Features:* The HO borrowings should be fully paid up, i.e. the entire borrowing or each tranche of the borrowing should be available in full to the

branch in India. It should be unsecured, subordinated to the claims of other creditors of the foreign bank in India, free of restrictive clauses and should not be redeemable at the instance of the HO.

(i) *Rate of discount:* The HO borrowings will be subjected to progressive discount as they approach maturity at the rates indicated below:

Remaining maturity of borrowing	Rate of discount (%)
More than 5 years	Not Applicable (the entire amount can be included as subordinated debt in Tier 2 capital)
More than 4 years and less than 5 years	20
More than 3 years and less than 4 years	40
More than 2 years and less than 3 years	60
More than 1 year and less than 2 years	80
Less than 1 year	100 (No amount can be treated as subordinated debt for Tier 2 capital)

1.19 Requirements

The total amount of HO borrowings is to be reckoned as liability for the calculation of net demand and time liabilities for the purpose of reserve requirements and, as such, will attract CRR/SLR requirements.

1.20 Hedging

The entire amount of HO borrowing should remain fully swapped with banks at all times. The swap should be in Indian rupees.

1.21 Reporting and Certification

Such borrowings done in compliance with the guidelines set out above would not require prior approval of Reserve Bank of India. However, information regarding the total amount of borrowing raised from Head Office under this Annex, along with a certification to the effect that the borrowing is as per the guidelines, should be advised to the Chief General Managers-in-Charge of the Department of Banking Operations and Development (International Banking Division), Department of External Investments and Operations and Foreign Exchange Department (Forex Markets Division), Reserve Bank of India, Mumbai.

Annex 6
(cf. para 4.2.5.1.A(iii)

Criteria for Inclusion of Perpetual Cumulative Preference Shares (PCPS)/ Redeemable Non-Cumulative Preference Shares (RNCPS) / Redeemable Cumulative Preference Shares (RCPS) as Part of Tier 2 Capital

1 Terms of Issue of Instruments[115]

1.1 Paid-in Status

The instruments should be issued by the bank (i.e. not by any 'SPV' etc. set up by the bank for this purpose) and fully paid-in.

1.2 Amount

The amount to be raised may be decided by the Board of Directors of banks.

1.3 Maturity Period

These instruments could be either perpetual (PCPS) or dated (RNCPS and RCPS) instruments with a fixed maturity of minimum 10 years and there should be no step-ups or other incentives to redeem. The perpetual instruments shall be cumulative. The dated instruments could be cumulative or non-cumulative.

1.4 Amortisation

The Redeemable Preference Shares (both cumulative and non-cumulative) shall be subjected to a progressive discount for capital adequacy purposes over the last five years of their tenor, as they approach maturity as indicated in the table below for being eligible for inclusion in Tier 2 capital.

Remaining Maturity of Instruments	Rate of Discount (%)
Less than one year	100
One year and more but less than two years	80
Two years and more but less than three years	60
Three years and more but less than four years	40
Four years and more but less than five years	20

1.5 Coupon

The coupon payable to the investors may be either at a fixed rate or at a floating rate referenced to a market determined rupee interest benchmark rate. Banks desirous of offering floating reference rate may take prior approval of the RBI (DBOD) as regard permissibility of such reference rates.

1.6 Optionality

These instruments shall not be issued with a 'put option'. However, banks may issue the instruments with a call option at a particular date subject to following conditions:

(a) The call option on the instrument is permissible after the instrument has run for at least five years; and

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[115] The criteria relating to loss absorbency through conversion / write-down / write-off at the point of non-viability are furnished in Annex 16.

(b) To exercise a call option a bank must receive prior approval of RBI (Department of Banking Operations and Development); and

(c) A bank must not do anything which creates an expectation that the call will be exercised; and

(d) Banks must not exercise a call unless:

(i) They replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank[116]; or

(ii) The bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.[117]

The use of tax event and regulatory event calls may be permitted. However, exercise of the calls on account of these events is subject to the requirements set out in points (b) to (d) of criterion 1.6. RBI will permit the bank to exercise the call only if the RBI is convinced that the bank was not in a position to anticipate these events at the time of issuance of these instruments as explained in case of Additional Tier 1 instruments.

1.7 Treatment in Bankruptcy / Liquidation

The investor must have no rights to accelerate the repayment of future scheduled payments (coupon or principal) except in bankruptcy and liquidation.

1.8 Prohibition on Purchase / Funding

Neither the bank nor a related party over which the bank exercises control or significant influence (as defined under relevant Accounting Standards) should purchase these instruments, nor can the bank directly or indirectly should fund the purchase of the instrument. Banks should also not grant advances against the security of these instruments issued by them.

1.9 Reporting of Non-payment of Coupon

All instances of non-payment of coupon should be notified by the issuing banks to the Chief General Managers-in-Charge of Department of Banking Operations and Development and Department of Banking Supervision of the Reserve Bank of India, Mumbai.

1.10 Seniority of Claim

The claims of the investors in instruments shall be:

(i) senior to the claims of investors in instruments eligible for inclusion in Tier 1 capital;

(ii) subordinate to the claims of all depositors and general creditors of the bank; and

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[116]Replacement issues can be concurrent with but not after the instrument is called.

[117]Minimum refers to Common Equity Tier 1 of 8% of RWAs (including capital conservation buffer of 2.5% of RWAs) and Total Capital of 11.5% of RWAs including and additional capital identifies under Pillar 2.

(iii) is neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis bank creditors.

1.11 Investment in Instruments Raised in Indian Rupees by Foreign Entities/NRIs

(i) Investment by FIIs and NRIs shall be within an overall limit of 49% and 24% of the issue respectively, subject to the investment by each FII not exceeding 10% of the issue and investment by each NRI not exceeding 5% of the issue. Investment by FIIs in these instruments shall be outside the ECB limit for rupee denominated corporate debt as fixed by Government of India from time to time. However, investment by FIIs in these instruments will be subject to separate ceiling of USD 500 million. The overall non-resident holding of Preference Shares and equity shares in public sector banks will be subject to the statutory / regulatory limit.

(ii) Banks should comply with the terms and conditions, if any, stipulated by SEBI / other regulatory authorities in regard to issue of the instruments.

1.12 Compliance with Reserve Requirements

(a) The funds collected by various branches of the bank or other banks for the issue and held pending finalization of allotment of these instruments will have to be taken into account for the purpose of calculating reserve requirements.

(b) The total amount raised by a bank through the issue of these instruments shall be reckoned as liability for the calculation of net demand and time liabilities for the purpose of reserve requirements and, as such, will attract CRR / SLR requirements.

1.13 Reporting of Issuances

Banks issuing these instruments shall submit a report to the Chief General Manager-in-charge, Department of Banking Operations and Development, Reserve Bank of India, Mumbai giving details of the debt raised, including the terms of issue specified in para 1 above (1.1 to 1.14), together with a copy of the offer document soon after the issue is completed.

1.14 Investment in these Instruments Issued by other Banks/ FIs

(i) A bank's investment in these instruments issued by other banks and financial institutions will be reckoned along with the investment in other instruments eligible for capital status while computing compliance with the overall ceiling of 10% of investing banks' total capital funds prescribed vide circular DBOD.BP.BC.No.3/21.01.002/ 2004-05 dated July 6, 2004 and also subject to cross holding limits.

(ii) Bank's investments in these instruments issued by other banks / financial institutions will attract risk weight for capital adequacy purposes as provided vide paragraphs 5.6 and 8.3.5 of the Master Circular on Basel III Capital Regulations, whichever applicable.

1.15 Classification in the Balance Sheet

These instruments will be classified as ‘Borrowings’ under Schedule 4 of the Balance Sheet under item No. I (i.e. Borrowings).

Annex 7
(cf para 5.17)

Prudential Guidelines on Credit Default Swaps (CDS)

(DBOD.BP.BC.NO.61/21.06.203/2011-12 dated November 30, 2011)

1. Introduction

With a view to providing market participants a tool to transfer and manage credit risk associated with corporate bonds, Reserve Bank of India has introduced single name CDS on corporate bonds. Banks can undertake transactions in such CDS, both as market-makers as well as users. As users, banks can buy CDS to hedge a Banking Book or Trading Book exposure. The prudential guidelines dealing with CDS are dealt with in the following paragraphs.

2. Definitions

The following definitions are used in these guidelines:

(i) **Credit event payment** - the amount which is payable by the credit protection provider to the credit protection buyer under the terms of the credit derivative contract following the occurrence of a credit event. The payment can be in the form of **physical settlement** (payment of par in exchange for physical delivery of a deliverable obligation of the reference entity) or **cash settlement** (either a payment determined on a par-less-recovery basis, i.e. determined using the par value of the reference obligation less that obligation's recovery value, **or** a fixed amount, **or** a fixed percentage of the par amount).

(ii) **Deliverable asset / obligation** - any obligation[118] of the reference entity which can be delivered, under the terms of the contract, if a credit event occurs. [A deliverable obligation is relevant for credit derivatives that are to be physically settled.]

(iii) **Reference obligation** - the obligation[119] used to calculate the amount payable when a credit event occurs under the terms of a credit derivative contract. [A reference obligation is relevant for obligations that are to be cash settled (on a par-less-recovery basis).]

(iv) **Underlying asset / obligation** - The asset[120] which a protection buyer is seeking to hedge.

3. Classification of CDS into Trading Book and Banking Book Positions

For the purpose of capital adequacy for CDS transactions, Trading Book would comprise *Held for Trading* positions and Banking Book would comprise *Held to Maturity* and *Available for Sale* positions. A CDS being a financial derivative will be classified in the Trading Book except when it is contracted and designated as a

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[118] For the present, only the deliverable obligations specified in the guidelines on CDS vide circular IDMD.PCD.No. 5053 /14.03.04/2010-11 dated May 23, 2011 will be permitted.

[119] Please refer to paragraph 2.4 of the circular IDMD.PCD.No. 5053 /14.03.04/2010-11 dated May 23, 2011.

[120] Please refer to paragraph 2.4 of the circular IDMD.PCD.No. 5053 /14.03.04/2010-11 dated May 23, 2011.

hedge for a Banking Book exposure. Thus, the CDS positions held in the Trading Book would include positions which:

(a) arise from market-making;
(b) are meant for hedging the exposures in the Trading Book;
(c) are held for short-term resale; and
(d) are taken by the bank with the intention of benefiting in the short-term from the actual and / or expected differences between their buying and selling prices

CDS positions meant for hedging Banking Book exposures will be classified in the Banking Book. However, all CDS positions, either in Banking Book or Trading Book, should be marked-to-market. All CDS positions should meet the operational requirements indicated in paragraph 4 below.

4. Operational requirements for CDS to be recognised as eligible External / Third-party hedges for Trading Book and Banking Book

(a) A CDS contract should represent a direct claim on the protection provider and should be explicitly referenced to specific exposure, so that the extent of the cover is clearly defined and incontrovertible.

(b) Other than non-payment by a protection purchaser of premium in respect of the credit protection contract it should be irrevocable.

(c) There should be no clause in the contract that would allow the protection provider unilaterally to cancel the credit cover or that would increase the effective cost of cover as a result of deteriorating credit quality in the hedged exposure.

(d) The CDS contract should be unconditional; there should be no clause in the protection contract outside the direct control of the bank (protection buyer) that could prevent the protection provider from being obliged to pay out in a timely manner in the event that the original counterparty fails to make the payment(s) due.

(e) The credit events specified by the contracting parties should at a minimum cover:

(i) failure to pay the amounts due under terms of the underlying obligation that are in effect at the time of such failure (with a grace period that is closely in line with the grace period in the underlying obligation);

(ii) bankruptcy, insolvency or inability of the obligor to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due, and analogous events; and

(iii) restructuring of the underlying obligation (as contemplated in the IDMD guidelines on CDS dated May 23, 2011) involving forgiveness or postponement of principal, interest or fees that results in a credit loss event (i.e. charge-off, specific provision or other similar debit to the profit and loss account);

(iv) when the restructuring of the underlying obligation is not covered by the CDS, but the other requirements in paragraph 4 are met, partial recognition of the CDS will be allowed. If the amount of the CDS is less than or equal to the amount of the underlying obligation, 60% of the amount of the hedge can be recognised as covered. If the amount of the CDS is larger than that of the underlying obligation, then the amount of eligible hedge is capped at 60% of the amount of the underlying obligation.

(f) If the CDS specifies deliverable obligations that are different from the underlying obligation, the resultant asset mismatch will be governed under paragraph (k) below.

(g) The CDS shall not terminate prior to expiration of any grace period required for a default on the underlying obligation to occur as a result of a failure to pay[121].

(h) The CDS allowing for cash settlement are recognised for capital purposes insofar as a robust valuation process is in place in order to estimate loss reliably. There should be a clearly specified period for obtaining post-credit event valuations of the underlying obligation. If the reference obligation specified in the CDS for purposes of cash settlement is different than the underlying obligation, the resultant asset mismatch will be governed under paragraph (k) below.

(i) If the protection purchaser's right/ability to transfer the underlying obligation to the protection provider is required for settlement, the terms of the underlying obligation should provide that any required consent to such transfer may not be unreasonably withheld.

(j) The identity of the parties responsible for determining whether a credit event has occurred should be clearly defined. This determination should not be the sole responsibility of the protection seller. The protection buyer should have the right/ability to inform the protection provider of the occurrence of a credit event.

(k) A mismatch between the underlying obligation and the reference obligation or deliverable obligation under the CDS (i.e. the obligation used for purposes of determining cash settlement value or the deliverable obligation) is permissible if (1) the reference obligation or deliverable obligation ranks *pari passu* with or is junior to the underlying obligation, and (2) the underlying obligation and reference obligation or deliverable obligation share the same obligor (i.e. the same legal entity) and legally enforceable cross-default or cross-acceleration clauses are in place.

(l) A mismatch between the underlying obligation and the obligation used for

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[121] The maturity of the underlying exposure and the maturity of the hedge should be defined conservatively. The effective maturity of the underlying should be gauged as the longest possible remaining time before the counterparty is scheduled to fulfill its obligation, taking into account any applicable grace period.

purposes of determining whether a credit event has occurred is permissible if (1) the latter obligation ranks *pari passu* with or is junior to the underlying obligation, and (2) the underlying obligation and reference obligation share the same obligor (i.e. the same legal entity) and legally enforceable cross-default or cross acceleration clauses are in place.

5. Capital Adequacy Requirement for CDS Positions in the Banking Book

5.1 Recognition of External/Third-party CDS Hedges

5.1.1 In case of Banking Book positions hedged by bought CDS positions, no exposure will be reckoned against the reference entity / underlying asset in respect of the hedged exposure, and exposure will be deemed to have been substituted by the protection seller, if the following conditions are satisfied:

(a) Operational requirements mentioned in paragraph 4 are met;

(b) The risk weight applicable to the protection seller under the Basel II[122] Standardised Approach for credit risk is lower than that of the underlying asset; and

(c) There is no maturity mismatch between the underlying asset and the reference / deliverable obligation. If this condition is not satisfied, then the amount of credit protection to be recognised should be computed as indicated in paragraph 5.1.3 (ii) below.

5.1.2 If the conditions (a) and (b) above are not satisfied or the bank breaches any of these conditions subsequently, the bank shall reckon the exposure on the underlying asset; and the CDS position will be transferred to Trading Book where it will be subject to specific risk, counterparty credit risk and general market risk (wherever applicable) capital requirements as applicable to Trading Book.

5.1.3 The unprotected portion of the underlying exposure should be risk-weighted as applicable under Basel II framework. The amount of credit protection shall be adjusted if there are any mismatches between the underlying asset/ obligation and the reference / deliverable asset / obligation with regard to *asset* or *maturity*. These are dealt with in detail in the following paragraphs.

(i) **Asset mismatches**

Asset mismatch will arise if the underlying asset is different from the reference asset or deliverable obligation. Protection will be reckoned as available by the protection buyer only if the mismatched assets meet the requirements specified in paragraph 4 (k) above.

(ii) **Maturity mismatches**

The protection buyer would be eligible to reckon the amount of protection if the maturity of the credit derivative contract were to be equal or more than the maturity of the underlying asset. If, however, the maturity of the CDS contract is less than the

[122] Basel II Framework has been modified and enhanced by Basel III capital regulations. Therefore, a reference to Basel II Framework in this Annex should now be construed as reference to Basel III guidelines as contained in this Master Circular.

maturity of the underlying asset, then it would be construed as a maturity mismatch. In case of maturity mismatch the amount of protection will be determined in the following manner:

a. If the residual maturity of the credit derivative product is less than **three months** no protection will be recognized.

b. If the residual maturity of the credit derivative contract is **three months** or more protection proportional to the period for which it is available will be recognised. When there is a maturity mismatch the following adjustment will be applied.

$$Pa = P \times (t - .25) \div (T - .25)$$

Where:

Pa = value of the credit protection adjusted for maturity mismatch

P = credit protection

t = min (T, residual maturity of the credit protection arrangement) expressed in years

T = min (5, residual maturity of the underlying exposure) expressed in years

Example: *Suppose the underlying asset is a corporate bond of Face Value of Rs. 100 where the residual maturity is of 5 years and the residual maturity of the CDS is 4 years. The amount of credit protection is computed as under:*

$$100 * \{(4-.25) \div (5-.25)\} = 100*(3.75 \div 4.75) = 78.95$$

c. Once the residual maturity of the CDS contract reaches **three months**, protection ceases to be recognised.

5.2 Internal Hedges

Banks can use CDS contracts to hedge against the credit risk in their existing corporate bonds portfolios. A bank can hedge a Banking Book credit risk exposure either by an internal hedge (the protection purchased from the trading desk of the bank and held in the Trading Book) or an external hedge (protection purchased from an eligible third party protection provider). When a bank hedges a Banking Book credit risk exposure (corporate bonds) using a CDS booked in its Trading Book (i.e. using an internal hedge), the Banking Book exposure is not deemed to be hedged for capital purposes unless the bank transfers the credit risk from the Trading Book to an eligible third party protection provider through a CDS meeting the requirements of paragraph 5.1 vis-à-vis the Banking Book exposure. Where such third party protection is purchased and is recognised as a hedge of a Banking Book exposure for regulatory capital purposes, no capital is required to be maintained on internal and external CDS hedge. In such cases, the external CDS will act as indirect hedge for the Banking Book exposure and the capital adequacy in terms of paragraph 5.1, as applicable for external / third party hedges, will be applicable.

6. Capital Adequacy for CDS in the Trading Book

6.1 General Market Risk

A credit default swap does not normally create a position for general market risk for either the protection buyer or protection seller. However, the present value of premium payable / receivable is sensitive to changes in the interest rates. In order to measure the interest rate risk in premium receivable/payable, the present value of the premium can be treated as a notional position in Government securities of relevant maturity. These positions will attract appropriate capital charge for general market risk. The protection buyer / seller will treat the present value of the premium payable / receivable equivalent to a short / long notional position in Government securities of relevant maturity.

6.2 Specific Risk for Exposure to Reference Entity

A CDS creates a notional long / short position for specific risk in the reference asset / obligation for protection seller / protection buyer. For calculating specific risk capital charge, the notional amount of the CDS and its maturity should be used. The specific risk capital charge for CDS positions will be as per Table-1 and Table-2 below.

Table-1: Specific risk capital charges for bought and sold CDS positions in the Trading Book: Exposures to entities <u>other than</u> Commercial Real Estate Companies/ NBFC-ND-SI

<table>
<tr><th colspan="3">Upto 90 days</th><th colspan="2">After 90 days[123]</th></tr>
<tr><th>Ratings by the ECAI*</th><th>Residual Maturity of the instrument</th><th>Capital charge</th><th>Ratings by the ECAI*</th><th>Capital charge</th></tr>
<tr><td rowspan="4">AAA to BBB</td><td>6 months or less</td><td>0.28 %</td><td>AAA</td><td>1.8 %</td></tr>
<tr><td>Greater than 6 months and up to and including 24 months</td><td>1.14%</td><td>AA</td><td>2.7%</td></tr>
<tr><td rowspan="2">Exceeding 24 months</td><td rowspan="2">1.80%</td><td>A</td><td>4.5%</td></tr>
<tr><td>BBB</td><td>9.0%</td></tr>
<tr><td>BB and below</td><td>All maturities</td><td>13.5%</td><td>BB and below</td><td>13.5%</td></tr>
<tr><td>Unrated (if permitted)</td><td>All maturities</td><td>9.0%</td><td>Unrated (if permitted)</td><td>9.0%</td></tr>
</table>

* These ratings indicate the ratings assigned by Indian rating agencies / ECAIs or foreign rating agencies. In the case of foreign ECAIs, the rating symbols used here correspond to Standard and Poor. The modifiers “+” or “-“ have been subsumed within the main category.

[123] Under Basel II, the specific risk capital charge for risk exposures to corporate bonds, CDS contracts, etc., held in Trading Book have been calibrated, keeping in view the generally short time horizon of the Trading Book. In case such positions remain in the Trading Book for longer time horizons, these are exposed to higher credit risk. In such cases, the normal specific risk capital charge will be inadequate. Hence, the specific risk capital charges on exposures remaining in Trading Book beyond 90 days have been suitably increased.

Table-2: Specific risk capital charges for bought and sold CDS positions in the Trading Book: Exposures to Commercial Real Estate Companies/ NBFC-ND-SI[#]

Ratings by the ECAI[*]	Residual Maturity of the instrument	Capital charge
AAA to BBB	6 months or less	1.4%
	Greater than 6 months and up to and including 24 months	7.7%
	Exceeding 24 months	9.0%
BB and below	All maturities	9.0%
Unrated (if permitted)	All maturities	9.0%

The above table will be applicable for exposures upto 90 days. Capital charge for exposures to Commercial Real Estate Companies / NBFC-ND-SI beyond 90 days shall be taken at 9.0%, regardless of rating of the reference /deliverable obligation.

* These ratings indicate the ratings assigned by Indian rating agencies / ECAIs or foreign rating agencies. In the case of foreign ECAIs, the rating symbols used here correspond to Standard and Poor. The modifiers "+" or "-" have been subsumed within the main category.

6.2.1 Specific Risk Capital Charges for Positions Hedged by CDS[124]

(i) Banks may fully offset the specific risk capital charges when the values of two legs (i.e. long and short in CDS positions) always move in the opposite direction and broadly to the same extent. This would be the case when the two legs consist of **completely identical CDS**. In these cases, no specific risk capital requirement applies to both sides of the CDS positions.

(ii) Banks may offset 80 per cent of the specific risk capital charges when the value of two legs (i.e. long and short) always moves in the opposite direction but not broadly to the same extent[125]. This would be the case when a long cash position is hedged by a credit default swap and there is an exact match in terms of the reference / deliverable obligation, and the maturity of both the reference / deliverable obligation and the CDS. In addition, key features of the CDS (e.g. credit event definitions, settlement mechanisms) should not cause the price movement of the

[124] This paragraph will be applicable only in those cases where a CDS position is explicitly meant for hedging a Trading Book exposure. In other words, a bank cannot treat a CDS position as a hedge against any other Trading Book exposure if it was not intended to be as such *ab initio.*

[125] A cash position in corporate bond in Trading Book hedged by a CDS position, even where the reference obligation and the underlying bonds are the same, will not qualify for 100% offset because a CDS cannot guarantee a 100% match between the market value of CDS and the appreciation / depreciation in the underlying bond at all times. This paragraph will apply only when two legs consist of completely identical CDS instruments.

CDS to materially deviate from the price movements of the cash position. To the extent that the transaction transfers risk, an 80% specific risk offset will be applied to the side of the transaction with the higher capital charge, while the specific risk requirement on the other side will be zero[126].

(iii) Banks may offset partially the specific risk capital charges when the value of the two legs (i.e. long and short) usually moves in the opposite direction. This would be the case in the following situations:

(a) The position is captured in paragraph 6.2.1 (ii) but there is an asset mismatch between the cash position and the CDS. However, the underlying asset is included in the (reference / deliverable) obligations in the CDS documentation and meets the requirements of paragraph 4 (k).

(b) The position is captured in paragraph 6.2.1 (ii) but there is maturity mismatch between credit protection and the underlying asset. However, the underlying asset is included in the (reference / deliverable) obligations in the CDS documentation.

(c) In each of the cases in paragraph (a) and (b) above, rather than applying specific risk capital requirements on each side of the transaction (i.e. the credit protection and the underlying asset), only higher of the two capital requirements will apply.

6.2.2 Specific Risk Charge in CDS Positions which are not meant for Hedging

In cases not captured in paragraph 6.2.1, a specific risk capital charge will be assessed against both sides of the positions.

7. Capital Charge for Counterparty Credit Risk

The credit exposure for the purpose of counterparty credit risk on account of CDS transactions in the Trading Book will be calculated according to the Current Exposure Method[127] under Basel II framework.

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[126] For example, if specific risk charge on long position (corporate bond) comes to Rs.1000 and that on the short position (credit protection bought through CDS) comes to Rs.700, there will be no capital change on the short position and the long position will attract specific risk capital charge of Rs.200 (1000-80% of 1000). Banks will not be allowed to offset specific risk charges between two opposite CDS positions which are not completely identical.

[127] A CDS contract, which is required to be marked-to-market, creates bilateral exposure for the parties to the contract. The mark-to-market value of a CDS contract is the difference between the default-adjusted present value of protection payment (called “protection leg” / “credit leg”) and the present value of premium payable called (“premium leg”). If the value of credit leg is less than the value of the premium leg, then the marked-to-market value for the protection seller in positive. Therefore, the protection seller will have exposure to the counterparty (protection buyer) if the value of premium leg is more than the value of credit leg. In case, no premium is outstanding, the value of premium leg will be zero and the mark-to-market value of the CDS contract will always be negative for the protection seller and therefore, protection seller will not have any exposure to the protection buyer. In no case, the protection seller’s exposure on protection buyer can exceed the amount of the premium unpaid. For the purpose of capital adequacy as well as exposure norms, the measure of counterparty exposures in case of CDS transaction held in Trading Book is the Potential Future Exposure (PFE) which is measured and recognised as per Current Exposure Method.

7.1 Protection Seller

A protection seller will have exposure to the protection buyer only if the fee / premia are outstanding. In such cases, the counterparty credit risk charge for all single name long CDS positions in the Trading Book will be calculated as the sum of the current marked-to-market value, if positive (zero, if marked-to-market value is negative) and the potential future exposure add-on factors based on Table 3 given below. However, the add-on will be capped to the amount of unpaid premia.

