Draft Reserve Bank of India (Payments Banks– Prudential Norms on Capital Adequacy) Directions, 2025

DRAFT FOR COMMENTS

RBI/2025-26/--

DOR.CAP.REC.No./ 00-00-000/2025-26 XX, 2025

Reserve Bank of India (Payments Banks– Prudential Norms on Capital Adequacy) Directions, 2025

Table of Contents

In exercise of the powers conferred under Section 35A of the Banking Regulation Act (BR Act), 1949, the Reserve Bank, being satisfied that it is necessary and expedient in the public interest and in the interest of banking policy to do so, hereby, issues the Directions hereinafter specified.

Chapter I
Preliminary

A Short title and commencement

1. These Directions shall be called the Reserve Bank of India (Payments Banks – Prudential Norms on Capital Adequacy) Directions, 2025.

2. These Directions shall come into effect immediately upon issuance.

B Applicability

3. These Directions shall be applicable to Payments Banks (PBs).

   Note: Mere mention of an activity, transaction or item in these directions does not imply that it is permitted, and the bank shall refer to the extant statutory and regulatory requirements while determining the permissibility or otherwise of an activity, transaction or item.

C Definitions

4. In these directions, unless the context states otherwise, the terms herein shall bear the meanings assigned to them below.

(1) 'Banking book' shall mean any instrument not included under trading book, including those classified under Held to Maturity (HTM), Available for Sale (AFS), Fair Value Through Profit and Loss (FVTPL) [non-Held for Trading (HFT)], and investments in own subsidiaries, joint ventures and associates.

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

either counterparty to the transaction. The market value is uncertain and can vary over time with the movement of underlying market factor.

(3) 'Credit risk' is defined as the potential that a bank's borrower or counterparty may fail to meet its obligations in accordance with agreed terms. It is also the possibility of losses associated with diminution in the credit quality of borrowers or counterparties.

(4) 'Deferred tax assets' and 'Deferred tax liabilities' shall have the same meaning as assigned under the applicable accounting standards.

(5) 'Derivative' shall have the same meaning as assigned to it in section 45U(a) of the RBI Act, 1934.

(6) 'General provisions and loss reserves' include such provisions of general nature appearing in the books of the bank which are not attributed to any identified potential loss or a diminution in value of an asset or a known liability.

(7) 'Going-concern capital', from regulatory perspective, is the capital which shall absorb losses without triggering bankruptcy of the bank.

(8) 'Gone-concern capital', from regulatory perspective, is the capital which shall absorb losses only in a situation of liquidation of the bank.

(9) 'Leverage ratio' is the net worth (the numerator) divided by the outside liabilites (the denominator), with this ratio expressed as a percentage.

$$\text{Leverage Ratio} = \frac{\text{Net worth (paid} - \text{up capital and reserves)}}{\text{Outside liabilities}}$$

(10) 'Market risk' means the risk of losses in on-balance sheet and off-balance sheet positions arising from movements in market prices.

(11) 'Operational risk' means the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events. This includes legal risk but excludes strategic and reputational risk.

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

(13) ‘Subsidiary’ shall mean an enterprise that is controlled by another enterprise (known as the parent). The definition of ‘control’ will be as given in the applicable accounting standards.

(14) ‘Trading book’ shall include all instruments that are classified as ‘Held for Trading’ as per Reserve Bank of India (Payment Banks – Classification, Valuation and Operation of Investment Portfolio) Directions, 2025 (as amended from time to time).

5. All other expressions unless defined herein shall have the same meaning as have been assigned to them under the applicable Acts, rules / regulations made thereunder, or any statutory modification or re-enactment thereto or as used in commercial parlance, as the case may be.

Chapter II
Regulatory capital

A General

6. The capital adequacy framework shall be based on three components or three pillars. Pillar 1 is the Minimum Capital Ratio requirement while Pillar 2 and Pillar 3 are the Supervisory Review and Evaluation Process (SREP) and market Discipline, respectively. A bank shall compute capital ratios in the following manner.

$$\text{Common Equity Tier 1 (CET 1) capital ratio} = \frac{\text{CET 1 capital}}{\text{Total Risk Weighted Assets (RWAs)}}$$

$$\text{Tier 1 capital ratio} = \frac{\text{Eligible Tier 1 capital}}{\text{Total RWAs}}$$

$$\text{Total Capital (CRAR)} = \frac{\text{Eligible Total Capital}}{\text{Total RWAs}}$$

B Components of capital

7. Total regulatory capital shall consist of the sum of the following categories:

(1) Tier 1 Capital (going-concern capital)

   (i) Common Equity Tier (CET) 1

   (ii) Additional Tier (AT) 1

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

C Limits and minima

8. The limits and minimum capital requirement are as under.

(1) A bank shall maintain a Minimum Total Capital (MTC) of 15 per cent of the Risk Weighted Assets (RWAs) on an ongoing basis i.e., Capital to Risk Weighted Asset Ratio (CRAR) shall be at least 15 per cent on an ongoing basis. This shall be further divided into different components as described under following paragraphs.

(2) CET 1 capital shall be at least 6 per cent of the total RWAs on an ongoing basis.

(3) Tier 1 capital shall be at least 7.5 per cent of the total RWAs on an ongoing basis. Thus, within the minimum Tier 1 capital, AT 1 capital shall be admitted maximum at 1.5 per cent of the total RWAs.

(4) As total capital (Tier 1 capital + Tier 2 capital) shall be at least 15 per cent of the total RWAs on an ongoing basis, within the minimum CRAR of 15 per cent, Tier 2 capital shall be admitted maximum up to 7.5 per cent of the total RWAs. Further, Tier 2 capital shall be limited to a maximum of 100 per cent of Tier 1 capital.

Explanation - If a bank has complied with the minimum CET 1 capital ratio, prescribed in these Directions, then excess CET 1 capital can be admitted for compliance with the minimum Tier 1 of 7.5 per cent of the total RWAs. Further, if a bank has complied with the minimum CET 1 and Tier 1 capital ratios, prescribed in these Directions, then the excess CET 1 and / or AT 1 capital can be admitted for compliance with the minimum CRAR of 15 per cent of the total RWAs.

D Common Equity Tier 1 (CET 1) capital

9. CET 1 capital of a bank shall consist of the sum of the following elements.

(i) Common shares (paid-up equity capital) issued by a bank that meet the criteria for classification as common shares for regulatory purposes as given in paragraph 10;

(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) AFS - Reserve arising out of fair valuation of investment under AFS category. Any negative balance in the AFS - Reserve shall be deducted from CET 1 capital.

(vi) Revaluation reserves arising out of change in the carrying amount of a bank's property consequent upon its revaluation may be reckoned as CET 1 capital at a discount of 55 per cent, subject to meeting the following conditions.

(a) the bank is able to sell the property readily at its own will and there is no legal impediment in selling the property.

(b) the revaluation reserves are shown under "Schedule 2: Reserves and Surplus" in the Balance Sheet of the bank.

(c) revaluations are realistic, in accordance with applicable Accounting Standards.

(d) valuations are obtained, from two independent valuers, at least once in every 3 years; where the value of the property has been substantially impaired by any event, these are to be immediately revalued and appropriately factored into capital adequacy computations.

(e) the external auditors of the bank have not expressed a qualified opinion on the revaluation of the property; and

(f) the instructions on valuation of properties and other specific requirements as mentioned in the Reserve Bank of India (Commercials Banks - Credit Risk Management) Directions, 2025 are strictly adhered to.

Revaluation reserves which do not qualify as CET 1 capital shall also not qualify as Tier 2 capital. A bank may choose to reckon revaluation reserves in CET 1 capital or Tier 2 capital at its discretion, subject to fulfilment of all the conditions specified above.

(vii) A bank may, at its discretion, reckon Foreign Currency Translation Reserve (FCTR) arising due to translation of financial statements of its foreign operations in terms of applicable accounting standard as CET 1 capital at a discount of 25 per cent subject to meeting the following conditions.

(a) The FCTR are shown under "Schedule 2: Reserves and Surplus" in the Balance Sheet of the bank.

(b) The external auditors of the bank have not expressed a qualified opinion on the FCTR.

(viii) Other disclosed free reserves, if any.

(ix) Balance in Profit and Loss Account at the end of the previous financial year.

(x) A bank may reckon the profits in current financial year for CRAR calculation on a quarterly basis provided the incremental provisions made for Non-Performing Assets (NPAs) at the end of any of the four quarters of the previous financial year have not deviated more than 25 per cent from the average of the four quarters. The amount which can be reckoned shall 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

The cumulative net loss up to the quarter end shall be deducted while calculating CET 1 capital for the relevant quarter.

(xi) Less: Regulatory adjustments / deductions applied in the calculation of CET 1 capital [i.e., to be deducted from the sum of items (i) to (x)].

Criteria for classification as common shares (paid-up equity capital) for regulatory capital purposes

10. Common shares, which are included in CET 1 capital, shall meet all the following criteria.

(i) All common shares shall ideally be the voting shares. However, in rare cases, where a bank needs to issue non-voting common shares as part of CET 1 capital, they shall be identical to voting common shares of the issuing bank in all respects except the absence of voting rights. Limit on voting rights shall be applicable based on the provisions of respective statutes governing a bank.

(ii) Represents the most subordinated claim in liquidation of the bank.

(iii) Entitled to a claim on the residual assets which is proportional to its share of paid-up capital, after all senior claims have been repaid in liquidation (i.e., has an unlimited and variable claim, not a fixed or capped claim).

(iv) Principal is perpetual and never repaid outside of liquidation (except discretionary repurchases / buy backs or other means of effectively reducing capital in a discretionary manner that is allowable under relevant law as well as guidelines, if any, issued by the Reserve Bank in the matter).

(v) The bank does nothing to create an expectation at issuance that the instrument shall be bought back, redeemed, or cancelled nor do the statutory or contractual terms provide any feature which might give rise to such an expectation.

(vi) Distributions are paid out of distributable items. The level of distributions is not in any way tied or linked to the amount paid up at issuance and is not subject to a contractual cap (except to the extent that a bank is unable to pay distributions that exceed the level of distributable items). As regards ‘distributable items’, dividend on common shares shall be paid out of current year’s profit only.

(vii) There are no circumstances under which the distributions are obligatory. Non-payment therefore shall not be an event of default.

(viii) Distributions are paid only after all legal and contractual obligations have been met and payments on more senior capital instruments have been made. This means that there are no preferential distributions, including in respect of other elements classified as the highest quality issued capital.

(ix) It is the paid-up capital that takes the first and proportionately greatest share of any losses as they occur. Within the highest quality capital, each instrument absorbs losses on a going concern basis proportionately and *pari passu* with all the others. In cases where capital instruments have a permanent write-down feature, this criterion is still deemed to be met by common shares.

(x) The paid-up amount is classified as equity capital (i.e., not recognised as a liability) for determining balance sheet insolvency.

(xi) The paid-up amount is classified as equity under the relevant accounting standards.

(xii) It is directly issued and paid up and the bank cannot directly or indirectly have funded the purchase of the instrument. A bank shall not grant advances against its own shares as this would be construed as indirect funding of its own capital.

