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## Chapter I - Preliminary

### 1. Short Title and Commencement

(a) These Directions shall be called the Reserve Bank of India (Prudential Regulations on Basel III Capital Framework, Exposure Norms, Significant Investments, Classification, Valuation and Operation of Investment Portfolio Norms and Resource Raising Norms for All India Financial Institutions) Directions, 2023.

(b) These Directions shall be applicable latest w.e.f. April 1, 2024.

### 2. Applicability

These Directions shall be applicable to the All India Financial Institutions (AIFIs) regulated by the Reserve Bank, viz. the Export-Import Bank of India (EXIM Bank), the National Bank for Agriculture and Rural Development (NABARD), the National Bank for Financing Infrastructure and Development (NaBFID), the National Housing Bank (NHB) and the Small Industries Development Bank of India (SIDBI).

### 3. Definitions

**3.1** In these Directions, unless the context states otherwise, the terms herein shall bear the meanings assigned to them below:

(a) “available for sale” means the category of investment portfolio of AIFIs which includes investment that do not fall within the HTM (Held To Maturity) or HFT (Held For Trading) category.

(b) “basis risk” means the risk that emanates from the changes in interest rate of different assets, liabilities and off-balance sheet items in different magnitudes;

(c) “capital funds” means the total regulatory capital of an AIFI, fulfilling the criteria defined in the prescribed capital regulations as per Chapter II of these Directions, as per the last audited balance sheet;

(d) “central counterparty” (CCP) means a system provider, who by way of novation interposes between system participants in the transactions admitted for settlement, thereby becoming the buyer to every seller and the seller to every buyer, for the purpose of effecting settlement of their transactions

(e) “clearing member” means a member of, or a direct participant in, a CCP that is entitled to enter into a transaction with the CCP, regardless of whether it enters into trades with a CCP for its own hedging, investment or speculative purposes or whether it also enters into trades as a financial intermediary between the CCP and other market participants[1];

(f) “client” means a party to a transaction with a CCP through either a clearing member acting as a financial intermediary, or a clearing member guaranteeing the performance of the client to the CCP;

[1] For the purpose of these guidelines, where a CCP has a link to a second CCP, that second CCP is to be treated as a clearing member of the first CCP. Whether the second CCP’s collateral contribution to the first CCP is treated as initial margin or a default fund contribution will depend upon the legal arrangement between the CCPs. In such cases, if any, the Reserve Bank should be consulted for determining the treatment of this initial margin and default fund contributions.

(g) “control” shall have the same meaning as assigned to it under clause (27) of Section 2 of the Companies Act, 2013 as amended from time to time;

(h) “corporate bonds / debentures” for the purpose of these Directions mean debt securities which create or acknowledge indebtedness, including (i) debentures (ii) bonds (iii) commercial papers (iv) certificate of deposits and such other securities of a company, a multilateral financial institution (MFI) or a body corporate constituted by or under a Central Act or a State Act, whether constituting a charge on the assets of the company or body corporate or not, and includes convertible instruments and instruments of a perpetual nature, but does not include debt securities issued by Central Government or a State Government, or such other persons as may be specified by the Reserve Bank, security receipts and securitized debt instruments.

(i) “counterparty credit risk” (CCR)[2] means 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.

(j) “credit enhancement” means a contractual arrangement in which an entity provides some degree of added protection to other parties to a transaction so as to mitigate the credit risk of their acquired exposures

(k) “credit risk” means the potential that an AIFI's borrower or counterparty may fail to meet its obligations in accordance with agreed terms and also includes the possibility of losses associated with diminution in the credit quality of borrowers or counterparties.;

(l) “credit valuation adjustment” means an adjustment to the mid-market valuation of the portfolio of trades with a counterparty. This adjustment reflects the market value of the credit risk due to any failure to perform on contractual agreements with a counterparty. This adjustment may reflect the market value of the credit risk of the counterparty or the market value of the credit risk of both the AIFI and the counterparty;

(m) “cross-product netting” means the inclusion of transactions of different product categories within the same netting set;

(n) “current exposure[3] under the Current Exposure Method” means the larger of zero, or the market value of a transaction or portfolio of transactions within a netting set with a counterparty that would be lost upon the default of the counterparty, assuming no recovery on the value of those transactions in bankruptcy;

(o) ”current or valid credit rating” means a credit rating granted by a credit rating agency in India, registered with SEBI and fulfilling the following conditions:

(i) The credit rating letter shall not be more than one month old on the date of opening of the issue;

(ii) The rating rationale shall not be more than one year old on the date of opening of the issue;

(iii) The credit rating letter and the rating rationale shall preferably be part of the offer document.

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[2] Unlike a firm’s exposure to credit risk through a loan, where the exposure to credit risk is unilateral and only the lending AIFI faces the risk of loss, CCR creates a bilateral risk of loss: the market value of the transaction can be positive or negative to either counterparty to the transaction. The market value is uncertain and can vary over time with the movement of underlying market factors.

[3] Current exposure is often also called Replacement Cost

(iv) In the case of secondary market acquisition, the credit rating of the issue shall be in force and confirmed from the monthly bulletin published by the respective rating agency.

(p) "default funds"[4] shall mean clearing member's funded or unfunded contributions towards, or underwriting of, a CCP's mutualised loss sharing arrangements;

(q) "deferred tax assets" shall have the same meaning as assigned under the extant Accounting Standards;

(r) "derivative" shall have the same meaning as assigned to it in Section 45U(a) of the Reserve Bank of India Act, 1934;

(s) "duration (Macaulay duration)"[5] measures the price volatility of fixed income securities often used in the comparison of the interest rate risk between securities with different coupons and different maturities.

(t) "exchange" means "Recognized stock exchange" and shall have the same meaning as defined in Section 2 (f) of Securities Contracts (Regulation) Act, 1956.

(u) "financial services company" means a company engaged in the 'business of financial services as defined in the Reserve Bank of India (Financial Services provided by Banks) Directions, 2016 dated May 26, 2016 as amended from time to time;

(v) "forward contract"[6] means an agreement between two parties to buy or sell an agreed amount of a financial instrument or currency at an agreed price, for delivery on an agreed future date.

(w) "general market risk" means risk of losses in on-and off-balance sheet positions arising from movements in market prices;

(x) "Government security" shall have the same meaning as assigned to it in Section 2(f) of the Government Securities Act, 2006.

(y) "hedging" means taking action to eliminate or reduce exposure to any type of risk;

(z) "hedging set" means a group of risk positions from the transactions within a single netting set for which only their balance is relevant for determining the exposure amount or Exposure at Default (EAD) under the CCR standardised method;

(aa) "Held for Trading" means the category of investment portfolio maintained by AIFIs with the intention to trade in securities by taking advantage of short-term price/interest rate movements;

(ab) "Held to Maturity" means the category of investment portfolio maintained by AIFIs with an intention to hold securities upto maturity;

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[4] also known as clearing deposits or guarantee fund contributions (or any other names). The description given by a CCP to its mutualised loss sharing arrangements is not determinative of their status as a default fund, rather, the substance of such arrangements will govern their status.

[5] Duration is calculated the weighted average of the present value of all the cash flows associated with a fixed income security. It is expressed in years. The duration of a fixed income security is always shorter than its term to maturity, except in the case of zero coupon securities where they are the same.

[6] In contrast to a futures contract, a forward contract is not transferable or exchange tradable, its terms are not standardized and no margin is exchanged. The buyer of the forward contract is said to be long the contract and the seller is said to be short the contract;

(ac) “horizontal disallowance” means a disallowance of offsets to required capital used for assessing market risk for regulatory capital. In order to calculate the capital required for interest rate risk of a trading book, offsetting of long and short positions is permitted. However, interest rate risk of instruments at different horizontal points of the yield curve are not perfectly correlated. Hence, this method requires that a portion of these offsets be disallowed;

(ad) “implicit support” means the protection arising when a lender provides support to a securitisation in excess of its predetermined contractual obligation;

(ae) “infrastructure projects/infrastructure lending” means any credit facility in whatever form extended by the AIFIs to any infrastructure facility that is a project in any of the sectors incorporated in the latest updated Harmonized Master List of Infrastructure Sub-sectors published by the Government of India;

(af) “initial margin” means a clearing member’s or client’s funded collateral posted to the CCP to mitigate the potential future exposure of the CCP to the clearing member arising from the possible future change in the value of their transactions. Initial margin shall not include contributions to a CCP for mutualised loss sharing arrangements[7].

(ag) “interest rate risk” means risk that the financial value of assets or liabilities (or inflows/outflows) will be altered because of fluctuations in interest rates.

(ah) “Large Exposure” means the sum of all exposure value of an AIFI measured in terms of Section 22 of Chapter III of these Directions, to a counterparty and / or a group of connected counterparties, if it is equal to or above 10 per cent of the AIFI’s eligible capital base;

(ai) “listed security” is a security, which is listed on an exchange;

(aj) “long position” refers to a position where gains arise from a rise in the value of the underlying;

(ak) “modified duration” or volatility of an interest bearing security is its Macaulay duration divided by one plus security’s yield to maturity (YTM) per period. It represents the percentage change in a securities’ price for a 100 basis points change in yield[8].

$$MD = -\frac{dP}{dY}\cdot\frac{1}{P}$$

where:
MD = Modified duration
P = Gross price (i.e., clean price plus accrued interest).
dP = Corresponding small change in price.
dY = Small change in yield compounded with the frequency of the coupon payment;

(al) “mortgage-backed security” shall have the same meaning as assigned under Master Direction Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021 as amended from time to time;

(am) “netting set” means a group of transactions with a single counterparty that are subject

[7] In cases where a CCP uses initial margin to mutualise losses among the clearing members, it shall be treated as a default fund exposure;
[8] It is generally accurate for only small changes in the yield.

to a legally enforceable bilateral netting arrangement and for which netting is recognised for regulatory capital purposes. Each transaction that is not subject to a legally enforceable bilateral netting arrangement which is recognised for regulatory capital purposes should be interpreted as its own netting set for the purpose of these Directions;

(an) “net interest margin” means the net interest income divided by average interest earning assets;

(ao) “net worth” shall have the same meaning as assigned to it under clause (57) of Section 2 of Companies Act, 2013 as amended from time to time;

(ap) “non-financial services company” means a company not engaged in any of the activities being conducted by a financial services company;

(aq) “nostro accounts” means foreign currency settlement accounts that an AIFI maintains with its overseas correspondent banks. These accounts are assets of the domestic AIFI;

(ar) “offsetting transaction” means the transaction leg between the clearing member and the CCP when the clearing member acts on behalf of a client (e.g. when a clearing member clears or novates a client’s trade);

(as) “one-sided credit valuation adjustment” is a credit valuation adjustment that reflects the market value of the credit risk of the counterparty to the AIFI but does not reflect the market value of the credit risk of the AIFI to the counterparty;

(at) “open position” means the net difference between the amounts payable and amounts receivable in a particular instrument or commodity. It results from the existence of a net long or net short position in the particular instrument or commodity;

(au) “option” means a contract which grants the buyer the right, but not the obligation, to buy (call option) or sell (put option) an asset, commodity, currency or financial instrument at a specified rate (exercise price) on or before an agreed date (expiry or settlement date).

