

Also Refer

RBI/2015-16/58

DBR.No.BP.BC.1/21.06.201/2015-16

July 1, 2015

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.6/21.06.201/2014-15 dated July 1, 2014, consolidating therein the prudential guidelines on capital adequacy issued to banks till June 30, 2014.

2. As you are aware, Basel III Capital Regulations are being implemented in India with effect from April 1, 2013 in a phased manner. This Master Circular consolidates instructions on the above matters issued up to June 30, 2015.

3. The Basel II guidelines as contained in the Master Circular DBOD.No.BP.BC. 4/21.06.001/2015-16 dated July 1, 2015 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,

Sd/-

(Sudarshan Sen)
 Chief General Manager-in-Charge

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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, 2019.

1.4 Further, on a review, the parallel run and prudential floor for implementation of Basel II vis-D-vis Basel I have been discontinued¹.

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 framework². 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

2.4 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, 2019. 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") level³ 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.

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:

Common Equity Tier 1 capital ratio	=	Common Equity Tier 1 Capital _____ Credit Risk RWA* + Market Risk RWA + Operational Risk RWA
Tier 1 capital ratio	=	Eligible Tier 1 Capital _____ Credit Risk RWA* + Market Risk RWA + Operational Risk RWA
Total Capital (CRAR#)	=	Eligible Total Capital _____ 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 capital⁴)
 - (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 4.2.2(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 ratios⁵ 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 all prudential exposure limits linked to capital funds, the 'capital funds'⁶ will be defined as the sum of all eligible Common Equity Tier 1 capital,

Additional Tier 1 capital and Tier 2 capital, net of regulatory adjustments and deductions.

4.2.3 Common Equity Tier 1 Capital

4.2.3.1 Common Equity - Indian Banks (Also Refer DBOD Mail Box Clarification dt 25-04-17)

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

(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 provisions⁷.

(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;
- (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.

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 Provisions⁸, incremental provisions in respect of unhedged foreign currency exposures⁹, Provisions held for Country Exposures, Investment Reserve Account, excess provisions which arise on account of sale of NPAs and 'countercyclical provisioning buffer'¹⁰, 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%¹¹;
- (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)].

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

Under Basel III, the criteria for instruments¹² 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 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 bank¹³. 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 subsidiary¹⁴

(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.

(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. Losses in the current period and those brought forward from previous periods should also be deducted from Common Equity Tier 1 capital, if not already deducted.

(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. DTAs may be netted with associated deferred tax liabilities (DTLs) only if the DTAs and DTLs relate to taxes levied by the same taxation authority and offsetting is permitted by the relevant taxation authority. The DTLs permitted to be netted against DTAs must exclude amounts that have been netted against the deduction of goodwill, intangibles and defined benefit pension assets.
- (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 Fund¹⁵ 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.80/21.04.018/2010-11 dated 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 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%¹⁶ 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*¹⁷

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.

(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:

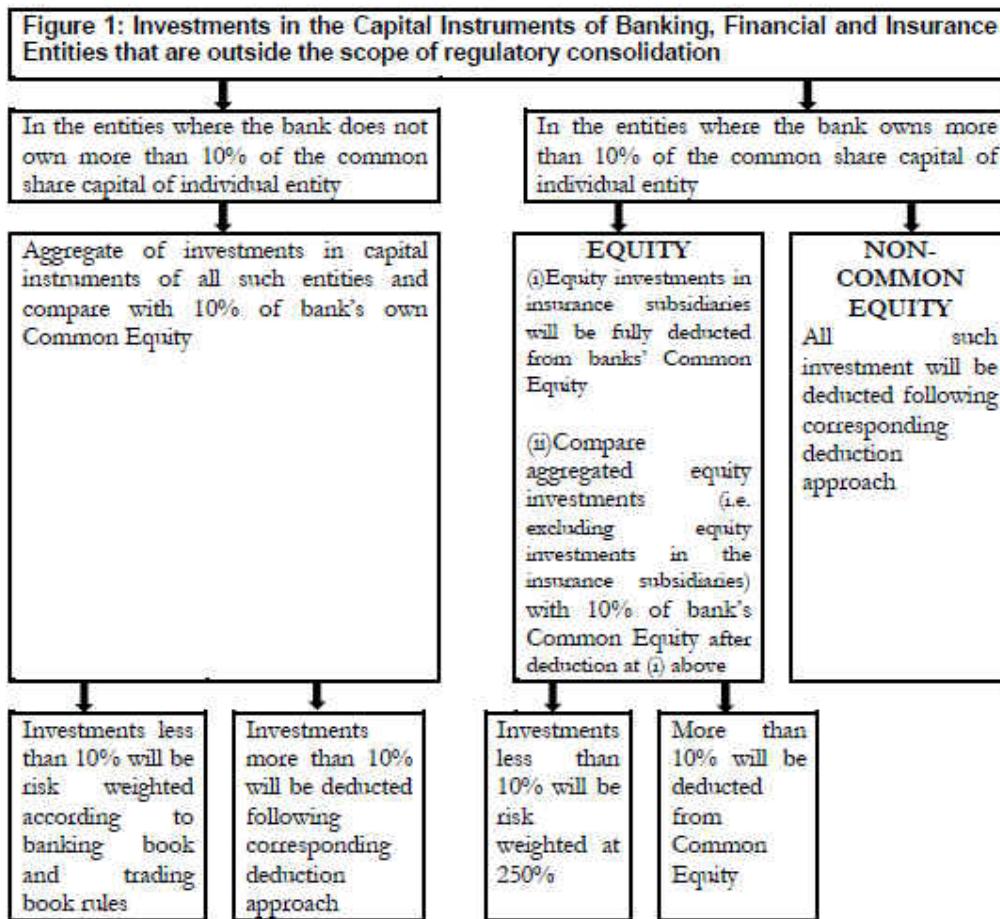
- * Asset Management Companies of Mutual Funds / Venture Capital Funds / Private Equity Funds etc;
- * Non-Banking Finance Companies;
- * Housing Finance Companies;