(xiii) The paid-up amount is neither secured nor covered by a guarantee of the issuer or related entity nor subject to any other arrangement that legally or economically enhances the seniority of the claim.

Explanation - A related entity can include a parent company, a sister company, a subsidiary, a holding company or any other affiliate.

(xiv) Paid up capital is only issued with the approval of the owners of the issuing bank, either given directly by the owners or, if permitted by applicable law, given by the Board of Directors or by other persons duly authorised by the owners.

(xv) Paid up capital is clearly and separately disclosed in the bank's balance sheet.

E Additional Tier 1 (AT 1) capital

11. AT 1 capital shall consist of the sum of the following elements:

(i) Basel III Perpetual Non-Cumulative Preference Shares (PNCPS), which comply with the regulatory requirements as specified in paragraph 12 below;

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

(iii) Basel III debt capital instruments eligible for inclusion in AT 1 capital, which comply with the regulatory requirements as specified in paragraph 13 below;

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

(v) Less: regulatory adjustments / deductions applied in the calculation of AT 1 capital [i.e., to be deducted from the sum of items (i) to (iii) above].

E.1 Criteria for inclusion of Basel III PNCPS in AT 1 capital

12. The PNCPS shall be issued, subject to extant legal provisions, only in Indian rupees and should meet the following terms and conditions to qualify for inclusion in AT 1 Capital for capital adequacy purposes.

(1) Paid up status

The instruments should be issued by the bank (i.e., not by any Special Purpose Vehicle (SPV) etc. set up by the bank for this purpose) and fully paid up.

(2) Amount

The amount of PNCPS to be raised shall be decided by the Board of Directors of a bank.

(3) Limits

While complying with minimum Tier 1 of 7.5 per cent of RWAs, a bank cannot admit, PNCPS together with Perpetual Debt Instrument (PDI) in AT 1 Capital, more than 1.5 per cent of RWAs. However, once this minimum total Tier 1 capital has been complied with, any additional PNCPS and PDI issued by the bank can be included in total Tier 1 capital reported. Excess PNCPS and PDI can be reckoned to comply with Tier 2 capital if the latter is less than 7.5 per cent of RWAs i.e., while complying with minimum Total Capital of 15 per cent of RWAs.

(4) Maturity period

The PNCPS shall be perpetual i.e., there is no maturity date and there are no step-ups or other incentives to redeem.

(5) Rate of dividend

The rate of dividend payable to the investors may be either a fixed rate or a floating rate referenced to a market determined rupee interest benchmark rate.

(6) Optionality

PNCPS shall not be issued with a 'put option'. However, a bank may issue the instruments with a call option at a particular date subject to following conditions:

(i) The call option on the instrument is permissible after the instrument has run for at least five years;

(ii) To exercise a call option a bank shall receive prior approval of the Reserve Bank (Department of Regulation);

(iii) A bank shall not do anything which creates an expectation that the call will be exercised. For example, to preclude such expectation of the instrument being called, the dividend / coupon reset date need not be co-terminus with the call date. A bank may, at its discretion, consider having an appropriate gap between dividend / coupon reset date and call date; and

Explanation - If a bank were to call a capital instrument and replace it with an instrument that is more costly (e.g., has a higher credit spread) this may create an expectation that the bank will exercise calls on its other capital instruments. Therefore, a bank may not be permitted to call an instrument if the bank intends to replace it with an instrument issued at a higher credit spread. This is applicable in cases of all AT 1 and Tier 2 instruments.

(iv) A bank shall not exercise a call unless:

(a) It replaces the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank; or

Note - Replacement issues can be concurrent with but not after the instrument is called.

(b) The bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.

Note - Here, minimum refers to CET 1 capital of 6 per cent of RWAs, Tier 1 capital of 7.5 per cent of RWAs and total capital of 15 per cent of RWAs including any additional capital requirement identified under Pillar 2.

(v) The use of tax event and regulatory event calls may be permitted. However, exercise of the calls on account of these events is subject to the requirements set out in paragraph 12(6)(ii) to 12(6)(iv). The Reserve Bank shall permit the bank to exercise the call only if the Reserve Bank is convinced that the bank was not in a position to anticipate these events at the time of issuance of PNCPS.

Explanation - To illustrate, if there is a change in tax treatment which makes the capital instrument with tax deductible coupons into an instrument with non-tax-deductible coupons, then the bank would have the option (not obligation) to repurchase the instrument. In such a situation, a bank may be allowed to replace the capital instrument with another capital instrument that perhaps does have tax deductible coupons. Similarly, if there is a downgrade of the instrument in regulatory classification (e.g., if it is decided by the Reserve Bank to exclude an instrument from regulatory capital) the bank has the option to call the instrument and replace it with an instrument with a better regulatory classification, or a lower coupon with the same regulatory classification with prior approval of Reserve Bank. However, a bank may not create an expectation / signal an early redemption / maturity of the regulatory capital instrument.

(7) Repurchase / buy-back / redemption

Principal of the instruments may be repaid (e.g., through repurchase or redemption) only with prior approval of the Reserve Bank and a bank shall not assume or create market expectations that supervisory approval shall be given (this repurchase / buy-back / redemption of the principal is in a situation other than in the event of exercise of call option by the bank. One of the major differences is that in the case of the former, the option to offer the instrument for repayment on announcement of the decision to repurchase / buy-back / redeem the instrument, shall lie with the investors whereas, in case of the latter, it lies with the bank).

(8) A bank may repurchase / buy-back / redeem the instruments only if:

(i) It replaces such instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank; or

(ii) The bank demonstrates that its capital position is well above the minimum capital requirements after the repurchase / buy-back / redemption.

(9) Dividend discretion

(i) The bank shall have full discretion at all times to cancel distributions / payments;

Note - Consequence of full discretion at all times to cancel distributions / payments is that 'dividend pushers' are prohibited. An instrument with a dividend pusher obliges the issuing bank to make a dividend / coupon payment on the instrument if it has made a payment on another (typically more junior) capital instrument or share. This obligation is inconsistent with the requirement for full discretion at all times. Furthermore, the term 'cancel distributions / payments' means extinguish these payments. It does not permit features that require the bank to make distributions / payments in kind.

(ii) Cancellation of discretionary payments shall not be an event of default;

(iii) A bank shall have full access to cancelled payments to meet obligations as they fall due;

(iv) Cancellation of distributions / payments shall not impose restrictions on the bank except in relation to distributions to common stakeholders; and

(v) Dividends shall be paid out of distributable items only. As regards 'distributable items', it is clarified that the dividend on PNCPS shall be paid out of current year's profit only.

Note - As provided in Reserve Bank of India (Payment Banks – Classification, Valuation and Operation of Investment Portfolio) Directions, 2025 , the unrealised gains transferred to AFS-Reserve shall not be available for any distribution such as dividend and coupon on AT 1. Further, the Directions ibid provide that a bank shall not pay dividends out of net unrealised gains recognised in the Profit and Loss Account arising on fair valuation of Level 3 financial instruments on its Balance Sheet.

(vi) The dividend shall not be cumulative. i.e., dividend missed in a year shall not be paid in future years, even if adequate profit is available and the level of CRAR conforms to the regulatory minimum. When dividend is paid at a rate lesser than the prescribed rate, the unpaid amount shall not be paid in future years, even if adequate profit is available and the level of CRAR conforms to the regulatory minimum.

(vii) The instrument shall not have a credit sensitive coupon feature, i.e., a dividend that is reset periodically based in whole or in part on the banks' credit standing. For this purpose, any reference rate including a broad index which is sensitive to changes to the bank's own creditworthiness and / or to changes in the credit worthiness of the wider banking sector shall be treated as a credit sensitive reference rate. A bank desirous of offering floating reference rate may take prior approval of the Reserve Bank (Department of Regulation) as regard permissibility of such reference rates.

(viii) A bank may have dividend stopper arrangement that stops dividend payments on common shares in the event the holders of AT1 instruments are not paid dividend / coupon. However, dividend stoppers shall not impede the full discretion that bank should have at all times to cancel distributions / payments on the AT 1 instrument, nor must they act in a way that could hinder the re-capitalisation of the bank. For example, it shall not be permitted for a stopper on an AT 1 instrument to:

(a) attempt to stop payment on another instrument where the payments on this other instrument were not also fully discretionary;

(b) prevent distributions to shareholders for a period that extends beyond the point in time that dividends / coupons on the AT 1 instrument are resumed;

(c) impede the normal operation of the bank or any restructuring activity (including acquisitions / disposals).

(ix) A stopper may act to prohibit actions that are equivalent to the payment of a dividend, such as the bank undertaking discretionary share buybacks, if otherwise permitted.

(10) Treatment in insolvency

The instrument shall not contribute to liabilities exceeding assets if such a balance sheet test forms part of a requirement to prove insolvency under any law or otherwise.

(11) Loss absorption features

PNCPS shall have loss absorption through conversion / write-down / write-off on breach of pre-specified trigger and at the point of non-viability, as detailed in paragraph 26 of Reserve Bank of India (Commercial Banks - Prudential Norms on Capital Adequacy) Directions, 2025. The pre-specified trigger for loss absorption through conversion / write-down of PNCPS shall be at least CET 1 capital of 7 per cent of RWAs. Prohibition on purchase / funding of PNCPS

Neither the bank nor a related party over which the bank exercises control or significant influence (as defined under relevant Accounting Standards) shall purchase PNCPS, nor can the bank directly or indirectly shall fund the purchase of the instrument. A bank shall also not grant advances against the security of PNCPS issued by them.

(12) Re-capitalisation

The instrument shall not have any features that hinder re-capitalisation, such as provisions which require the issuer to compensate investors if a new instrument is issued at a lower price during a specified time frame.

(13) Reporting of non-payment of dividends

All instances of non-payment of dividends shall be notified by the issuing banks to the Chief General Managers-in-Charge of Department of Regulation and Department of Supervision of the Reserve Bank of India, Mumbai.

(14) Seniority of claim

The claims of the investors in instruments shall be

(i) Superior to the claims of investors in equity shares;

(ii) Subordinated to the claims of PDIs, all Tier 2 regulatory capital instruments, depositors and general creditors of the bank; and

(iii) is neither secured nor covered by a guarantee of the issuer nor related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis bank creditors.

(15) Investment in instruments raised in Indian rupees by foreign entities / Non-Resident Indians (NRIs)

(i) Investment by Financial Institutional Investors (FIIs) and NRIs shall be within an overall limit of 49 per cent and 24 per cent of the issue respectively, subject to the investment by each FII not exceeding 10 per cent of the issue, and investment by each NRI not exceeding 5 per cent of the issue. Investment by FIIs in these instruments shall be outside the External Commercial Borrowing (ECB) limit for rupee-denominated corporate debt, as fixed by the Government of India from time to time. The overall non-resident holding of preference shares and equity shares in public sector banks shall be subjected to the applicable statutory / regulatory limit.

(ii) A bank shall comply with the terms and conditions, if any, stipulated by SEBI / other regulatory authorities in regard to issue of the instruments.