(av) “outstanding Exposure at Default (EAD)” for a given OTC derivative counterparty is defined as the greater of zero and the difference between the sum of EADs across all netting sets with the counterparty and the credit valuation adjustment (CVA) for that counterparty which has already been recognised by the AIFI as an incurred write-down (i.e., a CVA loss);

(aw) “qualifying central counterparty” (QCCP) means an entity that is licensed to operate as a CCP (including a license granted by way of confirming an exemption), and is permitted by the appropriate regulator / overseer to operate as such with respect to the products offered. This is subject to the provision that the CCP is based and prudentially supervised in a jurisdiction where the relevant regulator/overseer has established, and publicly indicated that it applies to the CCP on an ongoing basis, domestic rules and regulations that are consistent with the CPSS-IOSCO Principles for Financial Market Infrastructures;

(ax) “quoted security” is a security for which market prices are available at stock exchanges / reporting platforms / trading platforms authorized by the Reserve Bank / Securities and Exchange Board of India (SEBI).

(ay) “rated security” means a security which is subjected to a detailed credit rating exercise by a SEBI-registered credit rating agency and shall carry current or valid credit rating.

(az) “reconstitution” means the reverse process of stripping, where the individual STRIPS i.e., both coupon STRIPS and Principal STRIPS are reassembled to get back the original security, as defined in circular on Government Securities - Separate Trading of Registered

Interest and Principal of Securities (STRIPS) issued vide IDMD.1762/2009-10 dated October 16, 2009, as amended from time to time.

(ba) “repo” and “reverse repo” shall have the same meaning as defined in Section 45U of the Reserve Bank of India Act, 1934. For the purpose of these Directions, the word ‘repo’ is used to mean both ‘repo’ and ‘reverse repo’ with the appropriate meaning applied contextually.

(bb) “securities” shall have the same meaning as defined in Section 2(h) of Securities Contracts (Regulation) Act, 1956.

(bc) “securities financing transactions” (SFTs) means 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;

(bd) “securitisation” shall have the same meaning as assigned under Master Direction DOR.STR.REC.53/21.04.177/2021-22 dated September 24, 2021 – Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021;

(be) “securitisation exposures” shall have the same meaning as assigned under Master Direction DOR.STR.REC.53/21.04.177/2021-22 dated September 24, 2021 – Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021;

(bf) “securitized debt instrument” means securities of the nature referred to in Section 2(h)(ie) of the Securities Contracts (Regulation) Act, 1956.

(bg) “Security Receipts” shall have the same meaning as defined in Section 2(1)(zg) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

(bh) “significant influence” shall have the same meaning as assigned under the extant Accounting Standards;

(bi) “specific market risk” refers to the risk associated with a specific security, issuer or company, as opposed to the risk associated with a market or market sector (general market risk);

(bj) “stripping” means the process of separating the cash flows associated with a regular Government Security i.e., each outstanding semi-annual coupon payment and the final principal payment into separate securities, as defined in circular on Government Securities - Separate Trading of Registered Interest and Principal of Securities (STRIPS) issued vide IDMD.1762/2009-10 dated October 16, 2009, as amended from time to time.

(bk) “subsidiary” shall have the same meaning as assigned under the extant Accounting Standards;

(bl) “trade exposures” include the current[9] and potential future exposure of a clearing member or a client to a CCP arising from OTC derivatives, exchange traded derivatives transactions or SFTs, and initial margin;

[9] For the purpose of this definition, the current exposure of a clearing member includes the variation margin due to the clearing member but not yet received.

(bm) “unrated securities” means securities, which do not have a current or valid credit rating by a SEBI-registered credit rating agency;

(bn) “value at risk” (VAR) means a method for calculating and controlling exposure to market risk. VAR is a single number (amount) which estimates the maximum expected loss of a portfolio over a given time horizon (the holding period) and at a given confidence level;

(bo) “variation margin” means a clearing member’s or client’s funded collateral posted on a daily or intraday basis to a CCP based upon price movements of their transactions;

(bp) “vertical disallowance” means a reversal of the offsets of a general market risk charge of a long position by a short position in two or more securities in the same time band in the yield curve where the securities have differing credit risks under the method followed for determining regulatory capital necessary to cushion market risk.

(bq) “when, as and if issued” (commonly known as ‘when-issued’ (WI)) security means a security as referred to in When Issued Transactions (Reserve Bank) Directions, 2018 issued vide FMRD.DIRD.03/14.03.007/2018-19 dated July 24, 2018, as amended from time to time.

## Chapter II - Basel III Capital Regulations

### Part A: Guidelines on Minimum Capital Requirement

### 4. Introduction

**4.1** While being essentially risk-based, the prudential regulation for various types of financial sector entities (banks, security firms, development finance institutions, non-banking financial entities) across the world tends to be broadly similar. Internationally, many development finance institutions have chosen to adopt Basel III Regulations because the micro-prudential elements of Basel standards generally measure and capitalise financial risks regardless of the entities that undertake them. Basel III strengthens the institution-level i.e., micro prudential regulation, with the intention to raise the resilience of individual financial institutions in periods of stress. Basel III standards have a macro prudential focus also, addressing system wide risks, which can build up across the banking/ financial sector, as well as the pro-cyclical amplification of these risks over time. These standards mainly seek to raise the quality and level of capital to ensure that financial entities are better able to absorb losses on both a going concern and a gone concern basis, increase the risk coverage of the capital framework, introduce leverage ratio to serve as a backstop to the risk-based capital measure, raise the standards for the supervisory review process (Pillar 2) and public disclosures (Pillar 3) etc.

**4.2** Over the years, the role of the AIFIs in the Indian financial system has undergone significant change reflecting the changes in their business models. As the Indian economy grows further, the AIFIs are increasingly being seen as key institutions to promote the flow of direct or indirect credit to the economic sectors they cater to. It has been decided, therefore, to extend Basel III Capital framework to the AIFIs as detailed in the following sections.

### 5. Approach to Implementation and Effective Date

**5.1** The AIFIs shall implement all the three Pillars of Basel III capital regulations. Under Pillar 1, the AIFIs shall adopt the standardized approaches for measurement of capital charge for credit risk and market risk. For operational risk, AIFIs shall adopt the Basic Indicator Approach.

**5.2** The AIFIs shall implement the Basel III Capital Regulations as per the following timeline:

**Table 1: Basel III Capital Regulations for AIFIs**

| Minimum capital ratios | April 1, 2024[10] |
|---|---|
| **Minimum Common Equity Tier 1 (CET1)** | **5.5%** |
| **Minimum Tier 1 capital** | **7%** |
| **Minimum Total Capital*** | **9%** |

### 6. Scope of Application of Capital Adequacy Framework

**6.1** An AIFI shall comply with the capital adequacy ratio requirements at two levels:

(i) the consolidated ("Group") level[11] capital adequacy ratio requirements, which

[10] For NHB, since the accounting year is July-June, the implementation shall commence on July 1, 2024

[11] A consolidated AIFI should maintain a minimum Capital to Risk-weighted Assets Ratio (CRAR) as applicable to an AIFI on an ongoing basis.

measure the capital adequacy of an AIFI based on its capital strength and risk profile after consolidating the assets and liabilities of its subsidiaries / joint ventures / associates etc., except those engaged in insurance and any non-financial activities; and

(ii) the standalone ("Solo") level capital adequacy ratio requirements, which measure the capital adequacy of an AIFI based on its standalone capital strength and risk profile.

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

### 6.2 Capital Adequacy at Group / Consolidated Level

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

**6.2.2** The insurance and non-financial subsidiaries / joint ventures / associates etc., of an AIFI should not be consolidated for the purpose of capital adequacy. The equity and other regulatory capital investments in the insurance and non-financial subsidiaries will be deducted from consolidated regulatory capital of the group. Equity and other regulatory capital investments in the unconsolidated insurance and non-financial entities/subsidiaries of AIFIs (which also include joint ventures / associates of the parent AIFI) will be treated in terms of sections 7.5 and 8.13.6 respectively.

**6.2.3** All regulatory adjustments indicated in section 7.4 are required to be made to the consolidated Common Equity Tier 1 capital of the parent AIFI as indicated therein.

**6.2.4** Minority interest (i.e., non-controlling interest) and other capital issued out of consolidated subsidiaries as per section 7.3.1 that is held by third parties will be recognized in the consolidated regulatory capital of the parent AIFI subject to certain conditions as stipulated in section 7.3.

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

### 6.3 Capital Adequacy at Solo Level

**6.3.1** While assessing the capital adequacy of an AIFI at solo level, all regulatory adjustments indicated in section 7.4 are required to be made. In addition, investments in the capital instruments of the subsidiaries, which are consolidated in the consolidated financial statements of the group, will also have to be deducted from the corresponding capital instruments issued by the AIFI.

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

## 7. Composition of Regulatory Capital

### 7.1 General

AIFIs are required to maintain a minimum Pillar 1 Capital to Risk-weighted Assets Ratio

(CRAR) of 9% on an on-going basis. The Reserve Bank will take into account the relevant risk factors and the internal capital adequacy assessments of each AIFI to ensure that the capital held by an AIFI is commensurate with its overall risk profile. This would include, among others, the effectiveness of the AIFI's risk management systems in identifying, assessing / measuring, monitoring and managing various risks including interest rate risk in the banking book, liquidity risk, concentration risk and residual risk. Accordingly, the Reserve Bank will consider prescribing a higher level of minimum capital ratio for each AIFI under the Pillar 2 framework on the basis of their respective risk profiles and their risk management systems. Further, in terms of the Pillar 2 requirements, AIFIs are expected to operate at a level well above the minimum requirement. An AIFI should compute Basel III capital ratios in the following manner:

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

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

$$\text{Total Capital (CRAR)} = \frac{\text{Total Capital}}{\text{Credit Risk RWA + Market Risk RWA + Operational Risk RWA}}$$

* RWA = Risk weighted Assets;

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

#### 7.2.1 Components of Capital

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

(i) Tier 1 Capital (going-concern capital[12])
  (a) Common Equity Tier 1
  (b) Additional Tier 1

(ii) Tier 2 Capital (gone-concern capital[13])

#### 7.2.2 Limits and Minima

(i) As a matter of prudence, it has been decided that AIFIs shall maintain a minimum total capital (MTC) of 9% of total risk weighted assets (RWAs) i.e., capital to risk weighted assets (CRAR). This will be further divided into different components as described under clauses (ii) to (vi) below.

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

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

[12] From regulatory capital perspective, going-concern capital is the capital which can absorb losses without triggering bankruptcy of the AIFI.
[13] Gone-concern capital is the capital which will absorb losses only in a situation of liquidation of the AIFI.