Table 3: Add-on factors for Protection sellers

(As % of Notional Principal of CDS)

Type of Reference Obligation[128]	Add-on factor
Obligations rated BBB- and above	10%
Below BBB- and unrated	20%

7.2 Protection Buyer

A CDS contract creates a counterparty exposure on the protection seller on account of the credit event payment. The counterparty credit risk charge for all short CDS positions in the Trading Book will be calculated as the sum of the current marked-to-market value, if positive (zero, if marked-to-market value is negative) and the potential future exposure add-on factors based on Table 4 given below:

Table 4: Add-on factors for Protection Buyers

(As % of Notional Principal of CDS)

Type of Reference Obligation[129]	Add-on factor
Obligations rated BBB- and above	10%
Below BBB- and unrated	20%

7.3 Capital Charge for Counterparty risk for Collateralised Transactions in CDS

As mentioned in paragraph 3.3 of the circular IDMD.PCD.No. 5053/14.03.04/2010-11 dated May 23, 2011, collaterals and margins would be maintained by the individual market participants. The counterparty exposure for CDS traded in the OTC market will be calculated as per the Current Exposure Method. Under this method, the calculation of the counterparty credit risk charge for an individual contract, taking into account the collateral, will be as follows:

Counterparty risk capital charge = [(RC + add-on) – CA] x r x 9%
where:

RC = the replacement cost,
add-on = the amount for potential future exposure calculated according to

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[128] The add-on factors will be the same regardless of maturity of the reference obligations or CDS contract.
[129] The add-on factors will be the same regardless of maturity of the reference obligations or CDS contract.

paragraph 7 above.

CA = the volatility adjusted amount of eligible collateral under the comprehensive approach prescribed in paragraphs 7.3 “Credit Risk Mitigation Techniques-Collateralised Transactions” of these guidelines, or zero if no eligible collateral is applied to the transaction, and
r = the risk weight of the counterparty.

8. Treatment of Exposures Below Materiality Thresholds

Materiality thresholds on payments below which no payment is made in the event of loss are equivalent to retained first loss positions and should be assigned risk weight of 1111%[130] for capital adequacy purpose by the protection buyer.

9. General Provisions Requirements

At present, general provisions (standard asset provisions) are required only for Loans and Advances and the positive marked-to-market values of derivatives contracts. For all CDS positions including the hedged positions, both in the Banking Book and Trading Book, banks should hold general provisions for gross positive marked-to-market values of the CDS contracts.

10. Prudential Treatment Post-Credit Event

10.1 Protection Buyer

In case the credit event payment is not received within the period as stipulated in the CDS contract, the protection buyer shall ignore the credit protection of the CDS and reckon the credit exposure on the underlying asset and maintain appropriate level of capital and provisions as warranted for the exposure. On receipt of the credit event payment, (a) the underlying asset shall be removed from the books if it has been delivered to the protection seller or (b) the book value of the underlying asset shall be reduced to the extent of credit event payment received if the credit event payment does not fully cover the book value of the underlying asset and appropriate provisions shall be maintained for the reduced value.

10.2 Protection Seller

10.2.1 From the date of credit event and until the credit event payment in accordance with the CDS contract, the protection seller shall debit the Profit and Loss account and recognise a liability to pay to the protection buyer, for an amount equal to fair value of the contract (notional of credit protection less expected recovery value). In case, the fair value of the deliverable obligation (in case of physical settlement) / reference obligation (in case of cash settlement) is not available after the date of the credit event, then until the time that value is available, the protection seller should

[130] As per Basel II framework the first loss positions are required to be deducted from capital. However, according to Basel III, the risk weight for such positions consistent with minimum 8% capital requirement is 1250%. Since in India, minimum capital requirement is 9%, the risk weight has been capped at 1111% (100/9) so as to equate the capital charge to the exposure value.

debit the Profit and Loss account for the full amount of the protection sold and recognise a liability to pay to the protection buyer equal to that amount.

10.2.2. In case of physical settlement, after the credit event payment, the protection seller shall recognise the assets received, if any, from the protection buyer at the fair value. These investments will be classified as non-performing investments and valued in terms of paragraph 3.10 of the Master Circular on "*Prudential Norms for Classification, Valuation and Operation of Investment Portfolio by Banks*". Thereafter, the protection seller shall subject these assets to the appropriate prudential treatment as applicable to corporate bonds.

11. Exposure Norms

11.1 For the present, the CDS is primarily intended to provide an avenue to investors for hedging credit risk in the corporate bonds, after they have invested in the bonds. It should, therefore, not be used as a substitute for a bank guarantee. Accordingly, a bank should not sell credit protection by writing a CDS on a corporate bond on the date of its issuance in the primary market or undertake, before or at the time of issuance of the bonds, to write such protection in future[131].

11.2 Exposure on account of all CDS contracts will be aggregated and combined with other on-balance sheet and off-balance sheet exposures against the reference entity for the purpose of complying with the exposure norms.

11.3 Protection Seller

(i) A protection seller will recognise an exposure to the reference entity of the CDS contract equal to the amount of credit protection sold, subject to paragraph (ii) below.

(ii) If a market maker has two completely identical opposite positions in CDS forming a hedged position which qualifies for capital adequacy treatment in terms of paragraph 6.2.1(i), no exposure would be reckoned against the reference entity.

(iii) Protection seller will also recognise an exposure to the counterparty equal to the total credit exposure calculated under Current Exposure Method as prescribed in Basel II framework in the case of all CDS positions held in the Trading Book.

11.4 Protection Buyer

(i) In respect of obligations hedged in the Banking Book as indicated in paragraph 5.1 and Trading Book as indicated in paragraph 6.2.1 (ii), the protection buyer will not reckon any exposure on the reference entity. The exposure will be deemed to have been transferred on the protection seller to

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[131] As per extant instructions issued by RBI, banks are not permitted to guarantee the repayment of principal and/or interest due on corporate bonds. Considering this restriction, writing credit protection through CDS on a corporate bond on the date of its issuance or undertaking, before or at the time of issuance, to write such protection in future, will be deemed to be a violation of the said instructions.

the extent of protection available.

(ii) In all other cases where the obligations in Banking Book or Trading Book are hedged by CDS positions, the protection buyer will continue to reckon the exposure on the reference entity equal to the outstanding position of the underlying asset.

(iii) For all bought CDS positions (hedged and un-hedged) held in Trading Book, the protection buyer will also reckon exposure on the counterparties to the CDS contracts as measured by the Current Exposure Method.

(iv) The protection buyer needs to adhere to all the criteria required for transferring the exposures fully to the protection seller in terms of paragraph (i) above on an on-going basis so as to qualify for exposure relief on the underlying asset. In case any of these criteria are not met subsequently, the bank will have to reckon the exposure on the underlying asset. Therefore, banks should restrict the total exposure to an obligor including that covered by way of various unfunded credit protections (guarantees, LCs, standby LCs, CDS, etc.) within an internal exposure ceiling considered appropriate by the Board of the bank in such a way that it does not breach the single / group borrower exposure limit prescribed by RBI. In case of the event of any breach in the single / group borrower exposure limit, the entire exposure in excess of the limit will be risk weighted at 1111%. In order to ensure that consequent upon such a treatment, the bank does not breach the minimum capital requirement prescribed by RBI, it should keep sufficient cushion in capital in case it assumes exposures in excess of normal exposure limit.

(v) In respect of bought CDS positions held in Trading Book which are not meant for hedging, the protection buyer will not reckon any exposure against the reference entity[132].

12. Netting of Exposures

No netting of positive and negative marked-to-market values of the contracts with the same counterparty, including that in the case of hedged positions will be allowed for the purpose of capital adequacy for counterparty credit risk, provisioning and exposure norms in terms of circular DBOD.No.BP.BC.48/21.06.001/2010-11 October 1, 2010.

13. Reporting Requirements

Banks should report “total exposure” in all cases where they have assumed exposures against borrowers in excess of the normal single / group exposure limits due to the credit protections obtained by them through CDS, guarantees or any other instruments of credit risk transfer, to the Department of Banking Supervision (DBS) on a quarterly basis.

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[132] In a CDS transaction, the protection buyer does not suffer a loss when reference entity defaults; it rather gains in such a situation.

Annex 8
(Cf. para 7.3.6)

Part – A

Illustrations on Credit Risk Mitigation (Loan- Exposures)
Calculation of Exposure amount for collateralised transactions

$$E^* = \text{Max} \{ 0, [E \times (1 + H_e) - C \times (1 - H_c - H_{FX})] \}$$

Where,

E^* = Exposure value after risk mitigation

E = Current value of the exposure

H_e = Haircut appropriate to the exposure

C = Current value of the collateral received

H_c = Haircut appropriate to the collateral

H_{FX} = Haircut appropriate for currency mismatch between the collateral and exposure

Sly. No.	Particulars	Case I	Case 2	Case 3	Case 4	Case 5
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1	**Exposure**	**100**	**100**	**100**	**100**	**100**
2	Maturity of the exposure	2	3	6	3	3
3	Nature of the exposure	Corporate Loan	Corporat e Loan	Corporate Loan	Corporate Loan	Corporat e Loan
4	Currency	INR	INR	USD	INR	INR
5	Exposure in rupees	100	100	4000 (Row 1 x exch. rate##)	100	100
6	Rating of exposure	BB	A	BBB-	AA	B-
	Applicable Risk weight	150	50	100@	30	150
7	Haircut for exposure*	0	0	0	0	0
8	**Collateral**	100	100	4000	2	100
9	Currency	INR	INR	INR	USD	INR
10	**Collateral in Rs.**	**100**	**100**	**4000**	**80** (Row 1 x Exch. Rate)	**100**
11	Residual maturity of collateral (years)	2	3	6	3	5
12	Nature of collateral	Sovereign (GoI) Security	Bank Bonds	Corporate Bonds	Foreign Corporate Bonds	Units of Mutual Funds
13	Rating of Collateral	NA	Unrated	BBB	AAA (S & P)	AA
14	Haircut for	0.02	0.06	0.12	0.04	0.08

	collateral (%)					
15	Haircut for currency mismatches (%) [cf. para 7.3.7 (vi) of circular]	0	0	0.08	0.08	0
16	Total Haircut on collateral [Row 10 x (row 14+15)]	2	6	800	9.6	8.0
17	Collateral after haircut (Row 10 - Row 16)	98	94	3200	70.4	92
18	**Net Exposure (Row 5 – Row 17)**	**2**	**6**	**800**	**29.6**	**8**
19	Risk weight (%)	150	50	100@	30	150
20	**RWA (Row 18 x 19)**	**3**	**3**	**800**	**8.88**	**12**

Exchange rate assumed to be 1 USD = Rs.40

Not applicable

@ In case of long term ratings, as per para 6.4.2 of the circular, where "+" or "-" notation is attached to the rating, the corresponding main rating category risk weight is to be used. Hence risk weight is 100 per cent.

(*) Haircut for exposure is taken as zero because the loans are not marked to market and hence are not volatile

Case 4: Haircut applicable as per Table – 14 of Basel III Capital Regulations

Case 5: It is assumed that the Mutual Fund meets the criteria specified in paragraph 7.3.5(viii) and has investments in the securities all of which have residual maturity of more than five years are rated AA and above – which would attract a haircut of eight per cent in terms of Table 14.

Part - B

Illustrations on computation of capital charge for Counterparty Credit Risk (CCR) – Repo Transactions

An illustration showing computation of total capital charge for a repo transaction comprising the capital charge for CCR and Credit/Market risk for the underlying security, under Basel-II is furnished below:

A. Particulars of a Repo Transaction:

Let us assume the following parameters of a hypothetical repo transaction:

Type of the Security	GOI security
Residual Maturity	5 years
Coupon	6 %
Current Market Value	Rs.1050
Cash borrowed	Rs.1000
Modified Duration of the security	4.5 years
Assumed frequency of margining	Daily
Haircut for security	2% (Cf. Item A(i), Table 14 Circular)
Haircut on cash	Zero (Cf. Item C in Table 14 of the Circular)
Minimum holding period	5 business-days (Cf. para 7.3.7 (ix) of the Circular)
Change in yield for computing the capital charge for general market risk	0.7 % p.a. (Cf. Zone 3 in Table 17 of the Circular)

B. Computation of total capital charge comprising the capital charge for Counterparty Credit Risk (CCR) and Credit / Market risk for the underlying security

B.1 In the books of the borrower of funds (for the off-balance sheet exposure due to lending of the security under repo)

(In this case, the security lent is the exposure of the security lender while cash borrowed is the collateral)

Sl.No.	Items	Particulars	Amount (in Rs.)
A.	**Capital Charge for CCR**		
1.	Exposure	MV of the security	1050
2.	CCF for Exposure	100 %	
3.	On-Balance Sheet Credit Equivalent	1050 * 100 %	1050
4.	Haircut	1.4 % @	
5.	*Exposure adjusted for haircut as per Table 14 of the circular*	1050 * 1.014	1064.70
6.	Collateral for the security lent	Cash	1000
7.	Haircut for exposure	0 %	
8.	*Collateral adjusted for haircut*	1000 * 1.00	1000
9.	Net Exposure (5- 8)	1064.70 – 1000	64.70
10.	Risk weight (for a Scheduled CRAR-compliant bank)	20 %	

11.	Risk weighted assets for CCR (9 x 10)	**64.70 * 20 %**	**12.94**
12.	Capital Charge for CCR (11 x 9%)	12.94 * 0.09	1.16
B.	**Capital for Credit/ market Risk of the security**		
1.	Capital for credit risk (if the security is held under HTM)	Credit risk	Zero (Being Govt. security)
2.	Capital for market risk (if the security is held under AFS / HFT)	Specific Risk	Zero (Being Govt. security)
		General Market Risk (4.5 * 0.7 % * 1050) {Modified duration * assumed yield change (%) * market value of security}	33.07
Total capital required (for CCR + credit risk + specific risk + general market risk)			34.23

@ The supervisory haircut of 2 per cent has been scaled down using the formula indicated in paragraph 7.3.7 of the circular.

B.2 In the books of the lender of funds (for the on-balance sheet exposure due to lending of funds under repo)

(In this case, the cash lent is the exposure and the security borrowed is collateral)

Sl.No	Items	Particulars	Amount (in Rs.)
A.	**Capital Charge for CCR**		
1.	Exposure	Cash	1000
2.	Haircut for exposure	0 %	
3.	*Exposure adjusted for haircut as per Table 14 of the circular*	1000 * 1.00	1000
4.	Collateral for the cash lent	Market value of the security	1050
5.	Haircut for collateral	1.4 % @	
6.	*Collateral adjusted for haircut*	1050 * 0.986	1035.30
7.	Net Exposure (3 - 6)	Max { 1000 -1035.30}	0
8.	Risk weight (for a Scheduled CRAR-compliant bank)	20 %	
9.	Risk weighted assets for CCR (7 x 8)	**0 * 20 %**	**0**
10.	Capital Charge for CCR	0	**0**
B.	**Capital for Credit/ market Risk of the security**		
1.	Capital for credit risk (if the security is held under HTM)	Credit Risk	Not applicable, as it is maintained by the borrower of funds
2.	Capital for market risk (if the security is held under AFS/HFT)	Specific Risk	Not applicable, as it is maintained by the borrower of funds
		General Market Risk	Not applicable, as it is maintained by the borrower of funds

@ The supervisory haircut of 2 per cent has been scaled down using the formula indicated in paragraph 7.3.7 of the circular.

Annex 9
(cf. para 8.3.10)

Measurement of capital charge for Market Risks in respect of Interest Rate Derivatives and Options

A. Interest Rate Derivatives

The measurement system should include all interest rate derivatives and off-balance-sheet instruments in the trading book, which react to changes in interest rates, (e.g. forward rate agreements (FRAs), other forward contracts, bond futures, interest rate and cross-currency swaps and forward foreign exchange positions). Options can be treated in a variety of ways as described in para B.1 below. A summary of the rules for dealing with interest rate derivatives is set out in the Table at the end of this section.

1. Calculation of positions

The derivatives should be converted into positions in the relevant underlying and be subjected to specific and general market risk charges as described in the guidelines. In order to calculate the capital charge, the amounts reported should be the market value of the principal amount of the underlying or of the notional underlying. For instruments where the apparent notional amount differs from the effective notional amount, banks must use the effective notional amount.

(a) Futures and Forward Contracts, including Forward Rate Agreements

These instruments are treated as a combination of a long and a short position in a notional government security. The maturity of a future or a FRA will be the period until delivery or exercise of the contract, plus - where applicable - the life of the underlying instrument. *For example, a long position in a June three-month interest rate future (taken in April) is to be reported as a long position in a government security with a maturity of five months and a short position in a government security with a maturity of two months.* Where a range of deliverable instruments may be delivered to fulfill the contract, the bank has flexibility to elect which deliverable security goes into the duration ladder but should take account of any conversion factor defined by the exchange.

(b) Swaps

Swaps will be treated as two notional positions in government securities with relevant maturities. *For example, an interest rate swap under which a bank is receiving floating rate interest and paying fixed will be treated as a long position in a floating rate instrument of maturity equivalent to the period until the next interest fixing and a short position in a fixed-rate instrument of maturity equivalent to the residual life of the swap.* For swaps that pay or receive a fixed or floating interest rate against some other reference price, e.g. a stock index, the interest rate component should be slotted into the appropriate repricing maturity category, with the equity component being included in the equity framework.
Separate legs of cross-currency swaps are to be reported in the relevant maturity ladders for the currencies concerned.

2. Calculation of capital charges for derivatives under the Standardised Methodology

(a) Allowable offsetting of Matched Positions

Banks may exclude the following from the interest rate maturity framework altogether (for both specific and general market risk);

- Long and short positions (both actual and notional) in identical instruments with exactly the same issuer, coupon, currency and maturity.

- A matched position in a future or forward and its corresponding underlying may also be fully offset, (the leg representing the time to expiry of the future should however be reported) and thus excluded from the calculation.

When the future or the forward comprises a range of deliverable instruments, offsetting of positions in the future or forward contract and its underlying is only permissible in cases where there is a readily identifiable underlying security which is most profitable for the trader with a short position to deliver. The price of this security, sometimes called the "cheapest-to-deliver", and the price of the future or forward contract should in such cases move in close alignment.

No offsetting will be allowed between positions in different currencies; the separate legs of cross-currency swaps or forward foreign exchange deals are to be treated as notional positions in the relevant instruments and included in the appropriate calculation for each currency.

In addition, opposite positions in the same category of instruments can in certain circumstances be regarded as matched and allowed to offset fully. To qualify for this treatment the positions must relate to the same underlying instruments, be of the same nominal value and be denominated in the same currency. In addition:

- for Futures: offsetting positions in the notional or underlying instruments to which the futures contract relates must be for identical products and mature within seven days of each other;

- for Swaps and FRAs: the reference rate (for floating rate positions) must be identical and the coupon closely matched (i.e. within 15 basis points); and

- for Swaps, FRAs and Forwards: the next interest fixing date or, for fixed coupon positions or forwards, the residual maturity must correspond within the following limits:

    - less than one month hence: same day;
    - between one month and one year hence: within seven days;
    - over one year hence: within thirty days.

Banks with large swap books may use alternative formulae for these swaps to calculate the positions to be included in the duration ladder. The method would be to calculate the sensitivity of the net present value implied by the change in yield used in the duration method and allocate these sensitivities into the time-bands set out in Table 17 in paragraph 8.3.9 of the Basel III Capital Regulations.

(b) Specific Risk

Interest rate and currency swaps, FRAs, forward foreign exchange contracts and

interest rate futures will not be subject to a specific risk charge. This exemption also applies to futures on an interest rate index (e.g. LIBOR). However, in the case of futures contracts where the underlying is a debt security, or an index representing a basket of debt securities, a specific risk charge will apply according to the credit risk of the issuer as set out in paragraphs above.

(c) General Market Risk

General market risk applies to positions in all derivative products in the same manner as for cash positions, subject only to an exemption for fully or very closely matched positions in identical instruments as defined in paragraphs above. The various categories of instruments should be slotted into the maturity ladder and treated according to the rules identified earlier.

Table - Summary of Treatment of Interest Rate Derivatives

Instrument	Specific risk charge	General Market risk charge
Exchange-traded Future		
- Government debt security	No	Yes, as two positions
- Corporate debt security	Yes	Yes, as two positions
- Index on interest rates (e.g. MIBOR)	No	Yes, as two positions
OTC Forward		
- Government debt security	No	Yes, as two positions
- Corporate debt security	Yes	Yes, as two positions
- Index on interest rates (e.g. MIBOR)	No	Yes, as two positions
FRAs, Swaps	No	Yes, as two positions
Forward Foreign Exchange	No	Yes, as one position in each currency
Options		
- Government debt security	No	
- Corporate debt security	Yes	
- Index on interest rates (e.g. MIBOR)	No	
- FRAs, Swaps	No	

B. <u>Treatment of Options</u>

1. In recognition of the wide diversity of banks' activities in options and the difficulties of measuring price risk for options, alternative approaches are permissible as under:

- those banks which solely use purchased options[133] will be free to use the simplified approach described in Section I below;
- those banks which also write options will be expected to use one of the intermediate approaches as set out in Section II below.

2. In the ***simplified approach***, the positions for the options and the associated underlying, cash or forward, are not subject to the standardised methodology but rather are "carved-out" and subject to separately calculated capital charges that incorporate both general market risk and specific risk. The risk numbers thus generated are then added to the capital charges for the relevant category, i.e.

[133] Unless all their written option positions are hedged by perfectly matched long positions in exactly the same options, in which case no capital charge for market risk is required

interest rate related instruments, equities, and foreign exchange as described in paragraph 8.3 to 8.5 of the Basel III Capital Regulations. The *delta-plus method* uses the sensitivity parameters or "Greek letters" associated with options to measure their market risk and capital requirements. Under this method, the delta-equivalent position of each option becomes part of the standardised methodology set out in paragraph 8.3 to 8.5 of the Basel III Capital Regulations with the delta-equivalent amount subject to the applicable general market risk charges. Separate capital charges are then applied to the gamma and Vega risks of the option positions. The ***scenario approach*** uses simulation techniques to calculate changes in the value of an options portfolio for changes in the level and volatility of its associated underlyings. Under this approach, the general market risk charge is determined by the scenario "grid" (i.e. the specified combination of underlying and volatility changes) that produces the largest loss. For the delta-plus method and the scenario approach the specific risk capital charges are determined separately by multiplying the delta-equivalent of each option by the specific risk weights set out in paragraph 8.3 to 8.4 of the Basel III Capital Regulations.

I. Simplified Approach

3. Banks which handle a limited range of purchased options only will be free to use the simplified approach set out in Table A below, for particular trades. As an example of how the calculation would work, if a holder of 100 shares currently valued at Rs.10 each holds an equivalent put option with a strike price of Rs.11, the capital charge would be: Rs.1,000 x 18 per cent (i.e. 9 per cent specific plus 9 per cent general market risk) = Rs.180, less the amount the option is in the money (Rs.11 – Rs.10) x 100 = Rs.100, i.e. the capital charge would be Rs.80. A similar methodology applies for options whose underlying is a foreign currency or an interest rate related instrument.

Table A - *Simplified approach: capital charges*

Position	Treatment
Long cash and Long put Or Short cash and Long call	The capital charge will be the market value of the underlying security[134] multiplied by the sum of specific and general market risk charges[135] for the underlying less the amount the option is in the money (if any) bounded at zero[136]
Long call Or Long put	The capital charge will be the lesser of: (i) the market value of the underlying security multiplied by the sum of specific and general market risk charges[3] for the underlying (ii) the market value of the option[137]

[134] In some cases such as foreign exchange, it may be unclear which side is the "underlying security"; this should be taken to be the asset which would be received if the option were exercised. In addition the nominal value should be used for items where the market value of the underlying instrument could be zero, e.g. caps and floors, swaptions etc.

[135] Some options (e.g. where the underlying is an interest rate or a currency) bear no specific risk, but specific risk will be present in the case of options on certain interest rate-related instruments (e.g. options on a corporate debt security or corporate bond index; see Section B for the relevant capital charges) and for options on equities and stock indices (see Section C). The charge under this measure for currency options will be 9 per cent.

[136] For options with a residual maturity of more than six months, the strike price should be compared with the forward, not current, price. A bank unable to do this must take the "in-the-money" amount to be zero.

[137] Where the position does not fall within the trading book (i.e. options on certain foreign

II. Intermediate Approaches

(a) Delta-plus Method

4. Banks which write options will be allowed to include delta-weighted options positions within the standardised methodology set out in paragraph 8.3 to 8.5 of this Master Circular. Such options should be reported as a position equal to the market value of the underlying multiplied by the delta.

However, since delta does not sufficiently cover the risks associated with options positions, banks will also be required to measure gamma (which measures the rate of change of delta) and Vega (which measures the sensitivity of the value of an option with respect to a change in volatility) sensitivities in order to calculate the total capital charge. These sensitivities will be calculated according to an approved exchange model or to the bank's proprietary options pricing model subject to oversight by the Reserve Bank of India[138].

5. Delta-weighted positions with *debt securities or interest rates as the underlying* will be slotted into the interest rate time-bands, as set out in **Table 17** of paragraph 8.3 of the Basel III Capital Regulations**,** under the following procedure. A two-legged approach should be used as for other derivatives, requiring one entry at the time the underlying contract takes effect and a second at the time the underlying contract matures. For instance, a bought call option on a June three-month interest-rate future will in April be considered, on the basis of its delta-equivalent value, to be a long position with a maturity of five months and a short position with a maturity of two months[139]. The written option will be similarly slotted as a long position with a maturity of two months and a short position with a maturity of five months. Floating rate instruments with caps or floors will be treated as a combination of floating rate securities and a series of European-style options. For example, the holder of a three-year floating rate bond indexed to six month LIBOR with a cap of 15 per cent will treat it as:

(i) a debt security that reprices in six months; and

(ii) a series of five written call options on a FRA with a reference rate of 15 per cent, each with a negative sign at the time the underlying FRA takes effect and a positive sign at the time the underlying FRA matures[140].

6. The capital charge for *options with equities as the underlying* will also be based on the delta-weighted positions which will be incorporated in the measure of market risk described in paragraph 8.4 of the Basel III Capital Regulations. For purposes of this calculation each national market is to be treated as a separate underlying. The capital charge for *options on foreign exchange and gold positions* will be based on the method set out in paragraph 8.5 of the Basel III Capital Regulations.

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exchange or commodities positions not belonging to the trading book), it may be acceptable to use the book value instead.

[138] Reserve Bank of India may wish to require banks doing business in certain classes of exotic options (e.g. barriers, digitals) or in options "at-the-money" that are close to expiry to use either the scenario approach or the internal models alternative, both of which can accommodate more detailed revaluation approaches.

[139] Two-months call option on a bond future, where delivery of the bond takes place in September, would be considered in April as being long the bond and short a five-month deposit, both positions being delta-weighted.

[140] The rules applying to closely-matched positions set out in paragraph 2 (a) of this Annex will also apply in this respect.