(16) Compliance with reserve requirements

(i) The funds collected by various branches of the bank or other banks for the issue and held pending finalisation of allotment of the AT 1 preference shares shall have to be taken into account for the purpose of calculating reserve requirements.

(ii) However, the total amount raised by the bank by issue of PNCPS shall not be reckoned as liability for calculation of net demand and time liabilities for the purpose of reserve requirements and, as such, shall not attract Cash Reserve Ratio (CRR) / Statutory Liquidity Ratio (SLR) requirements.

(17) Reporting of issuances

(i) A bank issuing PNCPS shall submit a report to the Chief General Manager-in-charge, Department of Regulation, Central Office, Reserve Bank of India, Mumbai giving details of the instrument as per the format prescribed in Annex 2 duly certified by the chief compliance officer of the bank, soon after the issue is completed.

(ii) The issue-wise details of amount raised as PNCPS qualifying for AT 1 capital by the bank from FIIs / NRIs are required to be reported within 30 days of the issue to the Chief General Manager, Reserve Bank of India, Foreign Exchange Department, Central Office, Mumbai 400 001 in the proforma given in Annex 1. The details of the secondary market sales / purchases by FIIs and the NRIs in these instruments on the floor of the stock exchange shall be reported by the custodians and designated banks, respectively, to the Reserve Bank as per applicable FEMA guidelines, as amended from time to time.

(18) Investment in AT 1 capital instruments (PNCPS) Issued by other banks / FIs

(i) A bank's investment in PNCPS issued by other banks and financial institutions shall be reckoned along with the investment in other instruments eligible for capital status while computing compliance with the overall ceiling of 10 per cent of investing banks' capital funds as prescribed vide paragraph 18(8)(i).

(ii) Bank's investments in PNCPS issued by other banks / financial institutions shall attract risk weight as provided in Reserve Bank of India (Small Finance Banks – Prudential Norms on Capital Adequacy) Directions, 2025, whichever applicable for capital adequacy purposes.

(iii) A bank's investments in the PNCPS of other banks shall be treated as exposure to capital market and be reckoned for the purpose of compliance with the prudential ceiling for capital market exposure as fixed by the Reserve Bank.

(19) Classification in the balance sheet

PNCPS shall be classified as capital and shown under 'Schedule I - Capital' of the balance sheet.

(20) PNCPS to retail investors

A bank issuing PNCPS to retail investors, subject to approval of its Board, shall adhere to the following conditions:

(i) The requirement for specific sign-off as quoted below, from the investors for having understood the features and risks of the instrument may be incorporated in the common application form of the proposed issue.

"By making this application, I / We acknowledge that I / We have understood the terms and conditions of the Issue of [insert the name of the instruments being issued] of [Name of The Bank] as disclosed in the Draft Shelf Prospectus, Shelf Prospectus and Tranche Document".

(ii) All the publicity material, application form and other communication with the investor shall clearly state in bold letters (**with font size 14**) how PNCPS is different from common shares. In addition, the loss absorbency features of the instrument shall be clearly explained and the investor's sign-off for having understood these features and other terms and conditions of the instrument should be obtained.

E.2 Criteria for inclusion of Basel III PDI in AT 1 capital

13. The PDI that may be issued as bonds or debentures by a bank should meet the following terms and conditions to qualify for inclusion in AT 1 capital for capital adequacy purposes:

Terms of issue of instruments denominated in Indian rupees

(1) Paid-in Status

The instruments shall be issued by the bank (i.e., not by any 'SPV' etc. set up by the bank for this purpose) and fully paid-in.

(2) Amount

The amount of PDI to be raised shall be decided by the Board of Directors of a bank.

(3) Limits

While complying with minimum Tier 1 of 7.5 per cent of RWAs, a bank cannot admit, PNCPS together with PDI in AT 1 Capital, more than 1.5 per cent of RWAs. However, once this minimum total Tier 1 capital has been complied with, any additional PNCPS and PDI issued by the bank can be included in total Tier 1 capital reported. Excess PNCPS and PDI can be reckoned to comply with Tier 2 capital if the latter is less than 7.5 per cent of RWAs i.e., while complying with minimum total capital of 15 per cent of RWAs.

(4) Maturity period

The PDIs shall be perpetual i.e., there is no maturity date and there are no step-ups or other incentives to redeem.

(5) Rate of interest

The interest payable to the investors shall be either at a fixed rate or at a floating rate referenced to a market determined rupee interest benchmark rate.

(6) Optionality

PDIs shall not have any ‘put option’. However, a bank may issue the instruments with a call option at a particular date subject to following conditions:

(i) The call option on the instrument is permissible after the instrument has run for at least five years;

(ii) To exercise a call option a bank shall receive prior approval of the Reserve Bank (Department of Regulation);

(iii) A bank shall not do anything which creates an expectation that the call will be exercised. For example, to preclude such expectation of the instrument being called, the dividend / coupon reset date need not be co-terminus with the call date. A bank may, at its discretion, consider having an appropriate gap between dividend / coupon reset date and call date; and

(iv) A bank must not exercise a call unless:

(a) It replaces the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank; or

Note - Replacement issues can be concurrent with but not after the instrument is called.

(b) The bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.

Explanation - Here, minimum refers to CET 1 of 6 per cent of RWA, Tier capital of 7.50 per cent of RWAs and total capital of 15 per cent of RWAs including any additional capital requirement identified under Pillar 2.

(v) The use of tax event and regulatory event calls may be permitted. However, exercise of the calls on account of these events is subject to the requirements set out in points (ii) to (iv) above. The Reserve Bank shall permit the bank to exercise the call only if it is convinced that the bank was not in a position to anticipate these events at the time of issuance of PDIs.

(vi) To illustrate, if there is a change in tax treatment which makes the capital instrument with tax deductible coupons into an instrument with non-tax-deductible coupons, then the bank would have the option (not obligation) to repurchase the instrument. In such a situation, a bank may be allowed to replace the capital instrument with another capital instrument that perhaps does have tax deductible coupons. Similarly, if there is a downgrade of the instrument in regulatory classification (e.g., if it is decided by the Reserve Bank to exclude an instrument from regulatory capital) the bank shall have the option to call the instrument and replace it with an instrument with a better regulatory classification, or a lower coupon with the same regulatory classification with prior approval of the Reserve Bank. However, a bank shall not create an expectation / signal an early redemption / maturity of the regulatory capital instrument.

(7) Repurchase / buy-back / redemption

(i) Principal of the instruments may be repaid (e.g., through repurchase or redemption) only with the prior approval of the Reserve Bank and a bank shall not assume or create market expectations that supervisory approval shall be given (this repurchase / buy-back / redemption of the principal is in a situation other than in the event of exercise of call option by the bank. One of the major differences is that in the case of the former, the option to offer the instrument for repayment on announcement of the decision to repurchase / buy-back / redeem the instrument, would lie with the investors whereas, in case of the latter, it lies with the bank).

(ii) A bank may repurchase / buy-back / redeem only if:

(a) It replaces such instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank; or

(b) The bank demonstrates that its capital position is well above the minimum capital requirements after the repurchase / buy-back / redemption.

(8) Coupon discretion

(i) The bank shall have full discretion at all times to cancel distributions / payments.

Note - Consequence of full discretion at all times to cancel distributions / payments is that 'dividend pushers' are prohibited. An instrument with a dividend pusher obliges the issuing bank to make a dividend / coupon payment on the instrument if it has made a payment on another (typically more junior) capital instrument or share. This obligation is inconsistent with the requirement for full discretion at all times. Furthermore, the term 'cancel distributions / payments' means extinguish these payments. It does not permit features that require the bank to make distributions / payments in kind.

(ii) Cancellation of discretionary payments must not be an event of default.

(iii) A bank shall have full access to cancelled payments to meet obligations as they fall due.

(iv) Cancellation of distributions / payments must not impose restrictions on the bank except in relation to distributions to common stakeholders.

(v) Coupons shall be paid out of 'distributable items'. In this context, coupon may be paid out of current year profits. However, if current year profits are not sufficient, coupon may be paid subject to availability of:

(a) Profits brought forward from previous years, and / or

(b) Reserves representing appropriation of net profits, including statutory reserves, and excluding share premium, revaluation reserve, foreign currency translation reserve, unrealised gains transferred to AFS-Reserve investment reserve and reserves created on amalgamation.

(c) The accumulated losses and deferred revenue expenditure, if any, shall be netted off from (a) and (b) to arrive at the available balances for payment of coupon.

(d) If the aggregate of: (i) profits in the current year; (ii) profits brought forward from the previous years and (iii) permissible reserves as at (b) above, excluding statutory reserves, net of accumulated losses and deferred revenue expenditure are less than the amount of coupon, only then the bank shall make appropriation from the statutory reserves. In such cases, a bank is required to report to the Reserve Bank within twenty-one days from the date of such appropriation in compliance with Section 17(2) of the BR Act 1949.

(e) Prior approval of the Reserve Bank for appropriation of reserves as above, in terms of the Reserve Bank of India (Payments Banks – Financial Statements: Presentation and Disclosures) Directions, 2025 is not required in this regard.

(f) However, payment of coupons on PDIs from the reserves is subject to the issuing bank meeting minimum regulatory requirements for CET 1, Tier 1 and total capital ratios.

(vi) To meet the eligibility criteria for PDIs, a bank shall ensure and indicate in its offer documents that it has full discretion at all times to cancel distributions / payments.

(vii) The interest shall not be cumulative.

(viii) The instrument shall not have a credit sensitive coupon feature, i.e., a dividend that is reset periodically based in whole or in part on a bank's credit standing. For this purpose, any reference rate including a broad index which is sensitive to changes to the bank's own creditworthiness and / or to changes in the credit worthiness of the wider banking sector shall be treated as a credit sensitive reference rate. A bank desirous of offering floating reference rate may take prior approval of the Reserve Bank (Department of Regulation) as regard permissibility of such reference rates.

(ix) A bank may have dividend stopper arrangement that stops dividend payments on common shares in the event the holders of AT1 instruments are not paid dividend / coupon. However, dividend stoppers shall not impede the full discretion that bank shall have at all times to cancel distributions / payments on the AT 1 instrument, nor must they act in a way that could hinder the re-capitalisation of the bank. For example, it shall not be permitted for a stopper on an AT 1 instrument to:

(a) attempt to stop payment on another instrument where the payments on this other instrument were not also fully discretionary;

(b) prevent distributions to shareholders for a period that extends beyond the point in time that dividends / coupons on the AT 1 instrument are resumed;

(c) impede the normal operation of the bank or any restructuring activity (including acquisitions / disposals).

(x) A stopper may act to prohibit actions that are equivalent to the payment of a dividend, such as the bank undertaking discretionary share buybacks, if otherwise permitted.

(9) Treatment in insolvency

The instrument shall not contribute to liabilities exceeding assets if such a balance sheet test forms part of a requirement to prove insolvency under any law or otherwise.

(10) Loss absorption features

PDIs shall be classified as liabilities for accounting purposes (not for the purpose of insolvency as indicated in paragraph 13(9) above). In such cases, these instruments shall have loss absorption through conversion / write-down / write-off on breach of pre-specified trigger and at the point of non-viability, as detailed in paragraph 26 of Reserve Bank of India (Commercial Banks - Prudential Norms on Capital Adequacy) Directions, 2025. The pre-specified trigger for loss absorption through conversion / write-down of PDIs shall be at least CET 1 capital of 7 per cent of RWAs.