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

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

(vi) Thus, with full implementation of capital ratios, the capital requirements for AIFIs are summarised as follows:

| | Regulatory Capital | As % to RWAs |
|---|---|---|
| (i) | Minimum Common Equity Tier 1 Ratio | 5.5 |
| (ii) | Additional Tier 1 Capital | 1.5 |
| (iii) | Minimum Tier 1 Capital Ratio [(i) +(ii)] | 7.0 |
| (iv) | Tier 2 Capital | 2.0 |
| (v) | Minimum Total Capital Ratio (MTC) [(iii)+(iv)] | 9.0 |

### 7.2.3 Common Equity Tier 1 Capital

*(i)* ***Elements of Common Equity Tier 1 Capital***

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

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

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

(c) Statutory reserves;

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

(e) Revaluation reserves[14] arising out of change in the carrying amount of an AIFI's property consequent upon its revaluation may be reckoned as CET1 capital at a discount of 55 per cent, subject to meeting the following conditions:

- AIFI is able to sell the property readily at its own will and there is no legal impediment in selling the property;
- the revaluation reserves are shown under Schedule: Reserves & Surplus in the Balance Sheet of the AIFI;
- revaluations are realistic, in accordance with Indian Accounting Standards.
- 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;
- the external auditors of the AIFI have not expressed a qualified opinion on the revaluation of the property;

[14] Revaluation reserves arise from revaluation of assets that are undervalued on the AIFI's books, typically AIFI premises. The extent to which the revaluation reserves can be relied upon as a cushion for unexpected losses depends mainly upon the level of certainty that can be placed on estimates of the market values of the relevant assets, the subsequent deterioration in values under difficult market conditions or in a forced sale, potential for actual liquidation at those values, tax consequences of revaluation, etc. Therefore, it would be prudent to consider revaluation reserves at a discount of 55% while determining their value for inclusion in capital. Such reserves will have to be reflected on the face of the Balance Sheet as revaluation reserves.

- the instructions on valuation of properties and other specific requirements as mentioned in the circular DBOD.BP.BC.No.50/21.04.018/ 2006-07 January 4, 2007 on 'Valuation of Properties - Empanelment of Valuers' addressed to banks are strictly adhered to.

Revaluation reserves which do not qualify as CET1 capital shall also not qualify as Tier 2 capital. The bank may choose to reckon revaluation reserves in CET1 capital or Tier 2 capital at its discretion, subject to fulfilment of all the conditions specified above.

(f) AIFIs may, at their discretion, reckon foreign currency translation reserve (FCTR) arising due to translation of financial statements of their foreign operations in terms of Accounting Standard (AS) 11 as CET1 capital at a discount of 25% subject to meeting the following conditions:

- the FCTR is shown under Schedule: Reserves & Surplus in the Balance Sheet of the AIFI;
- the external auditors of the AIFI have not expressed a qualified opinion on the FCTR.

(g) Other disclosed free reserves, if any;

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

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

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

Where;

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

$NP_t$ = Net profit up to the quarter 't'

D= average annual dividend paid/surplus (balance of profits) transferred during last three years

*Note:* Cumulative net loss upto the quarter end must be deducted while calculating CET1 for the relevant quarter.

(j) While calculating capital adequacy at the consolidated level, common shares issued by consolidated subsidiaries of the AIFI and held by third parties (i.e., minority interest) which meet the criteria for inclusion in Common Equity Tier 1 capital (refer to section 7.3.2); and

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

***(ii) Criteria for Classification as Common Shares for Regulatory Purposes***

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

### 7.2.4 Additional Tier 1 Capital

***(i) Elements of Additional Tier 1 Capital***

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

(i) Perpetual Non-Cumulative Preference Shares (PNCPS), which comply with the regulatory requirements as specified in **Annex 2**;

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

(iii) Debt capital instruments eligible for inclusion in Additional Tier 1 capital, which comply with the regulatory requirements as specified in **Annex 3**;

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

(v) While calculating capital adequacy at the consolidated level, Additional Tier 1 instruments issued by consolidated subsidiaries of the AIFI and held by third parties which meet the criteria for inclusion in Additional Tier 1 capital (refer to section 7.3.3); and

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

***(ii) Criteria for Classification as Additional Tier 1 Capital for Regulatory Purposes***

Under Basel III, the criteria for instruments to be included in Additional Tier 1 capital have been modified to improve their loss absorbency as indicated in **Annex 2, 3 and 14.** The criteria for inclusion of Perpetual Non-Cumulative Preference Shares (PNCPS) and Perpetual Debt Instruments (PDI) in Additional Tier 1 Capital are furnished in **Annex 2** and **Annex 3,** respectively. **Annex 14** contains criteria for loss absorption through conversion / write-down / write-off of Additional Tier 1 instruments on breach of the pre-specified trigger and of all non-common equity regulatory capital instruments at the point of non-viability.

### 7.2.5 Tier 2 Capital

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

**(i) *Elements* of Tier 2 Capital**

*(a) General Provisions and Loss Reserves*

i. Provisions or loan-loss reserves held against future, presently unidentified losses, which are freely available to meet losses which subsequently materialize, will qualify for inclusion within Tier 2 capital. Accordingly, General Provisions on Standard Assets, Floating Provisions[15], incremental provisions in respect of unhedged foreign currency exposures[16], Provisions held for Country Exposures, Investment Reserve Account, excess provisions

[15] AIFIs shall have the option to net off such provisions from Gross NPAs to arrive at Net NPA or reckon it as part of their Tier 2 capital as per Master Circular dated April 1, 2023 on "Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances" addressed to banks.

[16] Please refer to circular Reserve Bank of India (Unhedged Foreign Currency Exposure) Directions, 2022 issued vide DOR.MRG.REC.76/00-00-007/2022-23 dated October 11, 2022.

which arise on account of sale of NPAs and 'countercyclical provisioning buffer[17]' will qualify for inclusion in Tier 2 capital. However, these items together will be admitted as Tier 2 capital up to a maximum of 1.25% of the total credit risk-weighted assets under the standardized approach.

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

(b) Debt Capital Instruments issued by the AIFIs;

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

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

(e) While calculating capital adequacy at the consolidated level, Tier 2 capital instruments issued by consolidated subsidiaries of the AIFI and held by third parties which meet the criteria for inclusion in Tier 2 capital (refer to section 7.3.4);

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

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

***(ii) Criteria for Classification as Tier 2 Capital for Regulatory Purposes***

Under Basel III, the criteria for instruments to be included in Tier 2 capital have been modified to improve their loss absorbency as indicated in **Annex 4, 5 and 14**. Criteria for inclusion of Debt Capital Instruments as Tier 2 capital are furnished in **Annex 4**. Criteria for inclusion of Perpetual Cumulative Preference Shares (PCPS) / Redeemable Non-Cumulative Preference Shares (RNCPS) / Redeemable Cumulative Preference Shares (RCPS) as part of Tier 2 capital are furnished in **Annex 5**. **Annex 14** contains criteria for loss absorption through conversion / write-off of all non-common equity regulatory capital instruments at the point of non-viability.

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

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

[17] Please refer to Master Circular dated April 1, 2023 on "Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances" addressed to banks.

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

Minority interest arising from the issue of common shares by a fully consolidated subsidiary of the AIFI may receive recognition in Common Equity Tier 1 capital only if: (a) the instrument giving rise to the minority interest would, if issued by the AIFI, meets all of the criteria for classification as common shares for regulatory capital purposes as stipulated in **Annex 1**; and (b) the subsidiary that issued the instrument is itself a bank[18]. The amount of minority interest meeting the criteria above that will be recognised in consolidated Common Equity Tier 1 capital will be calculated as follows:

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

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

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

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

Tier 1 capital instruments issued by a fully consolidated subsidiary of the AIFI to third party investors (including amounts under section 7.3.2) may receive recognition in Tier 1 capital only if the instruments would, if issued by the AIFI, meet all of the criteria for classification as Tier 1 capital. The amount of this capital that will be recognised in Tier 1 capital will be calculated as follows:

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

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

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

The amount of this Tier 1 capital that will be recognised in Additional Tier 1 capital will exclude amounts recognised in Common Equity Tier 1 capital under section 7.3.2.

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

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

Total capital instruments (i.e., Tier 1 and Tier 2 capital instruments) issued by a fully consolidated subsidiary of the AIFI to third party investors (including amounts under sections 7.3.2 and 7.3.3) may receive recognition in Total Capital only if the instruments would, if issued by the AIFI, meet all of the criteria for classification as Tier 1 or Tier 2 capital. The amount of this capital that will be recognised in consolidated Total Capital will be calculated as follows:

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

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

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

The amount of this Total Capital that will be recognised in Tier 2 capital will exclude amounts recognised in Common Equity Tier 1 capital under section 7.3.2 and amounts recognised in Tier 1 capital under section 7.3.3.

**7.3.5** An illustration of calculation of minority interest and other capital issued out of consolidated subsidiaries that is held by third parties is furnished in **Annex 15**.

## 7.4 Regulatory Adjustments / Deductions

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

### 7.4.1 Goodwill and all Other Intangible Assets

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

(ii) The full amount of the intangible assets is to be deducted net of any associated deferred tax liabilities which would be extinguished if the intangible assets become impaired or derecognized under the relevant accounting standards. For this purpose, the definition of intangible assets would be in accordance with the Indian accounting standards. Losses in the current period and those brought forward from previous periods should also be deducted from Common Equity Tier 1 capital, if not already deducted.

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

### 7.4.2 Deferred Tax Assets (DTAs)[19]

(i) Deferred tax assets (DTAs) associated with accumulated losses and other such assets shall be deducted in full from CET1 capital.

(ii) DTAs which relate to timing differences (other than those related to accumulated losses) may, instead of full deduction from CET1 capital, be recognised in the CET1 capital up to 10% of an AIFI's CET1 capital, at the discretion of AIFIs [after the application of all regulatory adjustments mentioned from section 7.4 and 7.5 of this Chapter].

(iii) Further, the limited recognition of DTAs as at (ii) above along with limited recognition of significant investments in the common shares of unconsolidated financial (i.e., financial and insurance) entities in terms of section 7.5.2 (C) (iii) of this Chapter taken together shall not exceed 15% of the CET1 capital, calculated after all regulatory adjustments set out in sections 7.4 and 7.5 of this Chapter. However, AIFIs shall ensure that the CET1 capital arrived at after application of 15% limit should in no case result in recognising any item more than the 10% limit applicable individually.

*Note:* The recognition of these specified items shall be limited to 15% of Common Equity Tier 1 (CET1) capital, after the application of all deductions. To determine the maximum amount of the specified items that can be recognised (actual amount may be lower than 15%), AIFIs shall multiply the amount of CET1 (after all deductions, including after the deduction of the specified items in full i.e., specified items shall be fully deducted from CET1 along with other deductions first for arriving at CET1) by 17.65%. This number i.e., 17.65% is derived from the proportion of 15% to 85% (15%/85% = 17.65%)[20].

(iv) The amount of DTAs which is to be deducted from CET1 capital may be netted with associated deferred tax liabilities (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 CET1 capital as at (i) and (ii) above.