For delta risk, the net delta-based equivalent of the foreign currency and gold options will be incorporated into the measurement of the exposure for the respective currency (or gold) position.

7. In addition to the above capital charges arising from delta risk, there will be further capital charges for *gamma* and for *Vega risk.* Banks using the delta-plus method will be required to calculate the gamma and Vega for each option position (including hedge positions) separately. The capital charges should be calculated in the following way:

(i) for ***each individual option*** a "gamma impact" should be calculated according to a Taylor series expansion as:

Gamma impact = ½ x Gamma x VU^2

where VU = Variation of the underlying of the option.

(ii) VU will be calculated as follows:

- for interest rate options if the underlying is a bond, the price sensitivity should be worked out as explained. An equivalent calculation should be carried out where the underlying is an interest rate.
- for options on equities and equity indices; which are not permitted at present, the market value of the underlying should be multiplied by 9 per cent[141];
- for foreign exchange and gold options: the market value of the underlying should be multiplied by 9 per cent;

(iii) For the purpose of this calculation the following positions should be treated as ***the same underlying***:

- for interest rates,[142] each time-band as set out in Table 17 of the Basel III Capital Regulations;[143]
- for equities and stock indices, each national market;
- for foreign currencies and gold, each currency pair and gold;

(iv) Each option on the same underlying will have a gamma impact that is either positive or negative. These individual gamma impacts will be summed, resulting in a net gamma impact for each underlying that is either positive or negative. Only those net gamma impacts that are negative will be included in the capital calculation.

(v) The total gamma capital charge will be the sum of the absolute value of the net negative gamma impacts as calculated above.

(vi) For ***volatility risk,*** banks will be required to calculate the capital charges by multiplying the sum of the Vegas for all options on the same underlying, as defined above, by a proportional shift in volatility of ± 25 per cent.

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[141] The basic rules set out here for interest rate and equity options do not attempt to capture specific risk when calculating gamma capital charges. However, Reserve Bank may require specific banks to do so.

[142] Positions have to be slotted into separate maturity ladders by currency.

[143] Banks using the duration method should use the time-bands as set out in Table 18 of the Basel III Capital Regulations.

(vi) The ***total capital charge*** for Vega risk will be the sum of the absolute value of the individual capital charges that have been calculated for Vega risk.

(b) Scenario Approach

8. More sophisticated banks will also have the right to base the market risk capital charge for options portfolios and associated hedging positions on *scenario matrix analysis*. This will be accomplished by specifying a fixed range of changes in the option portfolio's risk factors and calculating changes in the value of the option portfolio at various points along this "grid". For the purpose of calculating the capital charge, the bank will revalue the option portfolio using matrices for simultaneous changes in the option's underlying rate or price and in the volatility of that rate or price. A different matrix will be set up for each individual underlying as defined in paragraph 7 above. As an alternative, at the discretion of each national authority, banks which are significant traders in options for interest rate options will be permitted to base the calculation on a minimum of six sets of time-bands. When using this method, not more than three of the time-bands as defined in paragraph 8.3 of this Master Circular should be combined into any one set.

9. The options and related hedging positions will be evaluated over a specified range above and below the current value of the underlying. The range for interest rates is consistent with the assumed changes in yield in Table - 17 of paragraph 8.3 of this Master Circular. Those banks using the alternative method for interest rate options set out in paragraph 8 above should use, for each set of time-bands, the highest of the assumed changes in yield applicable to the group to which the time-bands belong.[144] The other ranges are ±9 per cent for equities and ±9 per cent for foreign exchange and gold. For all risk categories, at least seven observations (including the current observation) should be used to divide the range into equally spaced intervals.

10. The second dimension of the matrix entails a change in the volatility of the underlying rate or price. A single change in the volatility of the underlying rate or price equal to a shift in volatility of + 25 per cent and - 25 per cent is expected to be sufficient in most cases. As circumstances warrant, however, the Reserve Bank may choose to require that a different change in volatility be used and / or that intermediate points on the grid be calculated.

11. After calculating the matrix, each cell contains the net profit or loss of the option and the underlying hedge instrument. The capital charge for each underlying will then be calculated as the largest loss contained in the matrix.

12. In drawing up these intermediate approaches it has been sought to cover the major risks associated with options. In doing so, it is conscious that so far as specific risk is concerned, only the delta-related elements are captured; to capture other risks would necessitate a much more complex regime. On the other hand, in other areas

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[144] If, for example, the time-bands 3 to 4 years, 4 to 5 years and 5 to 7 years are combined, the highest assumed change in yield of these three bands would be 0.75.

the simplifying assumptions used have resulted in a relatively conservative treatment of certain options positions.

13. Besides the options risks mentioned above, the RBI is conscious of the other risks also associated with options, e.g. rho (rate of change of the value of the option with respect to the interest rate) and theta (rate of change of the value of the option with respect to time). While not proposing a measurement system for those risks at present, it expects banks undertaking significant options business at the very least to monitor such risks closely. Additionally, banks will be permitted to incorporate rho into their capital calculations for interest rate risk, if they wish to do so.

Annex 10
(cf. para 13.5)

An Illustrative Approach for Measurement of Interest Rate Risk in the Banking Book (IRRBB) under Pillar 2

The Basel-II Framework[145] (Paragraphs 739 and 762 to 764) require the banks to measure the interest rate risk in the banking book (IRRBB) and hold capital commensurate with it. If supervisors determine that banks are not holding capital commensurate with the level of interest rate risk, they must require the bank to reduce its risk, to hold a specific additional amount of capital or some combination of the two. To comply with the requirements of Pillar 2 relating to IRRBB, the guidelines on Pillar 2 issued by many regulators contain definite provisions indicating the approach adopted by the supervisors to assess the level of interest rate risk in the banking book and the action to be taken in case the level of interest rate risk found is significant.

In terms of para 764 of the Basel II framework, the banks can follow the indicative methodology prescribed in the supporting document "Principles for the Management and Supervision of Interest Rate Risk" issued by BCBS for assessment of sufficiency of capital for IRRBB.

2. The approach prescribed in the BCBS Paper on "Principles for the Management and Supervision of Interest Rate Risk"

The main components of the approach prescribed in the above mentioned supporting document are as under:

a) The assessment should take into account both the earnings perspective and economic value perspective of interest rate risk.

b) The impact on income or the economic value of equity should be calculated by applying a notional interest rate shock of 200 basis points.

c) The usual methods followed in measuring the interest rate risk are :

a) Earnings perspective
Gap Analysis, simulation techniques and Internal Models based on VaR

b) Economic perspective
Gap analysis combined with duration gap analysis, simulation techniques and Internal Models based on VaR

3. Methods for measurement of the IRRBB

3.1 Impact on Earnings

The major methods used for computing the impact on earnings are the gap Analysis, Simulations and VaR based Techniques. Banks in India have been using the Gap

[145] International Convergence of Capital Measurement and Capital Standards (June 2006) released by the Basel Committee on Banking Supervision.

Reports to assess the impact of adverse movements in the interest rate on income through gap method. The banks may continue with the same. However, the banks may use the simulations also. The banks may calculate the impact on the earnings by gap analysis or any other method with the assumed change in yield on 200 bps over one year. However, no capital needs to be allocated for the impact on the earnings.

3.2 Impact of IRRBB on the Market Value of Equity (MVE)

The banks may use the Method indicated in the Basel Committee on Banking Supervision (BCBS) Paper "Principles for the Management and Supervision of Interest rate Risk" (July 2004) for computing the impact of the interest rate shock on the MVE.

3.2.1 *Method indicated in the BCBS Paper on "Principles for the Management and Supervision of Interest Rate Risk"*

The following steps are involved in this approach:

a) The variables such as maturity/re-pricing date, coupon rate, frequency, principal amount for each item of asset/liability (for each category of asset / liability) are generated.

b) The longs and shorts in each time band are offset.

c) The resulting short and long positions are weighted by a factor that is designed to reflect the sensitivity of the positions in the different time bands to an assumed change in interest rates. These factors are based on an assumed parallel shift of 200 basis points throughout the time spectrum, and on a proxy of modified duration of positions situated at the middle of each time band and yielding 5 per cent.

d) The resulting weighted positions are summed up, offsetting longs and shorts, leading to the net short- or long-weighted position.

e) The weighted position is seen in relation to capital.

For details banks may refer to the **Annex 3 and 4** of captioned paper issued by the BCBS[146].

3.2.2 Other techniques for Interest rate risk measurement

The banks can also follow different versions / variations of the above techniques or entirely different techniques to measure the IRRBB if they find them conceptually sound. In this context, **Annex 1 and 2** of the BCBS paper referred to above provide broad details of interest rate risk measurement techniques and overview of some of the factors which the supervisory authorities might consider in obtaining and analysing the information on individual bank's exposures to interest rate risk.

[146] Principles for the Management and Supervision of Interest Rate Risk (July 2004).

4. Suggested approach for measuring the impact of IRRBB on capital

4.1 As per Basel II Framework, if the supervisor feels that the bank is not holding capital commensurate with the level of IRRBB, it may either require the bank to reduce the risk or allocate additional capital or a combination of the two.

4.2 The banks can decide, with the approval of the Board, on the appropriate level of interest rate risk in the banking book which they would like to carry keeping in view their capital level, interest rate management skills and the ability to re-balance the banking book portfolios quickly in case of adverse movement in the interest rates. In any case, a level of interest rate risk which generates a drop in the MVE of more than 20 per cent with an interest rate shock of 200 basis points, will be treated as excessive and such banks would normally be required by the RBI to hold additional capital against IRRBB as determined during the SREP. The banks which have IRRBB exposure equivalent to less than 20 per cent drop in the MVE may also be required to hold additional capital if the level of interest rate risk is considered, by the RBI, to be high in relation to their capital level or the quality of interest rate risk management framework obtaining in the bank. While the banks may on their own decide to hold additional capital towards IRRBB keeping in view the potential drop in their MVE, the IRR management skills and the ability to re-balance the portfolios quickly in case of adverse movement in the interest rates, the amount of exact capital add-on, if considered necessary, will be decided by the RBI as part of the SREP, in consultation with the bank.

5. Limit setting

The banks would be well advised to consider setting the internal limits for controlling their IRRBB. The following are some of the indicative ways for setting the limits:

a) Internal limits could be fixed in terms of the maximum decline in earnings (as a percentage of the base-scenario income) or decline in capital (as a percentage of the base-scenario capital position) as a result of 200 or 300 basis point interest-rate shock.

b) The limits could also be placed in terms of PV01 value (present value of a basis point) of the net position of the bank as a percentage of net worth/capital of the bank.

Annex 11
(cf para 4.4.9.2)

Investments in the Capital of Banking, Financial and Insurance Entities which are Outside the Scope of Regulatory Consolidation

PART A: Details of Regulatory Capital Structure of a Bank

Paid-up equity capital	300
Eligible Reserve and Surplus	100
Total common equity	**400**
Eligible Additional Tier 1 capital	15
Total Tier 1 capital	**415**
Eligible Tier 2 capital	135
Total Eligible capital	**550**

(Rs. in Crore)

PART B: Details of Capital Structure and Bank's Investments in Unconsolidated Entities

Entity	**Total Capital of the Investee entities**				**Investments of bank in these entities**			
	Common equity	Additional Tier 1	Tier 2	Total capital	Common Equity	Additional Tier 1	Tier 2	Total investment
Investments in the capital of banking, financial and insurance entities which are outside the scope of regulatory consolidation and where the bank does not own more than 10% of the issued common share capital of the entity								
A	250	0	80	**330**	12	0	15	**27**
B	300	10	0	**310**	14	10	0	**24**
Total	**550**	**10**	**80**	**640**	**26**	**10**	**15**	**51**
Significant investments in the capital of banking, financial and insurance entities which are outside the scope of regulatory consolidation								
C	150	20	10	**180**	20	10	0	**30**
D	200	10	5	**215**	25	5	5	**35**
Total	**350**	**30**	**15**	**395**	**45**	**15**	**5**	**65**

PART C: Regulatory Adjustments on Account of Investments in Entities where Bank Does not own more than 10% of the Issued Common Share Capital of the Entity

C-1: Bifurcation of Investments of bank into Trading and Banking Book				
	Common Equity	Additional Tier 1	Tier 2	Total investments
Total investments in A & B held in Banking Book	11	6	10	**27**
Total investments in A & B held in Trading Book	15	4	5	**24**
Total of Banking and Trading Book Investments in A & B	**26**	**10**	**15**	**51**

C-2: Regulatory adjustments	
Bank's aggregate investment in Common Equity of A & B	26
Bank's aggregate investment in Additional Tier 1 capital of A & B	10
Bank's aggregate investment in Tier 2 capital of A & B	15
Total of bank's investment in A and B	**51**
Bank common equity	400
10% of bank's common equity	40
Bank's total holdings in capital instruments of A & B in excess of 10% of banks common equity (51-40)	11
Note: Investments in both A and B will qualify for this treatment as individually, both of them are less than 10% of share capital of respective entity. Investments in C & D do not qualify; as bank's investment is more than 10% of their common shares capital.	

C-3: Summary of Regulatory Adjustments		Banking Book	Trading Book
Amount to be deducted from common equity of the bank (26/51)*11	5.60		
Amount to be deducted from Additional Tier 1 of the bank (10/51)*11	2.16		
Amount to be deducted from Tier 2 of the bank (15/51)*11	3.24		
Total Deduction	**11.00**		
Common equity investments of the bank in A & B to be risk weighted	20.40 (26-5.60)	8.63 (11/26)*20 .40	11.77
Additional Tier 1 capital investments of the bank in A & B to be risk weighted	7.84 (10-2.16)	4.70	3.14
Tier 2 capital investments of the bank in A & B to be risk weighted	11.76 (15-3.24)	7.84	3.92
Total allocation for risk weighting	**40.00**	**21.17**	**18.83**

PART D: Regulatory Adjustments on Account of Significant Investments in the Capital of Banking, Financial and Insurance Entities which are outside the Scope of Regulatory Consolidation

Bank aggregate investment in Common Equity of C & D	45
Bank's aggregate investment in Additional Tier 1 capital of C & D	15
Bank's aggregate investment in Tier 2 capital of C & D	5
Total of bank's investment in C and D	**65**
Bank's common equity	400
10% of bank's common equity	40
Bank's investment in equity of C & D in excess of 10% of its common equity (45-40)	5

D-1: Summary of regulatory adjustments	
Amount to be deducted from common equity of the bank (excess over 10%)	5
Amount to be deducted from Additional Tier 1 of the bank (all Additional Tier 1 investments to be deducted)	15
Amount to be deducted from Tier 2 of the bank (all Tier 2 investments to be deducted)	5
Total deduction	**25**
Common equity investments of the bank in C & D to be risk weighted (upto 10%)	40

PART E: Total Regulatory Capital of the Bank after Regulatory Adjustments

	Before deduction	Deductions as per Table C-3	Deductions as per Table D-1	After deductions
Common Equity	400.00	5.61	5.00	387.24*
Additional Tier 1 capital	15.00	2.16	15.00	0.00
Tier 2 capital	135.00	3.24	5.00	126.76
Total Regulatory capital	**550.00**	**11.00**	**25.00**	**514.00**

*Since there is a shortfall of 2.16 in the Additional Tier 1 capital of the bank after deduction, which has to be deducted from the next higher category of capital i.e. common equity.

Annex 12
(cf para 4.5.6)

Illustration of Transitional Arrangements - Capital Instruments Which No Longer Qualify as Non-Common Equity Tier 1 Capital or Tier 2 Capital

Date of Issue: April 14, 2005
Debt Capital Instrument: Notional amount = Rs. 1000 crore
Date of maturity – April 15, 2022
Date of call - April 15, 2015

Features:
1. Call with step-up and meeting the non-viability criteria of conversion / write-off
2. No step-up or other incentives to redeem but not meeting the non-viability criteria

Residual maturity of the instrument as on (in years)		**Amortised amount**	**Amount to be recognized for capital adequacy purpose**	
			Feature 1	Feature 2
January 1, 2013	More than 9 but less than 10	1000	900	900
March 31, 2014	More than 8 but less than 9	1000	800	800
March 31, 2015	More than 7 but less than 8	1000	700	700
March 31, 2016	More than 6 but less than 7	1000	1000 (restored- call not exercised)	600 (call not exercised)
March 31, 2017	More than 5 but less than 6	1000	1000	500
March 31, 2018	More than 4 but less than 5	800	800 (discounted value- for Tier 2 debt instrument)	400
March 31, 2019	More than 3 but less than 4	600	600	300
March 31, 2020	More than 2 but less than 3	400	400	200
March 31, 2021	More than 1 but less than 2	200	200	100
March 31, 2022	Less than 1	0	0	0

Annex 13
(cf para 5.15.3.6)

CALCULATION OF CVA RISK CAPITAL CHARGE

(Rs. in crore)

Derivatives	Counter party	Notional principal of trades whose MTM is negative	Notional principal of trades whose MTM is positive	Total Notional Principal (column 3+4)	Weighted average residual maturity	Positive MTM value of trades (column 4)	PFE	Total current credit exposure as per CEM	External rating of counter party
1	2	3	4	5	6	7	8	9	10
Interest rate swaps	A	150	150	300	1.85 years	1.5	1%	4.5	A (risk weight 50%)
Currency swaps	B	300	200	500	5.01 years	2.8	10%	52.8	AAA (risk weight 20%)

Formula to be used for calculation of capital charge for CVA risk:

$$K = 2.33 \cdot \sqrt{h} \cdot \sqrt{\left(\sum_i 0.5 \cdot w_i \cdot \left(M_i \cdot EAD_i^{total} - M_i^{hedge} B_i \right) - \sum_{ind} w_{ind} \cdot M_{ind} \cdot B_{ind} \right)^2 + \sum_i 0.75 \cdot w_i^2 \cdot \left(M_i \cdot EAD_i^{total} - M_i^{hedge} B_i \right)^2}$$

- B_i is the notional of purchased single name CDS hedges - nil
- B_{ind} is the full notional of one or more index CDS of purchased protection, used to hedge CVA risk. - nil
- w_{ind} is the weight applicable to index hedges - nil
- Mi^{hedge} is the maturity of the hedge instrument with notional Bi
- M_i is the effective maturity of the transactions with counterparty 'i'
- EAD_i^{total} is the exposure at default of counterparty 'i' (summed across its netting sets). For non-IMM banks the exposure should be discounted by applying the factor: (1-exp(-0.05*Mi))/(0.05*Mi).
- h = 1 year

Assumptions:

- Applicable coupon rate on both legs of swap with exchange of coupon at yearly intervals for swap with counterparty A = 6% p.a.

- Applicable coupon rate on both legs of swap with exchange of coupon at yearly intervals for swap with counterparty =7% p.a.

Calculation:

Discount factor to be applied to counterparty A: $(1-\exp(-0.05*M_A))/(0.05*M_A)$

= 0.95551

Discounted EAD_A = 4.5*0.95551=4.2981

Discount factor to be applied to counterparty B: $(1-\exp(-0.05*M_B))/(0.05*M_B)$

=0.8846

Discounted EAD_B = 52.8*0.8846=46.7061

$K= 2.33*1*[\{(0.5*.008*(1.85*4.2981-0) + (0.5*0.007*(5.01*46.7061-0))-0\}^2+$

$(0.75*0.008^2*(1.85*4.2981-0)^2 + (0.75*0.007^2*(5.01*46.7061-0)^2]^{1/2}$

= 2.33*1.66 = 3.86

Therefore, total capital charge for CVA risk on portfolio basis = Rs. 3.86 crore

Annex 14
(cf para 4.2.2(vii))

Calculation of Admissible Excess Additional Tier 1 (AT1) and Tier 2 Capital for the Purpose of Reporting and Disclosing Minimum Total Capital Ratios

Part A: Calculation of Admissible Additional Tier 1 / Tier 2 Capital

Capital Ratios as on March 31, 2018	
Common Equity Tier 1	7.5% of RWAs
CCB	2.5% of RWAs
Total CET1	10% of RWAs
PNCPS / PDI	3.0% of RWAs
PNCPS / PDI eligible for Tier 1 capital	2.05 % of RWAs {(1.5/5.5)*7.5% of CET1}
PNCPS / PDI ineligible for Tier 1 capital	0.95% of RWAs (3-2.05)
Eligible Total Tier 1 capital	**9.55% of RWAs**
Tier 2 issued by the bank	2.5% of RWAs
Tier 2 capital eligible for CRAR	2.73% of RWAs {(2/5.5)*7.5% of CET1}
PNCPS / PDI eligible for Tier 2 capital	0.23% of RWAs (2.73-2.5)
PNCPS / PDI not eligible Tier 2 capital	**0.72% of RWAs** **(0.95-.23)**
Total available capital	**15.50%**
Total capital	**14.78% (12.28% +2.5%)** **(CET1 -10%+AT1-2.05% +Tier 2-2.73)**

Part B: Computation of Capital for Market Risk

(Rs. crore)

1.	Capital Funds	
	Common Equity Tier 1 capital	75
	Capital Conservation Buffer	25
	PNCPS / PDI	30
	Eligible PNCPS / PDI	20.5
	Eligible Tier 1 capital	95.5
	Tier 2 capital available	25
	Tier 2 capital eligibility	27.3
	Excess PNCPS/ PDI eligible for Tier 2 capital	2.73
	Total eligible capital	122.8
2.	Total Risk Weighted Assets (RWA)	
	RWA for credit and operational risk	900
	RWA for market risk	100
3.	Minimum Common Equity Tier 1 capital required to support credit and operational risk (900*5.5%)	49.5
	Maximum Additional Tier 1 capital within Tier 1 capital required to support credit and operational risk (900*1.5%)	13.5
	Maximum Tier 2 capital within Total capital required to support credit and operational risk (900*2%)	18
	Total eligible capital required to support credit and operational risk	81 (49.5+13.5+18)
4.	Minimum Common Equity Tier 1 capital available to support market risk	25.5 (75-49.5)
	Maximum Additional Tier 1 capital within Tier 1 capital available to support market risk	7 (20.5-13.5)
	Maximum Tier 2 capital within Total capital available to support market risk	9.3(27.3-18)
	Total eligible capital available to support market risk	41.8(122.8-81)

Annex 15
(cf. para 12.3.3.7)

An illustrative outline of the ICAAP Document

1. What is an ICAAP document?

The ICAAP Document would be a comprehensive Paper furnishing detailed information on the ongoing assessment of the bank's entire spectrum of risks, how the bank intends to mitigate those risks and how much current and future capital is necessary for the bank, reckoning other mitigating factors. The purpose of the ICAAP document is to apprise the Board of the bank on these aspects as also to explain to the RBI the bank's internal capital adequacy assessment process and the banks' approach to capital management. The ICAAP could also be based on the existing internal documentation of the bank.

The ICAAP document submitted to the RBI should be formally approved by the bank's Board. It is expected that the document would be prepared in a format that would be easily understood at the senior levels of management and would contain all the relevant information necessary for the bank and the RBI to make an informed judgment as to the appropriate capital level of the bank and its risk management approach. Where appropriate, technical information on risk measurement methodologies, capital models, if any, used and all other work carried out to validate the approach (e.g. board papers and minutes, internal or external reviews) could be furnished to the RBI as appendices to the ICAAP Document.

2. Contents

The ICAAP Document should contain the following sections:

I. Executive Summary
II. Background
III. Summary of current and projected financial and capital positions
IV. Capital Adequacy
V. Key sensitivities and future scenarios
VI. Aggregation and diversification
VII. Testing and adoption of the ICAAP
VIII. Use of the ICAAP within the bank

I. Executive Summary

The purpose of the Executive Summary is to present an overview of the ICAAP methodology and results. This overview would typically include:

a) the purpose of the report and the regulated entities within a banking group that are covered by the ICAAP;

b) the main findings of the ICAAP analysis:

   i. how much and what composition of internal capital the bank considers it should hold as compared with the minimum CRAR requirement (CRAR) under 'Pillar 1' calculation, and

   ii. the adequacy of the bank's risk management processes;

c) a summary of the financial position of the bank, including the strategic position of the bank, its balance sheet strength, and future profitability;

d) brief descriptions of the capital raising and dividend plan including how the bank intends to manage its capital in the days ahead and for what purposes;

e) commentary on the most material risks to which the bank is exposed, why the level of risk is considered acceptable or, if it is not, what mitigating actions are planned;

f) commentary on major issues where further analysis and decisions are required; and

g) who has carried out the assessment, how it has been challenged / validated / stress tested, and who has approved it.

II. Background

This section would cover the relevant organisational and historical financial data for the bank. e.g., group structure (legal and operational), operating profit, profit before tax, profit after tax, dividends, shareholders' funds, capital funds held vis-à-vis the regulatory requirements, customer deposits, deposits by banks, total assets, and any conclusions that can be drawn from trends in the data which may have implications for the bank's future.

III. Summary of current and projected financial and capital positions

This section would explain the present financial position of the bank and expected changes to the current business profile, the environment in which it expects to operate, its projected business plans (by appropriate lines of business), projected financial position, and future planned sources of capital.

The starting balance sheet used as reference and date as of which the assessment is carried out should be indicated.

The projected financial position could reckon both the projected capital available and projected capital requirements based on envisaged business plans. These might then provide a basis against which adverse scenarios might be compared.

IV. <u>Capital Adequacy</u>

This section might start with a description of the bank's risk appetite, in quantitative terms, as approved by the bank's Board and used in the ICAAP. It would be necessary to clearly spell out in the document whether what is being presented represents the bank's view of the amount of capital required to meet minimum **regulatory needs or** whether represents the amount of capital that a bank believes it would need **to meet its business plans**. For instance, it should be clearly brought out whether the capital required is based on a particular credit rating desired by the bank or includes buffers for strategic purposes or seeks to minimise the chance of breaching regulatory requirements. Where economic capital models are used for internal capital assessment, the confidence level, time horizon, and description of the event to which the confidence level relates, should also be enumerated. Where scenario analyses or other means are used for capital assessment, then the basis / rationale for selecting the chosen severity of scenarios used, should also be included.

The section would then include a detailed review of the capital adequacy of the bank. The information provided would include the following elements:

Timing

- the effective date of the ICAAP calculations together with details of any events between this date and the date of submission to the Board / RBI which would materially impact the ICAAP calculations together with their effects; and
- details of, and rationale for, the time period selected for which capital requirement has been assessed.