(11) Prohibition on purchase / funding of instruments

Neither the bank nor a related party over which the bank exercises control or significant influence (as defined under relevant Accounting Standards) shall purchase the instrument, nor shall the bank directly or indirectly fund the purchase of the instrument. A bank shall also not grant advances against the security of the debt instruments issued by them.

(12) Re-capitalisation

The instrument shall not have any features that hinder re-capitalisation, such as provisions which require the issuer to compensate investors if a new instrument is issued at a lower price during a specified time frame.

(13) Reporting of non-payment of coupons

All instances of non-payment of coupon shall be notified by an issuing bank to the Chief General Managers-in-Charge of Department of Regulation and Department of Supervision of the Reserve Bank of India, Mumbai.

(14) Seniority of claim

The claims of the investors in instruments shall be

(i) superior to the claims of investors in equity shares and PNCPS;

(ii) subordinated to the claims of depositors, general creditors and subordinated debt of the bank;

(iii) is neither secured nor covered by a guarantee of the issuer nor related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis bank creditors.

(15) Investment in instruments raised in Indian Rupees by Foreign Entities / NRIs

(i) Investment by FIIs in instruments raised in Indian Rupees shall be outside the ECB limit for rupee denominated corporate debt, as fixed by the Government of India from time to time, for investment by FIIs in corporate debt instruments. Investment in these instruments by FIIs and NRIs shall be within an overall limit of 49 per cent and 24 per cent of the issue, respectively, subject to the investment by each FII not exceeding 10 per cent of the issue and investment by each NRI not exceeding 5 per cent of the issue.

(ii) A bank shall comply with the terms and conditions, if any, stipulated by the SEBI / other regulatory authorities in regard to issue of the instruments.

(16) Terms of Issue of Instruments denominated in foreign currency / rupee denominated bonds overseas

A bank may augment its capital funds through the issue of PDIs in foreign currency / rupee denominated bonds overseas without seeking the prior approval of the Reserve Bank, subject to compliance with the FEMA guidelines as applicable and the requirements mentioned below:

(i) These instruments shall comply with all terms and conditions as applicable to the instruments issued in Indian Rupees.

PDIs issued in foreign currency/ rupee denominated bonds overseas shall be eligible for inclusion in AT 1 capital up to a maximum amount of 1.5 per cent of RWAs as per the latest available financial statements (audited or subjected to limited review).

(ii) Instruments issued in foreign currency shall be outside the existing limit for foreign currency borrowings by Authorised Dealers, stipulated in terms of Master Direction - Risk Management and Inter-Bank Dealings dated July 5, 2016 as updated from time to time.

(iii) A bank raising PDIs overseas should obtain and keep on record a legal opinion from an advocate / attorney practicing in the relevant legal jurisdiction, that the terms and conditions of issue of the instrument are in conformity with these directions, as amended from to time, can be enforced in the concerned legal jurisdiction and the applicable laws there do not stand in the way of enforcement of those conditions.

(17) Compliance with reserve requirements

The total amount raised by a bank through debt instruments shall not be reckoned as liability for calculation of net demand and time liabilities for the purpose of reserve requirements and, as such, will not attract CRR / SLR requirements.

(18) Reporting of Issuances

A bank issuing PDIs shall submit a report to the Chief General Manager-in-charge, Department of Regulation, Reserve Bank of India, Mumbai giving details of the instrument as per the format prescribed in Annex 2 duly certified by the chief compliance officer of the bank, soon after the issue is completed.

(19) Investment in AT 1 PDIs Issued by other banks / FIs

(i) A bank's investment in debt instruments issued by other banks and financial institutions shall be reckoned along with the investment in other instruments eligible for capital status while computing compliance with the overall ceiling of 10 per cent for cross holding of capital among banks / FIs prescribed vide paragraph 18(8)(i) and also subject to cross holding limits.

(ii) Bank's investments in debt instruments issued by other banks shall attract risk weight for capital adequacy purposes, as prescribed in Reserve Bank of India (Small Finance Banks – Prudential Norms on Capital Adequacy) Directions, 2025, whichever applicable.

(20) Classification in the balance sheet

The amount raised by way of issue of debt capital instrument may be classified under ‘Schedule 4 - Borrowings’ in the balance sheet.

(21) PDIs to retail investors

A bank issuing PDIs to retail investors, subject to approval of its Board, shall adhere to the following conditions:

(i) For floating rate instruments, a bank shall not use its fixed deposit rate as benchmark.

(ii) The requirement for specific sign-off as quoted below, from the investors for having understood the features and risks of the instrument shall be incorporated in the common application form of the proposed debt issue.

"By making this application, I / We acknowledge that I / We have understood the terms and conditions of the Issue of [insert the name of the instruments being issued] of [Name of The Bank] as disclosed in the Draft Shelf Prospectus, Shelf Prospectus and Tranche Document ".

(iii) All the publicity material, application form and other communication with the investor shall clearly state in bold letters (**with font size 14**) how a PDI is different from fixed deposit particularly that it is not covered by deposit insurance. In addition, the loss absorbency features of the instrument shall be clearly explained and the investor's sign-off for having understood these features and other terms and conditions of the instrument shall be obtained.

F Tier 2 capital

14. Tier 2 capital shall consist of the sum of the following elements:

(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 materialise, shall qualify for inclusion within Tier 2 capital. Accordingly, general provisions on standard assets, floating provisions, excess provisions which arise on account of sale of NPAs and 'countercyclical provisioning buffer' shall qualify for inclusion in Tier 2 capital. However, these items together shall be admitted as Tier 2 capital up to a maximum of 1.25 per cent of the total credit RWAs under the standardised approach.

Note: A bank may net off floating provisions from Gross NPAs to arrive at Net NPA or reckon it as Tier 2 capital.

(b) Investment Fluctuation Reserve

(c) Provisions ascribed to identified deterioration of particular assets or loan liabilities, whether individual or grouped shall 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 shall be excluded.

(ii) Basel III debt capital instruments eligible for inclusion in Tier 2 capital, which comply with the regulatory requirements as specified in paragraph 15 below;

(iii) Basel II debt capital instruments, i.e., Upper Tier 2 bonds and Lower Tier 2 bonds, eligible for inclusion in Tier 2 capital, which comply with the regulatory requirements as specified in paragraph 16 and paragraph 17 respectively; and

(iv) Less: Regulatory adjustments / deductions applied in the calculation of Tier 2 capital [i.e., to be deducted from the sum of items in paragraph 14(i) to 16(iii)].

F.1 Criteria for inclusion of Basel III debt capital instruments as Tier 2 capital

15. The Basel III Tier 2 debt capital instruments that may be issued as bonds / debentures by a bank shall meet the following terms and conditions to qualify for inclusion as Tier 2 capital for capital adequacy purposes:

Terms of Issue of Instruments Denominated in Indian Rupees

(1) Paid-in status

The instruments shall be issued by the bank (i.e., not by any 'SPV' etc. set up by the bank for this purpose) and fully paid-in.

(2) Amount

The amount of these debt instruments to be raised shall be decided by the Board of Directors of a bank.

(3) Maturity period

The debt instruments shall have a minimum maturity of five years and there are no step-ups or other incentives to redeem.

(4) Discount

The debt instruments shall be subjected to a progressive discount for capital adequacy purposes. As they approach maturity these instruments shall be subjected to progressive discount as indicated in the table below for being eligible for inclusion in Tier 2 capital.

Table 1: Rate of discount on debt instruments

Remaining maturity of instruments	Rate of discount (%)
Less than one year	100
One year and more but less than two years	80
Two years and more but less than three years	60
Three years and more but less than four years	40

Remaining maturity of instruments	Rate of discount (%)
Four years and more but less than five years	20

(5) Rate of interest

(i) The interest payable to the investors shall be either at a fixed rate or at a floating rate referenced to a market determined rupee interest benchmark rate.

(ii) The instrument shall not have a credit sensitive coupon feature, i.e., a coupon that is reset periodically based in whole or in part on the banks' credit standing. A bank desirous of offering floating reference rate shall take prior approval of the Reserve Bank (Department of Regulation) as regard permissibility of such reference rates.

(6) Optionality

The debt instruments shall not have any 'put option'. However, it may be callable at the initiative of the issuer only after a minimum of five years subject to following conditions:

(i) To exercise a call option a bank must receive prior approval of the Reserve Bank (Department of Regulation); and

(ii) A bank shall not do anything which creates an expectation that the call will be exercised. For example, to preclude such expectation of the instrument being called, the dividend / coupon reset date need not be co-terminus with the call date. A bank may, at its discretion, consider having an appropriate gap between dividend / coupon reset date and call date; and

(iii) A bank shall not exercise a call unless:

(a) It replaces the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank; or

Note - Replacement issues can be concurrent with but not after the instrument is called.

(b) The bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.

Explanation - Here, minimum refers to CET 1 capital of 6 per cent of RWA, Tier 1 capital of 7.5 per cent of RWAs and Total Capital of 15 per cent of RWAs including any additional capital requirement identified under Pillar 2.

(iv) The use of tax event and regulatory event calls may be permitted. However, exercise of the calls on account of these events is subject to the requirements set out in points (i) to (iii) above. The Reserve Bank shall permit the bank to exercise the call only if the Reserve Bank is convinced that the bank was not in a position to anticipate these events at the time of issuance of these instruments as explained in case of AT 1 instruments.

(7) Loss absorption features

The instruments shall have loss absorption through conversion / write-off at the point of non-viability, as detailed in paragraph 26 of Reserve Bank of India (Commercial Banks - Prudential Norms on Capital Adequacy) Directions, 2025.

(8) Treatment in bankruptcy / liquidation

The investor shall have no rights to accelerate the repayment of future scheduled payments (coupon or principal) except in bankruptcy and liquidation.

(9) Prohibition on purchase / funding of instruments

Neither the bank nor a related party over which the bank exercises control or significant influence (as defined under relevant accounting standards) shall purchase the instrument, nor the bank shall directly or indirectly fund the purchase of the instrument. A bank shall also not grant advances against the security of the debt instruments issued by them.

(10) Reporting of non-payment of coupons

All instances of non-payment of coupon shall be notified by an issuing bank to the Chief General Managers-in-Charge of Department of Regulation and Department of Supervision of the Reserve Bank of India, Mumbai.

(11) Seniority of claim

The claims of the investors in instruments shall be

(i) senior to the claims of investors in instruments eligible for inclusion in Tier 1 capital;

(ii) subordinate to the claims of Basel II Upper Tier 2 bonds and Basel II Lower Tier 2 bonds;

(iii) subordinate to the claims of all depositors and general creditors of the bank; and

(iv) neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis bank creditors.

(12) Investment in Instruments raised in Indian rupees by foreign entities / NRIs

(i) Investment by FIIs in Tier 2 instruments raised in Indian rupees shall be outside the limit for investment in corporate debt instruments, as fixed by the Government of India from time to time. However, investment by FIIs in these instruments shall be subject to a separate ceiling of USD 500 million. In addition, NRIs shall also be eligible to invest in these instruments as per existing policy.