- * Primary Dealers;
- * Merchant Banking Companies; and
- * Entities engaged in activities which are ancillary to the business of banking under the B.R. Act, 1949; and
- * Central Counterparties (CCPs).

(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 interconnectedness 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 investments¹⁸ 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:



(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 treated as reciprocal cross holding if the investee entity has also invested in 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, indirect¹⁹ 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 adjustment²⁰.

(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 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*²¹

(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 affiliate²² of the bank. In addition:

* Investments include direct, indirect²³ 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 adjustment²⁴.

* 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 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.

4.4.10 As indicated in paragraphs 3.3.2 and 3.4.1, equity investments in non-financial subsidiaries should be fully deducted from the consolidated and solo CET1 capital of the bank respectively, after making all the regulatory adjustments as indicated in above paragraphs.

4.4.11 Intra Group Transactions and Exposures

Attention is invited to circular DBOD.No.BP.BC.96/21.06.102/ 2013-14 dated February 11, 2014 on "Guidelines on Management of Intra-Group Transactions and Exposures" in terms of which intra-group exposures beyond permissible limits subsequent to March 31, 2016, if any, would be deducted from Common Equity Tier 1 capital of the bank.

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 began as on April 1, 2013. However, the phasing out of non-Basel III compliant regulatory capital instruments began from January 1, 2013²⁵. Capital ratios and deductions from Common Equity will be fully phased-in and implemented as on March 31, 2019. 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)**

Minimum capital ratios	April 1, 2013	March 31, 2014	March 31, 2015	March 31, 2016	March 31, 2017	March 31, 2018	March 31, 2019	(% of RWAs)
Minimum Common Equity Tier 1 (CET1)	4.5	5	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	5.5	6.125	6.75	7.375	8	
Minimum Tier 1 capital	6	6.5	7	7	7	7	7	
Minimum Total Capital*	9	9	9	9	9	9	9	
Minimum Total Capital +CCB	9	9	9	9.625	10.25	10.875	11.5	
Phase-in of all deductions from CET1 (in %) #	20	40	60	80	100	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 framework²⁶.

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.

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 year²⁷. 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.

(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, 2012²⁸, 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.

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)²⁹. 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.

5.2.6 The above risk weights will be applied if such exposures are denominated in Indian Rupees and also funded in Indian Rupees.

5.3 Claims on Foreign Sovereigns

Also Refer [DBR.BP.BC.No.43/21.06.001/2015-16 dt 08-10-15](#)

5.3.1 Claims on foreign sovereigns will attract risk weights as per the rating assigned³⁰ 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 jurisdiction³¹ 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 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:

	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	125 % or the risk weight as	250	20	125% or the risk weight as	300	100

above	per the rating of the instrument or counterparty, whichever is higher			per the rating of the instrument or counterparty, whichever is higher		
Applicable Minimum CET1 + CCB = 75% and <100% of applicable CCB ³³	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 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.4/21.06.001/2015-16 dated July 1, 2015 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'³⁴ 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.

5.8 Claims on Corporates, AFCs and NBFC-IFCs (Also Refer DBR.No.BP.BC.6/21.06.001/2016-17 dt 25-08-16)

5.8.1 Claims on corporates³⁵, exposures on Asset Finance Companies (AFCs) and Non-Banking Finance Companies- Infrastructure Finance Companies (NBFC-IFC)³⁶, 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.

Also Refer DBR.BP.BC.No.20/21.06.001/2016-17 dt 20-10-16

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	ICRA	Brickwork	SMERA	(%)

		Research Private Limited (India Ratings)			Ratings Ltd. (SMERA) ³⁷	
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.