Risks Analysed

- an identification of the major risks faced by the bank in each of the following categories:

    a) credit risk
    b) market risk
    c) operational risk
    d) liquidity risk
    e) concentration risk
    f) interest rate risk in the banking book
    g) residual risk of securitisation
    h) strategic risk
    i) business risk
    j) reputation risk
    k) pension obligation risk
    l) other residual risk; and
    m) any other risks that might have been identified

- for each of these risks, an explanation of how the risk has been assessed and o the extent possible, the **quantitative results** of that assessment;

- where some of these risks have been highlighted in the report of the RBI's on-site inspection of the bank, an explanation of how the bank has mitigated these;
- where relevant, a comparison of the RBI-assessed CRAR during on-site inspection with the results of the CRAR calculations of the bank under the ICAAP;
- a clear articulation of the bank's risk appetite, in quantitative terms, by risk category and the extent of its consistency (its 'fit') with the overall assessment of bank's various risks; and
- where relevant, an explanation of any other methods, apart from capital, used by the bank to mitigate the risks.

Methodology and Assumptions

A description of how assessments for each of the major risks have been approached and the main assumptions made.

For instance, banks may choose to base their ICAAP on the results of the CRAR calculation with the capital for additional risks (e.g. concentration risk, interest rate

risk in the banking book, etc.) assessed separately and added to the Pillar 1 computations. Alternatively, banks could choose to base their ICAAP on internal models for all risks, including those covered under the CRAR (i.e. Credit, Market and Operational Risks).

The description here would make clear which risks are covered by which modelling or calculation approach. This would include details of the methodology and process used to calculate risks in each of the categories identified and reason for choosing the method used in each case.

Where the bank uses an internal model for the quantification of its risks, this section should explain for each of those models:

- the key assumptions and parameters within the capital modelling work and background information on the derivation of any key assumptions;
- how parameters have been chosen, including the historical period used and the calibration process;
- the limitations of the model;
- the sensitivity of the model to changes in those key assumptions or parameters chosen; and
- the validation work undertaken to ensure the continuing adequacy of the model.

Where stress tests or scenario analyses have been used to validate, supplement, or probe the results of other modelling approaches, then this section should provide:

- details of simulations to capture risks not well estimated by the bank's internal capital model (e.g. non-linear products, concentrations, illiquidity and shifts in correlations in a crisis period);

- details of the quantitative results of stress tests and scenario analyses the bank carried out and the confidence levels and key assumptions behind those analyses, including, the distribution of outcomes obtained for the main individual risk factors;

- details of the range of combined adverse scenarios which have been applied, how these were derived and the resulting capital requirements; and

- where applicable, details of any additional business-unit-specific or business-plan-specific stress tests selected.

Capital Transferability

In case of banks with conglomerate structure, details of any restrictions on the management's ability to transfer capital into or out of the banking business(es) arising from, for example, by contractual, commercial, regulatory or statutory constraints that apply, should be furnished. Any restrictions applicable and flexibilities available for distribution of dividend by the entities in the Group could also be enumerated. In case of overseas banking subsidiaries of the banks, the regulatory

restrictions would include the minimum regulatory capital level acceptable to the host-country regulator of the subsidiary, after declaration of dividend.

V. Firm-wide risk oversight and specific aspects of risk management [147]

V.1 Risk Management System in the bank

This section would describe the risk management infrastructure within the bank along the following lines:

- The oversight of board and senior management
- Policies, Procedures and Limits
- identification, measurement, mitigation, controlling and reporting of risks
- MIS at the firm wide level
- Internal controls

V.2 Off-balance Sheet Exposures with a focus on Securitisation

This section would comprehensively discuss and analyse underlying risks inherent in the off-balance sheet exposures particularly its investment in structured products. When assessing securitisation exposures, bank should thoroughly analyse the credit quality and risk characteristics of the underlying exposures. This section should also comprehensively explain the maturity of the exposures underlying securitisation transactions relative to issued liabilities in order to assess potential maturity mismatches.

V.3 Assessment of Reputational Risk and Implicit Support

This section should discuss the possibilities of reputational risk leading to provision of implicit support, which might give rise to credit, market and legal risks. This section should thoroughly discuss potential sources of reputational risk to the bank.

V. 4 Assessment of valuation and Liquidity Risk

This section would describe the governance structures and control processes for valuing exposures for risk management and financial reporting purposes, with a special focus on valuation of illiquid positions. This section will have relevant details leading to establishment and verification of valuations for instruments and transactions in which it engages.

V. 5 Stress Testing practices

This section would explain the role of board and senior management in setting stress testing objectives, defining scenarios, discussing the results of stress

[147] Master Circular DBOD.No.BP.BC.73/21.06.001/2009-10 dated Feb 8, 2010.

tests, assessing potential actions and decision making on the basis of results of stress tests. This section would also describe the rigorous and forward looking stress testing that identifies possible events or changes in market conditions that could adversely the bank. RBI would assess the effectiveness of banks' stress testing programme in identifying relevant vulnerabilities.

V. 6 Sound compensation practices

This section should describe the compensation practices followed by the bank and how far the compensation practices are linked to long-term capital preservation and the financial strength of the firm. The calculation of risk-adjusted performance measure for the employees and its link, if any, with the compensation should clearly be disclosed in this section

VI. Key sensitivities and future scenarios

This section would explain how a bank would be affected by an economic recession or downswings in the business cycle or markets relevant to its activities. The RBI would like to be apprised as to how a bank would manage its business and capital so as to survive a recession while meeting the minimum regulatory standards. The analysis would include future financial projections for, say, three to five years based on business plans and solvency calculations.

For the purpose of this analysis, the severity of the recession reckoned should typically be one that occurs only once in a 25 year period. The time horizon would be from the day of the ICAAP calculation to at least the deepest part of the recession envisaged.

Typical scenarios would include:

- how an economic downturn would affect:
    - the bank's capital funds and future earnings; and
    - the bank's CRAR taking into account future changes in its projected balance sheet.
- In both cases, it would be helpful if these projections show separately the effects of management actions to change the bank's business strategy and the implementation of contingency plans.
- projections of the future CRAR would include the effect of changes in the credit quality of the bank's credit risk counterparties (including migration in their ratings during a recession) and the bank's capital and its credit risk capital requirement;
- an assessment by the bank of any other capital planning actions to enable it to continue to meet its regulatory capital requirements throughout a recession such as new capital injections from related companies or new share issues;
- This section would also explain which key macroeconomic factors are being stressed, and how those have been identified as drivers of the bank's earnings. The bank would also explain how the macroeconomic factors affect

the key parameters of the internal model by demonstrating, for instance, how the relationship between the two has been established.

Management Actions

This section would elaborate on the management actions assumed in deriving the ICAAP, in particular:

- the quantitative impact of management actions – sensitivity testing of key management actions and revised ICAAP figures with management actions excluded.

- evidence of management actions implemented in the past during similar periods of economic stress.

VII. Aggregation and Diversification

This section would describe how the results of the various separate risk assessments are brought together and an overall view taken on capital adequacy. At a technical level, this would, therefore, require some method to be used to combine the various risks using some appropriate quantitative techniques. At the broader level, the overall reasonableness of the detailed quantification approaches might be compared with the results of an analysis of capital planning and a view taken by senior management as to the overall level of capital that is considered appropriate.

- In enumerating the process of technical aggregation, the following aspects could be covered:

    i) any allowance made for diversification, including any assumed correlations within risks and between risks and how such correlations have been assessed, including in stressed conditions;

    ii) the justification for any credit taken for diversification benefits between legal entities, and the justification for the free movement of capital, if any assumed, between them in times of financial stress;

    iii) the impact of diversification benefits with management actions excluded. It might be helpful to work out revised ICAAP figures with all correlations set to ‘1’ i.e., no diversification; and similar figures with all correlations set to ‘0’ i.e. assuming all risks are independent i.e., full diversification.

- As regards the overall assessment, this should describe how the bank has arrived at its overall assessment of the capital it needs taking into account such matters as:

    i) the inherent uncertainty in any modelling approach;
    ii) weaknesses in the bank’s risk management procedures, systems or controls;

iii) the differences between regulatory capital and internal capital; and
iv) the differing purposes that capital serves: shareholder returns, rating objectives for the bank as a whole or for certain debt instruments the bank has issued, avoidance of regulatory intervention, protection against uncertain events, depositor protection, working capital, capital held for strategic acquisitions, etc.

VIII. Testing and Adoption of the ICAAP

This section would describe the extent of challenging and testing that the ICAAP has been subjected to. It would thus include the testing and control processes applied to the ICAAP models and calculations. It should also describe the process of review of the test results by the senior management or the Board and the approval of the results by them. A copy of any relevant report placed before the senior management or the Board of the bank in this regard, along with their response, could be attached to the ICAAP Document sent to the RBI.

Details of the reliance placed on any external service providers or consultants in the testing process, for instance, for generating economic scenarios, could also be detailed here.

In addition, a copy of any report obtained from an external reviewer or internal audit should also be sent to the RBI.

IX. Use of the ICAAP within the bank

This section would contain information to demonstrate the extent to which the concept of capital management is embedded within the bank, including the extent and use of capital modelling or scenario analyses and stress testing within the bank's capital management policy. For instance, use of ICAAP in setting pricing and charges and the level and nature of future business, could be an indicator in this regard.

This section could also include a statement of the bank's actual operating philosophy on capital management and how this fits in to the ICAAP Document submitted. For instance, differences in risk appetite used in preparing the ICAAP Document vis-à-vis that used for business decisions might be discussed.

Lastly, the banks may also furnish the details of any anticipated future refinements envisaged in the ICAAP (highlighting those aspects which are work-in-progress) apart from any other information that the bank believes would be helpful to the RBI in reviewing the ICAAP Document.

Annex 16
(cf para 4.2)

Minimum Requirements to Ensure Loss Absorbency of Additional Tier 1 Instruments at Pre-specified Trigger and of All Non-equity Regulatory Capital Instruments at the Point of Non-viability

1. INTRODUCTION

1.1 As indicated in paragraph 4.2.4 of Basel III Capital Regulations, under Basel III non-common equity elements to be included in Tier 1 capital should absorb losses while the bank remains a going concern. Towards this end, one of the important criteria for Additional Tier 1 instruments is that these instruments should have principal loss absorption through either (i) conversion into common shares at an objective pre-specified trigger point or (ii) a write-down mechanism which allocates losses to the instrument at a pre-specified trigger point.

1.2 Further, during the financial crisis a number of distressed banks were rescued by the public sector injecting funds in the form of common equity and other forms of Tier 1 capital. While this had the effect of supporting depositors it also meant that Tier 2 capital instruments (mainly subordinated debt), and in some cases Tier 1 instruments, did not absorb losses incurred by certain large internationally-active banks that would have failed had the public sector not provided support. Therefore, the Basel III requires that the terms and conditions of all non-common Tier 1 and Tier 2 capital instruments issued by a bank must have a provision that requires such instruments, at the option of the relevant authority, to either be written off or converted into common equity upon the occurrence of the trigger event.

1.3 Therefore, in order for an instrument issued by a bank to be included in Additional (i.e. non-common) Tier 1 or in Tier 2 capital, in addition to criteria for individual types of non-equity regulatory capital instruments mentioned in **Annex 3, 4, 5 and 6,** it must also meet or exceed minimum requirements set out in the following paragraphs.

2. LOSS ABSORPTION OF ADDITIONAL TIER 1 INSTRUMENTS (AT1) AT THE PRE-SPECIFIED TRIGGER

I. Level of Pre-specified Trigger and Amount of Equity to be Created by Conversion / Write-down

2.1 As a bank's capital conservation buffer falls to 0.625% of RWA, it will be subject to 100% profit retention requirements. One of the important objectives of capital conservation buffer is to ensure that a bank always operates above minimum Common Equity Tier 1 (CET1) level. Therefore, a pre-specified trigger for loss absorption through conversion / write-down of the level of Additional Tier 1 (AT1) instruments (PNCPS and PDI) at CET1 of 6.125% of RWAs (minimum CET1 of 5.5% + 25% of capital conservation buffer of 2.5% i.e. 0.625%) has been fixed.

2.2 The write-down / conversion must generate CET1 under applicable Indian Accounting Standard equal to the written-down / converted amount net of tax, if any.

2.3 The aggregate amount to be written-down / converted for all such instruments on breaching the trigger level must be at least the amount needed to immediately return the bank's CET1 ratio to the trigger level or, if this is not sufficient, the full principal value of the instruments. Further, the issuer should have full discretion to determine the amount of AT1 instruments to be converted/written-down subject to the amount of conversion/write-down not exceeding the amount which would be required to bring the total Common Equity ratio to 8% of RWAs (minimum CET1 of 5.5% + capital conservation buffer of 2.5%).

2.4 The conversion / write-down of AT1 instruments are primarily intended to replenish the equity in the event it is depleted by losses. Therefore, banks should not use conversion / write-down of AT1 instruments to support expansion of balance sheet by incurring further obligations / booking assets. Accordingly, a bank whose total Common Equity ratio slips below 8% due to losses and is still above 6.125% i.e. trigger point, should seek to expand its balance sheet further only by raising fresh equity from its existing shareholders or market and the internal accruals. However, fresh exposures can be taken to the extent of amortization of the existing ones. If any expansion in exposures, such as due to draw down of sanctioned borrowing limits, is inevitable, this should be compensated within the shortest possible time by reducing other exposures[148]. The bank should maintain proper records to facilitate verification of these transactions by its internal auditors, statutory auditors and Inspecting Officers of RBI.

II Types of Loss Absorption Features

2.5 Banks may issue AT1 instruments with conversion / temporary written-down / permanent write-off features. Further, banks may issue single AT1 instrument having both conversion and write-down features with the option for conversion or write-down to be exercised by the bank. However, whichever option is exercised, it should be exercised across all investors of a particular issue.

2.6 The instruments subject to temporary write-down may be written-up subsequently subject to the following conditions:

(i) It should be done at least one year after the bank made the first payment of dividends to common shareholders after breaching the pre-specified trigger.

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[148] For the purpose of determination of breach of trigger, the fresh equity, if any, raised after slippage of CET1 below 8% will not be subtracted. In other words, if CET1 of the bank now is above the trigger level though it would have been below the trigger had it not raised the fresh equity which it did, the trigger will not be treated as breached.

(ii) Aggregate write-up in a year should be restricted to a percentage of dividend declared during a year, the percentage being the ratio of the 'equity created by written-down instruments' to 'the total equity minus the equity created by written-down instruments' (Please see illustration at the end of this Annex).

(iii) Aggregate write-up in a year, should also not exceed 25% of the amount paid as dividend to the common shareholders in a particular year.

(iv) A bank can pay coupon / dividend on written-up amount from the distributable surplus as and when due subject to the normal rules applicable to AT1 instruments. However, both the amount written-up and paid as coupon in a year will be reckoned as amount distributed for the purpose of complying with restrictions on distributing earnings as envisaged in the capital conservation buffer framework.

(v) If the bank is amalgamated with or acquired by another bank after a temporary write-down and the equity holders get positive compensation on amalgamation / acquisition, the holders of AT1 instruments which have been temporarily written-down should also be appropriately compensated.

2.7 When a bank breaches the pre-specified trigger of loss absorbency of AT1 and the equity is replenished either through conversion or write-down, such replenished amount of equity will be excluded from the total equity of the bank for the purpose of determining the proportion of earnings to be paid out as dividend in terms of rules laid down for maintaining capital conservation buffer. However, once the bank has attained total Common Equity ratio of 8% without counting the replenished equity capital, that point onwards, the bank may include the replenished equity capital for all purposes[149].

2.8 The conversion / write-down may be allowed more than once in case a bank hits the pre-specified trigger level subsequent to the first conversion / write-down which was partial. Also, the instrument once written-up can be written-down again.

III. Treatment of AT1 Instruments in the event of Winding-Up, Amalgamation, Acquisition, Re-Constitution etc. of the Bank

2.9 If a bank goes into liquidation before the AT1 instruments have been written-down/ converted, these instruments will absorb losses in accordance with the order of seniority indicated in the offer document and as per usual legal provisions governing priority of charges.

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[149] If the total CET1 ratio of the bank falls again below the 8%, it would include the replenished capital for the purpose of applying the capital conservation buffer framework.

2.10 If a bank goes into liquidation after the AT1 instruments have been written-down temporarily but yet to be written-up, the holders of these instruments will have a claim on the proceeds of liquidation pari-passu with the equity holders in proportion to the amount written-down.

2.11 If a bank goes into liquidation after the AT1 instruments have been written-down permanently, the holders of these instruments will have no claim on the proceeds of liquidation.

(a) Amalgamation of a banking company: (Section 44 A of BR Act, 1949)

2.12 If a bank is amalgamated with any other bank before the AT1 instruments have been written-down/converted, these instruments will become part of the corresponding categories of regulatory capital of the new bank emerging after the merger.

2.13 If a bank is amalgamated with any other bank after the AT1 instruments have been written-down temporarily, the amalgamated entity can write-up these instruments as per its discretion.

2.14 If a bank is amalgamated with any other bank after the non-equity regulatory capital instruments have been written-off permanently, these cannot be written-up by the amalgamated entity.

(b) Scheme of reconstitution or amalgamation of a banking company: (Section 45 of BR Act, 1949)

2.15 If the relevant authorities decide to reconstitute a bank or amalgamate a bank with any other bank under the Section 45 of BR Act, 1949, such a bank will be deemed as non-viable or approaching non-viability and both the pre-specified trigger and the trigger at the point of non-viability for conversion / write-down of AT1 instruments will be activated. Accordingly, the AT1 instruments will be converted / written-off before amalgamation / reconstitution in accordance with these rules.

IV. Fixation of Conversion Price, Capping of Number of Shares / Voting Rights

2.16 Banks may issue AT1 instruments with conversion features either based on price fixed at the time of issuance or based on the market price prevailing at the time of conversion[150].

2.17 There will be possibility of the debt holders receiving a large number of shares in the event the share price is very low at the time of conversion. Thus, debt holders will end up holding the number of shares and attached voting rights

[150] Market price here does not mean the price prevailing on the date of conversion; banks can use any pricing formula such as weighted average price of shares during a particular period before conversion.

exceeding the legally permissible limits. Banks should therefore, always keep sufficient headroom to accommodate the additional equity due to conversion without breaching any of the statutory / regulatory ceilings especially that for maximum private shareholdings and maximum voting rights per investors / group of related investors. In order to achieve this, banks should cap the number of shares and / or voting rights in accordance with relevant laws and regulations on Ownership and Governance of banks. Banks should adequately incorporate these features in the terms and conditions of the instruments in the offer document. In exceptional circumstances, if the breach is inevitable, the bank should immediately inform the Reserve Bank of India (DBOD) about it. The investors will be required to bring the shareholdings below the statutory / regulatory ceilings within the specific time frame as determined by the Reserve Bank of India.

2.18 In the case of unlisted banks, the conversion price should be determined based on the fair value of the bank's common shares to be estimated according to a mutually acceptable methodology which should be in conformity with the standard market practice for valuation of shares of unlisted companies.

2.19 In order to ensure the criteria that the issuing bank must maintain at all times all prior authorisation necessary to immediately issue the relevant number of shares specified in the instrument's terms and conditions should the trigger event occur, the capital clause of each bank will have to be suitably modified to take care of conversion aspects.

V. Order of Conversion / Write-down of Various Types of AT1 Instruments

2.20 The instruments should be converted / written-down in order in which they would absorb losses in a gone concern situation. Banks should indicate in the offer document clearly the order of conversion / write-down of the instrument in question vis-à-vis other capital instruments which the bank has already issued or may issue in future, based on the advice of its legal counsels.

3. Minimum Requirements to Ensure Loss Absorbency of Non-equity Regulatory Capital Instruments at the Point of Non-Viability

I. Mode of Loss Absorption and Trigger Event

3.1 The terms and conditions of all non-common equity Tier 1 and Tier 2 capital instruments issued by banks in India must have a provision that requires such instruments, at the option of the Reserve Bank of India, to either be written off or converted into common equity upon the occurrence of the trigger event, called the 'Point of Non-Viability (PONV) Trigger' stipulated below:

The PONV Trigger event is the earlier of:

a. a decision that a conversion or temporary/permanent write-off[151], without which the firm would become non-viable, is necessary, as determined by the Reserve Bank of India; and

b. the decision to make a public sector injection of capital, or equivalent support, without which the firm would have become non-viable, as determined by the relevant authority. Such a decision would invariably imply that the write-off or issuance of any new shares as a result of conversion or consequent upon the trigger event must occur prior to any public sector injection of capital so that the capital provided by the public sector is not diluted. The AT1 instruments with write-off clause will be permanently written-off when there is public sector injection of funds[152].

II. A Non-viable Bank

3.2 For the purpose of these guidelines, a non-viable bank will be:

A bank which, owing to its financial and other difficulties, may no longer remain a going concern on its own in the opinion of the Reserve Bank unless appropriate measures are taken to revive its operations and thus, enable it to continue as a going concern. The difficulties faced by a bank should be such that these are likely to result in financial losses and raising the Common Equity Tier 1 capital of the bank should be considered as the most appropriate way to prevent the bank from turning non-viable. Such measures would include write-off / conversion of non-equity regulatory capital into common shares in combination with or without other measures as considered appropriate by the Reserve Bank[153].

III. Restoring Viability

3.3 A bank facing financial difficulties and approaching a PONV will be deemed to achieve viability if within a reasonable time in the opinion of Reserve Bank, it will be able to come out of the present difficulties if appropriate measures are taken to revive it. The measures including augmentation of equity capital through write-off/conversion/public sector injection of funds are likely to:

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[151] In cases of temporary write-off, it will be possible to write-up the instruments subject to the same conditions as in the case of pre-specified trigger for AT1 instruments as explained in paragraph 2.6.

[152] The option of temporary write-off will not be available in case there is public sector injection of funds.

[153] In rare situations, a bank may also become non-viable due to non-financial problems, such as conduct of affairs of the bank in a manner which is detrimental to the interest of depositors, serious corporate governance issues, etc. In such situations raising capital is not considered a part of the solution and therefore, may not attract provisions of this framework.

a. Restore depositors'/investors' confidence;

b. Improve rating /creditworthiness of the bank and thereby improve its borrowing capacity and liquidity and reduce cost of funds; and

c. Augment the resource base to fund balance sheet growth in the case of fresh injection of funds.

IV. Other Requirements to be met by the Non-common Equity Capital Instruments so as to Absorb Losses at the PONV

3.4 A single instrument may have one or more of the following features:

a. conversion;

b. temporary/permanent write-off in cases where there is no public sector injection of funds; and

c. permanent write-off in cases where there is public sector injection of funds.

3.5 The amount of non-equity capital to be converted / written-off will be determined by RBI.

3.6 When a bank breaches the PONV trigger and the equity is replenished either through conversion or write-down / write-off, such replenished amount of equity will be excluded from the total equity of the bank for the purpose of determining the proportion of earnings to be paid out as dividend in terms of rules laid down for maintaining capital conservation buffer. However, once the bank has attained total Common Equity ratio of 8% without counting the replenished equity capital, that point onwards, the bank may include the replenished equity capital for all purposes[154].

3.7 The provisions regarding treatment of AT1 instruments in the event of winding-up, amalgamation, acquisition, re-constitution etc. of the bank as given in paragraphs 2.9 to 2.15 will also be applicable to all non-common equity capital instruments when these events take place after conversion/write-off at the PONV.

3.8 The provisions regarding fixation of conversion price, capping of number of shares/voting rights applicable to AT1 instruments in terms of paragraphs 2.16 to 2.19 above will also be applicable for conversion at the PONV.

3.9 The provisions regarding order of conversion/write-down/write-off of AT1 instruments as given in paragraph 2.20 above will also be applicable for conversion/ write-down/write-off of non-common equity capital instruments at the PONV.

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[154] If the total CET1 ratio of the bank falls again below the total Common Equity ratio of 8%, it would include the replenished capital for the purpose of applying the capital conservation buffer framework.

V. Criteria to Determine the PONV

3.10 The above framework will be invoked when a bank is adjudged by Reserve Bank of India to be approaching the point of non-viability, or has already reached the point of non-viability, but in the views of RBI:

a) there is a possibility that a timely intervention in form of capital support, with or without other supporting interventions, is likely to rescue the bank; and

b) if left unattended, the weaknesses would inflict financial losses on the bank and, thus, cause decline in its common equity level.

3.11 The purpose of write-off and / or conversion of non-equity regulatory capital elements will be to shore up the capital level of the bank. RBI would follow a two-stage approach to determine the non-viability of a bank. The **Stage 1** assessment would consist of purely objective and quantifiable criteria to indicate that there is a *prima facie* case of a bank approaching non-viability and, therefore, a closer examination of the bank's financial situation is warranted. The **Stage 2** assessment would consist of supplementary subjective criteria which, in conjunction with the Stage 1 information, would help in determining whether the bank is about to become non-viable. These criteria would be evaluated together and not in isolation.

3.12 Once the PONV is confirmed, the next step would be to decide whether rescue of the bank would be through write-off/conversion alone or write-off/conversion in conjunction with a public sector injection of funds.

3.13 The trigger at PONV will be evaluated both at consolidated and solo level and breach at either level will trigger conversion / write-down.

3.14 As the capital adequacy is applicable both at solo and consolidated levels, the **minority interests** in respect of capital instruments issued by subsidiaries of banks including overseas subsidiaries can be included in the consolidated capital of the banking group only if these instruments have pre-specified triggers/loss absorbency at the PONV[155]. In addition, where a bank wishes the instrument issued by its subsidiary to be included in the consolidated group's capital, the terms and conditions of that instrument must specify an additional trigger event.
The additional trigger event is the earlier of:

(1) a decision that a conversion or temporary/permanent write-off, without

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[155] The cost to the parent of its investment in each subsidiary and the parent's portion of equity of each subsidiary, at the date on which investment in each subsidiary is made, is eliminated as per AS-21. So, in case of wholly-owned subsidiaries, it would not matter whether or not it has same characteristics as the bank's capital. However, in the case of less than wholly owned subsidiaries, minority interests constitute additional capital for the banking group over and above what is counted at solo level; therefore, it should be admitted only when it (and consequently the entire capital in that category) has the same characteristics as the bank's capital.

which the bank or the subsidiary would become non-viable, is necessary, as determined by the Reserve Bank of India; and

(2) the decision to make a public sector injection of capital, or equivalent support, without which the bank or the subsidiary would have become non-viable, as determined by the Reserve Bank of India. Such a decision would invariably imply that the write-off or issuance of any new shares as a result of conversion or consequent upon the trigger event must occur prior to any public sector injection of capital so that the capital provided by the public sector is not diluted. The AT1 instruments with write-off clause will be permanently written-off when there is public sector injection of funds.

3.15 In such cases, the subsidiary should obtain its regulator's approval/no-objection for allowing the capital instrument to be converted/written-off at the additional trigger point referred to in paragraph 3.14 above.

3.16 Any common stock paid as compensation to the holders of the instrument must be common stock of either the issuing subsidiary or the parent bank (including any successor in resolution).