(ii) A bank shall comply with the terms and conditions, if any, stipulated by the SEBI / other regulatory authorities in regard to issue of the instruments.

(13) Issuance of rupee denominated bonds overseas by a bank

A bank is permitted to raise funds through issuance of rupee denominated bonds overseas for qualification as debt capital instruments eligible for inclusion as Tier 2 capital, subject to compliance with all the terms and conditions applicable to instruments issued in Indian rupees and FEMA guidelines, as applicable.

(14) Terms of Issue of Tier 2 Debt capital instruments in foreign currency

(i) A bank may issue Tier 2 debt Instruments in foreign currency without seeking the prior approval of the Reserve Bank, subject to compliance with the requirements mentioned below:

(a) Tier 2 Instruments issued in foreign currency shall comply with all terms and conditions applicable to instruments issued in Indian rupees.

(b) The total outstanding amount of Tier 2 Instruments in foreign currency shall not exceed 25 per cent of the unimpaired Tier 1 capital. This eligible amount shall be computed with reference to the amount of Tier 1 capital as on March 31 of the previous financial year, after deduction of goodwill and other intangible assets but before the deduction of investments, as per paragraph 18.

(c) This shall be in addition to the existing limit for foreign currency borrowings by Authorised Dealers stipulated in terms of Master Direction - Risk Management and Inter-Bank Dealings dated July 5, 2016 as updated from time to time.

(ii) A bank raising Tier 2 bonds overseas (both foreign currency and rupee denominated bonds) shall obtain and keep on record a legal opinion from an advocate / attorney practicing in the relevant legal jurisdiction, that the terms and conditions of issue of the instrument are in conformity with these directions, as amended from to time, can be enforced in the concerned legal jurisdiction and the applicable laws there do not stand in the way of enforcement of those conditions.

(15) Compliance with reserve requirements

(i) The funds collected by various branches of the bank or other banks for the issue and held pending finalisation of allotment of the Tier 2 capital instruments shall have to be taken into account for the purpose of calculating reserve requirements.

(ii) The total amount raised by a bank through Tier 2 instruments shall be reckoned as liability for the calculation of net demand and time liabilities for the purpose of reserve requirements and, as such, will attract CRR / SLR requirements.

(16) Reporting of Issuances

A bank issuing debt instruments shall submit a report to the Chief General Manager-in-charge, Department of Regulation, Reserve Bank of India, Mumbai giving details of the instrument as per the format prescribed in Annex 2 duly certified by the compliance officer of the bank, soon after the issue is completed.

(17) Investment in Tier 2 debt capital instruments issued by other banks / FIs

(i) A bank's investment in Tier 2 debt instruments issued by other banks and financial institutions shall be reckoned along with the investment in other instruments eligible for capital status while computing compliance with the overall ceiling of 10 per cent for cross holding of capital among banks / FIs prescribed vide paragraph 18(8)(i) and also subject to cross holding limits.

(ii) Bank's investments in Tier 2 instruments issued by other banks / financial institutions will attract risk weight as per Reserve Bank of India (Small Finance Banks – Prudential Norms on Capital Adequacy) Directions, 2025, whichever applicable for capital adequacy purposes.

(18) Classification in the balance sheet

The amount raised by way of issue of Tier 2 debt capital instrument may be classified under 'Schedule 4 – Borrowings' in the balance sheet.

(19) Debt capital instruments to retail investors

A bank issuing subordinated debt to retail investors, subject to approval of its Board, shall adhere to the following conditions:

(i) For floating rate instruments, a bank shall not use its Fixed Deposit rate as benchmark.

(ii) The requirement for specific sign-off as quoted below, from the investors for having understood the features and risks of the instrument may be incorporated in the common application form of the proposed debt issue.

"**By making this application, I / We acknowledge that I / We have understood the terms and conditions of the Issue of [insert the name of the instruments being issued] of [Name of The Bank] as disclosed in the Draft Shelf Prospectus, Shelf Prospectus and Tranche Document** ".

(iii) All the publicity material, application form and other communication with the investor should clearly state in bold letters (with **font size 14**) how a subordinated bond is different from fixed deposit particularly that it is not covered by deposit insurance. In addition, the loss absorbency features of the instrument shall be clearly explained and the investor's sign-off for having understood these features and other terms and conditions of the instrument should be obtained.

F.2 Terms and conditions applicable to debt capital instruments to qualify for inclusion as Basel II Upper Tier 2 capital

16. The debt capital instruments that may be issued as bonds / debentures by a bank shall meet the following terms and conditions to qualify for inclusion as Upper Tier 2 Capital for capital adequacy purposes.

Terms of Issue of Upper Tier 2 capital instruments in Indian rupees

(1) Amount

The amount of Upper Tier 2 instruments to be raised shall be decided by the Board of Directors of a bank.

(2) Limits

Upper Tier 2 instruments, along with other components of Tier 2 capital other than Basel III Tier 2 bonds, shall not exceed 100 per cent of Tier 1 capital. The above limit shall be based on the amount of Tier 1 capital after deduction of goodwill, DTA and other intangible assets but before the deduction of investments,, as required in paragraph 18.

(3) Maturity period

(i) Upper Tier 2 instruments shall have a minimum maturity of 15 years.

(ii) Upper Tier 2 instruments shall be subjected to progressive discount as indicated in the table below for inclusion in Tier 2 capital:

Table 2: Rate of discount on debt instruments qualifying for inclusion as Basel II Upper Tier 2 capital

Remaining maturity of instruments	Rate of Discount (per cent)
Less than one year	100
One year and more but less than two years	80
Two years and more but less than three years	60
Three years and more but less than four years	40
Four years and more but less than five years	20

(4) Rate of interest

The interest payable to the investors shall be either at a fixed rate or at a floating rate referenced to a market determined rupee interest benchmark rate.

(5) Options

Upper Tier 2 instruments shall not be issued with a 'put option'. However, a bank may issue the instruments with a call option subject to strict compliance with each of the following conditions:

(i) Call option shall be exercised only if the instrument has run for at least 10 years;

(ii) Call option shall be exercised only with the prior approval of the Reserve Bank (Department of Regulation). While considering the proposals received from a bank for exercising the call option the Reserve Bank shall, among other things, take into consideration the bank's CRAR position both at the time of exercise of the call option and after exercise of the call option.

(6) Step-up option

Upper Tier 2 instruments shall not have any step-up option.

(7) Lock-in-clause

(i) Upper Tier 2 instruments shall be subjected to a lock-in clause in terms of which the issuing bank shall not be liable to pay either interest or principal, even at maturity, if

(a) the bank's CRAR is below the minimum regulatory requirement prescribed by the Reserve Bank; OR

(b) the impact of such payment results in bank's CRAR falling below or remaining below the minimum regulatory requirement prescribed by the Reserve Bank.

(ii) However, a bank may pay interest with the prior approval of the Reserve Bank when the impact of such payment may result in net loss or increase the net loss provided CRAR remains above the regulatory norm.

(iii) The interest amount due and remaining unpaid may be allowed to be paid in the later years subject to the bank complying with the above regulatory requirement.

(iv) All instances of invocation of the lock-in clause should be notified by the issuing bank to the Chief General Managers-in-Charge of Department of Regulation and Department of Supervision of the Reserve Bank of India, Mumbai.

(8) Seniority of claim

The claims of the investors in Upper Tier 2 instruments shall be:

(i) superior to the claims of investors in instruments eligible for inclusion in Tier 1 capital;

(ii) superior to the claims of Basel III Tier 2 bonds;

(iii) subordinate to the claims of Basel II Lower Tier 2 bonds;

(iv) subordinate to the claims of all depositors and general creditors of the bank; and

(v) neither secured nor covered by a guarantee of the issuer nor related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis bank creditors.

(9) Redemption

Upper Tier 2 instruments shall not be redeemable at the initiative of the holder. All redemptions shall be made only with the prior approval of the Reserve Bank (Department of Regulation).

(10) Other conditions

(i) Upper Tier 2 instruments shall be fully paid-up, unsecured, and free of any restrictive clauses.

(ii) Investment by FIIs in Upper Tier 2 Instruments raised in Indian rupees shall be outside the limit for investment in corporate debt instruments, as fixed by the Government of India from time to time. However, investment by FIIs in these instruments shall be subject to a separate ceiling of USD 500 million. In addition, NRIs shall also be eligible to invest in these instruments as per existing policy.

(iii) A bank shall comply with the terms and conditions, if any, stipulated by the SEBI / other regulatory authorities in regard to issue of the instruments.

(11) Terms of issue of Upper Tier 2 capital instruments in foreign currency

A bank may augment its capital funds through the issue of Upper Tier 2 Instruments in foreign currency without seeking the prior approval of the Reserve Bank of India, subject to compliance with the under-mentioned requirements:

(i) Upper Tier 2 Instruments issued in foreign currency should comply with all terms and conditions applicable to instruments issued in Indian rupees.

(ii) The total amount of Upper Tier 2 Instruments issued in foreign currency shall not exceed 25 per cent of the unimpaired Tier 1 capital. This eligible amount will be computed with reference to the amount of Tier I capital as on March 31 of the previous financial year, after deduction of goodwill and other intangible assets but before the deduction of investments, as required in paragraph 18.

(iii) This will be in addition to the existing limit for foreign currency borrowings by Authorised Dealers stipulated in terms of Master Direction - Risk Management and Inter-Bank Dealings dated July 05, 2016.

(12) Compliance with reserve requirements

(i) The funds collected by various branches of the bank or other banks for the issue and held pending finalisation of allotment of the Upper Tier 2 Capital instruments shall have to be taken into account for the purpose of calculating reserve requirements.

(ii) The total amount raised by a bank through Upper Tier 2 instruments shall be reckoned as liability for the calculation of net demand and time liabilities for the purpose of reserve requirements and, as such, will attract CRR / SLR requirements.

(13) Reporting requirements

A bank issuing upper Tier 2 instruments shall submit a report to the Chief General Manager-in-charge, Department of Regulation, Reserve Bank of India, Mumbai giving details of the instrument as per the format prescribed in Annex 2 duly certified by the compliance officer of the bank, soon after the issue is completed.

(14) Investment in Upper Tier 2 instruments issued by other banks / FIs

(i) A bank's investment in Upper Tier 2 instruments issued by other banks and financial institutions shall be reckoned along with the investment in other instruments eligible for capital status while computing compliance with the overall ceiling of 10 percent for cross holding of capital among banks / FIs prescribed vide paragraph 18(8)(i) and also subject to cross holding limits.

(ii) A bank's investments in Upper Tier 2 instruments issued by other banks / financial institutions shall attract risk weight as per Reserve Bank of India (Small Finance Banks – Prudential Norms on Capital Adequacy) Directions, 2025, whichever applicable for capital adequacy purposes.

(15) Grant of advances against Upper Tier 2 instruments

A bank shall not grant advances against the security of the Upper Tier 2 instruments issued by them.

(16) Classification in the balance sheet

The amount raised through Upper Tier 2 capital instruments shall be classified under 'Schedule 4- Borrowing' in the balance sheet.