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 property³⁸ or claims secured by commercial real estate³⁹;
- (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.

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 and HUF; small business would include 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 ⁴³				
Category of Loan		LTV Ratio ⁴⁴ (%)	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	
(b)	Above Rs.75 lakh	75	75	
	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 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 exposures⁴².

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-IDFs⁴³, please refer to [paragraph 5.8.1](#)).

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 1250%⁴⁴. 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.⁴⁵

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](#).

5.13.9 Unhedged Foreign Currency Exposure⁴⁶

The extent of unhedged foreign currency exposures of entities⁴⁷ continues to be significant and this can increase the probability of default in times of high currency volatility. It was, therefore, decided to introduce incremental capital requirements for bank exposures to entities with unhedged foreign currency exposures (i.e. over and above the present capital

requirements) as per the instructions contained in circulars DBOD.No.BP.BC.85/21.06.200/2013-14 and DBOD.No.BP.BC.116/21.06.200/2013-14 dated January 15, 2014 and June 3, 2014, respectively, as under:

Likely Loss / EBID (%)	Incremental Capital Requirement
Up to 75 per cent	0
More than 75 per cent	25 per cent increase in the risk weight

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

[Next](#)

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 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.4/21.06.001/2015-16 dated July 1, 2015.

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. Please also refer to circular DBOD.No.FSD.BC.46/24.01.028/2006-07 dated December 12, 2006.

4 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.

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

6 The definition of capital funds for the purpose of prudential exposures is only an interim measure. The applicability of this definition is being reviewed by the RBI based on the large exposures framework. In this context, please refer to the 'Discussion Paper on Large Exposures Framework and Enhancing Credit Supply through Market Mechanism' issued by RBI on March 27, 2015.

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

8 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.

9 Please refer to circular DBOD.No.BP.BC.85/21.06.200/2013-14 dated January 15, 2014 as well as circular DBOD.No.BP.BC.116/21.06.200/2013-14 dated June 3, 2014 on "Capital and Provisioning Requirements for Exposures to entities with Unhedged Foreign Currency Exposure".

10 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.

11 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.

12 Please also refer circular DBOD.BP.BC.No.75/21.06.001/2010-11 dated January 20, 2011 on eRegulatory 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

13 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.

14 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.

15 It includes other defined employees' funds also.

16 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.

17 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.

18 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.

19 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.

20 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.

21 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.

22 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.

23 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.

24 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.

25 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' read with circular DBOD.No. BP.BC.102/21.06.201/2013-14 dated March 27, 2014.

26 Master Circular on Prudential Guidelines on Capital Adequacy and Market Discipline - New Capital Adequacy Framework (NCAF) issued vide circular DBOD.No.BP.BC.4/ 21.06.001/2015-16 dated July 1, 2015.

27 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.

28 Please refer circular DBOD.BP.BC.No.75/21.06.001/2010-11 dated January 20, 2011 on eRegulatory Capital Instruments . Step up Optionf. 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

29 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'.

30 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.

31 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.

32 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'

33 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%.

34 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.

35 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.

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

37 Please refer to circular DBOD.BP.BC.No.59/21.06.007/2013-14 dated October 17, 2013.

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

39 As defined in paragraph 5.11.1.

40 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

41 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.

42 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.

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

44 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.

45 Equity shares of entities acquired by banks under the guidelines on 'Strategic Debt Restructuring Scheme' contained in circular DBR.BP.BC.No.101/21.04.132/2014-15 dated June 8, 2015 shall be assigned a 150% risk weight for a period of 18 months from the 'reference date'. After 18 months from the 'reference date', these shares shall be assigned risk weights as per the extant capital adequacy regulations. For this purpose, 'reference date' is the date of Joint Lenders Forum's decision to undertake Strategic Debt Restructuring.

46 Please refer to the circulars DBOD.No.BP.BC.85/21.06.200/2013-14 and DBOD.No.BP.BC.116/21.06.200/2013-14 dated January 15, 2014 and June 3, 2014, respectively on "Capital and Provisioning Requirements for Exposures to entities with Unhedged Foreign Currency Exposure".

47 In this context, 'entities' means those entities which have borrowed from banks including borrowing in INR and other currencies.

Refer

DBR.BP.BC.No.50/21.06.201/2016-17 dt 02-02-17
A.P. (DIR Series) Circular No.14 dt 03-11-16

DBR.BP.BC.No.28/21.06.001/2016-17 dt 03-11-16
DBR.BP.BC.No.20/21.06.001/2016-17 dt 20-10-16
DBR.BP.BC.No.105/21.06.001/2015-16 dt 23-06-16
DBR.No.BP.BC.83/21.06.201/2015-16 dt 01-03-16
DBR.No.BP.BC.71/21.06.201/2015-16 dt 14-01-16