3.17 The conversion / write-down should be allowed more than once in case a bank hits the pre-specified trigger level subsequent to the first conversion / write-down which was partial. Also, the instrument once written-up can be written-down again.

Calculation of Write-Up in Case of Temporarily Written-down Instruments

1	Basic details	Amount
(i)	Book value of the equity	70
(ii)	Market value of the debt with an assumed coupon of 10% at the time of write-down	30
(iii)	Equity created from write-down	30
(iv)	Fresh equity issued after write-down	50
2	**Position at the end of first year after write-down**	
(i)	Total book value of the equity in the beginning of the period: [1(i)+1(iii)+1(iv)]	150
(ii)	Equity belonging to equity holders in the beginning of the period	120
(iii)	Balance of equity created out of write-down	30
(iv)	Accretion to reserves/distributable surplus during the first year	25
(v)	Dividend paid during the first year to the equity holders	Nil
(vi)	Amount to be written-up	Nil
(vii)	Interest payable on written-up amount	Nil
(viii)	Total book value of the equity at the end of the period: [(i)+(iv)]	175
(ix)	Equity belonging to equity holders at the end of the period: [2(ii)+(2(iv)]	145
(x)	Balance of equity created out of write-down at the end of the period : 2(iii)	30
3	**Position at the end of second year**	
(i)	Accretion to reserves/distributable surplus during the second year	40
(ii)	Dividend paid during the second year to the equity holders	20
(iii)	Amount to be written-up :[3(ii)/2(ix)]* 2(x): (20/145)*30	4.14
(iv)	Total amount written-up at the end of the year: 3(iii)	4.14
(v)	Interest payable on written-up amount	Nil
(vi)	Total distribution to be considered for complying with the restriction on capital distribution under the capital conservation buffer requirement:[(3(ii)+(3(iii)]: 20+4.14	24.14[156]
(vii)	Net equity after distributions at the end of the period:[(2(viii)+3(i)-3(vi): 175+40-24.14	190.86
(viii)	Equity belonging to equity holders at the end of the period: [2(ix) +3(i)-3(vi)+(3(iii)]:145+40-24.14+4.14[157]	165
(ix)	Balance of equity created out of write-down at the end of the period : 2(ix)-3(iii):30-4.14	25.86
4	**Position at the end of third year**	
(i)	Accretion to reserves/distributable surplus during the third year	75
(ii)	Dividend paid during the third year to the equity holders	35
(iii)	Amount to be written-up :[4(ii)/3(viii)]* 3(ix): (35/165)*25.86	5.49
(iv)	Total written-up amount at the end of the year [(3(iv)+(4(iii)]: 4.14+5.49	9.63
(v)	Interest payable on written-up amount: 4.14*0.1	0.414
(vi)	Total distribution to be considered for complying with the restriction on capital distribution under the capital conservation buffer requirement:[(4(ii)+(4(iii)]: 35+5.49	40.49

[156] If a bank is not comfortable with a cash outflow of 24.14, it has the discretion to reduce both the dividend and write-up proportionately. For instance, if the bank was comfortable with cash outflow of only 15, then it would have declared a dividend of only 12.43 and written-up AT1 instruments to an extent of 2.57.

[157] Even though the write-up is done out of distributable surplus, it is assumed to be return of the equity to the AT1 holders which was created out of the write-down. Therefore, on write-up, the balance of equity created out of write-down would come down and equity belonging to equity holders would increase to that extent.

Annex 17
(cf para 4.3.5)

Calculation of Minority Interest - Illustrative Example

This Annex illustrates the treatment of minority interest and other capital issued out of subsidiaries to third parties, which is set out in paragraph 4.3 of Basel III Capital Regulations.

A banking group for this purpose consists of two legal entities that are both banks. Bank P is the parent and Bank S is the subsidiary and their unconsolidated balance sheets are set out below:

Bank P Balance Sheet		**Bank S Balance Sheet**	
Assets		**Assets**	
Loans to customers	100	Loans to customers	150
Investment in CET1 of Bank S	7		
Investment in the AT1 of Bank S	4		
Investment in the T2 of Bank S	2		
Total	**113**	**Total**	**150**
Liabilities and equity		**Liabilities and equity**	
Depositors	70	Depositors	127
Tier 2	10	Tier 2	8
Additional Tier 1	7	Additional Tier 1	5
Common equity	26	Common equity	10
Total	**113**	**Total**	**150**

The balance sheet of Bank P shows that in addition to its loans to customers, it owns 70% of the common shares of Bank S, 80% of the Additional Tier 1 of Bank S and 25% of the Tier 2 capital of Bank S.

The ownership of the capital of Bank S is therefore as follows:

Capital issued by Bank S			
	Amount issued to parent (Bank P)	**Amount issued to third parties**	**Total**
Common Equity Tier 1 (CET1)	7	3	10
Additional Tier 1 (AT1)	4	1	5
Tier 1 (T1)	***11***	***4***	***15***
Tier 2 (T2)	2	6	8
Total capital (TC)	***13***	***10***	***23***

Consolidated Balance Sheet		
Assets		Remarks
Loans to customers	250	Investments of P in S aggregating Rs.13 will be cancelled during accounting consolidation.
Liabilities and equity		
Depositors	197	
Tier 2 issued by subsidiary to third parties	6	(8-2)
Tier 2 issued by parent	10	
Additional Tier 1 issued by subsidiary to third parties	1	(5-4)
Additional Tier 1 issued by parent	7	
Common equity issued by subsidiary to third parties (i.e. minority interest)	3	(10-7)
Common equity issued by parent	26	
Total	**250**	

For illustrative purposes Bank S is assumed to have risk weighted assets of 100 against the actual value of assets of 150. In this example, the minimum capital requirements of Bank S and the subsidiary's contribution to the consolidated requirements are the same. This means that it is subject to the following minimum plus capital conservation buffer requirements and has the following surplus capital:

Minimum and surplus capital of Bank S			
	Minimum plus capital conservation buffer required[158]	**Actual capital available**	**Surplus** (3-2)
1	2	3	4
Common Equity Tier 1capital	7.0 (= 7.0% of 100)	10	3.0
Tier 1 capital	8.5 (= 8.5% of 100)	15 (10+5)	6.5
Total capital	10.5 (= 10.5% of 100)	23 (10+5+8)	12.5

The following table illustrates how to calculate the amount of capital issued by Bank S to include in consolidated capital, following the calculation procedure set out in paragraph 4.3.4 of Basel III Capital Regulations:

[158] Illustration is based on Basel III minima. The Common Equity Tier 1 in the example should be read to include issued common shares plus retained earnings and reserves in Bank S.

Bank S: Amount of capital issued to third parties included in consolidated capital					
	Total amount issued (a)	**Amount issued to third parties (b)**	**Surplus (c)**	**Surplus attributable to third parties (i.e. amount excluded from consolidated capital) (d) = (c) * (b)/(a)**	**Amount included in consolidated capital (e) = (b) – (d)**
Common Equity Tier 1 capital	10	3	3.0	0.90	2.10
Tier 1 capital	15	4	6.5	1.73	2.27
Total capital	23	10	12.5	5.43	4.57

The following table summarises the components of capital for the consolidated group based on the amounts calculated in the table above. Additional Tier 1 is calculated as the difference between Common Equity Tier 1 and Tier 1 and Tier 2 is the difference between Total Capital and Tier 1.

	Total amount issued by parent (all of which is to be included in consolidated capital)	**Amount issued by subsidiaries to third parties to be included in consolidated capital**	**Total amount issued by parent and subsidiary to be included in consolidated capital**
Common Equity Tier 1 capital	26	2.10	28.10
Additional Tier 1 capital	*7*	*0.17*	*7.17*
Tier 1 capital	33	2.27	35.27
Tier 2 capital	*10*	*2.30*	*12.30*
Total capital	43	4.57	47.57

Annex 18
(cf para 14.15)

Pillar 3 Disclosure Requirements

1 Scope of Application and Capital Adequacy

Table DF-1: Scope of Application

Name of the head of the banking group to which the framework applies_____

(i) Qualitative Disclosures:

Name of the entity / Country of incorporation	Whether the entity is included under accounting scope of consolidation (yes / no)	Explain the method of consolidation	Whether the entity is included under regulatory scope of consolidation[159] (yes / no)	Explain the method of consolidation	Explain the reasons for difference in the method of consolidation	Explain the reasons if consolidated under only one of the scopes of consolidation [160]

a. List of group entities considered for consolidation

b. List of group entities not considered for consolidation both under the accounting and regulatory scope of consolidation

Name of the entity / country of incorporation	Principle activity of the entity	Total balance sheet equity (as stated in the accounting balance sheet of the legal entity)	% of bank's holding in the total equity	Regulatory treatment of bank's investments in the capital instruments of the entity	Total balance sheet assets (as stated in the accounting balance sheet of the legal entity)

[159] If the entity is not consolidated in such a way as to result in its assets being included in the calculation of consolidated risk-weighted assets of the group, then such an entity is considered as outside the regulatory scope of consolidation.

[160] Also explain the treatment given i.e. deduction or risk weighting of investments under regulatory scope of consolidation.

(ii) Quantitative Disclosures:

c. List of group entities considered for consolidation

Name of the entity / country of incorporation *(as indicated in (i)a. above)*	Principle activity of the entity	Total balance sheet equity *(as stated in the accounting balance sheet of the legal entity)*	Total balance sheet assets *(as stated in the accounting balance sheet of the legal entity)*

d. The aggregate amount of capital deficiencies[161] in all subsidiaries which are not included in the regulatory scope of consolidation i.e. that are deducted:

Name of the subsidiaries / country of incorporation	Principle activity of the entity	Total balance sheet equity *(as stated in the accounting balance sheet of the legal entity)*	% of bank's holding in the total equity	Capital deficiencies

e. The aggregate amounts (e.g. current book value) of the bank's total interests in insurance entities, which are risk-weighted:

Name of the insurance entities / country of incorporation	Principle activity of the entity	Total balance sheet equity *(as stated in the accounting balance sheet of the legal entity)*	% of bank's holding in the total equity / proportion of voting power	Quantitative impact on regulatory capital of using risk weighting method versus using the full deduction method

f. Any restrictions or impediments on transfer of funds or regulatory capital within the banking group:

[161] A capital deficiency is the amount by which actual capital is less than the regulatory capital requirement. Any deficiencies which have been deducted on a group level in addition to the investment in such subsidiaries are not to be included in the aggregate capital deficiency.

Table DF-2: Capital Adequacy

Qualitative disclosures (a) A summary discussion of the bank's approach to assessing the adequacy of its capital to support current and future activities
Quantitative disclosures (b) Capital requirements for credit risk: • Portfolios subject to standardised approach • Securitisation exposures
(c) Capital requirements for market risk: • Standardised duration approach; - Interest rate risk - Foreign exchange risk (including gold) - Equity risk
(d) Capital requirements for operational risk: • Basic Indicator Approach • The Standardised Approach (if applicable)
(e) Common Equity Tier 1, Tier 1and Total Capital ratios: • For the top consolidated group; and • For significant bank subsidiaries (stand alone or sub-consolidated depending on how the Framework is applied)

2. Risk exposure and assessment

The risks to which banks are exposed and the techniques that banks use to identify, measure, monitor and control those risks are important factors market participants consider in their assessment of an institution. In this section, several key banking risks are considered: credit risk, market risk, and interest rate risk in the banking book and operational risk. Also included in this section are disclosures relating to credit risk mitigation and asset securitisation, both of which alter the risk profile of the institution. Where applicable, separate disclosures are set out for banks using different approaches to the assessment of regulatory capital.

2.1 General qualitative disclosure requirement

For each separate risk area (e.g. credit, market, operational, banking book interest rate risk) banks must describe their risk management objectives and policies, including:

(i) strategies and processes;
(ii) the structure and organisation of the relevant risk management function;
(iii) the scope and nature of risk reporting and/or measurement systems;
(iv) policies for hedging and/or mitigating risk and strategies and processes for monitoring the continuing effectiveness of hedges/mitigants.

Credit risk

General disclosures of credit risk provide market participants with a range of information about overall credit exposure and need not necessarily be based on information prepared for regulatory purposes. Disclosures on the capital assessment techniques give information on the specific nature of the exposures, the means of capital assessment and data to assess the reliability of the information disclosed.

Table DF-3: Credit Risk: General Disclosures for All Banks

Qualitative Disclosures

(a) The general qualitative disclosure requirement with respect to credit risk, including:

- Definitions of past due and impaired (for accounting purposes);
- Discussion of the bank's credit risk management policy;

Quantitative Disclosures

(b) Total gross credit risk exposures[162], Fund based and Non-fund based separately.

(c) Geographic distribution of exposures[163], Fund based and Non-fund based separately

- Overseas
- Domestic

(d) Industry[164] type distribution of exposures, fund based and non-fund based separately

(e) Residual contractual maturity breakdown of assets,[165]

(f) Amount of NPAs (Gross)

- Substandard
- Doubtful 1
- Doubtful 2
- Doubtful 3
- Loss

(g) Net NPAs

(h) NPA Ratios

- Gross NPAs to gross advances
- Net NPAs to net advances

(i) Movement of NPAs (Gross)

- Opening balance
- Additions
- Reductions
- Closing balance

(j) Movement of provisions for NPAs

- Opening balance
- Provisions made during the period
- Write-off
- Write-back of excess provisions
- Closing balance

(k) Amount of Non-Performing Investments

(l) Amount of provisions held for non-performing investments

(m) Movement of provisions for depreciation on investments

- Opening balance
- Provisions made during the period
- Write-off
- Write-back of excess provisions
- Closing balance

[162] That is after accounting offsets in accordance with the applicable accounting regime and without taking into account the effects of credit risk mitigation techniques, e.g. collateral and netting.

[163] That is, on the same basis as adopted for Segment Reporting adopted for compliance with AS 17.

[164] The industries break-up may be provided on the same lines as prescribed for DSB returns. If the exposure to any particular industry is more than 5 per cent of the gross credit exposure as computed under (b) above it should be disclosed separately.

[165] Banks shall use the same maturity bands as used for reporting positions in the ALM returns.

Table DF-4 - Credit Risk: Disclosures for Portfolios Subject to the Standardised Approach

Qualitative Disclosures (a) For portfolios under the standardised approach: • Names of credit rating agencies used, plus reasons for any changes; • Types of exposure for which each agency is used; and • A description of the process used to transfer public issue ratings onto comparable assets in the banking book;
Quantitative Disclosures (b) For exposure[166] amounts after risk mitigation subject to the standardised approach, amount of a bank's outstandings (rated and unrated) in the following three major risk buckets as well as those that are deducted; • Below 100 % risk weight • 100 % risk weight • More than 100 % risk weight • Deducted

Table DF-5: Credit Risk Mitigation: Disclosures for Standardised Approaches [167]

Qualitative Disclosures (a) The general qualitative disclosure requirement with respect to credit risk mitigation including: ***a) Policies and processes for, and an indication of the extent to which the bank makes use of, on- and off-balance sheet netting;*** • policies and processes for collateral valuation and management; • a description of the main types of collateral taken by the bank; • the main types of guarantor counterparty and their credit worthiness; and • information about (market or credit) risk concentrations within the mitigation taken
Quantitative Disclosures ***(b) For each separately disclosed credit risk portfolio the total exposure (after, where applicable, on- or off balance sheet netting) that is covered by eligible financial collateral after the application of haircuts.*** ***(c) For each separately disclosed portfolio the total exposure (after, where applicable, on- or off-balance sheet netting) that is covered by guarantees/credit derivatives (whenever specifically permitted by RBI)***

[166] As defined for disclosures in Table 3.

[167] At a minimum, banks must give the disclosures in this Table in relation to credit risk mitigation that has been recognised for the purposes of reducing capital requirements under this Framework. Where relevant, banks are encouraged to give further information about mitigants that have not been recognised for that purpose.

Table DF-6: Securitisation Exposures: Disclosure for Standardised Approach

Qualitative Disclosures	
(a)	The general qualitative disclosure requirement with respect to securitisation including a discussion of: • the bank's objectives in relation to securitisation activity, including the extent to which these activities transfer credit risk of the underlying securitised exposures away from the bank to other entities. • the nature of other risks (e.g. liquidity risk) inherent in securitised assets; • the various roles played by the bank in the securitisation process (For example: originator, investor, servicer, provider of credit enhancement, liquidity provider, swap provider[@], protection provider[#]) and an indication of the extent of the bank's involvement in each of them; • a description of the processes in place to monitor changes in the credit and market risk of securitisation exposures (for example, how the behaviour of the underlying assets impacts securitisation exposures as defined in paragraph 5.16.1 of Basel III Capital Regulations). • a description of the bank's policy governing the use of credit risk mitigation to mitigate the risks retained through securitisation exposures; [@] A bank may have provided support to a securitisation structure in the form of an interest rate swap or currency swap to mitigate the interest rate/currency risk of the underlying assets, if permitted as per regulatory rules. [#] A bank may provide credit protection to a securitisation transaction through guarantees, credit derivatives or any other similar product, if permitted as per regulatory rules.
(b)	**Summary of the bank's accounting policies for securitisation activities, including**: • whether the transactions are treated as sales or financings; • methods and key assumptions (including inputs) applied in valuing positions retained or purchased • changes in methods and key assumptions from the previous period and impact of the changes; • policies for recognising liabilities on the balance sheet for arrangements that could require the bank to provide financial support for securitised assets.
(c)	In the banking book, the names of ECAIs used for securitisations and the types of securitisation exposure for which each agency is used.
Quantitative disclosures: Banking Book	
(d)	The total amount of exposures securitised by the bank.
(e)	For exposures securitised losses recognised by the bank during the current period broken by the exposure type (e.g. Credit cards, housing loans, auto loans etc. detailed by underlying security)
(f)	Amount of assets intended to be securitised within a year
(g)	Of (f), amount of assets originated within a year before securitisation.
(h)	The total amount of exposures securitised (by exposure type) and unrecognised gain or losses on sale by exposure type.
(i)	Aggregate amount of: • on-balance sheet securitisation exposures retained or purchased broken down by exposure type and • off-balance sheet securitisation exposures broken down by exposure type
(j)	(i) Aggregate amount of securitisation exposures retained or purchased and the associated capital charges, broken down between exposures and further broken down into different risk weight bands for each regulatory capital

	approach (ii) Exposures that have been deducted entirely from Tier 1 capital, credit enhancing I/Os deducted from total capital, and other exposures deducted from total capital (by exposure type).
Quantitative Disclosures: Trading book	
(k)	Aggregate amount of exposures securitised by the bank for which the bank has retained some exposures and which is subject to the market risk approach, by exposure type.
(l)	Aggregate amount of: • on-balance sheet securitisation exposures retained or purchased broken down by exposure type; and • off-balance sheet securitisation exposures broken down by exposure type.
(m)	**Aggregate amount of securitisation exposures retained or purchased separately for**: • securitisation exposures retained or purchased subject to Comprehensive Risk Measure for specific risk; and • securitisation exposures subject to the securitisation framework for specific risk broken down into different risk weight bands.
(n)	Aggregate amount of: • the capital requirements for the securitisation exposures, subject to the securitisation framework broken down into different risk weight bands. • securitisation exposures that are deducted entirely from Tier 1 capital, credit enhancing I/Os deducted from total capital, and other exposures deducted from total capital(by exposure type).

Table DF-7: Market Risk in Trading Book

Qualitative disclosures (a) The general qualitative disclosure requirement for market risk including the portfolios covered by the standardised approach.
Quantitative disclosures (b) The capital requirements for: • interest rate risk; • equity position risk; and • foreign exchange risk;

Table DF-8: Operational Risk

Qualitative disclosures • In addition to the general qualitative disclosure requirement, the approach(es) for operational risk capital assessment for which the bank qualifies.

Table DF-9: Interest Rate Risk in the Banking Book (IRRBB)

Qualitative Disclosures (a) The general qualitative disclosure requirement including the nature of IRRBB and key assumptions, including assumptions regarding loan prepayments and behaviour of non-maturity deposits, and frequency of IRRBB measurement.
Quantitative Disclosures (b) The increase (decline) in earnings and economic value (or relevant measure used by management) for upward and downward rate shocks according to management's method for measuring IRRBB, broken down by currency (where the turnover is more than 5% of the total turnover).

Table DF-10: General Disclosure for Exposures Related to Counterparty Credit Risk

Qualitative Disclosures	(a)	The general qualitative disclosure requirement with respect to derivatives and CCR, including: • Discussion of methodology used to assign economic capital and credit limits for counterparty credit exposures; • Discussion of policies for securing collateral and establishing credit reserves; • Discussion of policies with respect to wrong-way risk exposures; • Discussion of the impact of the amount of collateral the bank would have to provide given a credit rating downgrade.
Quantitative Disclosures	(b)	Gross positive fair value of contracts, netting benefits[168], netted current credit exposure, collateral held (including type, e.g. cash, government securities, etc.), and net derivatives credit exposure[169]. Also report measures for exposure at default, or exposure amount, under CEM. The notional value of credit derivative hedges, and the distribution of current credit exposure by types of credit exposure[170].
	(c)	Credit derivative transactions that create exposures to CCR (notional value), segregated between use for the institution's own credit portfolio, as well as in its intermediation activities, including the distribution of the credit derivatives products used[171], broken down further by protection bought and sold within each product group

[168] Please refer to the circular DBOD.No.BP.BC.48/21.06.001/2010-11 dated October 1, 2010.
[169] *Net credit exposure* is the credit exposure on derivatives transactions after considering both the benefits from legally enforceable netting agreements and collateral arrangements. The notional amount of credit derivative hedges alerts market participants to an additional source of credit risk mitigation.
[170] For example, interest rate contracts, FX contracts, credit derivatives, and other contracts.
[171] For example, credit default swaps.

3 Composition of Capital Disclosure Templates

3.1 Post March 31, 2017 Disclosure Template

(i) The template is designed to capture the capital positions of banks after the transition period for the phasing-in of deductions ends on March 31, 2017. Certain rows are in *italics*. These rows will be deleted after all the ineligible capital instruments have been fully phased out (i.e. from April 1, 2022 onwards).

(ii) The reconciliation requirement in terms of paragraph 14.14 of Basel III Capital Regulations results in the decomposition of certain regulatory adjustments. For example, the disclosure template below includes the adjustment of 'Goodwill net of related tax liability'. The requirements will lead to the disclosure of both the goodwill component and the related tax liability component of this regulatory adjustment.

(iii) Certain rows of the template are shaded as explained below:

a. each dark grey row introduces a new section detailing a certain component of regulatory capital.
b. the light grey rows with no thick border represent the sum cells in the relevant section.
c. the light grey rows with a thick border show the main components of regulatory capital and the capital ratios.

(iv) Also provided along with the Table, an explanation of each line of the template, with references to the appropriate paragraphs of the text of the Basel III capital regulations.

Table DF-11: Composition of Capital

Part I: Template to be used only from March 31, 2017

(Rs. in million)

	Basel III common disclosure template to be used from March 31, 2017		
	Common Equity Tier 1 capital: instruments and reserves		Ref No
1	Directly issued qualifying common share capital plus related stock surplus (share premium)		
2	Retained earnings		
3	Accumulated other comprehensive income (and other reserves)		
4	*Directly issued capital subject to phase out from CET1 (only applicable to non-joint stock companies[1])*		
5	Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1)		
6	**Common Equity Tier 1 capital before regulatory adjustments**		
	Common Equity Tier 1 capital: regulatory adjustments		
7	Prudential valuation adjustments		
8	Goodwill (net of related tax liability)		
9	Intangibles (net of related tax liability)		
10	Deferred tax assets[2]		
11	Cash-flow hedge reserve		
12	Shortfall of provisions to expected losses		
13	Securitisation gain on sale		
14	Gains and losses due to changes in own credit risk on fair valued liabilities		
15	Defined-benefit pension fund net assets		
16	Investments in own shares (if not already netted off paid-up capital on reported balance sheet)		
17	Reciprocal cross-holdings in common equity		

[1] Not Applicable to commercial banks in India.

[2] In terms of Basel III rules text issued by the Basel Committee (December 2010), DTAs that rely on future profitability of the bank to be realized are to be deducted. DTAs which relate to temporary differences are to be treated under the “threshold deductions” as set out in paragraph 87. However, banks in India are required to deduct all DTAs, irrespective of their origin, from CET1 capital.

18	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued share capital (amount above 10% threshold)		
19	Significant investments in the common stock of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions (amount above 10% threshold)[3]		
20	Mortgage servicing rights[4] (amount above 10% threshold)		
21	Deferred tax assets arising from temporary differences[5] (amount above 10% threshold, net of related tax liability)		
22	Amount exceeding the 15% threshold[6]		
23	*of which: significant investments in the common stock of financial entities*		
24	*of which: mortgage servicing rights*		
25	*of which: deferred tax assets arising from temporary differences*		
26	National specific regulatory adjustments[7] (26a+26b+26c+26d)		
26a	*of which:* Investments in the equity capital of unconsolidated insurance subsidiaries		
26b	*of which:* Investments in the equity capital of unconsolidated non-financial subsidiaries[8]		
26c	*of which:* Shortfall in the equity capital of majority owned financial entities which have not been consolidated with the bank[9]		
26d	*of which:* Unamortised pension funds expenditures		
27	Regulatory adjustments applied to Common Equity Tier 1 due to insufficient Additional Tier 1 and Tier 2 to cover deductions		
28	**Total regulatory adjustments to Common equity Tier 1**		
29	**Common Equity Tier 1 capital (CET1)**		
Additional Tier 1 capital: instruments			
30	Directly issued qualifying Additional Tier 1 instruments plus related stock surplus (share premium) (31+32)		

[3] Only significant investments other than in the insurance and non-financial subsidiaries should be reported here. The insurance and non-financial subsidiaries are not consolidated for the purpose of capital adequacy. The equity and other regulatory capital investments in insurance subsidiaries are fully deducted from consolidated regulatory capital of the banking group. However, in terms of Basel III rules text of the Basel Committee, insurance subsidiaries are included under significant investments and thus, deducted based on 10% threshold rule instead of full deduction.

[4] Not applicable in Indian context.

[5] Please refer to Footnote 2 above.

[6] Not applicable in Indian context.

[7] Adjustments which are not specific to the Basel III regulatory adjustments (as prescribed by the Basel Committee) will be reported under this row. However, regulatory adjustments which are linked to Basel III i.e. where there is a change in the definition of the Basel III regulatory adjustments, the impact of these changes will be explained in the Notes of this disclosure template.

[8] Non-financial subsidiaries are not consolidated for the purpose of capital adequacy. The equity and other regulatory capital investments in the non-financial subsidiaries are deducted from consolidated regulatory capital of the group. These investments are not required to be deducted fully from capital under Basel III rules text of the Basel Committee.