F.3 Terms and conditions applicable to subordinated debt to qualify for inclusion as Basel II Lower Tier 2 capital

17. A bank can issue Rupee denominated subordinated debt qualifying for inclusion in Lower Tier 2 capital as per the following conditions:

Terms of issue of bond

(1) Amount

The amount of subordinated debt to be raised shall be decided by the Board of Directors of a bank.

(2) Maturity period

(i) Subordinated debt instruments with an initial maturity period of less than 5 years, or with a remaining maturity of one-year shall not be included as part of Tier 2 Capital. They shall be subjected to progressive discount as they approach maturity at the rates shown below:

Table 3: Rate of discount on subordinated debt instruments qualifying for inclusion as Basel II Lower Tier 2 capital

Remaining Maturity of Instruments	Rate of Discount (per cent)
Less than one year	100
One year and more but less than two years	80
Two years and more but less than three years	60
Three years and more but less than four years	40
Four years and more but less than five years	20

(ii) The bonds shall have a minimum initial maturity of five years. However, if the bonds are issued in the last quarter of the year i.e., from 1st January to 31st March, they should have a minimum initial tenure of sixty three months.

(3) Rate of interest

The coupon rate shall be decided by the Board of Directors of a bank.

(4) Call option

Subordinated debt instruments shall not be issued with a 'put option'. However, a bank may issue the instruments with a call option subject to strict compliance with each of the following conditions:

(i) Call option shall be exercised after the instrument has run for at least five years; and

(ii) Call option shall be exercised only with the prior approval of the Reserve Bank (Department of Regulation). While considering the proposals received from a bank for exercising the call option the Reserve Bank shall, among other things, take into consideration the bank's CRAR position both at the time of exercise of the call option and after exercise of the call option.

(5) Step-up option

Subrodinated debt instruments shall not have any step-up option.

(6) Seniority of claim

The claims of the investors in subordinated debt instruments shall be:

(i) superior to the claims of investors in instruments eligible for inclusion in Tier 1 capital;

(ii) superior to the claims of Basel III Tier 2 bonds and Basel II Upper Tier 2 bonds;

(iii) subordinate to the claims of all depositors and general creditors of a bank; and

(iv) neither secured nor covered by a guarantee of the issuer nor related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis bank creditors.

(7) Other conditions

(i) The instruments shall be fully paid-up, unsecured, free of restrictive clauses and should not be redeemable at the initiative of the holder or without the consent of the Reserve Bank.

(ii) Necessary permission from Foreign Exchange Department shall be obtained for issuing the instruments to NRIs / FIIs.

(iii) A bank shall comply with the terms and conditions, if any, set by the SEBI / other regulatory authorities in regard to issue of the instruments.

(8) Limits

Subordinated debt instruments shall be limited to 50 per cent of Tier 1 capital of a bank. These instruments, together with other components of Tier 2 capital, shall not exceed 100 per cent of Tier 1 capital.

(9) Grant of advances against bonds

A bank shall not grant advances against the security of its own bonds.

(10) Compliance with reserve requirements

The total amount of subordinated debt raised by the bank shall be reckoned as liability for the calculation of net demand and time liabilities for the purpose of reserve requirements and, as such, will attract CRR / SLR requirements.

(11) Treatment of investment in subordinated debt

Investments by a bank in subordinated debt of other banks shall be assigned 100 per cent risk weight for capital adequacy purpose. Also, the bank's aggregate investment in Tier 2 bonds issued by other banks and financial institutions shall be within the overall ceiling of 10 percent of the investing bank's total capital. The capital for this purpose shall be the same as that reckoned for the purpose of capital adequacy.

(12) Subordinated debt to retail investors

A bank issuing subordinated debt to retail investors shall adhere to the following conditions:

(i) The requirement for specific sign-off as quoted below, from the investors for having understood the features and risks of the instrument may be incorporated in the common application form of the proposed debt issue.

"By making this application, I / We acknowledge that I / We have understood the terms and conditions of the Issue of [insert the name of the instruments being issued] of [Name of The Bank] as disclosed in the Draft Shelf Prospectus, Shelf Prospectus and Tranche Document ".

(ii) For floating rate instruments, a bank shall not use its fixed deposit rate as benchmark.

(iii) All the publicity material, application form and other communication with the investor should clearly state in bold letters (**with font size 14**) how a subordinated bond is different from fixed deposit particularly that it is not covered by deposit insurance.

(13) Subordinated debt in foreign currency

A bank shall take approval of the Reserve Bank on a case-by-case basis.

(14) Reporting requirements

A bank issuing debt instruments shall submit a report to the Chief General Manager-in-charge, Department of Regulation, Reserve Bank of India, Mumbai giving details of the instrument as per the format prescribed in Annex 2 duly certified by the compliance officer of the bank, soon after the issue is completed.

(15) Classification in the balance sheet

The amount of subordinated debt raised should be classified under 'Schedule 4- Borrowing' in the balance sheet.

G Regulatory adjustments / deductions

18. The following paragraphs deal with the regulatory adjustments / deductions which shall be applied to regulatory capital.

(1) Goodwill and all other intangible assets

(i) Goodwill and all other intangible assets shall be deducted from CET 1 capital including any goodwill included in the valuation of significant investments in the capital of banking, financial and insurance entities. In terms of AS 23 - Accounting for investments in associates - goodwill / capital reserve arising on the acquisition of an associate by an investor shall be included in the carrying amount of investment in the associate but shall be disclosed separately. Therefore, if the acquisition of equity interest in any associate involves payment which can be attributable to goodwill, this shall be deducted from the CET 1 capital of a bank.

(ii) The full amount of the intangible assets shall be deducted net of any associated Deferred Tax Liabilities (DTL) which shall be extinguished if the intangible assets become impaired or derecognised under the relevant accounting standards. For this purpose, the definition of intangible assets shall be in accordance with the applicable accounting standards. Losses in the current period and those brought forward from previous periods shall also be deducted from CET 1 capital, if not already deducted.

(2) Deferred tax assets (DTAs)

(i) DTAs associated with accumulated losses and other such assets shall be deducted in full, from CET 1 capital.

(ii) DTAs which relate to timing differences (other than those related to accumulated losses) may, instead of full deduction from CET 1 capital, be recognised in the CET 1 capital up to 10 per cent of a bank's CET 1 capital, at its discretion [after the application of all regulatory adjustments mentioned from paragraphs 18(1) to 18(8)(ii)(c)(ii)]

(iii) Further, the limited recognition of DTAs as at paragraph (ii) above along with limited recognition of significant investments in the common shares of financial (i.e., banking, financial and insurance) entities in terms of paragraph 18(8)(ii)(c)(iii) taken together shall not exceed 15 per cent of the CET 1 capital, calculated after all regulatory adjustments set out from paragraphs 18(1) to 20(8). Paragraph 18(2)(vi) under this paragraph below provides an illustration of this applicable limited recognition. However, a bank shall ensure that the CET 1 capital arrived at after application of 15 per cent limit, specified above, shall in no case result in recognising any item more than the 10 per cent limit applicable individually.

(iv) The amount of DTAs to be deducted from CET 1 capital may be netted with associated DTLs provided that

   (a) both the DTAs and DTLs relate to taxes levied by the same taxation authority and offsetting is permitted by the relevant taxation authority;

   (b) the DTLs permitted to be netted against DTAs shall exclude amounts that have been netted against the deduction of goodwill, intangibles and defined benefit pension assets; and

   (c) the DTLs shall be allocated on a pro rata basis between DTAs subject to deduction from CET 1 capital as at 18(2)(i) and 18(2)(ii) above.

(v) The amount of DTAs which is not deducted from CET 1 capital (in terms of paragraph 18(2)(ii) above) shall be risk weighted at 250 per cent as in the case of significant investments in common shares not deducted from bank's CET 1 capital as indicated in paragraph 18(8)(ii)(c)(iii).

(vi) Illustration on calculation of 15 per cent of common equity limit on items subject to limited recognition (i.e., DTAs associated with timing differences and significant investments in common shares of financial entities)

(a) A bank shall follow the 15 per cent limit on significant investments in the common shares of financial institutions (banks, insurance and other financial entities) and DTA arising from timing differences (collectively referred to as specified items).

(b) The recognition of these specified items will be limited to 15 per cent of CET 1 capital, after the application of all deductions. To determine the maximum amount of the specified items that can be recognised*, a bank shall multiply the amount of CET 1** (after all deductions, including after the deduction of the specified items in full i.e., specified items should be fully deducted from CET1 along with other deductions first for arriving at CET 1**) by 17.65 per cent. This number i.e., 17.65 per cent is derived from the proportion of 15 per cent to 85 per cent (15% / 85% = 17.65%).

Note-

(i) * The actual amount that will be recognised may be lower than this maximum, either because the sum of the three specified items is below the 15 per cent limit set out in this illustration, or due to the application of the 10 per cent limit applied to each item.

(ii) ** At this point, this is a ‘hypothetical’ amount of CET 1 in that it is used only for the purposes of determining the deduction of the specified items.

(c) As an example, take a bank with ₹85 of common equity (calculated net of all deductions, including after the deduction of the specified items in full).

(d) The maximum amount of specified items that can be recognised by this bank in its calculation of CET 1 capital is ₹85 x 17.65 per cent = ₹15. Any excess above ₹15 shall be deducted from CET 1. If the bank has specified items (excluding amounts deducted after applying the individual 10 per cent limits) that in aggregate sum up to the 15 per cent limit, CET1 after inclusion of the specified items, shall amount to

₹85 + ₹15 = ₹100. The percentage of specified items to total CET 1 shall equal 15 per cent.

(3) Cash flow hedge reserve

(i) The amount of the cash flow hedge reserve that relates to the hedging of items that are not fair valued on the balance sheet (including projected cash flows) shall be derecognised in the calculation of CET 1 capital. This means that positive amounts shall be deducted, and negative amounts shall be added back.

(4) Cumulative gains and losses due to changes in own credit risk on fair valued financial liabilities

(i) A bank shall derecognise all unrealised gains and losses resulting from changes in the fair value of liabilities due to changes in the bank’s own credit risk from CET 1 capital. Additionally, with regard to derivative liabilities, all accounting valuation adjustments arising from the bank's own credit risk shall also be derecognised from CET 1 capital. The offsetting between valuation adjustments arising from the bank's own credit risk and those arising from its counterparties' credit risk shall not be allowed.

(ii) 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 shall deduct all DVAs from its CET 1 capital, irrespective of whether the DVAs arises due to changes in its own credit risk or other market factors. Thus, such deduction shall also include the deduction of initial DVA at inception of a new trade.

(5) Defined benefit pension fund (including other defined employees’ funds) assets and liabilities

(i) Defined benefit pension fund liabilities, as included on the balance sheet, shall be fully recognised in the calculation of CET 1 capital (i.e., CET 1 capital shall not be increased by derecognising these liabilities). For each defined benefit pension fund that is an asset on the balance sheet, the asset shall be deducted in the calculation of CET 1 capital net of any associated

DTL which shall be extinguished if the asset become impaired or derecognised under the relevant accounting standards.