(v) The amount of DTAs which is not deducted from CET1 capital (in terms of clause (ii) above) will be risk weighted at 250% as in the case of significant investments in common shares not deducted from AIFI's CET1 capital as indicated in section 7.5.2(C)(iii) of this Chapter.

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

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[19] Please refer to circular DBR.No.BP.BC.83/21.06.201/2015-16 dated March 1, 2016 on "Master Circular – Basel III Capital Regulations – Revision" addressed to banks

[20] For example, take an AIFI with ₹ 85 of common equity (calculated net of all deductions, including after the deduction of the specified items in full). The maximum amount of specified items that can be recognised by this AIFI in its calculation of CET1 capital is ₹ 85 x 17.65% = ₹ 15. Any excess above ₹ 15 must be deducted from CET1. If the AIFI has specified items (excluding amounts deducted after applying the individual 10% limits) that in aggregate sum up to the 15% limit, CET1 after inclusion of the specified items, will amount to ₹ 85 + ₹ 15 = ₹ 100. The percentage of specified items to total CET1 would equal 15%.

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

### 7.4.3 Cash Flow Hedge Reserve

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

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

### 7.4.4 Gain-on-Sale Related to Securitisation Transactions

(i) AIFIs shall be guided by the Master Direction no. DOR.STR.REC.53/21.04.177/2021-22 dated September 24, 2021 titled Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021 in this regard.

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

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

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

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

### 7.4.6 Defined Benefit Pension Fund[21] Assets and Liabilities

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

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

## 7.5 Investments in the Capital of Banking, Financial and Insurance Entities[22]

### 7.5.1 Limits on an AIFI's Investments in the Capital of Banking, Financial and Insurance Entities

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

(a) An AIFI's investments in the **capital instruments** issued by banking, financial and insurance entities should not exceed 10% of its **capital funds**, but after all deductions mentioned in section 7.4.

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

(c) An AIFI's equity investment in a single company /non-financial/ commercial entity that is made in conformity with its statutory mandate shall not exceed 49 per cent of the equity of the investee company/entity. An AIFI can hold up to 49 per cent of equity of a company as a pledgee. However, if the AIFI ends up acquiring this in satisfaction of its claims, it shall be brought down below 10 per cent limit within three years.

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

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

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

(g) An AIFI's equity investments in subsidiaries and other entities that are engaged in financial services activities together with equity investments in entities

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

[22] These rules will be applicable to an AIFI's equity investments in banking, financial and insurance entities, even if such investments are exempted from 'capital market exposure' limit.

engaged in non-financial services activities should not exceed 20% of the AIFI's paid-up share capital and reserves. The cap of 20% would not apply for investments classified under 'Held for Trading' category and which are not held beyond 90 days.

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

(a) Asset Management Companies of Mutual Funds / Alternative Investment Funds / Private Equity Funds etc;
(b) Non-Banking Finance Companies;
(c) Housing Finance Companies;
(d) Primary Dealers;
(e) Merchant Banking Companies;
(f) Entities engaged in activities which are ancillary to the business of banking as defined under the Banking Regulation Act, 1949; and
(g) Central Counterparties (CCPs).

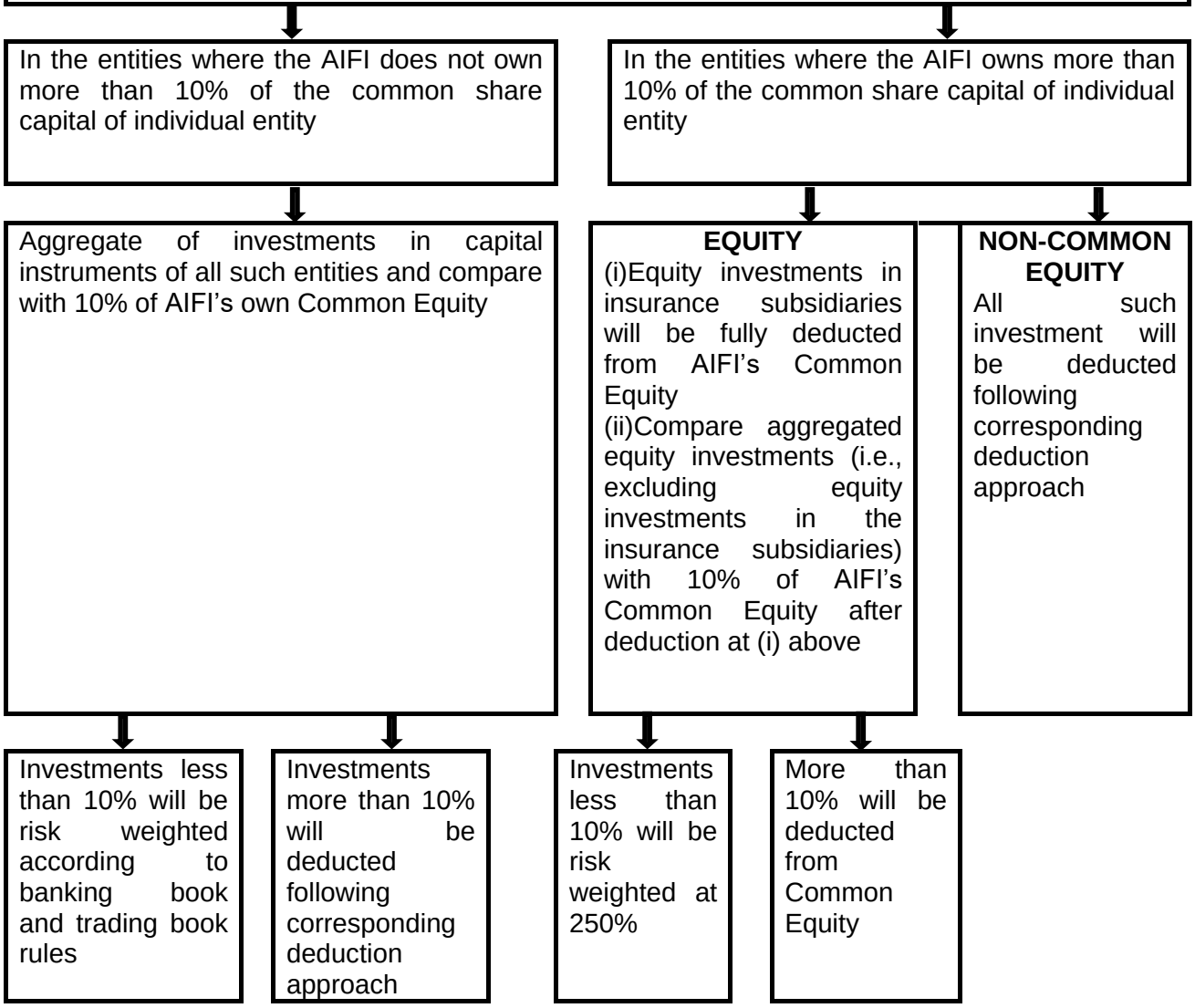
(iii) Investments made by a banking subsidiary/ associate in the equity or non-equity regulatory capital instruments issued by its parent AIFI should be deducted from such subsidiary's regulatory capital following corresponding deduction approach, in its capital adequacy assessment on a solo basis. The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

### 7.5.2 Treatment of an AIFI's Investments in the Capital Instruments Issued by Banking, Financial and Insurance Entities within Limits

The investment of AIFIs in the regulatory capital instruments of other financial entities contributes to the inter-connectedness amongst the financial institutions. In addition, these investments also amount to double counting of capital in the financial system. Therefore, these investments have been subjected to stringent treatment in terms of deduction from respective tiers of regulatory capital. A schematic representation of treatment of AIFIs' investments in capital instruments of financial entities is shown in **Figure 1** below. Accordingly, all investments[23] in the capital instruments issued by banking, financial and insurance entities within the limits mentioned in section 7.5.1 will be subject to the following rules:

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

**Figure 1: Investments in the Capital Instruments of Banking, Financial and Insurance Entities that are outside the scope of regulatory consolidation**




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

Reciprocal cross holdings of capital might result in artificially inflating the capital position of AIFIs. Such holdings of capital will be fully deducted. AIFIs shall apply a "corresponding deduction approach" to such investments in the capital of other banks, other financial institutions and insurance entities. This means the deduction should be applied to the same component of capital (Common Equity, Additional Tier 1 and Tier 2 capital) for which the capital would qualify if it was issued by the AIFI itself. For this purpose, a holding will be treated as reciprocal cross holding if the investee entity has also invested in any class of AIFI's capital instruments which need not necessarily be the same as the AIFI's holdings.

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

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

(a) Investments include direct, indirect[24] and synthetic holdings of capital instruments. For example, AIFIs should look through holdings of index securities to determine their underlying holdings of capital.

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

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

(d) If the capital instrument of the entity in which the AIFI has invested does not meet the criteria for Common Equity Tier 1, Additional Tier 1, or Tier 2 capital of the AIFI, the capital is to be considered common shares for the purposes of this regulatory adjustment[25].

(e) With the prior approval of the Reserve Bank an AIFI 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 clause (i) above, in aggregate exceed 10% of the AIFI's Common Equity (after applying all other regulatory adjustments in full listed prior to this one), then the amount above 10% is required to be deducted, applying a corresponding deduction approach. This means the deduction should be applied to the same component of capital for which the capital would qualify if it was issued by the AIFI itself. Accordingly, the amount to be deducted from common equity should be calculated as the total of all holdings which in aggregate exceed 10% of the AIFI's common equity (as per above) multiplied by the common equity holdings as a percentage of the total capital holdings. This would result in a Common Equity deduction which corresponds to the proportion of total capital holdings held in Common Equity. Similarly, the amount to be deducted from Additional Tier 1 capital should be calculated as the total of all holdings which in aggregate exceed 10% of the AIFI's Common Equity (as per above) multiplied by the Additional Tier 1 capital holdings as a percentage of the total capital holdings. The amount to be deducted from Tier 2 capital should be calculated as the total of all holdings which in aggregate exceed 10% of the AIFI's Common Equity (as per above) multiplied by the Tier 2 capital holdings as a percentage of the total capital holdings. (Please refer to illustration given in **Annex 10**).

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

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

[25] 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.

(iv) Investments below the threshold of 10% of AIFI's Common Equity, which are not deducted, will be risk weighted. Thus, instruments in the trading book will be treated as per the market risk rules and instruments in the banking book should be treated as per the standardised approach or internal ratings-based approach (as applicable). For the application of risk weighting the amount of the holdings which are required to be risk weighted would be allocated on a pro rata basis between the Banking and Trading Book. However, in certain cases, such investments in both scheduled and non-scheduled commercial banks will be fully deducted from Common Equity Tier 1 capital of investing AIFI as indicated in sections 8.6, 11.3.5 and 11.4.4.