[9] Please refer to paragraph 3.3.5 of the Master Circular on Basel III Capital Regulations. Please also refer to the Paragraph 34 of the Basel II Framework issued by the Basel Committee (June 2006). Though this is not national specific adjustment, it is reported here.

31	of which: classified as equity under applicable accounting standards (Perpetual Non-Cumulative Preference Shares)		
32	of which: classified as liabilities under applicable accounting standards (Perpetual debt Instruments)		
33	*Directly issued capital instruments subject to phase out from Additional Tier 1*		
34	Additional Tier 1 instruments (and CET1 instruments not included in row 5) issued by subsidiaries and held by third parties (amount allowed in group AT1)		
35	*of which: instruments issued by subsidiaries subject to phase out*		
36	**Additional Tier 1 capital before regulatory adjustments**		
Additional Tier 1 capital: regulatory adjustments			
37	Investments in own Additional Tier 1 instruments		
38	Reciprocal cross-holdings in Additional Tier 1 instruments		
39	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above 10% threshold)		
40	Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)[10]		
41	National specific regulatory adjustments (41a+41b)		
41a	*of which:* Investments in the Additional Tier 1 capital of unconsolidated insurance subsidiaries		
41b	*of which:* Shortfall in the Additional Tier 1 capital of majority owned financial entities which have not been consolidated with the bank		
42	Regulatory adjustments applied to Additional Tier 1 due to insufficient Tier 2 to cover deductions		
43	**Total regulatory adjustments to Additional Tier 1 capital**		
44	**Additional Tier 1 capital (AT1)**		
44a	**Additional Tier 1 capital reckoned for capital adequacy[11]**		
45	**Tier 1 capital (T1 = CET1 + Admissible AT1) (29 + 44a)**		
Tier 2 capital: instruments and provisions			
46	Directly issued qualifying Tier 2 instruments plus related stock surplus		
47	*Directly issued capital instruments subject to phase out from Tier 2*		
48	Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties (amount allowed in group Tier 2)		
49	*of which: instruments issued by subsidiaries subject to phase out*		
50	Provisions[12]		
51	**Tier 2 capital before regulatory adjustments**		

[10] Please refer to Footnote 3 above.
[11] Please refer paragraph 4.2.2(vii) of the Master Circular on Basel III Capital Regulations.
[12] Eligible Provisions and revaluation Reserves in terms of paragraph 4.2.5.1 of the Master Circular on Basel III Capital Regulations, both to be reported and break-up of these two items to be furnished in Notes.

Tier 2 capital: regulatory adjustments			
52	Investments in own Tier 2 instruments		
53	Reciprocal cross-holdings in Tier 2 instruments		
54	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above the 10% threshold)		
55	Significant investments[13] in the capital banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)		
56	National specific regulatory adjustments (56a+56b)		
56a	*of which:* Investments in the Tier 2 capital of unconsolidated insurance subsidiaries		
56b	*of which:* Shortfall in the Tier 2 capital of majority owned financial entities which have not been consolidated with the bank		
57	**Total regulatory adjustments to Tier 2 capital**		
58	**Tier 2 capital (T2)**		
58a	**Tier 2 capital reckoned for capital adequacy[14]**		
58b	**Excess Additional Tier 1 capital reckoned as Tier 2 capital**		
58c	**Total Tier 2 capital admissible for capital adequacy (58a + 58b)**		
59	**Total capital (TC = T1 + Admissible T2) (45 + 58c)**		
60	**Total risk weighted assets (60a + 60b + 60c)**		
60a	*of which: total credit risk weighted assets*		
60b	*of which: total market risk weighted assets*		
60c	*of which: total operational risk weighted assets*		
Capital ratios and buffers			
61	Common Equity Tier 1 (as a percentage of risk weighted assets)		
62	Tier 1 (as a percentage of risk weighted assets)		
63	Total capital (as a percentage of risk weighted assets)		
64	Institution specific buffer requirement (minimum CET1 requirement plus capital conservation plus countercyclical buffer requirements plus G-SIB buffer requirement, expressed as a percentage of risk weighted assets)		
65	*of which: capital conservation buffer requirement*		
66	*of which: bank specific countercyclical buffer requirement*		
67	*of which: G-SIB buffer requirement*		
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk weighted assets)		
National minima (if different from Basel III)			
69	National Common Equity Tier 1 minimum ratio (if different from Basel III minimum)		
70	National Tier 1 minimum ratio (if different from Basel III minimum)		
71	National total capital minimum ratio (if different from Basel III		

[13] Please refer to Footnote 3 above.
[14] Please refer paragraph 4.2.2(vii) of the Master Circular on Basel III Capital Regulations.

	minimum)		
Amounts below the thresholds for deduction (before risk weighting)			
72	Non-significant investments in the capital of other financial entities		
73	Significant investments in the common stock of financial entities		
74	Mortgage servicing rights (net of related tax liability)		
75	Deferred tax assets arising from temporary differences (net of related tax liability)		
Applicable caps on the inclusion of provisions in Tier 2			
76	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to standardised approach (prior to application of cap)		
77	Cap on inclusion of provisions in Tier 2 under standardised approach		
78	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to internal ratings-based approach (prior to application of cap)		
79	Cap for inclusion of provisions in Tier 2 under internal ratings-based approach		
Capital instruments subject to phase-out arrangements (only applicable between March 31, 2017 and March 31, 2022			
80	*Current cap on CET1 instruments subject to phase out arrangements*		
81	*Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)*		
82	*Current cap on AT1 instruments subject to phase out arrangements*		
83	*Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)*		
84	*Current cap on T2 instruments subject to phase out arrangements*		
85	*Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)*		

Notes to the Template

Row No. of the template	Particular	(Rs. in million)
10	Deferred tax assets associated with accumulated losses	
	Deferred tax assets (excluding those associated with accumulated losses) net of Deferred tax liability	
	Total as indicated in row 10	
19	If investments in insurance subsidiaries are not deducted fully from capital and instead considered under 10% threshold for deduction, the resultant increase in the capital of bank	
	of which: Increase in Common Equity Tier 1 capital	
	of which: Increase in Additional Tier 1 capital	
	of which: Increase in Tier 2 capital	
26b	If investments in the equity capital of unconsolidated non-financial subsidiaries are not deducted and hence, risk weighted then:	
	(i) Increase in Common Equity Tier 1 capital	
	(ii) Increase in risk weighted assets	
44a	Excess Additional Tier 1 capital not reckoned for capital adequacy (difference between Additional Tier 1 capital as reported in row 44 and admissible Additional Tier 1 capital as reported in 44a)	
	of which: Excess Additional Tier 1 capital which is considered as	

	Tier 2 capital under row 58b	
50	Eligible Provisions included in Tier 2 capital	
	Eligible Revaluation Reserves included in Tier 2 capital	
	Total of row 50	
58a	Excess Tier 2 capital not reckoned for capital adequacy (difference between Tier 2 capital as reported in row 58 and T2 as reported in 58a)	

Explanation of each row of the Common Disclosure Template	
Row No.	**Explanation**
1	Instruments issued by the parent bank of the reporting banking group which meet all of the CET1 entry criteria set out in paragraph 4.2.3 (read with Annex 1 / Annex 2) of the Master Circular. This should be equal to the sum of common shares (and related surplus only) which must meet the common shares criteria. This should be net of treasury stock and other investments in own shares to the extent that these are already derecognised on the balance sheet under the relevant accounting standards. Other paid-up capital elements must be excluded. All minority interest must be excluded.
2	Retained earnings, prior to all regulatory adjustments in accordance with paragraph 4.2.3 of the Master Circular
3	Accumulated other comprehensive income and other disclosed reserves, prior to all regulatory adjustments.
4	Banks must report zero in this row.
5	Common share capital issued by subsidiaries and held by third parties. Only the amount that is eligible for inclusion in group CET1 should be reported here, as determined by the application of paragraph 4.3.4 of the Master Circular (Also see Annex 17 of the Master Circular for illustration).
6	Sum of rows 1 to 5.
7	Valuation adjustments according to the requirements of paragraph 8.8 of the Master Circular
8	Goodwill net of related tax liability, as set out in paragraph 4.4.1 of the Master Circular
9	Intangibles (net of related tax liability), as set out in paragraph 4.4.1 of the Master Circular
10	Deferred tax assets (net of related tax liability), as set out in paragraph 4.4.2 of the Master Circular
11	The element of the cash-flow hedge reserve described in paragraph 4.4.3 of the Master Circular
12	Shortfall of provisions to expected losses as described in paragraph 4.4.4 of the Master Circular
13	Securitisation gain on sale as described in paragraph 4.4.5 of the Master Circular
14	Gains and losses due to changes in own credit risk on fair valued liabilities as described in paragraph 4.4.6 of the Master Circular
15	Defined benefit pension fund net assets, the amount to be deducted, as set out in paragraphs 4.4.7 of the Master Circular
16	Investments in own shares (if not already netted off paid-in capital on reported balance sheet), as set out in paragraph 4.4.8 of the Master Circular
17	Reciprocal cross-holdings in common equity as set out in paragraph 4.4.9.2(A) of the Master Circular
18	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation where the bank does not own more than 10% of the issued share capital (amount above 10% threshold), amount to be deducted from CET1 in accordance with paragraph 4.4.9.2(B) of the Master Circular

19	Significant investments in the common stock of banking, financial and insurance entities that are outside the scope of regulatory consolidation (amount above 10% threshold), amount to be deducted from CET1 in accordance with paragraph 4.4.9.2(C) of the Master Circular
20	Not relevant
21	Not relevant
22	Not relevant
23	Not relevant
24	Not relevant
25	Not relevant
26	Any national specific regulatory adjustments that are required by national authorities to be applied to CET1 in addition to the Basel III minimum set of adjustments [i.e. in terms of December 2010 (rev June 2011) document issued by the Basel Committee on Banking Supervision].
27	Regulatory adjustments applied to Common Equity Tier 1 due to insufficient Additional Tier 1 to cover deductions. If the amount reported in row 43 exceeds the amount reported in row 36 the excess is to be reported here.
28	Total regulatory adjustments to Common equity Tier 1, to be calculated as the sum of rows 7 to 22 plus row 26 and 27.
29	Common Equity Tier 1 capital (CET1), to be calculated as row 6 minus row 28.
30	Instruments that meet all of the AT1 entry criteria set out in paragraph 4.2.4. All instruments issued of subsidiaries of the consolidated group should be excluded from this row.
31	The amount in row 30 classified as equity under applicable Accounting Standards.
32	The amount in row 30 classified as liabilities under applicable Accounting Standards.
33	Directly issued capital instruments subject to phase out from Additional Tier 1 in accordance with the requirements of paragraph 4.5.4 of the Master Circular
34	Additional Tier 1 instruments (and CET1 instruments not included in row 5) issued by subsidiaries and held by third parties, the amount allowed in group AT1 in accordance with paragraph 4.3.4 of the Master Circular (please see Annex 17 for illustration).
35	The amount reported in row 34 that relates to instruments subject to phase out from AT1 in accordance with the requirements of paragraph 4.5.4 of the Master Circular
36	The sum of rows 30, 33 and 34.
37	Investments in own Additional Tier 1 instruments, amount to be deducted from AT1 in accordance with paragraph 4.4.8 of the Master Circular
38	Reciprocal cross-holdings in Additional Tier 1 instruments, amount to be deducted from AT1 in accordance with paragraph 4.4.9.2 (A) of the Master Circular
39	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation where the bank does not own more than 10% of the issued common share capital of the entity (net of eligible short positions), amount to be deducted from AT1 in accordance with paragraph 4.4.9.2(B) of the Master Circular
40	Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions), amount to be deducted from AT1 in accordance with paragraph 4.4.9.2(C) of the Master Circular
41	Any national specific regulatory adjustments that are required by national authorities to be applied to Additional Tier 1 in addition to the Basel III minimum set of adjustments [i.e. in terms of December 2010 (rev June 2011) document issued by the Basel Committee on Banking Supervision.
42	Regulatory adjustments applied to Additional Tier 1 due to insufficient Tier 2 to cover deductions. If the amount reported in row 57 exceeds the amount reported in row 51 the excess is to be reported here.
43	The sum of rows 37 to 42.
44	Additional Tier 1 capital, to be calculated as row 36 minus row 43.

45	Tier 1 capital, to be calculated as row 29 plus row 44a.
46	Instruments that meet all of the Tier 2 entry criteria set out in paragraph 4.2.5 of the Master Circular. All instruments issued of subsidiaries of the consolidated group should be excluded from this row. Provisions and Revaluation Reserves should not be included in Tier 2 in this row.
47	Directly issued capital instruments subject to phase out from Tier 2 in accordance with the requirements of paragraph 4.5.4 of the Master Circular
48	Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 32) issued by subsidiaries and held by third parties (amount allowed in group Tier 2) in accordance with paragraph 4.3.4 of the Master Circular
49	The amount reported in row 48 that relates to instruments subject to phase out from Tier 2 in accordance with the requirements of paragraph 4.5.4 of the Master Circular
50	Provisions and Revaluation Reserves included in Tier 2 calculated in accordance with paragraph 4.2.5 of the Master Circular
51	The sum of rows 46 to 48 and row 50.
52	Investments in own Tier 2 instruments, amount to be deducted from Tier 2 in accordance with paragraph 4.4.8 of the Master Circular
53	Reciprocal cross-holdings in Tier 2 instruments, amount to be deducted from Tier 2 in accordance with paragraph 4.4.9.2(A) of the Master Circular
54	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation where the bank does not own more than 10% of the issued common share capital of the entity (net of eligible short positions), amount to be deducted from Tier 2 in accordance with paragraph 4.4.9.2(B) of the Master Circular
55	Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions), amount to be deducted from Tier 2 in accordance with paragraph 4.4.9.2(C) of the Master Circular
56	Any national specific regulatory adjustments that are required by national authorities to be applied to Tier 2 in addition to the Basel III minimum set of adjustments [i.e. in terms of December 2010 (rev June 2011) document issued by the Basel Committee on Banking Supervision].
57	The sum of rows 52 to 56.
58	Tier 2 capital, to be calculated as row 51 minus row 57.
59	Total capital, to be calculated as row 45 plus row 58c.
60	Total risk weighted assets of the reporting group. Details to be furnished under rows 60a, 60b and 60c.
61	Common Equity Tier 1ratio (as a percentage of risk weighted assets), to be calculated as row 29 divided by row 60 (expressed as a percentage).
62	Tier 1 ratio (as a percentage of risk weighted assets), to be calculated as row 45 divided by row 60 (expressed as a percentage).
63	Total capital ratio (as a percentage of risk weighted assets), to be calculated as row 59 divided by row 60 (expressed as a percentage).
64	Institution specific buffer requirement (minimum CET1 requirement plus capital conservation buffer plus countercyclical buffer requirements plus G-SIB buffer requirement, expressed as a percentage of risk weighted assets). To be calculated as 5.5% plus 2.5% capital conservation buffer plus the bank specific countercyclical buffer requirement whenever activated and applicable plus the bank G-SIB requirement (where applicable) as set out in *Global systemically important banks: assessment methodology and the additional loss absorbency requirement: Rules text (November 2011) issued by the Basel Committee*. This row will show the CET1 ratio below which the bank will become subject to constraints on distributions.
65	The amount in row 64 (expressed as a percentage of risk weighed assets) that relates to the capital conservation buffer), i.e. banks will report 2.5% here.
66	The amount in row 64 (expressed as a percentage of risk weighed assets) that relates to the bank specific countercyclical buffer requirement.

67	The amount in row 64 (expressed as a percentage of risk weighed assets) that relates to the bank's G-SIB requirement.
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk weighted assets). To be calculated as the CET1 ratio of the bank, less any common equity used to meet the bank's minimum Tier 1 and minimum Total capital requirements.
69	National Common Equity Tier 1 minimum ratio (if different from Basel III minimum). 5.5% should be reported.
70	National Tier 1 minimum ratio (if different from Basel III minimum). 7% should be reported.
71	National total capital minimum ratio (if different from Basel III minimum). 9% should be reported.
72	Non-significant investments in the capital of other financial entities, the total amount of such holdings that are not reported in row 18, row 39 and row 54.
73	Significant investments in the common stock of financial entities, the total amount of such holdings that are not reported in row 19
74	Mortgage servicing rights, the total amount of such holdings that are not reported in row 19 and row 23. - Not Applicable in India.
75	Deferred tax assets arising from temporary differences, the total amount of such holdings that are not reported in row 21 and row 25. – Not applicable in India.
76	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to standardised approach calculated in accordance paragraph 4.2.5 of the Master Circular, prior to the application of the cap.
77	Cap on inclusion of provisions in Tier 2 under standardised approach calculated in accordance paragraph 4.2.5 of the Master Circular.
78	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to internal ratings-based approach calculated in accordance paragraph 4.2.5 of the Master Circular.
79	Cap for inclusion of provisions in Tier 2 under internal ratings-based approach calculated in accordance paragraph 4.2.5 of the Master Circular
80	Current cap on CET1 instruments subject to phase out arrangements see paragraph 4.5.5 of the Master Circular
81	Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities), see paragraph 4.5.5 of the Master Circular
82	Current cap on AT1 instruments subject to phase out arrangements see paragraph 4.5.4 of the Master Circular
83	Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities) see paragraph 4.5.4 of the Master Circular
84	Current cap on T2 instruments subject to phase out arrangements see paragraph 4.5.4 of the Master Circular
85	Amount excluded from T2 due to cap (excess over cap after redemptions and maturities) see paragraph 4.5.4 of the Master Circular

3.2 Disclosure Template during the Basel III Transition Phase (i.e. before March 31, 2017)

(i) The template that banks must use during the transition phase is the same as the Post March 31, 2017 disclosure template set out in Part A above, except for the following additions (all of which are highlighted in the template below using cells with dotted borders):

- A new column has been added for banks to report the amount of each regulatory adjustment that is subject to the existing national treatment (i.e. before implementation of Basel III capital regulations) during the transition phase (labelled as the "pre-Basel III treatment").

– Example 1: In 2013, banks are required to make 20% of the regulatory adjustments in terms of transitional arrangements provided in accordance with Basel III capital regulations. Consider a bank with 'goodwill, net of related tax liability' of Rs.10 million. Currently, this is not required to be deducted from Common Equity Tier 1. Therefore, banks will report Rs. 2 million in the first of the two empty cells in row 8 and report Rs. 8 million in the second of the two cells. The sum of the two cells will therefore equal the total Basel III regulatory adjustment.

- While the new column shows the amount of each regulatory adjustment that is subject to the existing treatment, it is necessary to show how this amount is included under existing treatment in the calculation of regulatory capital. Therefore, new rows have been added in each of the three sections on regulatory adjustments to show the existing treatment.

– Example 2: Continuing from the above example, in terms of existing treatment goodwill is to be deducted from Tier 1 capital. Therefore, a new row is inserted in between rows 41 and 42 **(please refer to Table DF-11, Part II below)**, to indicate that during the transition phase some goodwill will continue to be deducted from Tier 1 (i.e. in effect from Additional Tier 1). Therefore, Rs. 8 million which is reported in the last cell of row 8 will be reported in this new row inserted between rows 41 and 42.

(ii) In addition to the phasing-in of some regulatory adjustments described above, the transition period of Basel III will in some cases result in the phasing-out of previous prudential adjustments. In these cases the new rows added in each of the three sections on regulatory adjustments will be used by jurisdictions to set out the impact of the phase-out.

– Example 3: Consider a jurisdiction that currently filters out unrealised gains and losses on holdings of AFS debt securities and consider a bank in that jurisdiction that has an unrealised loss of $50 mn. The transitional arrangements provided by the Basel Committee require this bank to recognise 20% of this loss (i.e. $10 mn) in 2014. This means that 80% of this loss (i.e. $40 mn) is not recognised. The jurisdiction will therefore include a row between rows 26 and 27 that allows banks to add back this unrealised loss. The bank will then report $40 mn in this row as an addition to Common Equity Tier 1.

- To take account of the fact that the existing treatment of a Basel III regulatory adjustment may be to apply a risk weighting, new rows have been added immediately prior to the row on risk weighted assets (row 60).

– Example 4: Consider that a bank currently risk weights defined benefit pension fund net assets at 100%. In 2013 the bank has Rs. 50 million of these assets. The transitional arrangements require this bank to deduct 20% of the assets in 2013. This means that the bank will report Rs. 10 million in the first empty cell in row 15 and Rs. 40 million in the second empty cell (the total of the two cells therefore, equals the total Basel III regulatory adjustment). The bank will disclose in one of the rows inserted between row 59 and 60 that such assets are risk weighted at 100% during the transitional phase. The bank will then be required to report a figure of Rs. 40 million (Rs. 40 million * 100%) in that row.

– Example 5: Consider a case wherein the investments in the capital of financial entity of Rs. 100 million qualify for risk weighting of 125% under existing treatment. Consider that these investments will now be deducted from Common Equity Tier 1 capital under Basel III. In 2013, in terms of transitional arrangements, the bank needs to deduct Rs. 20 million of investments and report in the first empty cell in row 18 and Rs. 80 million in the second

empty cell. Then the bank will disclose in one of the row inserted between row 59 and row 60 that such assets are risk weighted at 125% during the transitional phase. The bank will then be required to report an amount of Rs. 100 million (Rs. 80 million * 125%) in that row.

- As explained in above examples and as can be seen from the reporting template (Table 2 below), new rows have been added in each of the three sections on regulatory adjustments to show the existing treatment. These three sections are between row 26 and 27, row 41 and 42 and row 56 and 57. Banks have the flexibility to add as many rows as required to show each of the pre-Basel III treatment (i.e. treatment before implementation of Basel III capital regulations) during the transition period.

- Similarly, another section is added between row 59 and row 60, in respect of risk weighted assets to show existing treatment of risk weighting. Banks have the flexibility to add as many rows as required to show each of the pre-Basel III (i.e. prior to April 1, 2013 treatment) of risk weighting during the transition period.

Table DF-11: Composition of Capital

Part II: Template to be used before March 31, 2017 (i.e. during the transition period of Basel III regulatory adjustments)

(Rs. in million)

	Basel III common disclosure template to be used during the transition of regulatory adjustments (i.e. from April 1, 2013 to December 31, 2017)		Amounts Subject to Pre-Basel III Treatment	Ref No.
Common Equity Tier 1 capital: instruments and reserves				
1	Directly issued qualifying common share capital plus related stock surplus (share premium)			
2	Retained earnings			
3	Accumulated other comprehensive income (and other reserves)			
4	*Directly issued capital subject to phase out from CET1 (only applicable to non-joint stock companies[1])*			
	Public sector capital injections grandfathered until January 1, 2018			
5	Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1)			
6	**Common Equity Tier 1 capital before regulatory adjustments**			
Common Equity Tier 1 capital: regulatory adjustments				
7	Prudential valuation adjustments			
8	Goodwill (net of related tax liability)			
9	Intangibles other than mortgage-servicing rights (net of related tax liability)			
10	Deferred tax assets [2]			
11	Cash-flow hedge reserve			
12	Shortfall of provisions to expected losses			
13	Securitisation gain on sale			
14	Gains and losses due to changes in own credit risk on fair valued liabilities			
15	Defined-benefit pension fund net assets			
16	Investments in own shares (if not already netted off paid-in capital on reported balance sheet)			
17	Reciprocal cross-holdings in common equity			
18	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued share capital (amount above 10% threshold)			
19	Significant investments in the common stock of banking, financial and insurance entities that are outside the scope of			

[1] Not applicable to commercial banks in India.

[2] In terms of Basel III rules text issued by the Basel Committee (December 2010), DTAs that rely on future profitability of the bank to be realized are to be deducted. DTAs which relate to temporary differences are to be treated under the "threshold deductions" as set out in paragraph 87. However, banks in India are required to deduct all DTAs, irrespective of their origin, from CET1 capital.

	regulatory consolidation, net of eligible short positions (amount above 10% threshold)[3]			
20	Mortgage servicing rights[4] (amount above 10% threshold)			
21	Deferred tax assets arising from temporary differences[5] (amount above 10% threshold, net of related tax liability)			
22	Amount exceeding the 15% threshold[6]			
23	of which: significant investments in the common stock of financial entities			
24	of which: mortgage servicing rights			
25	of which: deferred tax assets arising from temporary differences			
26	National specific regulatory adjustments[7] (26a+26b+26c+26d)			
26a	*of which:* Investments in the equity capital of the unconsolidated insurance subsidiaries			
26b	*of which:* Investments in the equity capital of unconsolidated non-financial subsidiaries[8]			
26c	*of which:* Shortfall in the equity capital of majority owned financial entities which have not been consolidated with the bank[9]			
26d	*of which:* Unamortised pension funds expenditures			
	Regulatory Adjustments Applied to Common Equity Tier 1 in respect of Amounts Subject to Pre-Basel III Treatment			
	of which: [INSERT TYPE OF ADJUSTMENT] For example: filtering out of unrealised losses on AFS debt securities (not relevant in Indian context)			
	of which: [INSERT TYPE OF ADJUSTMENT]			
	of which: [INSERT TYPE OF ADJUSTMENT]			
27	Regulatory adjustments applied to Common Equity Tier 1 due to insufficient Additional Tier 1 and Tier 2 to cover deductions			
28	**Total regulatory adjustments to Common equity Tier 1**			
29	**Common Equity Tier 1 capital (CET1)**			

[3] Only significant investments other than in the insurance and non-financial subsidiaries should be reported here. The insurance and non-financial subsidiaries are not consolidated for the purpose of capital adequacy. The equity and other regulatory capital investments in insurance subsidiaries are fully deducted from consolidated regulatory capital of the banking group. However, in terms of Basel III rules text of the Basel Committee, insurance subsidiaries are included under significant investments and thus, deducted based on 10% threshold rule instead of full deduction.

[4] Not applicable in Indian context.

[5] Please refer to Footnote 2.

[6] Not applicable in Indian context.

[7] Adjustments which are not specific to the Basel III regulatory adjustments (as prescribed by the Basel Committee) will be reported under this row. However, regulatory adjustments which are linked to Basel III i.e. where there is a change in the definition of the Basel III regulatory adjustments, the impact of these changes will be explained in the Notes of this disclosure template.

[8] Non-financial subsidiaries are not consolidated for the purpose of capital adequacy. The equity and other regulatory capital investments in the non-financial subsidiaries are deducted from consolidated regulatory capital of the group. These investments are not required to be fully deducted from capital under Basel III rules text of the Basel Committee.

[9] Please refer to paragraph 3.3.5 of Master Circular on Basel III Capital Regulations. Please also refer to the Paragraph 34 of the Basel II Framework issued by the Basel Committee (June 2006). Though this is not national specific adjustment, it is reported here.