(6) Investments in own shares (Treasury stock)

(i) Investment in a bank's own shares shall be 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 shall remove the double counting of equity capital arising from direct holdings, indirect holdings via index funds and potential future holdings as a result of contractual obligations to purchase own shares.

(ii) A bank shall not repay its equity capital without specific approval of the Reserve Bank. 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, a bank may end up having indirect investments in its own stock if it invests in / take exposures to mutual funds or index funds / securities which have long position in the bank's share. In such cases, the bank shall look through holdings of index securities to deduct exposures to own shares from its CET 1 capital. Following the same approach outlined above, a bank shall deduct investments in its own AT 1 capital from the calculation of its AT 1 capital and investments in its own Tier 2 capital from the calculation of its 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 shall be equal to the 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 the bank’s investments in these entities multiplied by 10 per cent of investments of such entities in the investing bank’s capital instruments. A bank shall not follow corresponding deduction approach i.e., all deductions shall be made from the CET 1 capital even though, the investments of such entities are in the AT 1 / Tier 2 capital of an investing bank.

Note - In terms of Securities and Exchange Board of India (SEBI) (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.

(7) Investments in the capital of banking, financial and insurance entities

The rules under this paragraph shall 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.

(i) Limits on a bank’s investments in the capital of banking, financial and insurance entities

(a) A bank’s investments in capital instruments issued by banking, financial and insurance entities shall not exceed 10 per cent of its total regulatory capital (Tier 1 plus Tier 2), but after all deductions mentioned in paragraph 18 [up to paragraph 18(7)].

(b) The indicative list of institutions which shall be deemed to be financial institutions other than banks and insurance companies for the purpose of this paragraph is as under:

(i) Asset Management Companies of Mutual Funds / Venture Capital Funds / Private Equity Funds etc.;

(ii) Non-Banking Finance Companies;

(iii) Housing Finance Companies;

(iv) Primary Dealers;

(v) Merchant Banking Companies;

(vi) Entities engaged in activities which are ancillary to the business of banking under the BR Act, 1949;

(vii) Central Counterparties (CCPs).

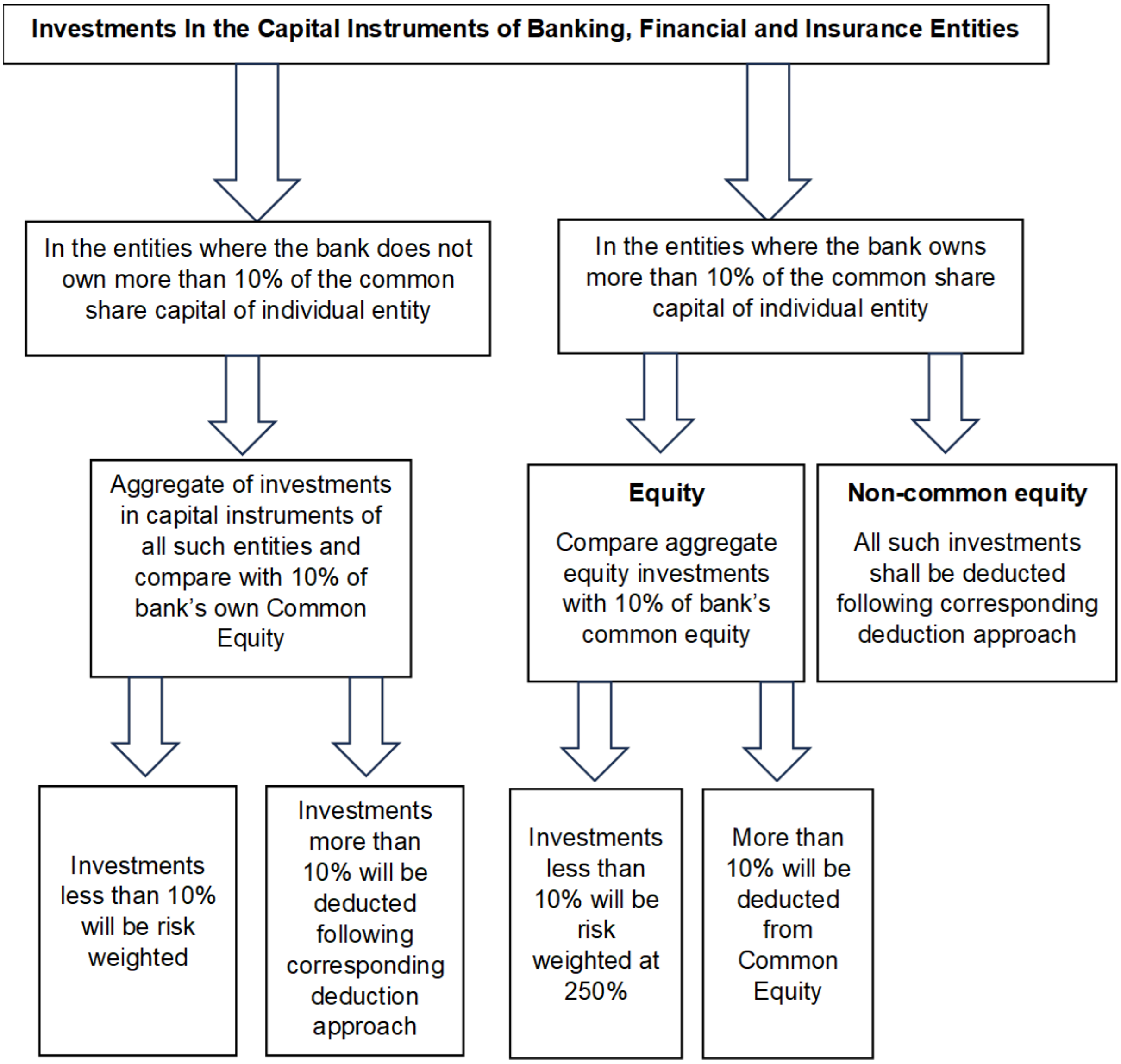
(c) Investments made by a banking subsidiary / associate in the equity or non- equity regulatory capital instruments issued by its parent bank shall be deducted from such subsidiaries' regulatory capital following corresponding deduction approach, in its capital adequacy assessment.

(d) The regulatory treatment of investment by a non-banking financial associate in the parent bank's regulatory capital shall be governed by the applicable regulatory capital norms of the respective regulators of the associate.

(ii) Treatment of a bank's investments in capital instruments issued by banking, financial and insurance entities within limits

A schematic representation of treatment of a bank's investments in capital instruments of financial entities is shown below. All investments in the capital instruments issued by banking, financial and insurance entities within the limits mentioned in paragraph 18(8)(i) shall be subject to the following rules:

Note - For this purpose, investments may be reckoned at values according to their classification in terms of Reserve Bank of India (Payment Banks– Classification, Valuation and Operation of Investment Portfolio) Directions, 2025 .



(a) Reciprocal cross holdings in the capital of banking, financial and insurance entities

Reciprocal cross holdings of capital shall be fully deducted. A bank shall apply a corresponding deduction approach to such investments in the capital of the other banks, financial institutions and insurance entities. This means the deduction shall be applied to the same component of capital (CET 1, AT 1 and Tier 2 capital) for which the capital would qualify if it was issued by the bank itself. For this purpose, a holding shall be treated as reciprocal cross holding if the investee entity has also invested in any class of a 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 where the bank does not own more than 10 per cent of the issued common share capital of entity

(i) The regulatory adjustment described in this paragraph applies to investments in the capital of banking, financial and insurance entities where a bank does not own more than 10 per cent of the issued common share capital of individual entity. In addition:

(a) Investments include direct, indirect and synthetic holdings of capital instruments. For example, a bank shall look through holdings of index securities to determine its underlying holdings of capital.

Explanation - 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.

(b) Holdings in both the banking book and trading book shall 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 shall be included.

(d) If the capital instrument of the entity in which a bank has invested does not meet the criteria for CET 1, AT 1, or Tier 2 capital of the bank, the capital is to be considered common shares for the purposes of this regulatory adjustment. 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.

(e) With the prior approval of the Reserve Bank, 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 18(8)(ii)(b)(i) above, in aggregate exceed 10 per cent of the bank's CET 1 capital (after applying all other regulatory adjustments in full), then the amount above 10 per cent shall be deducted, applying a corresponding deduction approach. This means the deduction shall 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 the CET 1 capital shall be calculated as the total of all holdings which in aggregate exceed 10 per cent of the bank's CET 1 capital (as per above) multiplied by the common equity holdings as a percentage of the total capital holdings. This shall result in a deduction from CET 1 capital which corresponds to the proportion of total capital holdings held in common equity. Similarly, the amount to be deducted from AT 1 capital shall be calculated as the total of all holdings which in aggregate exceed 10 per cent of the bank's CET 1 capital (as per above) multiplied by the AT 1 capital holdings as a percentage of the total capital holdings. The amount to be deducted from Tier 2 capital shall be calculated as the total of all holdings which in aggregate exceed 10 per cent of the bank's CET 1 capital (as per above) multiplied by the Tier 2 capital holdings as a percentage of the total capital holdings. (Please refer to illustration given under paragraph 18(8)(ii)(b)(vi) below).

(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 capital under that Tier to meet that deduction, the shortfall shall be deducted from the next higher Tier of capital (e.g., if a bank does not have enough AT 1 capital to satisfy the deduction, the shortfall shall be deducted from CET 1 capital).

(iv) Investments below the threshold of 10 per cent of a bank's CET 1 capital, which are not deducted, shall be risk weighted. In certain cases, such investments in both scheduled and non-scheduled commercial banks shall be fully deducted from CET 1 capital of the investing bank .

(v) For risk weighting as indicated in paragraph 18(8)(ii)(b)(iv) above, investments in securities having comparatively higher risk weights shall be considered for risk weighting to the extent required to be risk weighted. In other words, investments with comparatively poor ratings (i.e., with higher risk weights) shall be considered for application of risk weighting first and the residual investments shall be considered for deduction.

(vi) Illustration on regulatory adjustment due to investments in the capital of banking, financial and insurance entities is as under.