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

**(C) Significant Investments in the Capital of Banking, Financial and Insurance Entities which are outside the Scope of Regulatory Consolidation**[26]

(i) The regulatory adjustment described in this section applies to investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation where the AIFI owns more than 10% of the issued common share capital of the issuing entity or where the entity is an affiliate[27] of the AIFI. In addition:

(a) Investments include direct, indirect[28] and synthetic holdings of capital instruments. For example, AIFI should look through holdings of index securities to determine their underlying holdings of capital.

(b) Holdings in both the banking book and trading book are to be included. Capital includes common stock 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 the AIFI has invested does not meet the criteria for Common Equity Tier 1, Additional Tier 1, or Tier 2 capital of the bank, the capital is to be considered common shares for the purposes of this regulatory adjustment[29].

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

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

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

[29] 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 an AIFI can temporarily exclude certain investments where these have been made in the context of resolving or providing financial assistance to reorganise a distressed institution.

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

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

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

All investments included in clause (i) above which are common shares and which exceed 10% of the AIFI's Common Equity (after the application of all regulatory adjustments) will be deducted while calculating Common Equity Tier 1 capital. The amount that is not deducted (upto 10% if AIFI's common equity invested in the equity capital of such entities) in the calculation of Common Equity Tier 1 will be risk weighted at 250% (refer to illustration in **Annex 10**). However, in certain cases, such investments in both scheduled and non-scheduled commercial banks will be fully deducted from Common Equity Tier 1 capital of investing AIFI as indicated in sections 8.6, 11.3.5 and 11.4.4.

**7.5.3** With regard to computation of indirect holdings through mutual funds or index funds, of capital of banking, financial and insurance entities which are outside the scope of regulatory consolidation as mentioned in sections 7.5.2(B) and 7.5.2(C) above, the following rules may be observed:

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

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

(iii) If neither the amount of investments made by the mutual funds / index funds / alternative investment 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 AIFI in these entities would be treated as indirect investment in financial entities. AIFIs shall note that this method does not follow corresponding deduction approach i.e., all deductions will be made from the Common Equity Tier 1 capital even though, the investments of such entities are in the Additional Tier 1 / Tier 2 capital of the investing AIFI.

**7.5.4 Application of these rules at consolidated level would mean:**

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

(parent plus consolidated subsidiaries) in common share capital of individual investee entities.

(ii) Applying the rules as stipulated in section 7.5.2 and segregating investments into those which will be deducted from the consolidated capital and those which will be risk weighted. For this purpose,

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

(b) the consolidated Common Equity of the group will be taken into account.

**7.5.5** When returns of the investors of the capital issues are counter guaranteed by the AIFI, such investments will not be considered as regulatory capital for the purpose of capital adequacy.

**7.5.6** As indicated in sections 6.2.2 and 6.3.1, equity investments in non-financial subsidiaries should be fully deducted from the consolidated and solo CET1 capital of the AIFI respectively, after making all the regulatory adjustments as indicated in above sections.

### 7.5.7 Intra Group Transactions and Exposures

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

## 7.6 Transitional arrangements for AIFIs

Capital instruments already issued by the AIFIs which no longer qualify under Basel III will be allowed to be counted as Tier 1 or Tier 2, as the case may be, as per the existing rules until their maturity or the first call date, whichever is earlier. All capital instruments issued by AIFIs after these Directions come into effect shall comply with the requirements set out in these Directions.

# 8. Capital Charge for Credit Risk

## 8.1 General

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

## 8.2 Claims on Domestic Sovereigns

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

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

**8.2.3** The risk weight applicable to claims on central government exposures shall also apply to the claims on the Reserve Bank and DICGC. The risk weight of zero per cent shall

be applicable in respect of exposures guaranteed under any existing[30] or future[31] schemes launched by Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE), Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH)[32] and National Credit Guarantee Trustee Company Ltd. (NCGTC) satisfying the following conditions:

(i) **Prudential Aspects:** The guarantees provided under the respective schemes should comply with the requirements for credit risk mitigation in terms of section 10.5 of this Chapter which inter alia requires such guarantees to be direct, explicit, irrevocable and unconditional;

(ii) **Restrictions on permissible claims:** Where the terms of the guarantee schemes restrict the maximum permissible claims through features like specified extent of guarantee coverage, clause on first loss absorption by member lending institutions (MLI), payout cap, etc., the zero per cent risk weight shall be restricted to the maximum permissible claim and the residual exposure shall be subjected to risk weight as applicable to the counterparty in terms of extant regulations.

(iii) In case of a portfolio-level guarantee, the extent of exposure subjected to first loss absorption by the MLI, if any, shall be subjected to full capital deduction and the residual exposure shall be subjected to risk weight as applicable to the counterparty in terms of extant regulations, on a pro rata basis. The maximum capital charge shall be capped at a notional level arrived at by treating the entire exposure as unguaranteed.

The claims on ECGC shall attract a risk weight of 20 per cent.

**8.2.4** The above risk weights for both direct claims and guarantee claims will be applicable as long as they are classified as 'standard' / performing assets. Where these sovereign exposures are classified as non-performing, they would attract risk weights as applicable to NPAs, which are detailed in section 8.12.

**8.2.5** The above risk weights will be applied if such exposures are denominated in Indian Rupees and also funded in Indian Rupees[33].

### 8.3 Claims on Foreign Sovereigns and Foreign Central Banks

**8.3.1** Subject to section 8.3.2 below, claims on foreign sovereigns and their central banks will attract risk weights as per the rating assigned[34] to them by international rating agencies as follows:

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[30] For illustrative examples of risk weights applicable on claims guaranteed under specific existing schemes, AIFIs may refer Annex given in circular DOR.STR.REC.67/21.06.201/2022-23 dated September 7, 2022 on "Review of Prudential Norms – Risk Weights for Exposures guaranteed by Credit Guarantee Schemes (CGS)"

[31] Any future scheme launched under any of the mentioned Trust Funds, in order to be eligible for zero percent risk weight, shall provide for settlement of the eligible guaranteed claims within thirty days from the date of lodgement, and the lodgement shall be permitted within sixty days from the date of default.

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

[33] The Lines of Credit (LOCs) extended by EXIM Bank at the behest of Central Government and secured by guarantee of the Central Government shall attract zero per cent risk weight.

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

**Table 2: Claims on Foreign Sovereigns/Central Banks – Risk Weights**

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

* Standard & Poor's

**8.3.2** Claims on the foreign sovereigns or foreign central banks in their jurisdiction, denominated in domestic currency of that jurisdiction[35], met out of the resources of the same currency will attract a risk weight of zero per cent. However, in case a Host Supervisor requires a more conservative treatment to such claims in the books of the foreign branches of the AIFIs, they should adopt the requirements prescribed by the Host Country Supervisors for computing capital adequacy.

### 8.4 Claims on Public Sector Entities (PSEs)

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

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

**Table 3: Claims on Foreign PSEs – Risk Weights**

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

### 8.5 Claims on MDBs, BIS and IMF

**8.5.1** Claims on the Bank for International Settlements (BIS), the International Monetary Fund (IMF) and the following eligible Multilateral Development Banks (MDBs) evaluated by the Basel Committee on Banking Supervision (BCBS) will be treated similar to claims on scheduled commercial banks meeting the minimum capital adequacy requirements and assigned a uniform twenty per cent risk weight:

(a) World Bank Group: IBRD and IFC,
(b) Asian Development Bank,
(c) African Development Bank,
(d) European Bank for Reconstruction and Development,
(e) Inter-American Development Bank,
(f) European Investment Bank,
(g) European Investment Fund,
(h) Nordic Investment Bank,
(i) Caribbean Development Bank,
(j) Islamic Development Bank,
(k) Council of Europe Development Bank,
(l) International Finance Facility for Immunization (IFFIm) and
(m) Asian Infrastructure Investment Bank (AIIB)

### 8.6 Claims on Banks (Exposure to capital instruments)

**8.6.1** In case of an AIFI's investment in capital instruments of banks, the following such investments would not be deducted, but would attract appropriate risk weights (refer to the section 7.5 above:

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

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

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

(b) The equity investment in the investee entities is outside the scope of regulatory consolidation.

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

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

(b) The equity investment in the investee entities is outside the scope of regulatory consolidation.

**8.6.2** Accordingly, the claims on banks incorporated in India and the branches of foreign banks in India, other than those deducted in terms of section 7.5.2 above, will be risk weighted as under:

**Table 4: Claims on banks[36] Incorporated in India and Foreign Bank Branches in India**

| | Risk Weights (%) | | | | | |
|---|---|---|---|---|---|---|
| | All Scheduled Banks (Commercial Banks, Regional Rural Banks, Local Area Banks and Co-operative Banks) | | | All Non-Scheduled Banks (Commercial Banks, Regional Rural Banks, Local Area Banks and Co-operative Banks) | | |
| Level of Common Equity Tier 1 capital (CET1) including applicable capital conservation buffer (CCB) (%) of the investee bank under Basel III/Total Capital of other banks (where applicable) | Investments referred to in section 8.6.1 (i) | Investments referred to in section 8.6.1 (ii) | All other claims | Investments referred to in section 8.6.1 (i) | Investments referred to in section 8.6.1 (ii) | All Other Claims |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| **For banks which are under Basel III Capital Regulations** | | | | | | |
| Applicable Minimum CET1 + Applicable CCB and above | 125 % or the risk weight as per the rating of the instrument or counterparty, whichever is higher | 250 | 20 | 125% or the risk weight as per the rating of the instrument or counterparty, whichever is higher | 300 | 100 |
| Applicable Minimum CET1 + CCB = 75% | 150 | 300 | 50 | 250 | 350 | 150 |

[36] For claims held in AFS and HFT portfolios, please see the sections 11.3.5 and 11.4.4 under 'capital charge for market risk'

| | Risk Weights (%) | | | | | |
|---|---|---|---|---|---|---|
| | All Scheduled Banks (Commercial Banks, Regional Rural Banks, Local Area Banks and Co-operative Banks) | | | All Non-Scheduled Banks (Commercial Banks, Regional Rural Banks, Local Area Banks and Co-operative Banks) | | |
| Level of Common Equity Tier 1 capital (CET1) including applicable capital conservation buffer (CCB) (%) of the investee bank under Basel III/Total Capital of other banks (where applicable) | Investments referred to in section 8.6.1 (i) | Investments referred to in section 8.6.1 (ii) | All other claims | Investments referred to in section 8.6.1 (i) | Investments referred to in section 8.6.1 (ii) | All Other Claims |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| and <100% of applicable CCB[37] | | | | | | |
| Applicable Minimum CET1 + CCB = 50% and <75% of applicable CCB | 250 | 350 | 100 | 350 | 450 | 250 |
| Applicable Minimum CET1 + CCB = 0% and <50% of applicable CCB | 350 | 450 | 150 | 625 | Full deduction* | 350 |
| Minimum CET1 less than applicable minimum | 625 | Full deduction * | 625 | Full deduction* | Full deduction* | 625 |
| **For banks which are not under Basel III Capital Regulations** | | | | | | |
| 9 and above | 100 % or the risk weight as per the rating of the instrument or counterparty, whichever is higher | 250 | 20 | Higher of 100 % or the risk weight as per the rating of the instrument or counterparty, whichever is higher | 300 | 100 |
| 6 to < 9 | 150 | 300 | 50 | 250 | 350 | 150 |
| 3 to < 6 | 250 | 350 | 100 | 350 | 450 | 250 |
| 0 to < 3 | 350 | 450 | 150 | 625 | Full deduction* | 350 |
| Negative | 625 | Full deduction * | 625 | Full deduction* | Full deduction* | 625 |

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

**Notes:**

[37] For example, as on March 31, 2022, minimum Common Equity Tier 1 of 5.5% and CCB between equal to 75% of 2.50% and less than 2.50%.