Additional Tier 1 capital: instruments				
30	Directly issued qualifying Additional Tier 1 instruments plus related stock surplus (31+32)			
31	of which: classified as equity under applicable accounting standards (Perpetual Non-Cumulative Preference Shares)			
32	of which: classified as liabilities under applicable accounting standards (Perpetual debt Instruments)			
33	*Directly issued capital instruments subject to phase out from Additional Tier 1*			
34	Additional Tier 1 instruments (and CET1 instruments not included in row 5) issued by subsidiaries and held by third parties (amount allowed in group AT1)			
35	*of which: instruments issued by subsidiaries subject to phase out*			
36	**Additional Tier 1 capital before regulatory adjustments**			
Additional Tier 1 capital: regulatory adjustments				
37	Investments in own Additional Tier 1 instruments			
38	Reciprocal cross-holdings in Additional Tier 1 instruments			
39	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above 10% threshold)			
40	Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)[10]			
41	National specific regulatory adjustments (41a+41b)			
41a	Investments in the Additional Tier 1 capital of unconsolidated insurance subsidiaries			
41b	Shortfall in the Additional Tier 1 capital of majority owned financial entities which have not been consolidated with the bank			
	Regulatory Adjustments Applied to Additional Tier 1 in respect of Amounts Subject to Pre-Basel III Treatment			
	of which: [INSERT TYPE OF ADJUSTMENT e.g. DTAs]			
	of which: [INSERT TYPE OF ADJUSTMENT e.g. existing adjustments which are deducted from Tier 1 at 50%]			
	of which: [INSERT TYPE OF ADJUSTMENT]			
42	Regulatory adjustments applied to Additional Tier 1 due to insufficient Tier 2 to cover deductions			
43	**Total regulatory adjustments to Additional Tier 1 capital**			
44	**Additional Tier 1 capital (AT1)**			
44a	**Additional Tier 1 capital reckoned for capital adequacy[11]**			
45	**Tier 1 capital (T1 = CET1 + AT1) (29 + 44a)**			
Tier 2 capital: instruments and provisions				
46	Directly issued qualifying Tier 2 instruments plus related stock surplus			

[10] Please refer to Footnote 3 above.
[11] Please refer paragraph 4.2.2(vii) of the Master Circular on Basel III Capital Regulations.

47	Directly issued capital instruments subject to phase out from Tier 2			
48	Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties (amount allowed in group Tier 2)			
49	*of which: instruments issued by subsidiaries subject to phase out*			
50	Provisions[12]			
51	**Tier 2 capital before regulatory adjustments**			
	Tier 2 capital: regulatory adjustments			
52	Investments in own Tier 2 instruments			
53	Reciprocal cross-holdings in Tier 2 instruments			
54	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above the 10% threshold)			
55	Significant investments[13] in the capital banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)			
56	National specific regulatory adjustments (56a+56b)			
56a	*of which:* Investments in the Tier 2 capital of unconsolidated subsidiaries			
56b	*of which:* Shortfall in the Tier 2 capital of majority owned financial entities which have not been consolidated with the bank			
	Regulatory Adjustments Applied To Tier 2 in respect of Amounts Subject to Pre-Basel III Treatment			
	of which: [INSERT TYPE OF ADJUSTMENT e.g. existing adjustments which are deducted from Tier 2 at 50%]			
	of which: [INSERT TYPE OF ADJUSTMENT			
57	**Total regulatory adjustments to Tier 2 capital**			
58	**Tier 2 capital (T2)**			
58a	**Tier 2 capital reckoned for capital adequacy[14]**			
58b	**Excess Additional Tier 1 capital reckoned as Tier 2 capital**			
58c	**Total Tier 2 capital admissible for capital adequacy (58a + 58b)**			
59	**Total capital (TC = T1 + T2) (45 + 58c)**			
	Risk Weighted Assets in respect of Amounts Subject to Pre-Basel III Treatment			
	of which: [INSERT TYPE OF ADJUSTMENT]			
	of which: …			
60	**Total risk weighted assets (60a + 60b + 60c)**			

[12] Eligible Provisions and revaluation Reserves in terms of paragraph 4.2.5.1 of the Master Circular on Basel III Capital Regulations, both to be reported and break-up of these two items to be furnished in Notes.

[13] Please refer to Footnote 3 above.

[14] Please refer paragraph 4.2.2(vii) of the Master Circular on Basel III Capital Regulations.

60a	*of which: total credit risk weighted assets*		
60b	*of which: total market risk weighted assets*		
60c	*of which: total operational risk weighted assets*		
Capital ratios			
61	Common Equity Tier 1 (as a percentage of risk weighted assets)		
62	Tier 1 (as a percentage of risk weighted assets)		
63	Total capital (as a percentage of risk weighted assets)		
64	Institution specific buffer requirement (minimum CET1 requirement plus capital conservation and countercyclical buffer requirements, expressed as a percentage of risk weighted assets)		
65	*of which: capital conservation buffer requirement*		
66	*of which: bank specific countercyclical buffer requirement*		
67	*of which: G-SIB buffer requirement*		
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk weighted assets)		
National minima (if different from Basel III)			
69	National Common Equity Tier 1 minimum ratio (if different from Basel III minimum)		
70	National Tier 1 minimum ratio (if different from Basel III minimum)		
71	National total capital minimum ratio (if different from Basel III minimum)		
Amounts below the thresholds for deduction (before risk weighting)			
72	Non-significant investments in the capital of other financial entities		
73	Significant investments in the common stock of financial entities		
74	Mortgage servicing rights (net of related tax liability)		
75	Deferred tax assets arising from temporary differences (net of related tax liability)		
Applicable caps on the inclusion of provisions in Tier 2			
76	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to standardised approach (prior to application of cap)		
77	Cap on inclusion of provisions in Tier 2 under standardised approach		
78	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to internal ratings-based approach (prior to application of cap)		
79	Cap for inclusion of provisions in Tier 2 under internal ratings-based approach		
Capital instruments subject to phase-out arrangements (only applicable between March 31, 2017 and March 31, 2022)			
80	*Current cap on CET1 instruments subject to phase out arrangements*		
81	*Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)*		
82	*Current cap on AT1 instruments subject to phase out*		

	arrangements			
83	*Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)*			
84	*Current cap on T2 instruments subject to phase out arrangements*			
85	*Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)*			

Notes to the Template

Row No. of the template	Particular	(Rs. in million)
10	Deferred tax assets associated with accumulated losses	
	Deferred tax assets (excluding those associated with accumulated losses) net of Deferred tax liability	
	Total as indicated in row 10	
19	If investments in insurance subsidiaries are not deducted fully from capital and instead considered under 10% threshold for deduction, the resultant increase in the capital of bank	
	of which: Increase in Common Equity Tier 1 capital	
	of which: Increase in Additional Tier 1 capital	
	of which: Increase in Tier 2 capital	
26b	If investments in the equity capital of unconsolidated non-financial subsidiaries are not deducted and hence, risk weighted then:	
	(i) Increase in Common Equity Tier 1 capital	
	(ii) Increase in risk weighted assets	
44a	Excess Additional Tier 1 capital not reckoned for capital adequacy (difference between Additional Tier 1 capital as reported in row 44 and admissible Additional Tier 1 capital as reported in 44a)	
	of which: Excess Additional Tier 1 capital which is considered as Tier 2 capital under row 58b	
50	Eligible Provisions included in Tier 2 capital	
	Eligible Revaluation Reserves included in Tier 2 capital	
	Total of row 50	
58a	Excess Tier 2 capital not reckoned for capital adequacy (difference between Tier 2 capital as reported in row 58 and T2 as reported in 58a)	

Explanation of each row of the common disclosure template	
Row No.	**Explanation**
1	Instruments issued by the parent bank of the reporting banking group which meet all of the CET1 entry criteria set out in paragraph 4.2.3 of the Master Circular (read with Annex 1 / Annex 2), as applicable. This should be equal to the sum of common shares (and related surplus only) which must meet the common shares criteria. This should be net of treasury stock and other investments in own shares to the extent that these are already derecognised on the balance sheet under the relevant accounting standards. Other paid-up capital elements must be excluded. All minority interest must be excluded.

2	Retained earnings, prior to all regulatory adjustments in accordance with paragraph 4.2.3 of the Master Circular
3	Accumulated other comprehensive income and other disclosed reserves, prior to all regulatory adjustments.
4	Banks must report zero in this row.
5	Common share capital issued by subsidiaries and held by third parties. Only the amount that is eligible for inclusion in group CET1 should be reported here as determined by the application of paragraph 4.3.4 of the Master Circular (Also see Annex 17 for illustration).
6	Sum of rows 1 to 5.
7	Valuation adjustments according to the requirements of paragraph 8.8 of the Master Circular
8	Goodwill net of related tax liability as set out in paragraph 4.4.1 of the Master Circular
9	Intangibles (net of related tax liability) as set out in paragraph 4.4.1 of the Master Circular
10	Deferred tax assets (net of related tax liability) as set out in paragraph 4.4.2 of the Master Circular
11	The element of the cash-flow hedge reserve described in paragraph 4.4.3 of the Master Circular
12	Shortfall of provisions to expected losses as described in paragraph 4.4.4 of the Master Circular
13	Securitisation gain on sale as described in paragraph 4.4.5 of the Master Circular
14	Gains and losses due to changes in own credit risk on fair valued liabilities as described in paragraph 4.4.6 of the Master Circular
15	Defined-benefit pension fund net assets, the amount to be deducted as set out in paragraphs 4.4.7 of the Master Circular
16	Investments in own shares (if not already netted off paid-in capital on reported balance sheet) as set out in paragraph 4.4.8 of the Master Circular
17	Reciprocal cross-holdings in common equity as set out in paragraph 4.4.9.2(A) of the Master Circular
18	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation where the bank does not own more than 10% of the issued share capital (amount above 10% threshold), amount to be deducted from CET1 in accordance with paragraph 4.4.9.2 (B) of the Master Circular
19	Significant investments in the common stock of banking, financial and insurance entities that are outside the scope of regulatory consolidation (amount above 10% threshold), amount to be deducted from CET1 in accordance with paragraph 4.4.9.2 (C) of the Master Circular
20	Not relevant
21	Not relevant
22	Not relevant
23	Not relevant
24	Not relevant
25	Not relevant
26	Any national specific regulatory adjustments that are required by national authorities to be applied to CET1 in addition to the Basel III minimum set of adjustments [i.e. in terms of December 2010 (rev June 2011) document issued by the Basel Committee on Banking Supervision].
27	Regulatory adjustments applied to Common Equity Tier 1 due to insufficient Additional Tier 1 to cover deductions. If the amount reported in row 43 exceeds the amount reported in row 36 the excess is to be reported here.
28	Total regulatory adjustments to Common equity Tier 1, to be calculated as the sum of rows 7 to 22 plus row 26 and 27.

29	Common Equity Tier 1 capital (CET1), to be calculated as row 6 minus row 28.
30	Instruments that meet all of the AT1 entry criteria set out in paragraph 4.2.4 of the Master Circular. All instruments issued of subsidiaries of the consolidated group should be excluded from this row.
31	The amount in row 30 classified as equity under applicable Accounting Standards.
32	The amount in row 30 classified as liabilities under applicable Accounting Standards.
33	Directly issued capital instruments subject to phase out from Additional Tier 1 in accordance with the requirements of paragraph 4.5.4 of the Master Circular
34	Additional Tier 1 instruments (and CET1 instruments not included in row 5) issued by subsidiaries and held by third parties, the amount allowed in group AT1 in accordance with paragraph 4.3.4 of the Master Circular (please see Annex 17 for illustration).
35	The amount reported in row 34 that relates to instruments subject to phase out from AT1 in accordance with the requirements of paragraph 4.5.4 of the Master Circular
36	The sum of rows 30, 33 and 34.
37	Investments in own Additional Tier 1 instruments, amount to be deducted from AT1 in accordance with paragraph 4.4.8 of the Master Circular
38	Reciprocal cross-holdings in Additional Tier 1 instruments, amount to be deducted from AT1 in accordance with paragraph 4.4.9.2 (A) of the Master Circular
39	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation where the bank does not own more than 10% of the issued common share capital of the entity (net of eligible short positions), amount to be deducted from AT1 in accordance with paragraph 4.4.9.2 (B) of the Master Circular
40	Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions), amount to be deducted from AT1 in accordance with paragraph 4.4.9.2 (C) of the Master Circular
41	Any national specific regulatory adjustments that are required by national authorities to be applied to Additional Tier 1 in addition to the Basel III minimum set of adjustments [i.e. in terms of December 2010 (rev June 2011) document issued by the Basel Committee on Banking Supervision].
42	Regulatory adjustments applied to Additional Tier 1 due to insufficient Tier 2 to cover deductions. If the amount reported in row 57 exceeds the amount reported in row 51 the excess is to be reported here.
43	The sum of rows 37 to 42.
44	Additional Tier 1 capital, to be calculated as row 36 minus row 43.
45	Tier 1 capital, to be calculated as row 29 plus row 44a.
46	Instruments that meet all of the Tier 2 entry criteria set out in paragraph 4.2.5 of the Master Circular. All instruments issued of subsidiaries of the consolidated group should be excluded from this row. Provisions and Revaluation Reserves should not be included in Tier 2 in this row
47	Directly issued capital instruments subject to phase out from Tier 2 in accordance with the requirements of paragraph 4.5.4 of the Master Circular
48	Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 32) issued by subsidiaries and held by third parties (amount allowed in group Tier 2), in accordance with paragraph 4.3.4 of the Master Circular
49	The amount reported in row 48 that relates to instruments subject to phase out from Tier 2 in accordance with the requirements of paragraph 4.5.4 of the Master Circular
50	Provisions and Revaluation Reserves included in Tier 2, calculated in accordance with paragraph 4.2.5 of the Master Circular
51	The sum of rows 46 to 48 and row 50.
52	Investments in own Tier 2 instruments, amount to be deducted from Tier 2 in accordance with paragraph 4.4.8 of the Master Circular
53	Reciprocal cross-holdings in Tier 2 instruments, amount to be deducted from Tier 2 in

	accordance with paragraph 4.4.9.2 (A) of the Master Circular
54	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation where the bank does not own more than 10% of the issued common share capital of the entity (net of eligible short positions), amount to be deducted from Tier 2 in accordance with paragraph 4.4.9.2(B) of the Master Circular
55	Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions), amount to be deducted from Tier 2 in accordance with paragraph 4.4.9.2(C) of the Master Circular
56	Any national specific regulatory adjustments that are required by national authorities to be applied to Tier 2 in addition to the Basel III minimum set of adjustments [i.e. in terms of December 2010 (rev June 2011) document issued by the Basel Committee on Banking Supervision]..
57	The sum of rows 52 to 56.
58	Tier 2 capital, to be calculated as row 51 minus row 57.
59	Total capital, to be calculated as row 45 plus row 58c.
60	Total risk weighted assets of the reporting group. Details to be furnished under rows 60a, 60b and 60c.
61	Common Equity Tier 1 ratio (as a percentage of risk weighted assets), to be calculated as row 29 divided by row 60 (expressed as a percentage).
62	Tier 1 ratio (as a percentage of risk weighted assets), to be calculated as row 45 divided by row 60 (expressed as a percentage).
63	Total capital ratio (as a percentage of risk weighted assets), to be calculated as row 59 divided by row 60 (expressed as a percentage).
64	Institution specific buffer requirement (minimum CET1 requirement plus capital conservation buffer plus countercyclical buffer requirements plus G-SIB buffer requirement, expressed as a percentage of risk weighted assets). To be calculated as 5.5% plus 2.5% capital conservation buffer plus the bank specific countercyclical buffer requirement whenever activated and applicable plus the bank G-SIB requirement (where applicable) as set out in document '*Global systemically important banks: assessment methodology and the additional loss absorbency requirement': Rules text (November 2011) issued by the Basel Committee*. This row will show the CET1 ratio below which the bank will become subject to constraints on distributions.
65	The amount in row 64 (expressed as a percentage of risk weighed assets) that relates to the capital conservation buffer), i.e. banks will report 2.5% here.
66	The amount in row 64 (expressed as a percentage of risk weighed assets) that relates to the bank specific countercyclical buffer requirement.
67	The amount in row 64 (expressed as a percentage of risk weighed assets) that relates to the bank's G-SIB requirement.
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk weighted assets). To be calculated as the CET1 ratio of the bank, less any common equity used to meet the bank's minimum Tier 1 and minimum Total capital requirements.
69	National Common Equity Tier 1 minimum ratio (if different from Basel III minimum). 5.5% should be reported.
70	National Tier 1 minimum ratio (if different from Basel III minimum). 7% should be reported.
71	National total capital minimum ratio (if different from Basel III minimum). 9% should be reported.
72	Non-significant investments in the capital of other financial entities, the total amount of such holdings that are not reported in row 18, row 39 and row 54.
73	Significant investments in the common stock of financial entities, the total amount of such holdings that are not reported in row 19
74	Mortgage servicing rights, the total amount of such holdings that are not reported in row 19 and row 23 - Not Applicable in India.

75	Deferred tax assets arising from temporary differences, the total amount of such holdings that are not reported in row 21 and row 25. – Not applicable in India.
76	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to standardised approach, calculated in accordance paragraph 4.2.5 of the Master Circular, prior to the application of the cap.
77	Cap on inclusion of provisions in Tier 2 under standardised approach, calculated in accordance paragraph 4.2.5 of the Master Circular
78	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to internal ratings-based approach, calculated in accordance paragraph 4.2.5 of the Master Circular.
79	Cap for inclusion of provisions in Tier 2 under internal ratings-based approach, calculated in accordance paragraph 4.2.5 of the Master Circular
80	Current cap on CET1 instruments subject to phase out arrangements, see paragraph 4.5.5.
81	Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities), see paragraph 4.5.5 of the Master Circular
82	Current cap on AT1 instruments subject to phase out arrangements, see paragraph 4.5.4 of the Master Circular
83	Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities), see paragraph 4.5.4 of the Master Circular
84	Current cap on T2 instruments subject to phase out arrangements, see paragraph 4.5.4 of the Master Circular
85	Amount excluded from T2 due to cap (excess over cap after redemptions and maturities), see paragraph 4.5.4 of the Master Circular

3.3 Three Step Approach to Reconciliation Requirements

Step 1

Under Step 1, banks are required to take their balance sheet in their financial statements (numbers reported the middle column below) and report the numbers when the regulatory scope of consolidation is applied (numbers reported in the right hand column below). If there are rows in the regulatory consolidation balance sheet that are not present in the published financial statements, banks are required to give a value of zero in the middle column and furnish the corresponding amount in the column meant for regulatory scope of consolidation. Banks may however, indicate what the exact treatment is for such amount in the balance sheet.

Table DF-12: Composition of Capital- Reconciliation Requirements

(Rs. in million)

		Balance sheet as in financial statements	**Balance sheet under regulatory scope of consolidation**
		As on reporting date	**As on reporting date**
A	**Capital & Liabilities**		
i	Paid-up Capital		
	Reserves & Surplus		
	Minority Interest		
	Total Capital		
ii	Deposits		
	of which: Deposits from banks		
	of which: Customer deposits		
	of which: Other deposits (pl. specify)		
iii	Borrowings		
	of which: From RBI		
	of which: From banks		
	of which: From other institutions & agencies		
	of which: Others (pl. specify)		
	of which: Capital instruments		
iv	Other liabilities & provisions		
	Total		
B	**Assets**		
i	Cash and balances with Reserve Bank of India		
	Balance with banks and money at call and short notice		
ii	Investments:		
	of which: Government securities		
	of which: Other approved		

	securities		
	of which: Shares		
	of which: Debentures & Bonds		
	of which: Subsidiaries / Joint Ventures / Associates		
	of which: Others (Commercial Papers, Mutual Funds etc.)		
iii	Loans and advances		
	of which: Loans and advances to banks		
	of which: Loans and advances to customers		
iv	Fixed assets		
v	Other assets		
	of which: Goodwill and intangible assets		
	of which: Deferred tax assets		
vi	Goodwill on consolidation		
vii	Debit balance in Profit & Loss account		
	Total Assets		

Step 2

Under Step 2 banks are required to expand the regulatory-scope balance sheet (revealed in Step 1) to identify all the elements that are used in the definition of capital disclosure template set out in Table DF-11 (Part I / Part II whichever, applicable). Set out below are some examples of elements that may need to be expanded for a particular banking group. The more complex the balance sheet of the bank, the more items would need to be disclosed. Each element must be given a reference number/letter that can be used in Step 3.

(Rs. in million)

		Balance sheet as in financial statements	**Balance sheet under regulatory scope of consolidation**
		As on reporting date	**As on reporting date**
A	**Capital & Liabilities**		
i	Paid-up Capital		
	of which: Amount eligible for CET1		e
	of which: Amount eligible for AT1		f
	Reserves & Surplus		
	Minority Interest		
	Total Capital		
ii	Deposits		
	of which: Deposits from banks		
	of which: Customer deposits		
	of which: Other deposits (pl. specify)		

iii	Borrowings		
	of which: From RBI		
	of which: From banks		
	of which: From other institutions & agencies		
	of which: Others (pl. specify)		
	of which: Capital instruments		
iv	Other liabilities & provisions		
	of which: DTLs related to goodwill		c
	of which: DTLs related to intangible assets		d
	Total		
B	**Assets**		
i	Cash and balances with Reserve Bank of India		
	Balance with banks and money at call and short notice		
ii	Investments		
	of which: Government securities		
	of which: Other approved securities		
	of which: Shares		
	of which: Debentures & Bonds		
	of which: Subsidiaries / Joint Ventures / Associates		
	of which: Others (Commercial Papers, Mutual Funds etc.)		
iii	Loans and advances		
	of which: Loans and advances to banks		
	of which: Loans and advances to customers		
iv	Fixed assets		
v	Other assets		
	of which: Goodwill and intangible assets *Out of which:*		
	Goodwill		a
	Other intangibles (excluding MSRs)		b
	Deferred tax assets		
vi	Goodwill on consolidation		
vii	Debit balance in Profit & Loss account		
	Total Assets		

Step 3: Under Step 3 banks are required to complete a column added to the Table DF-11 (Part I / Part II whichever, applicable) disclosure template to show the source of every input.

(iii) For example, the definition of capital disclosure template includes the line “goodwill net of related deferred tax liability”. Next to the disclosure of this item in the disclosure template under Table DF-11 (Part I / Part II whichever, applicable), the bank would be required to put ‘a – c’ to show that row 8 of the template has been calculated as the difference between component ‘a’ of the balance sheet under the regulatory scope of consolidation, illustrated in step 2, and component ‘c’.

Extract of Basel III common disclosure template (with added column) – Table DF-11 (Part I / Part II whichever, applicable)			
Common Equity Tier 1 capital: instruments and reserves			
		Component of regulatory capital reported by bank	Source based on reference numbers/letters of the balance sheet under the regulatory scope of consolidation from step 2
1	Directly issued qualifying common share (and equivalent for non-joint stock companies) capital plus related stock surplus		e
2	Retained earnings		
3	Accumulated other comprehensive income (and other reserves)		
4	Directly issued capital subject to phase out from CET1 (only applicable to non-joint stock companies)		
5	Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1)		
6	Common Equity Tier 1 capital before regulatory adjustments		
7	Prudential valuation adjustments		
8	Goodwill (net of related tax liability)		a-c

3.2 Main Features Template

(i) Template which banks must use to ensure that the key features of regulatory capital instruments are disclosed is set out below. Banks will be required to complete all of the shaded cells for each outstanding regulatory capital instrument (banks should insert “NA” if the question is not applicable).

Table DF-13: Main Features of Regulatory Capital Instruments

	Disclosure template for main features of regulatory capital instruments	
1	Issuer	
2	Unique identifier (e.g. CUSIP, ISIN or Bloomberg identifier for private placement)	
3	Governing law(s) of the instrument	
	Regulatory treatment	
4	Transitional Basel III rules	
5	Post-transitional Basel III rules	
6	Eligible at solo/group/ group & solo	
7	Instrument type	
8	Amount recognised in regulatory capital (Rs. in million, as of most recent reporting date)	
9	Par value of instrument	
10	Accounting classification	
11	Original date of issuance	
12	Perpetual or dated	
13	Original maturity date	
14	Issuer call subject to prior supervisory approval	
15	Optional call date, contingent call dates and redemption amount	
16	Subsequent call dates, if applicable	
	Coupons / dividends	
17	Fixed or floating dividend/coupon	
18	Coupon rate and any related index	
19	Existence of a dividend stopper	
20	Fully discretionary, partially discretionary or mandatory	
21	Existence of step up or other incentive to redeem	
22	Noncumulative or cumulative	
23	Convertible or non-convertible	
24	If convertible, conversion trigger(s)	
25	If convertible, fully or partially	
26	If convertible, conversion rate	
27	If convertible, mandatory or optional conversion	
28	If convertible, specify instrument type convertible into	
29	If convertible, specify issuer of instrument it converts into	
30	Write-down feature	
31	If write-down, write-down trigger(s)	
32	If write-down, full or partial	
33	If write-down, permanent or temporary	
34	If temporary write-down, description of write-up mechanism	
35	Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	
36	Non-compliant transitioned features	
37	If yes, specify non-compliant features	

(ii) Using the reference numbers in the left column of the table above, the following table provides a more detailed explanation of what banks would be required to report in each of the grey cells, including, where relevant, the list of options contained in the spread sheet's drop down menu.

Further explanation of items in main features disclosure template	
1	Identifies issuer legal entity. *Free text*
2	Unique identifier (e.g. CUSIP, ISIN or Bloomberg identifier for private placement) *Free text*
3	Specifies the governing law(s) of the instrument *Free text*
4	Specifies transitional Basel III regulatory capital treatment. *Select from menu: [Common Equity Tier 1] [Additional Tier 1] [Tier 2]*
5	Specifies regulatory capital treatment under Basel III rules not taking into account transitional treatment. *Select from menu: [Common Equity Tier 1] [Additional Tier 1] [Tier 2] [Ineligible]*
6	Specifies the level(s) within the group at which the instrument is included in capital. *Select from menu: [Solo] [Group] [Solo and Group]*
7	Specifies instrument type, varying by jurisdiction. Helps provide more granular understanding of features, particularly during transition. *Select from menu: [Common Shares] [Perpetual Non-cumulative Preference Shares] [Perpetual Debt Instruments] [Upper Tier 2 Capital Instruments] [Perpetual Cumulative Preference Shares] [Redeemable Non-cumulative Preference Shares] [Redeemable Cumulative Preference Shares] [Tier 2 Debt Instruments] [Others- specify]*
8	Specifies amount recognised in regulatory capital. *Free text*
9	Par value of instrument *Free text*
10	Specifies accounting classification. Helps to assess loss absorbency. *Select from menu:* *[Shareholders' equity] [Liability] [Non-controlling interest in consolidated subsidiary]*
11	Specifies date of issuance. *Free text*
12	Specifies whether dated or perpetual. *Select from menu: [Perpetual] [Dated]*
13	For dated instrument, specifies original maturity date (day, month and year). For perpetual instrument put "no maturity". *Free text*
14	Specifies whether there is an issuer call option. Helps to assess permanence. *Select from menu: [Yes] [No]*
15	For instrument with issuer call option, specifies first date of call if the instrument has a call option on a specific date (day, month and year) and, in addition, specifies if the instrument has a tax and/or regulatory event call. Also specifies the redemption price. Helps to assess permanence. *Free text*
16	Specifies the existence and frequency of subsequent call dates, if applicable. Helps to assess permanence. *Free text*
17	Specifies whether the coupon/dividend is fixed over the life of the instrument, floating over the life of the instrument, currently fixed but will move to a floating rate in the future, currently floating but will move to a fixed rate in the future. *Select from menu: [Fixed], [Floating] [Fixed to floating], [Floating to fixed]*
18	Specifies the coupon rate of the instrument and any related index that the coupon/dividend rate references. *Free text*
19	Specifies whether the non-payment of a coupon or dividend on the instrument prohibits the payment of dividends on common shares (i.e. whether there is a dividend stopper).

