RBI proposes New Capital Adequacy Framework

RBI/2012-13/467
DBOD.No.BP.BC.89.21.04.009/2012-13

April 02, 2013

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

Dear Sir/ Madam,

New Capital Adequacy Framework- Non-market related Off Balance Sheet Items - Bank Guarantees

Please refer to the **Master Circular DBOD.No.BP.BC.16/21.06.001/2012-13 dated July 2, 2012** on 'Prudential Guidelines on Capital Adequacy and Market Discipline- New Capital Adequacy Framework (NCAF)'. Paragraph 5.15.2(iv) (Table 8) of the circular stipulates the applicable credit conversion factor (CCF) for determining the credit equivalent amount with regard to non-market related Off Balance Sheet items. The applicable CCFs for direct credit substitutes, e.g., general guarantees of indebtedness like standby L/Cs serving as financial guarantees for loans and securities, credit enhancements, etc., and certain transaction-related contingent items, like performance bonds, bid bonds, etc., have been stipulated at 100 per cent and 50 per cent respectively, depending on whether a bank guarantee is considered as financial guarantee i.e., direct credit substitute or a performance guarantee i.e., transaction-related contingent item.

2. Large disparities have been noticed in the application of CCFs on guarantees issued by banks. As incorrect application of CCFs may have a direct bearing on the capital adequacy, banks are advised to keep in view the following principles for 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:

i. Guarantees for credit facilities;
ii. Guarantees in lieu of repayment of financial securities;
iii. Guarantees in lieu of margin requirements of exchanges;
iv. Guarantees for mobilisation advance, advance money before the commencement of a project and for money to be received in various stages of project implementation;
v. 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;
vi. Credit Enhancements;

vii. Liquidity facilities for securitisation transactions;
viii. Acceptances (including endorsements with the character of acceptance);
ix. 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:

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

Yours faithfully,

(Chandan Sinha)
Chief General Manager-in-Charge

Refer Attached Circular