(i) In the case of banks where no capital adequacy norms have been prescribed by the Reserve Bank, the lending / investing AIFI may calculate the CRAR of such a bank, notionally, by obtaining necessary information from the investee bank, using the capital adequacy norms as applicable to the commercial banks. In case, it is not found feasible to compute CRAR on such notional basis, the risk weight of 350 or 625 per cent, as per the risk perception of the investing AIFI, should be applied uniformly to the investing AIFI's entire exposure.

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

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

**Table 5: Claims on Foreign Banks – Risk Weights**

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

If the AIFI reckons the exposure on the original counterparty, it shall attract the risk weight as per Table 5, if the counterparty is a person resident in India, or 150%[38] if the counterparty is a person resident outside India.

**8.6.4** However, the claims on a bank which are denominated in 'domestic[39]' foreign currency met out of the resources in the same currency raised in that jurisdiction will be risk weighted at 20 per cent provided the bank complies with the minimum CRAR prescribed by the concerned bank regulator(s).

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

### 8.7 Claims on Primary Dealers

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

### 8.8 Claims on Corporates and NBFCs

**8.8.1** Claims on corporates[40] and exposures to all NBFCs[41] (excluding Core Investment

[38] Please refer to Chapter III of these Directions

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

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

[41] Please refer to circular DBR.BP.BC.No.25/21.06.001/2018-19 dated February 22, 2019 on "Risk Weights for exposures to NBFCs" applicable to banks

Companies-CICs) shall be risk weighted as per the ratings assigned by the rating agencies registered with the SEBI and accredited by the Reserve Bank. Exposure to CICs, rated as well as unrated, shall be risk-weighted at 100%. The following table indicates the risk weight applicable to claims on corporates and NBFCs (excluding CICs):

**Table 6: Part A – Long term Claims on Corporates and NBFCs (excluding CICs) – Risk Weights**

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

**Table 6: Part B - Short Term Claims on Corporates and NBFCs (excluding CICs) - Risk Weights**

| CARE | CRISIL Ratings Limited | India Ratings and Research Private Limited (India Ratings) | ICRA | Acuite Ratings & Research Ltd. (Acuite) | INFOMERICS | (%) |
|---|---|---|---|---|---|---|
| CARE A1+ | CRISIL A1+ | IND A1+ | ICRA A1+ | Acuité A1+ | INFOMERICS A1+ | 20 |
| CARE A1 | CRISIL A1 | IND A1 | ICRA A1 | Acuité A1 | INFOMERICS A1 | 30 |
| CARE A2 | CRISIL A2 | IND A2 | ICRA A2 | Acuité A2 | INFOMERICS A2 | 50 |
| CARE A3 | CRISIL A3 | IND A3 | ICRA A3 | Acuité A3 | INFOMERICS A3 | 100 |
| CARE A4 & D | CRISIL A4 & D | IND A4 & D | ICRA A4 & D | Acuité A4 & D | INFOMERICS A4 & D | 150 |
| Unrated | Unrated | Unrated | Unrated | Unrated | Unrated | 100 |

**Note:**

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

(ii) All unrated claims on corporates and NBFCs (except CICs) having aggregate exposure from banking system of more than ₹ 200 crore shall attract a risk weight of 150%.

(iii) Claims on corporates and NBFCs (except CICs) having aggregate exposure from banking system of more than ₹ 100 crore which were rated earlier and subsequently have become unrated shall attract a risk weight of 150%.

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

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

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

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

**Note:**

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

(ii) All unrated claims having aggregate exposure from banking system of more than ₹ 200 crore shall attract a risk weight of 150%.

(iii) Claims having aggregate exposure from banking system of more than ₹ 100 crore which were rated earlier and subsequently have become unrated shall attract a risk weight of 150%.

### 8.9 Claims included in the Regulatory Retail Portfolios

**8.9.1** Claims (including both fund-based and non-fund based) that meet all the four criteria listed below in section 8.9.3 may be considered as retail claims for regulatory capital purposes and included in a regulatory retail portfolio. Claims included in this portfolio shall be assigned a risk-weight of 75 per cent, except as provided in section 8.12 below for non-performing assets.

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

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

(ii) Mortgage Loans to the extent that they qualify for treatment as claims secured by residential property[42] or claims secured by commercial real estate[43];

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

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

(v) Capital Market Exposures;

(vi) Alternative Investment Funds.

**8.9.3 Qualifying Criteria**

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

[42] Mortgage loans qualifying for treatment as 'claims secured by residential property' are defined in section 8.10.

[43] As defined in section 8.11.1.

are yet to complete three years.

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

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

(iv) ***Low value of individual exposures*** **-** The maximum aggregated retail exposure to one counterpart should not exceed the absolute threshold limit of ₹ 7.5 crore.

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

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

### 8.10 Claims secured by Residential Property

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

**Table 7B: Claims Secured by Residential Property – Risk Weights[44]**

| Category of loan | LTV ratio (%) | Risk Weight(%) |
|---|---|---|
| **(a) Individual Housing Loans** | | |
| (i) Upto ₹. 30 lakh | ≤ 80 | 35 |
| | ≥ 80 and ≤ 90 | 50 |
| (ii) Above ₹. 30 lakh and upto ₹. 75 lakh | ≤ 80 | 35 |
| (iv) Above ₹. 75 lakh | ≤ 75 | 50 |
| (b) Commercial Real Estate – Residential Housing (CRE-RH) | N A | 75 |
| (c) Commercial Real Estate (CRE) | N A | 100 |

*Notes:*

1. Individual Housing Loans sanctioned between October 16, 2020 and March 31, 2023 shall be subject to the risk weights mentioned in circular DOR.No.BP.BC.24/08.12.015/2020-21 dated October 16, 2020 and DOR. CRE.REC.13/08.12.015/2022-23 dated April 8, 2022 on Individual Housing Loans – Rationalisation of Risk Weights".

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

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

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

**8.10.3** Loans / exposures to intermediaries for on-lending will not be eligible for inclusion under claims secured by residential property but will be treated as claims on corporates or claims included in the regulatory retail portfolio as the case may be.

**8.10.4** Investments in mortgage backed securities (MBS) backed by exposures as at section 8.10.1 above shall be governed by the guidelines pertaining to securitisation exposures – Reserve Bank of India (Securitisation of Standard Assets) Direction, 2021 dated September 24, 2021 (refer to section 8.17 below).

### 8.11 Claims Classified as Commercial Real Estate Exposure

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

[44] Please refer to the circular DBOD.BP.BC.No.104/08.12.015/2012-13 dated June 21, 2013 on Housing Sector: New sub-sector CRE (Residential Housing) within CRE & Rationalisation of provisioning, risk-weight and LTV ratios, DBR.BP.BC.No.44/08.12.015/2015-16 dated October 8, 2015 and DBR.BP.BC.No.72/08.12.015/2016-17 dated June 7, 2017 on Individual Housing Loans: Rationalisation of Risk Weights and LTV Ratios addressed to banks.

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

**8.11.3** Investments in mortgage backed securities (MBS) backed by exposures as at section 8.11.1 above shall be governed by the guidelines pertaining to securitisation exposures - Reserve Bank of India (Securitisation of Standard Assets) Direction, 2021 dated September 24, 2021 (refer to section 8.17 below).

### 8.12 Non-Performing Assets (NPAs)

**8.12.1** The unsecured portion of NPA (other than a qualifying residential mortgage loan which is addressed in section 8.12.6), net of specific provisions (including partial write-offs), will be risk-weighted as follows:

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

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

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

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

**8.12.3** For the purpose of defining the secured portion of the NPA, eligible collateral will be the same as recognised for credit risk mitigation purposes (section 10.3.5). Hence, other forms of collateral like land, buildings, plant, machinery, current assets, etc., will not be reckoned while computing the secured portion of NPAs for capital adequacy purposes.

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

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

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

**8.12.5** The above collaterals (mentioned in section 8.12.4) will be recognized only where the AIFI is having clear title to realize the sale proceeds thereof and can appropriate the same towards the amounts due to the AIFI. The AIFI's title to the collateral should be well documented. These forms of collaterals are not recognised anywhere else under the standardised approach.

**8.12.6** Claims secured by residential property, as defined in section 8.10.1, which are NPA will be risk weighted at 100 per cent net of specific provisions. If the specific provisions in such loans are at least 20 per cent but less than 50 per cent of the outstanding amount, the risk weight applicable to the loan net of specific provisions will be 75 per cent. If the specific provisions are 50 per cent or more the applicable risk weight will be 50 per cent.

### 8.13 Specified Categories

**8.13.1** Fund based and non-fund based claims on Alternative Investment Funds, which are considered as high risk exposures, will attract a higher risk weight of 150 per cent[45].

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

**8.13.3** Consumer credit, including personal loans will attract a risk weight of 100 per cent. As gold and gold jewellery are eligible financial collateral, the counterparty exposure in respect of personal loans secured by gold and gold jewellery will be worked out under the comprehensive approach as per section 10.3.4. The 'exposure value after risk mitigation' shall attract the risk weight of 125 per cent.

**8.13.4** Advances classified as 'Capital market exposures' will attract a 125 per cent risk weight or risk weight warranted by external rating (or lack of it) of the counterparty, whichever is higher. These risk weights will also be applicable to all banking book exposures, which are exempted from capital market exposure ceilings for direct investments / total capital market exposures[46].

**8.13.5** The exposure to capital instruments issued by NBFCs which are not deducted and are required to be risk weighted in terms of section 7.5.2(B) would be risk weighted at 125% or as per the external ratings, whichever is higher. The exposure to equity instruments issued by NBFCs which are not deducted and are required to be risk weighted in terms of section 7.5.2(C) would be risk weighted at 250%.

**8.13.6** All investments made by the AIFIs in the paid-up equity of non-financial entities (other than subsidiaries) made under their statutory mandate which exceed 49%[47] of the issued common share capital of the issuing entity or where the entity is an unconsolidated affiliate as defined in section 7.5.2(C)(i) shall receive a risk weight of 1250%. Equity investments equal to or below 49%[48] paid-up equity of such investee companies shall be assigned a 125% risk weight or the risk weight as warranted by rating or lack of it, whichever higher.

**8.13.7** The exposure to capital instruments issued by financial entities (other than banks and NBFCs) which are not deducted and are required to be risk weighted in terms of section 7.5.2(B) would be risk weighted at 125% or as per the external ratings whichever is higher. The exposure to equity instruments issued by financial entities (other than banks and NBFCs) which are not deducted and are required to be risk weighted in terms of section 7.5.2(C) would be risk weighted at 250%.