	Select from menu: [Yes], [No]
20	Specifies whether the issuer has full discretion, partial discretion or no discretion over whether a coupon/dividend is paid. If the bank has full discretion to cancel coupon/dividend payments under all circumstances it must select “fully discretionary” (including when there is a dividend stopper that does not have the effect of preventing the bank from cancelling payments on the instrument). If there are conditions that must be met before payment can be cancelled (e.g. capital below a certain threshold), the bank must select “partially discretionary”. If the bank is unable to cancel the payment outside of insolvency the bank must select “mandatory”. *Select from menu: [Fully discretionary] [Partially discretionary] [Mandatory]*
21	Specifies whether there is a step-up or other incentive to redeem. *Select from menu: [Yes] [No]*
22	Specifies whether dividends / coupons are cumulative or noncumulative. *Select from menu: [Noncumulative] [Cumulative]*
23	Specifies whether instrument is convertible or not. Helps to assess loss absorbency. *Select from menu: [Convertible] [Nonconvertible]*
24	Specifies the conditions under which the instrument will convert, including point of non-viability. Where one or more authorities have the ability to trigger conversion, the authorities should be listed. For each of the authorities it should be stated whether it is the terms of the contract of the instrument that provide the legal basis for the authority to trigger conversion (a contractual approach) or whether the legal basis is provided by statutory means (a statutory approach). *Free text*
25	Specifies whether the instrument will always convert fully, may convert fully or partially, or will always convert partially *Select from menu: [Always Fully] [Fully or Partially] [Always partially]*
26	Specifies rate of conversion into the more loss absorbent instrument. Helps to assess the degree of loss absorbency. *Free text*
27	For convertible instruments, specifies whether conversion is mandatory or optional. Helps to assess loss absorbency. *Select from menu: [Mandatory] [Optional] [NA]*
28	For convertible instruments, specifies instrument type convertible into. Helps to assess loss absorbency. *Select from menu: [Common Equity Tier 1] [Additional Tier 1] [Tier 2] [Other]*
29	If convertible, specify issuer of instrument into which it converts. *Free text*
30	Specifies whether there is a write down feature. Helps to assess loss absorbency. *Select from menu: [Yes] [No]*
31	Specifies the trigger at which write-down occurs, including point of non-viability. Where one or more authorities have the ability to trigger write-down, the authorities should be listed. For each of the authorities it should be stated whether it is the terms of the contract of the instrument that provide the legal basis for the authority to trigger write-down (a contractual approach) or whether the legal basis is provided by statutory means (a statutory approach). *Free text*
32	Specifies whether the instrument will always be written down fully, may be written down partially, or will always be written down partially. Helps assess the level of loss absorbency at write-down. *Select from menu: [Always Fully] [Fully or Partially] [Always partially]*
33	For write down instrument, specifies whether write down is permanent or temporary. Helps to assess loss absorbency. *Select from menu: [Permanent] [Temporary] [NA]*
34	For instrument that has a temporary write-down, description of write-up mechanism.

	Free text
35	Specifies instrument to which it is most immediately subordinate. Helps to assess loss absorbency on gone-concern basis. Where applicable, banks should specify the column numbers of the instruments in the completed main features template to which the instrument is most immediately subordinate. *Free text*
36	Specifies whether there are non-compliant features. *Select from menu: [Yes] [No]*
37	If there are non-compliant features, banks to specify which ones. Helps to assess instrument loss absorbency. *Free text*

3.3 Full Terms and Conditions of Regulatory Capital Instruments

Under this template, banks are required to disclose the full terms and conditions of all instruments included in the regulatory capital

Table DF-14: Full Terms and Conditions of Regulatory Capital Instruments

Instruments	Full Terms and Conditions

3.6 Disclosure Requirements for Remuneration

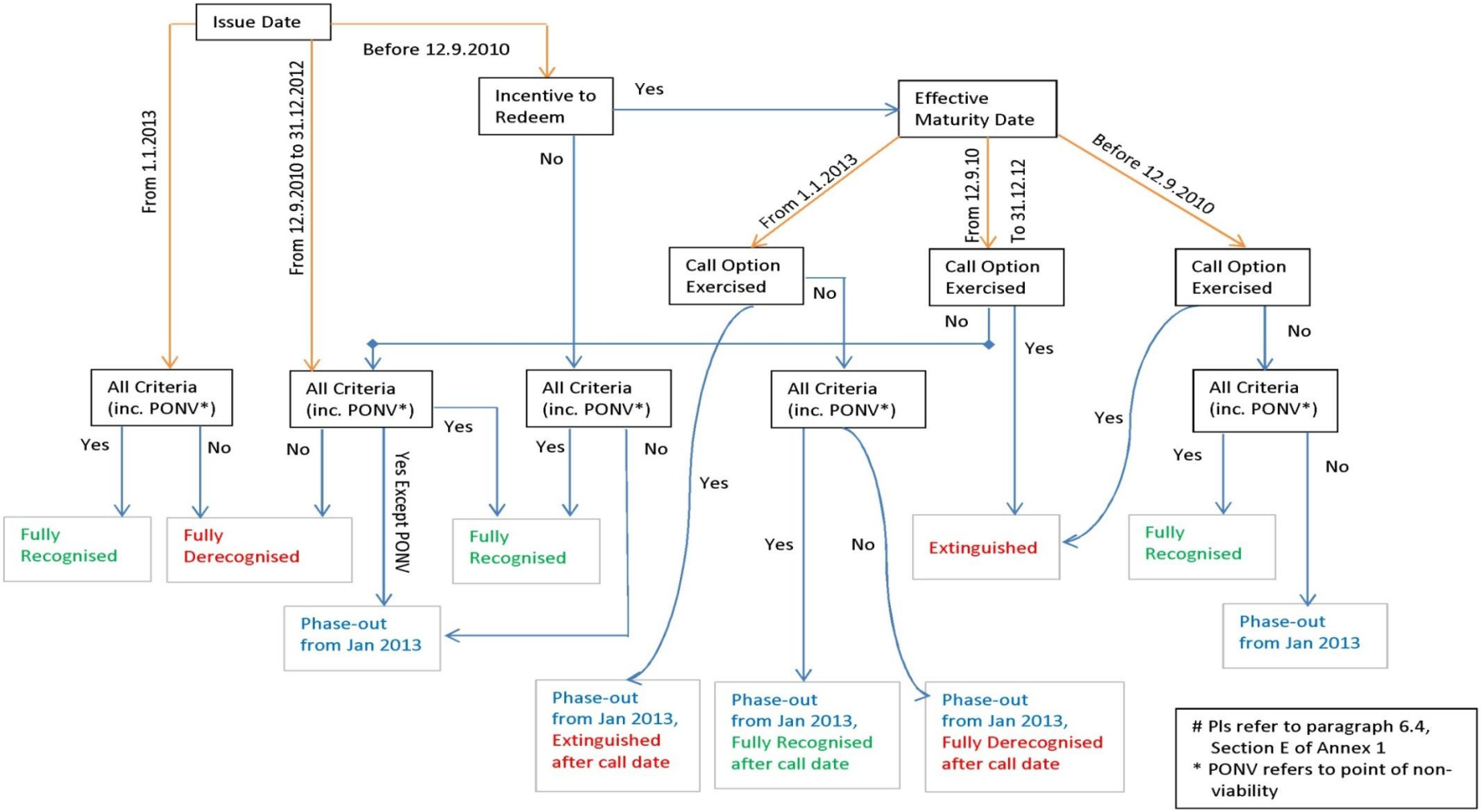
Please refer to the Guidelines on Compensation of Whole Time Directors / Chief Executive Officers / Other Risk Takers issued vide circular DBOD.No.BC.72/29.67.001/2011-12 dated January 13, 2012 addressed to all private sector and foreign banks operating in India. Private sector and foreign banks operating in India are required to make disclosure on remuneration on an annual basis at the minimum, in their Annual Financial Statements in the following template:

Table DF-15: Disclosure Requirements for Remuneration

Remuneration			
Qualitative disclosures	(a)		Information relating to the composition and mandate of the Remuneration Committee.
	(b)		Information relating to the design and structure of remuneration processes and the key features and objectives of remuneration policy.
	(c)		Description of the ways in which current and future risks are taken into account in the remuneration processes. It should include the nature and type of the key measures used to take account of these risks.
	(d)		Description of the ways in which the bank seeks to link performance during a performance measurement period with levels of remuneration.
	(e)		A discussion of the bank's policy on deferral and vesting of variable remuneration and a discussion of the bank's policy and criteria for adjusting deferred remuneration before vesting and after vesting.
	(f)		Description of the different forms of variable remuneration (i.e. cash, shares, ESOPs and other forms) that the bank utilizes and the rationale for using these different forms.
Quantitative disclosures (The quantitative disclosures should only cover Whole Time Directors / Chief Executive Officer / Other Risk Takers)	(g)	*	Number of meetings held by the Remuneration Committee during the financial year and remuneration paid to its members.
	(h)	*	Number of employees having received a variable remuneration award during the financial year.
		*	Number and total amount of sign-on awards made during the financial year.
		*	Details of guaranteed bonus, if any, paid as joining / sign on bonus.
		*	Details of severance pay, in addition to accrued benefits, if any.
	(i)	*	Total amount of outstanding deferred remuneration, split into cash, shares and share-linked instruments and other forms.
		*	Total amount of deferred remuneration paid out in the financial year.
	(j)	*	Breakdown of amount of remuneration awards for the financial year to show fixed and variable, deferred and non-deferred.
	(k)	*	Total amount of outstanding deferred remuneration and retained remuneration exposed to ex post explicit and / or implicit adjustments.
		*	Total amount of reductions during the financial year due to ex- post explicit adjustments.
		*	Total amount of reductions during the financial year due to ex- post implicit adjustments.

Annex 19

TRANSITIONAL ARRANGEMENTS FOR NON-EQUITY REGULATORY CAPITAL INSTRUMENTS



Annex 20

GLOSSARY

Asset	An asset is anything of value that is owned by a person or business
Available for Sale	The securities available for sale are those securities where the intention of the bank is neither to trade nor to hold till maturity. These securities are valued at the fair value which is determined by reference to the best available source of current market quotations or other data relative to current value.
Balance Sheet	A balance sheet is a financial statement of the assets and liabilities of a trading concern, recorded at a particular point in time.
Banking Book	The banking book comprises assets and liabilities, which are contracted basically on account of relationship or for steady income and statutory obligations and are generally held till maturity.
Basel Committee on Banking Supervision	The Basel Committee is a committee of bank supervisors consisting of members from each of the G10 countries. The Committee is a forum for discussion on the handling of specific supervisory problems. It coordinates the sharing of supervisory responsibilities among national authorities in respect of banks' foreign establishments with the aim of ensuring effective supervision of banks' activities worldwide. Update with latest
Basic Indicator Approach	An operational risk measurement technique permitted under Basel II. The approach sets a charge for operational risk as a fixed percentage ("alpha factor") of a single indicator. The indicator serves as a proxy for the bank's risk exposure.
Basis Risk	The risk that the interest rate of different assets, liabilities and off-balance sheet items may change in different magnitude is termed as basis risk.
Capital	Capital refers to the funds (e.g., money, loans, equity, etc.) which are available to carry on a business, make an investment, and generate future revenue. Capital also refers to physical assets which can be used to generate future returns.
Capital adequacy	A measure of the adequacy of an entity's capital resources in relation to its current liabilities and also in relation to the risks associated with its assets. An appropriate level of capital adequacy ensures that the entity has sufficient capital to support its activities and that its net worth is sufficient to absorb adverse changes in the value of its assets without becoming insolvent. For example, under BIS (Bank for International Settlements) rules, banks are required to maintain a certain level of capital against their risk-adjusted assets.
Capital reserves	That portion of a company's profits not paid out as dividends to shareholders. They are also known as undistributable reserves.
Convertible Bond	A bond giving the investor the option to convert the bond into equity at a fixed conversion price or as per a pre-determined pricing formula.
Credit risk	Risk that a party to a contractual agreement or transaction will be unable to meet their obligations or will default on commitments. Credit risk can be associated with almost any transaction or instrument such as swaps, repos, CDs, foreign exchange transactions, etc. Specific types of credit risk include sovereign risk, country risk, legal or force majeure risk, marginal risk and settlement risk.
Debentures	Bonds issued by a company bearing a fixed rate of interest usually payable half yearly on specific dates and principal amount repayable on a particular date on redemption of the debentures.

Deferred Tax Assets	Unabsorbed depreciation and carry forward of losses which can be set-off against future taxable income which is considered as timing differences result in deferred tax assets. The deferred Tax Assets are accounted as per the Accounting Standard 22. Deferred Tax Assets have an effect of decreasing future income tax payments, which indicates that they are prepaid income taxes and meet definition of assets. Whereas deferred tax liabilities have an effect of increasing future year's income tax payments, which indicates that they are accrued income taxes and meet definition of liabilities
Delta (∆)	The delta of an option / a portfolio of options is the rate of change in the value of the option / portfolio with respect to change in the price of the asset(s) underlying the option(s).
Derivative	A derivative instrument derives much of its value from an underlying product. Examples of derivatives include futures, options, forwards and swaps. For example, a forward contract can be derived from the spot currency market and the spot markets for borrowing and lending. In the past, derivative instruments tended to be restricted only to those products which could be derived from spot markets. However, today the term seems to be used for any product that can be derived from any other.
Duration	Duration (Macaulay duration) measures the price volatility of fixed income securities. It is often used in the comparison of the interest rate risk between securities with different coupons and different maturities. It is the weighted average of the present value of all the cash flows associated with a fixed income security. It is expressed in years. The duration of a fixed income security is always shorter than its term to maturity, except in the case of zero coupon securities where they are the same.
Foreign Institutional Investor	An institution established or incorporated outside India which proposes to make investment in India insecurities; provided that a domestic asset management company or domestic portfolio manager who manages funds raised or collected or brought from outside India for investment in India on behalf of a sub-account, shall be deemed to be a Foreign Institutional Investor.
Forward Contract	A forward contract is an agreement between two parties to buy or sell an agreed amount of a commodity or financial instrument at an agreed price, for delivery on an agreed future date. In contrast to a futures contract, a forward contract is not transferable or exchange tradable, its terms are not standardized and no margin is exchanged. The buyer of the forward contract is said to be long the contract and the seller is said to be short the contract.
Gamma(Γ)	The gamma of an option / portfolio of options is the rate of change of the option's / portfolio's delta with respect to the change in the price of the asset(s) underlying the option (s).
General provisions & loss reserves	Such reserves, if they are not attributable to the actual diminution in value or identifiable potential loss in any specific asset and are available to meet unexpected losses, can be included in Tier II capital.
General market risk	Risk that relates to overall market conditions while specific risk is risk that relates to the issuer of a particular security
Hedging	Taking action to eliminate or reduce exposure to risk
Held for Trading	Securities where the intention is to trade by taking advantage of short-term price / interest rate movements.
Horizontal Disallowance	A disallowance of offsets to required capital used the BIS Method for assessing market risk for regulatory capital. In order to calculate the capital required for interest rate risk of a trading portfolio, the BIS Method allows

	offsets of long and short positions. Yet interest rate risk of instruments at different horizontal points of the yield curve are not perfectly correlated. Hence, the BIS Method requires that a portion of these offsets be disallowed.
Interest rate risk	Risk that the financial value of assets or liabilities (or inflows/outflows) will be altered because of fluctuations in interest rates. For example, the risk that future investment may have to be made at lower rates and future borrowings at higher rates.
Long Position	A long position refers to a position where gains arise from a rise in the value of the underlying.
Market risk	Risk of loss arising from movements in market prices or rates away from the rates or prices set out in a transaction or agreement.
Modified Duration	The modified duration or volatility of an interest bearing security is its Macaulay duration divided by one plus the coupon rate of the security. It represents the percentage change in a securities' price for a 100 basis points change in yield. It is generally accurate for only small changes in the yield. $MD = -\frac{dP}{dY}\cdot\frac{1}{P}$ where: MD = Modified duration P = Gross price (i.e. clean price plus accrued interest). dP = Corresponding small change in price. dY = Small change in yield compounded with the frequency of the coupon payment.
Mortgage-backed security	A bond-type security in which the collateral is provided by a pool of mortgages. Income from the underlying mortgages is used to meet interest and principal repayments.
Mutual Fund	Mutual Fund is a mechanism for pooling the resources by issuing units to the investors and investing funds in securities in accordance with objectives as disclosed in offer document. A fund established in the form of a trust to raise monies through the sale of units to the public or a section of the public under one or more schemes for investing in securities, including money market instruments.
Net Interest Margin	Net interest margin is the net interest income divided by average interest earning assets
Net NPA	Net NPA = Gross NPA – (Balance in Interest Suspense account + DICGC/ECGC claims received and held pending adjustment + Part payment received and kept in suspense account + Total provisions held)‘
Nostro accounts	Foreign currency settlement accounts that a bank maintains with its overseas correspondent banks. These accounts are assets of the domestic bank.
Off-Balance Sheet expos-ures	Off-Balance Sheet exposures refer to the business activities of a bank that generally do not involve booking assets (loans) and taking deposits. Off-balance sheet activities normally generate fees, but produce liabilities or assets that are deferred or contingent and thus, do not appear on the institution's balance sheet until or unless they become actual assets or liabilities.
Open position	It is the net difference between the amounts payable and amounts receivable in a particular instrument or commodity. It results from the existence of a net long or net short position in the particular instrument or commodity.

Option	An option is a contract which grants the buyer the right, but not the obligation, to buy (call option) or sell (put option) an asset, commodity, currency or financial instrument at an agreed rate (exercise price) on or before an agreed date (expiry or settlement date). The buyer pays the seller an amount called the premium in exchange for this right. This premium is the price of the option.
Rho(ρ)	Rho of an option / a portfolio of options is the rate of change in the value of an option / portfolio with respect to change in the level of interest rates.
Risk	The possibility of an outcome not occurring as expected. It can be measured and is not the same as uncertainty, which is not measurable. In financial terms, risk refers to the possibility of financial loss. It can be classified as credit risk, market risk and operational risk.
Risk Asset Ratio	A bank's risk asset ratio is the ratio of a bank's risk assets to its capital funds. Risk assets include assets other than highly rated government and government agency obligations and cash, for example, corporate bonds and loans. The capital funds include capital and undistributed reserves. The lower the risk asset ratio the better the bank's 'capital cushion'
Risk Weights	Basel II sets out a risk-weighting schedule for measuring the credit risk of obligors. The risk weights are linked to ratings given to sovereigns, financial institutions and corporations by external credit rating agencies.
Securitis-ation	The process whereby similar debt instruments/assets are pooled together and repackaged into marketable securities which can be sold to investors. The process of loan securitisation is used by banks to move their assets off the balance sheet in order to improve their capital asset ratios.
Short position	A short position refers to a position where gains arise from a decline in the value of the underlying. It also refers to the sale of a security in which the seller does not have a long position.
Specific risk	Within the framework of the BIS proposals on market risk, specific risk refers to the risk associated with a specific security, issuer or company, as opposed to the risk associated with a market or market sector (general risk).
Subordinated debt	Refers to the status of the debt. In the event of the bankruptcy or liquidation of the debtor, subordinated debt only has a secondary claim on repayments, after other debt has been repaid.
Theta(θ)	The theta of an option / a portfolio of options is the rate of change in the value of the option / portfolio with respect to passage of time, with all else remaining the same. It is also called the “time decay” of the option.
Trading Book	A trading book or portfolio refers to the book of financial instruments held for the purpose of short-term trading, as opposed to securities that would be held as a long-term investment. The trading book refers to the assets that are held primarily for generating profit on short-term differences in prices/yields. The price risk is the prime concern of banks in trading book.
Underwrite	Generally, to underwrite means to assume a risk for a fee. Its two most common contexts are: a) Securities: a dealer or investment bank agrees to purchase a new issue of securities from the issuer and distribute these securities to investors. The underwriter may be one person or part of an underwriting syndicate. Thus the issuer faces no risk of being left with unsold securities. b) Insurance: a person or company agrees to provide financial compensation against the risk of fire, theft, death, disability, etc., for a fee called a premium.
Value at risk (VAR)	It is a method for calculating and controlling exposure to market risk. VAR is a single number (currency amount) which estimates the maximum expected

	loss of a portfolio over a given time horizon (the holding period) and at a given confidence level.
Vega (v)	The Vega of an option / a portfolio of options is the rate of change in the value of the option / portfolio with respect to volatility of the asset(s) underlying the option(s).
Venture capital Fund	A fund with the purpose of investing in start-up businesses that is perceived to have excellent growth prospects but does not have access to capital markets.
Vertical Disallowance	In the BIS Method for determining regulatory capital necessary to cushion market risk, a reversal of the offsets of a general risk charge of a long position by a short position in two or more securities in the same time band in the yield curve where the securities have differing credit risks.

Annex 21
(Cf. Para 2 of the covering circular)

List of Circulars Consolidated in the Master Circular

Sl. No	Circular No.	Subject	Updated Para No. of the Master Circular
1.	DBOD.No.BP.BC.16 /21.06.001/2012-13	Master Circular - Prudential Guidelines on Capital Adequacy and Market Discipline- New Capital Adequacy Framework (NCAF)	
2.	DBOD.No.BC.72/29.6 7.001/2011-12 dated January 13, 2012	Guidelines on Compensation of Whole Time Directors / Chief Executive Officers / Risk takers and Control function Staff, etc.	Table DF-15 on Disclosure Requirements for Remuneration
3.	DBOD.No.BP.BC.98 /21.06.201/2011-12 dated May 2, 2012	Guidelines on Implementation of Basel III Capital Regulations in India	Scope of Application (paragraph 3) is replaced by sub-paragraph 3.1 of Section B of Annex 1; • Definition of Capital (paragraph 4) is replaced by Annex 1 (excluding sub-paragraph 3.1of Section B) ; • Risk Coverage : Capital Charge for Credit Risk (paragraph 5), External Credit Assessments (paragraph 6), Credit Risk Mitigation (paragraph 7) and Capital Charge for Market Risk (paragraph 8) will be modified as indicated in Annex 2; • Supervisory Review and Evaluation Process under Pillar 2 (paragraphs 12 & 13) is modified as indicated in Annex 3.
4.	DBOD.No.BP.BC.28/2 1.06.001/2012- 13 dated July 9, 2012	Prudential Guidelines on Capital Adequacy Treatment of Head Office Debit Balance - Foreign Banks	Para 4.2.3.2.(B)(iv)

5.	DBOD.No.BP.BC.41/21.06.009/2012-13 dated September 13, 2012	Prudential Guidelines on Capital Adequacy and Market Discipline - New Capital Adequacy Framework (NCAF) Eligible Credit Rating Agencies - SME Rating Agency of India Ltd. (SMERA)	Para 6.1.2 Para 7.3.5.(vi) (b) Para 7.3.5.(vii) (d) and (e) Table 6:Part B, 12, 13
6.	DBOD.No.BP.BC.54/21.06.007/2012-13 dated November 5, 2012	Prudential Guidelines on Capital Adequacy and Market Discipline - New Capital Adequacy Framework (NCAF) - Change of Name of Fitch Ratings to India Ratings and Research Private Limited (India Ratings)	Para 6.1.2 Para 7.3.5.(vi) (b) Para 7.3.5.(vii) (d) and (e) Table 6:Part B, 12, 13
7.	DBOD.BP.BC.No.72/21.01.002/2012-13 dated January 1, 2013	Retail Issue of Subordinated Debt for Raising Tier II Capital	Footnote 111 under para 1.17
8.	DBOD.No.BP.BC.88/21.06.201/2012-13 dated March 28, 2013	Guidelines on Implementation of Basel III Capital Regulations in India - Clarifications	Footnote 8 under para 4.2.2.(vii) Paragraphs 3.3.2, 4.4.6.(i), 4.4.9.2 .B.(iv) , 4.4.9.2 .C.(iii), 4.5.4.2, 4.5.4.2 (C), 4.5.4.3, 7.5.6, 8.4.4, 15.2.2, 16.5.3 Table 4, Table 16 - Part C, Table 16 - Part D Annex 16, 21 and 24
9.	DBOD.No.BP.BC.89.21.04.009/2012-13 dated April 2, 2013	New Capital Adequacy Framework - Non-market related Off Balance Sheet Items - Bank Guarantees	Paragraph 5.15.2.(vii)
10.	DBOD.No.BP.BC-90/21.04.048/2012-13 dated April 16, 2013	Advances Guaranteed by Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH) - Risk Weights and Provisioning	Para 5.2.3
11.	DBOD.BP.BC.No.95/21.06.001/2012-13 dated May 27, 2013	Prudential Guidelines on Capital Adequacy and Market Discipline - New Capital Adequacy Framework (NCAF) - Parallel Run and Prudential Floor	Paragraph 2.4
12.	DBOD.No.BP.BC.98/21.06.201/2012-13 dated May 28, 2013	Guidelines on Composition of Capital Disclosure Requirements	Part – C : Market Discipline (Pillar 3) and Annex 22

13.	DBOD.BP.BC. No.103/21.06.001/2012-13 dated June 20, 2013	Risk Weights on deposits placed with NABARD/SIDBI/NHB in lieu of shortfall in achievement of priority sector lending targets/sub-targets	Para 6.8.2
14.	DBOD.BP.BC.No. 104/08.12.015/2012-13 dated June 21, 2013	Housing Sector: New sub-sector CRE (Residential Housing) within CRE and Rationalisation of provisioning, risk-weight and LTV ratios	Para 5.10.1 and Table 7A