(a) Details of regulatory capital structure of a bank

	(Amount in ₹ crore)
Paid-up equity capital	300
Eligible Reserve and Surplus	100
Total common equity	**400**
Eligible Additional Tier 1 capital	15
Total Tier 1 capital	**415**
Eligible Tier 2 capital	135
Total Eligible capital	**550**

(b) Details of capital structure and bank's investments

Entity	Total Capital of the Investee entities				Investments of bank in these entities			
	CET 1	Additional Tier 1	Tier 2	Total capital	Common Equity	Additional Tier 1	Tier 2	Total investment
Investments in the capital of banking, financial and insurance entities where the bank does not own more than 10% of the issued common share capital of the entity								
A	250	0	80	**330**	12	0	15	**27**
B	300	10	0	**310**	14	10	0	**24**
Total	**550**	**10**	**80**	**640**	**26**	**10**	**15**	**51**
Significant investments in the capital of banking, financial and insurance entities								
C	150	20	10	**180**	20	10	0	**30**
D	200	10	5	**215**	25	5	5	**35**
Total	**350**	**30**	**15**	**395**	**45**	**15**	**5**	**65**

(c) Regulatory adjustments on account of investments in entities where bank does not own more than 10 per cent of the issued common share capital of the entity

C-1: Bifurcation of Investments of bank into Trading and Banking Book				
	CET1	AT1	Tier 2	Total Investment
Total investments in A & B held in Banking Book	11	6	10	**27**
Total investments in A & B held in Trading Book	15	4	5	**24**
Total of Banking and Trading Book Investments in A & B	**26**	**10**	**15**	**51**

C-2: Regulatory adjustments	
Bank's aggregate investment in Common Equity of A & B	26
Bank's aggregate investment in Additional Tier 1 capital of A & B	10
Bank's aggregate investment in Tier 2 capital of A & B	15
Total of bank's investment in A and B	**51**
Bank common equity	400
10% of bank's common equity	40
Bank's total holdings in capital instruments of A & B in excess of 10% of banks common equity (51-40)	11

***Note* - **Investments in both A and B will qualify for this treatment as individually, both of them are less than 10% of share capital of respective entity. Investments in C & D do not qualify; as bank's investment is more than 10% of its common shares capital.

C-3: Summary of Regulatory Adjustments		Banking Book	Trading Book
Amount to be deducted from common equity of the bank (26 / 51) *11	5.60		
Amount to be deducted from Additional Tier 1 of the bank (10 / 51) *11	2.16		
Amount to be deducted from Tier 2 of the bank (15 / 51)*11	3.24		
Total Deduction	**11.00**		
Common equity investments of the bank in A & B to be risk weighted	20.40 (26-5.60)	8.63 (11 / 26) *20.40	11.77
Additional Tier 1 capital investments of the bank in A & B to be risk weighted	7.84 (10-2.16)	4.70	3.14
Tier 2 capital investments of the bank in A & B to be risk weighted	11.76 (15-3.24)	7.84	3.92
Total allocation for risk weighting	**40.00**	21.17	18.83

(d) Regulatory adjustments on account of significant investments in the capital of banking, financial and insurance entities.

Bank aggregate investment in Common Equity of C & D	45
Bank's aggregate investment in Additional Tier 1 capital of C & D	15
Bank's aggregate investment in Tier 2 capital of C & D	5
Total of bank's investment in C and D	**65**
Bank's common equity	400
10% of bank's common equity	40
Bank's investment in equity of C & D in excess of 10% of its common equity (45-40)	5

D-1: Summary of regulatory adjustments	
Amount to be deducted from common equity of the bank (excess over 10%)	5
Amount to be deducted from Additional Tier 1 of the bank (all Additional Tier 1 investments to be deducted)	15
Amount to be deducted from Tier 2 of the bank (all Tier 2 investments to be deducted)	5
Total deduction	**25**
Common equity investments of the bank in C & D to be risk weighted (up to 10%)	40

(e) Total regulatory capital of the bank after regulatory adjustments

	Before deduction	Deductions as per Table C-3	Deductions as per Table D-1	After deductions
Common Equity	400.00	5.61	5.00	387.24*
AT 1 capital	15.00	2.16	15.00	0.00
Tier 2 capital	135.00	3.24	5.00	126.76
Total Regulatory capital	**550.00**	**11.00**	**25.00**	**514.00**
*Since there is a shortfall of 2.16 in the Additional Tier 1 capital of the bank after deduction, which has to be deducted from the next higher category of capital i.e., common equity.				

(c) **Investments in the capital of banking, financial and insurance entities where the bank owns more than 10 per cent of the issued common share capital of individual entity**

(i) The regulatory adjustment described in this paragraph applies to investments in the capital of banking, financial and insurance entities where a bank owns more than 10 per cent of the issued common share capital of the issuing entity or where the entity is an affiliate of the bank. In addition:

(a) Investments include direct, indirect and synthetic holdings of capital instruments. For example, a bank shall look through holdings of index securities to determine its underlying holdings of capital.

(b) Holdings in both the banking book and trading book shall be included. Capital includes common stock 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 shall be included.

(d) If the capital instrument of the entity in which a bank has invested does not meet the criteria for CET 1, AT 1, or Tier 2 capital of the bank, the capital shall be considered common shares for the purposes of this regulatory adjustment. 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.

(e) With the prior approval of the Reserve Bank, 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.

Explanation -

(i) 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 (i) ownership, control, or holding with power to vote 20 per cent or more of a class of voting securities of the company; or (ii) consolidation of the company for financial reporting purposes

(ii) 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.

(ii) Investments other than common shares

All investments included in paragraph 18(8)(ii)(c)(i) above which are not common shares shall be fully deducted following a corresponding deduction approach. This means the deduction shall be applied to the same Tier of capital for which the capital would qualify if it was issued by a bank itself. If a bank is required to make a deduction from a particular Tier of capital and it does not have enough capital under that Tier to meet that deduction, the shortfall shall be deducted from the next higher Tier of capital (e.g., if a bank does not have enough AT 1 capital to satisfy the deduction, the shortfall shall be deducted from CET 1 capital).

(iii) Investments which are common shares

All investments included in paragraph 18(8)(ii)(c)(i) above which are common shares, and which exceed 10 per cent of a bank's CET 1 capital (after the application of all regulatory adjustments) shall be deducted while calculating CET 1 capital. The amount that is not deducted (up to 10 per cent if bank's common equity invested in the equity capital of such entities) in the calculation of CET 1 shall be risk weighted at 250 per cent (refer to illustration given under paragraph 18(8)(ii)(b)(vi) of these directions). However, in certain cases, such investments in both scheduled and non-scheduled commercial banks shall be fully deducted from CET 1 capital of an investing bank as required in Reserve Bank of India (Small Finance Banks – Prudential Norms on Capital Adequacy) Directions, 2025.

(iii) With regard to computation of indirect holdings through mutual funds or index funds, of capital of banking, financial and insurance entities as mentioned in paragraphs 18(8)(ii)(b) and paragraphs 18(8)(ii)(c) above, the following rules shall 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 financial entities is known, the indirect investment of a bank in such entities shall be equal to bank's investments in these entities multiplied by the percent of investments of such entities in the financial entities' 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 shall be equal to the bank's investments in these entities multiplied by maximum permissible limit which these entities are authorized to invest in the financial entities' capital instruments.

(c) 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 shall be treated as indirect investment in financial entities. A bank shall note that this method does not follow corresponding deduction approach i.e., all deductions shall be made from the CET 1 capital even though, the investments of such entities are in the AT 1 / Tier 2 capital of the investing bank.

(8) When returns of the investors of the capital issues are counter guaranteed by the bank, such investments shall not be considered as regulatory capital for the purpose of capital adequacy.

Explanation - Certain investors such as Employee Pension Funds subscribe to regulatory capital issues of commercial banks concerned and these funds enjoy the counter guarantee by the bank concerned in respect of returns. Such investments shall not be considered as regulatory capital.

(9) Net unrealised gains arising on fair valuation of Level 3 financial instruments

The net unrealised gains arising on fair valuation of Level 3 financial instruments (including investments and derivatives) recognised in the Profit and Loss Account or in the AFS-Reserve and unrealised gains transferred to Revenue/ General Reserve and AFS-Reserve at the time of transition, i.e., April 1, 2024, shall be deducted from CET 1 capital.

Chapter III

Calculation of risk weighted assets (RWAs)

19. Market Risk and Operational Risk capital charges shall not be currently applicable for a bank.

A Capital charge for Credit Risk

20. The capital charge for credit risk, including counterparty credit risk, as applicable to Small Finance Banks, shall mutatis mutandis apply to Payments Banks, subject to their licensing conditions and extant operating guidelines.

Chapter IV

Supervisory Review and Evaluation Process (SREP) and Market Discipline

21. The Pillar 2: Supervisory Review and Evaluation Process (SREP) and Pillar 3: Market Discipline, as applicable to Small Finance Banks, shall mutatis mutandis apply to Payments Banks, subject to their licensing conditions and extant operating guidelines.

Chapter V

Leverage ratio framework

22. Payment Banks should have a leverage ratio of not less than 3 per cent, i.e., its outside liabilities should not exceed 33.33 times its net worth (paid-up capital and reserves) on an ongoing basis.

Chapter VI
General provisions

23. It may be noted that mention of an activity, transaction or item in these Directions shall not imply that it is permitted. A bank shall refer to the extant statutory and regulatory requirements while determining the permissibility or otherwise of an activity or transaction.

Chapter VII
Repeal and Other Provisions

Repeal provisions

24. With the issue of these Directions, the existing Directions, instructions, and guidelines relating to Prudential Norms on Capital Adequacy as applicable to Payment Banks stand repealed, as communicated vide notification dated XX, 2025. The Directions, instructions and guidelines repealed prior to the issuance of these Directions shall continue to remain repealed.

25. Notwithstanding such repeal, any action taken or purported to have been taken, or initiated under the repealed Directions, instructions, or guidelines shall continue to be governed by the provisions thereof. All approvals or acknowledgments granted under these repealed lists shall be deemed as governed by these Directions.

Application of other laws not barred

26. The provisions of these Directions shall be in addition to, and not in derogation of the provisions of any other laws, rules, regulations or directions, for the time being in force.

Interpretations

27. For giving effect to the provisions of these Directions or in order to remove any difficulties in the application or interpretation of the provisions of these Directions, the Reserve Bank may, if it considers necessary, issue necessary clarifications in respect of any matter covered herein and the interpretation of any provision of these Directions given by the Reserve Bank shall be final and binding.

Annex 1

Reporting format for details of investments by FIIs and NRIs in PNCPS qualifying as AT 1 capital

(1) Name of the bank:

(2) Total issue size / amount raised (in ₹):

(3) Date of issue:

<table>
<tr><td></td><td colspan="2">FIIs</td><td></td><td colspan="2">NRIs</td></tr>
<tr><td rowspan="2">Number of FIIs</td><td colspan="2">Amount raised</td><td rowspan="2">Number of NRIs</td><td colspan="2">Amount raised</td></tr>
<tr><td>(in ₹)</td><td>As a percentage of the total issue size</td><td>(in ₹)</td><td>As a percentage of the total issue size</td></tr>
<tr><td></td><td></td><td></td><td></td><td></td><td></td></tr>
</table>

(4) It is certified that:

(i) the aggregate investment by all FIIs does not exceed 49 per cent of the issue size and investment by no individual FII exceeds 10 per cent of the issue size.

(ii) It is certified that the aggregate investment by all NRIs does not exceed 24 per cent of the issue size and investment by no individual NRI exceeds 5 per cent of the issue size.

Authorised Signatory

Date

Seal of the bank

Annex 2

Format for reporting of capital issuances

Issuer	
Issue size	
Instrument	
Deemed date of allotment	
Coupon	
Tenor	
Credit rating	
Put Option	
Call Option	
Redemption / maturity	
Whether private placement or otherwise	

Note -

(i) A bank may also email a soft copy of such details in excel format to capdor@rbi.org.in.

(ii) The reporting shall be duly certified by the compliance officer of the bank.

(iii) The compliance of the capital issuances with the applicable norms shall continue to be examined in course of the supervisory evaluation.