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[45] SIDBI's investment limit in MSME-dedicated VCFs without the prior approval of the Reserve Bank shall be 20% subject to the proviso that SIDBI will maintain a capital charge of 175%. For specific risk where SIDBI's CME is between 20% and 30%, the capital charge will be at 200% and for CME above 30% and upto 40% the capital charge on specific risk will be 225%.

[46] The applicable risk weight for banking book exposure / capital charge for market risk exposure for an AIFI's equity investments in banks/financial institutions etc., are covered under section 8 and 11 respectively. These risk weights / capital charge will also apply to exposures which are exempt from 'capital market exposure' limit.

[47] For investments not made under the AIFI's statutory mandate, this limit would be 10%.

[48] Please refer to footnote 47 above

**8.13.8** AIFI's investments in the non-equity capital eligible instruments of banks should be risk weighted as prescribed in section 8.6.1.

### 8.14 Unhedged Foreign Currency Exposure[49]

If the extent of unhedged foreign currency exposures of entities[50] is significant, this can increase the probability of default in times of high currency volatility. Therefore, the incremental capital requirements for AIFIs' exposures to entities with unhedged foreign currency exposures (i.e., over and above the present capital requirements) shall be as under:

| Potential Loss/EBID (%) | Incremental Capital Requirement |
|---|---|
| Up to 75 per cent | 0 |
| More than 75 per cent | 25 per centage point[51] increase in the risk weight |

### 8.15 Other Assets

**8.15.1** Loans and advances to AIFI's own staff which are fully covered by superannuation benefits and/or mortgage of flat/ house will attract a 20 per cent risk weight. Since flat / house is not an eligible collateral and since AIFIs normally recover the dues by adjusting the superannuation benefits only at the time of cessation from service, the concessional risk weight shall be applied without any adjustment of the outstanding amount. In case an AIFI is holding eligible collateral in respect of amounts due from a staff member, the outstanding amount in respect of that staff member may be adjusted to the extent permissible, as indicated in section 10 below.

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

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

### 8.16 Off-Balance Sheet Items

#### 8.16.1 General

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

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

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

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[49] Please refer to the Reserve Bank of India (Unhedged Foreign Currency Exposure) Directions, 2022 issued vide DOR.MRG.REC.76/00-00-007/2022-23 dated October 11, 2022.

[50] In this context, 'entities' means those entities which have borrowed from AIFIs including borrowing in INR and other currencies.

[51] For example: for an entity which otherwise attracts a risk weight of 50 per cent, the applicable risk weight would become 75 per cent.

(ii) Where the off-balance sheet item is secured by eligible collateral or guarantee, the credit risk mitigation guidelines detailed in section 10 may be applied.

### 8.16.2 Non-market-related Off Balance Sheet Items[52]

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

(ii) Where the non-market related off-balance sheet item is an undrawn or partially undrawn fund-based facility[53], the amount of undrawn commitment to be included in calculating the off-balance sheet non-market related credit exposures is the maximum unused portion of the commitment that could be drawn during the remaining period to maturity. Any drawn portion of a commitment forms a part of AIFI's on-balance sheet credit exposure.

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

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

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

| Sr. No. | Instruments | Credit Conversion Factor (%) |
|---|---|---|
| 1. | Direct credit substitutes e.g., general guarantees of indebtedness (including | 100 |

[52] The aggregate capital required to be maintained by the AIFIs providing Partial Credit Enhancement will be computed as provided in circular DBR.BP.BC.No.40/21.04.142/2015-16 dated September 24, 2015 addressed to banks, as amended from time to time.

[53] For example: (a) In the case of a cash credit facility for Rs.100 lakh (which is not unconditionally cancellable) where the drawn portion is ₹ 60 lakh, the undrawn portion of ₹ 40 lakh will attract a CCF of 20 per cent (since the CC facility is subject to review / renewal normally once a year). The credit equivalent amount of ₹ 8 lakh (20% of ₹ 40 lakh) will be assigned the appropriate risk weight as applicable to the counterparty / rating to arrive at the risk weighted asset for the undrawn portion. The drawn portion (₹ 60 lakh) will attract a risk weight as applicable to the counterparty / rating.
(b) A TL of ₹ 700 cr is sanctioned for a large project which can be drawn down in stages over a three year period. The terms of sanction allow draw down in three stages – ₹ 150 cr in Stage I, ₹ 200 cr in Stage II and ₹ 350 cr in Stage III, where the borrower needs the AIFI's explicit approval for draw down under Stages II and III after completion of certain formalities. If the borrower has drawn already ₹ 50 cr under Stage I, then the undrawn portion would be computed with reference to Stage I alone i.e., it will be ₹ 100 cr. If Stage I is scheduled to be completed within one year, the CCF will be 20 per cent and if it is more than one year then the applicable CCF will be 50 per cent.

| Sr. No. | Instruments | Credit Conversion Factor (%) |
|---|---|---|
| | standby L/Cs serving as financial guarantees for loans and securities, credit enhancements, liquidity facilities for securitisation transactions), and acceptances (including endorsements with the character of acceptance).<br>(i.e., the risk of loss depends on the credit worthiness of the counterparty or the party against whom a potential claim is acquired) | |
| 2. | Certain transaction-related contingent items (e.g., performance bonds, bid bonds, warranties, indemnities and standby letters of credit related to particular transaction). | 50 |
| 3. | Short-term self-liquidating trade letters of credit arising from the movement of goods (e.g., documentary credits collateralised by the underlying shipment) for both issuing and confirming financial entity. | 20 |
| 4. | Sale and repurchase agreement and asset sales with recourse, where the credit risk remains with the AIFI.<br>(These items are to be risk weighted according to the type of asset and not according to the type of counterparty with whom the transaction has been entered into.) | 100 |
| 5. | Forward asset purchases, forward deposits and partly paid shares and securities, which represent commitments with certain drawdown.<br>(These items are to be risk weighted according to the type of asset and not according to the type of counterparty with whom the transaction has been entered into.) | 100 |
| 6 | Lending of securities or posting of securities as collateral by AIFIs, including instances where these arise out of repo style transactions (i.e., repurchase / reverse repurchase and securities lending / securities borrowing transactions) | 100 |
| 7. | Note issuance facilities and revolving / non-revolving underwriting facilities. | 50 |
| 8 | Commitments with certain drawdown | 100 |
| 9. | Other commitments (e.g., formal standby facilities and credit lines) with an original maturity of<br>a) up to one year<br>b) over one year<br>Similar commitments that are unconditionally cancellable at any time by the bank without prior notice or that effectively provide for automatic cancellation due to deterioration in a borrower's credit worthiness[54] | <br><br>20<br>50<br>0 |
| 10. | Take-out Finance in the books of taking-over institution | |
| | (i) Unconditional take-out finance | 100 |
| | (ii) Conditional take-out finance | 50 |

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

(a) Guarantees issued by banks against the counter guarantees of other banks.

(b) Rediscounting of documentary bills discounted by banks and bills discounted by banks which have been accepted by another bank will be treated as a funded claim on a bank.

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

In all the above cases AIFIs should be fully satisfied that the risk exposure is in fact on the other bank. If they are satisfied that the exposure is on the other bank they may assign these exposures the risk weight applicable to banks as detailed in section 8.6.

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

(vii) For classification of AIFI's guarantees[55] viz. direct credit substitutes and transaction-related contingent items etc. (Sr. No. 1 and 2 of Table 8 above), the following principles should be kept in view for the application of CCFs:

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

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

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

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

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

### 8.16.3 Treatment of Total Counterparty Credit Risk

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

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

The '**capital charge for default risk'** will be calculated using **Current Exposure Method** as explained in **section 8.16.3.3**. The '**capital charge for CVA risk'** will be calculated as explained in **section 8.16.3.4**. The Current Exposure method is applicable only to OTC derivatives. The counterparty risk on account of Securities Financing Transactions is covered in **section 10.3.8** of this Chapter.

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

#### 8.16.3.3 Default Risk Capital Charge for CCR

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

(i) The credit equivalent amount of a market related off-balance sheet transaction calculated using the current exposure method is the sum of current credit exposure and potential future credit exposure of these contracts. For this purpose, credit equivalent amount will be adjusted for legally valid eligible financial collaterals in accordance with section 10.3 – Credit Risk Mitigation Techniques – Collateralised Transactions and the provisions held by the AIFI for CVA losses.

(ii) The CVA loss will be calculated as a prudent valuation adjustment as per prudent valuation guidance contained in section 11.8.1, without taking into account any offsetting debit valuation adjustments (DVA) which have been deducted from capital (please see section 7.4.5). The CVA loss deducted from exposures to determine outstanding EAD is the CVA loss gross of all DVA which have been separately deducted from capital. To the extent DVA has not been separately deducted from an AIFI's capital, the CVA loss used to determine outstanding EAD will be net of such DVA. Risk Weighted Assets for a given OTC

derivative counterparty may be calculated as the applicable risk weight under the Standardised or IRB approach multiplied by the outstanding EAD of the counterparty. This reduction of EAD by CVA losses does not apply to the determination of the CVA risk capital charge as per formula given in **section 8.16.3.4 (ii).**

(iii) While computing the credit exposure AIFIs may exclude 'sold options' that are outside netting and margin agreements, provided the entire premium / fee or any other form of income is received / realised.

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

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

**Table 9: Credit Conversion Factors for Market-Related Off-Balance Sheet Items[56]**

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

*Notes:*

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

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

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

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

[56] Please refer to section 11.6.3 for credit default swaps.

(vi) When effective bilateral netting contracts as specified in **Annex 17** (part B) are in place, RC will be the net replacement cost and the add-on will be $A_{Net}$ as calculated below:

(a) Credit exposure on bilaterally netted forward transactions will be calculated as the sum of the net mark-to-market replacement cost, if positive, plus an add-on based on the notional underlying principal. The add-on for netted transactions ($A_{Net}$) will equal the weighted average of the gross add-on ($A_{Gross}$) and the gross add-on adjusted by the ratio of net current replacement cost to gross current replacement cost (NGR). This is expressed through the following formula:

$$A_{Net} = 0.4 \cdot A_{Gross} + 0.6 \cdot NGR \cdot A_{Gross}$$

where:

NGR = level of net replacement cost/level of gross replacement cost for transactions subject to legally enforceable netting agreements[57]

$A_{Gross}$ = sum of individual add-on amounts (calculated by multiplying the notional principal amount by the appropriate add-on factors set out in Table 9 of section 8.16.3.3 and Tables 20 & 21 of section 11.6.3) of all transactions subject to legally enforceable netting agreements with one counterparty.

(b) For the purposes of calculating potential future credit exposure to a netting counterparty for forward foreign exchange contracts and other similar contracts in which the notional principal amount is equivalent to cash flows, the notional principal is defined as the net receipts falling due on each value date in each currency. The reason for this is that offsetting contracts in the same currency maturing on the same date will have lower potential future exposure as well as lower current exposure.

Note: For any clarifications regarding Bilateral Netting, AIFIs may refer to Annex 23 of Master Circular on Basel III Capital Regulations dated May 12, 2023 addressed to banks.

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

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

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

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

Where;

- **h** is the one-year risk horizon (in units of a year), h = 1.
- $\mathbf{w_i}$ is the weight applicable to counterparty 'i'. Counterparty 'i' shall be mapped to one of the seven weights $\mathbf{w_i}$ based on its external rating as shown in the Table below.

[57] AIFIs must calculate NGR on a counterparty by counterparty basis for all transactions that are subject to legally enforceable netting agreements

| Rating | $W_i$ |
|---|---|
| AAA | 0.7% |
| AA | 0.7% |
| A | 0.8% |
| BBB | 1.0% |
| BB | 2.0% |
| B and unrated | 3.0% |
| CCC | 10.0%[58] |

- **$EAD_i^{total}$** is the exposure at default of counterparty 'i' (summed across its netting sets) including the effect of collateral as per the existing Current Exposure Method (CEM) as applicable to the calculation of counterparty risk capital charges for such counterparty by the AIFI. The exposure should be discounted by applying the factor $(1-\exp(-0.05*M_i))/(0.05*M_i)$.

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

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

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

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

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

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

- For any counterparty that is also a constituent of an index on which a CDS is used for hedging counterparty credit risk, the notional amount attributable to that single name (as per its reference entity weight) may be subtracted from the index CDS notional amount and treated as a single name hedge (Bi) of the individual counterparty with maturity based on the maturity of the index.
- In cases where the unrated counterparty is a scheduled commercial bank, AIFIs may use the following Table to arrive at the implied ratings of the counterparty-bank and consequently, the $W_i$

| Applicable Risk weight of the Counterparty-bank according to Table 4 of section 8.6 | Implied ratings | $W_i$ |
|---|---|---|
| 20 | AAA/AA | 0.7% |

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

| | | |
|---|---|---|
| 50 | A | 0.8% |
| 100 | BBB | 1% |
| 150 | BB | 2% |
| 625 | CCC | 10% |

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

An illustration of CVA risk capital charge has been furnished in **Annex 11.**

#### 8.16.3.5 Calculation of the Aggregate CCR and CVA Risk Capital Charges

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

(i) The sum over all counterparties of the CEM based capital charge determined as per **section 8.16.3.3**; and

(ii) The standardised CVA risk capital charge determined as per **section 8.16.3.4**

#### 8.16.3.6 Capital requirement for exposures to Central Counterparties (CCPs) Scope of Application

(i) Exposures to central counterparties arising from OTC derivatives transactions, exchange traded derivatives transactions and securities financing transactions (SFTs) will be subject to the counterparty credit risk treatment as indicated in this section below.

(ii) Exposures arising from the settlement of cash transactions (equities, fixed income, spot FX, commodity etc.) are not subject to this treatment. The settlement of cash transactions remains subject to the treatment described in section 8.16.4 of this Chapter.

(iii) When the clearing member-to-client leg of an exchange traded derivatives transaction is conducted under a bilateral agreement, both the client bank and the clearing member are to capitalise that transaction as an OTC derivative.

(iv) For the purpose of capital adequacy framework, CCPs will be considered as financial institution. Accordingly, an AIFI's investments in the capital of CCPs will be guided in terms of section 7.5.2 of this Chapter.

(v) Capital requirements will be dependent on the nature of CCPs viz. Qualifying CCPs (QCCPs) and non-Qualifying CCPs.

(a) Regardless of whether a CCP is classified as a QCCP or not, an AIFI retains the responsibility to ensure that it maintains adequate capital for its exposures. Under Pillar 2, an AIFI should consider whether it might need to hold capital in excess of the minimum capital requirements if, for example, (i) its dealings with a CCP give rise to more risky exposures or (ii) where, given the context of that AIFI's dealings, it is unclear that the CCP meets the definition of a QCCP.

(b) AIFIs may be required to hold additional capital against their exposures to QCCPs via Pillar 2, if in the opinion of the Reserve Bank, it is necessary to do so. This might be considered appropriate where, for example, an external assessment such as an Financial Sector Assessment Program (FSAP) of International Monetary Fund / World

Bank has found material shortcomings in the CCP or the regulation of CCPs, and the CCP and / or the CCP regulator have not since publicly addressed the issues identified.

(c) Where the AIFI is acting as a clearing member, the AIFI should assess through appropriate scenario analysis and stress testing whether the level of capital held against exposures to a CCP adequately addresses the inherent risks of those transactions. This assessment will include potential future or contingent exposures resulting from future drawings on default fund commitments, and/or from secondary commitments to take over or replace offsetting transactions from clients of another clearing member in case of this clearing member defaulting or becoming insolvent.

(d) An AIFI shall monitor and report to senior management and the appropriate committee of the Board (e.g., Risk Management Committee) on a regular basis (quarterly or at more frequent intervals) all of its exposures to CCPs, including exposures arising from trading through a CCP and exposures arising from CCP membership obligations such as default fund contributions.

(e) Unless Reserve Bank (DOR) requires otherwise, the trades with a former QCCP may continue to be capitalised as though they are with a QCCP for a period not exceeding three months from the date it ceases to qualify as a QCCP. After that time, the AIFI's exposures with such a central counterparty shall be capitalised according to rules applicable for non-QCCP.

### 8.16.3.7 Exposures to Qualifying CCPs (QCCPs)

**(A) Trade exposures**

**(i) *Clearing member* exposures *to QCCPs***

(a) Where an AIFI acts as a clearing member of a QCCP for its own purposes, a risk weight of 2% shall be applied to the AIFI's trade exposure to the QCCP in respect of OTC derivatives transactions, exchange traded derivatives transactions and SFTs.

(b) The exposure amount for such trade exposure will be calculated in accordance with the Current Exposure Method (CEM) for derivatives and rules as applicable for capital adequacy for Repo / Reverse Repo-style transactions[59].

(c) Where settlement is legally enforceable on a net basis in an event of default and regardless of whether the counterparty is insolvent or bankrupt, the total replacement cost of all contracts relevant to the trade exposure determination can be calculated as a net replacement cost if the applicable close-out netting sets meet the requirements set out in **Annex 17** of these guidelines.

(d) AIFIs will have to demonstrate that the conditions mentioned in **Annex 17** are fulfilled on a regular basis by obtaining independent and reasoned legal opinion as regards legal certainty of netting of exposures to QCCPs. AIFIs may also obtain from the QCCPs, the legal opinion taken by the respective QCCPs on the legal certainty of their major activities such as settlement finality, netting, collateral arrangements (including margin arrangements); default procedures etc.

**(ii) *Client AIFI exposures to clearing member***

(a) Where an AIFI is a client of the clearing member, and enters into a transaction with the clearing member acting as a financial intermediary (i.e., the clearing member completes an offsetting transaction with a QCCP), the client's exposures to the clearing member will receive the treatment prescribed in clause (i) above provided the following conditions are met:

[59] Please refer to paragraph 10.3.8 of this Master Direction

➢ The offsetting transactions are identified by the QCCP as client transactions and collateral to support them is held by the QCCP and / or the clearing member, as applicable, under arrangements that prevent any losses to the client due to:

- the default or insolvency of the clearing member;
- the default or insolvency of the clearing member's other clients; and
- the joint default or insolvency of the clearing member and any of its other clients.

The client AIFI shall obtain an independent, written and reasoned legal opinion that concludes that, in the event of legal challenge, the relevant courts and administrative authorities would find that the client would bear no losses on account of the insolvency of an intermediary under the relevant law, including:

- the law(s) applicable to client AIFI, clearing member and QCCP;
- the law of the jurisdiction(s) of the foreign countries in which the client AIFI, clearing member or QCCP are located
- the law that governs the individual transactions and collateral; and
- the law that governs any contract or agreement necessary to meet this condition.

➢ Relevant laws, regulations, rules, contractual, or administrative arrangements provide that the offsetting transactions with the defaulted or insolvent clearing member are highly likely to continue to be indirectly transacted through the QCCP, or by the QCCP, should the clearing member default or become insolvent. In such circumstances, the client positions and collateral with the QCCP will be transferred at the market value unless the client requests to close out the position at the market value. In this context, it may be clarified that if relevant laws, regulations, rules, contractual or administrative agreements provide that trades are highly likely to be ported, this condition can be considered to be met. If there is a clear precedent for transactions being ported at a QCCP and intention of the participants is to continue this practice, then these factors should be considered while assessing if trades are highly likely to be ported. The fact that QCCP documentation does not prohibit client trades from being ported is not sufficient to conclude that they are highly likely to be ported. Other evidence such as the criteria mentioned in this section is necessary to make this claim.

(b) Where a client is not protected from losses in the case that the clearing member and another client of the clearing member jointly default or become jointly insolvent, but all other conditions mentioned above are met and the concerned CCP is a QCCP, a risk weight of 4% will apply to the client's exposure to the clearing member.

(c) Where the client AIFI does not meet the requirements in the above sections, the AIFI will be required to capitalize its exposure (including potential CVA risk exposure) to the clearing member as a bilateral trade.

(d) Under situations in which a client enters into a transaction with the QCCP with a clearing member guaranteeing its performance, the capital requirements will be based on section 8 of this Chapter.

**(iii)** ***Treatment of posted collateral***

(a) In all cases, any assets or collateral posted shall, from the perspective of the AIFI posting such collateral, receive the risk weights that otherwise applies to such assets or collateral under the capital adequacy framework, regardless of the fact that such assets have been posted as collateral. Thus, collateral posted from Banking Book will receive Banking Book treatment and collateral posted from Trading Book will receive Trading Book treatment. Where assets or collateral of a clearing member or client are posted with a QCCP or a clearing member and are not held in a bankruptcy remote manner, the AIFI posting such assets or collateral shall also recognise credit risk based upon the assets or collateral

being exposed to risk of loss based on the creditworthiness of the entity[60] holding such assets or collateral.

(b) Collateral posted by the clearing member (including cash, securities, other pledged assets, and excess initial or variation margin, also called over-collateralisation), that is held by a custodian[61], and is bankruptcy remote from the QCCP, is not subject to a capital requirement for counterparty credit risk exposure to such bankruptcy remote custodian.

(c) Collateral posted by a client, that is held by a custodian, and is bankruptcy remote from the QCCP, the clearing member and other clients, is not subject to a capital requirement for counterparty credit risk. If the collateral is held at the QCCP on a client's behalf and is not held on a bankruptcy remote basis, a 2% risk weight will be applied to the collateral if the conditions established in the section on "client AIFI exposures to clearing member" of this section are met (mentioned above). A risk weight of 4% will be made applicable if a client is not protected from losses in the case that the clearing member and another client of the clearing member jointly default or become jointly insolvent, but all other conditions mentioned in the section on "client AIFI exposures to clearing members" of this section are met.

(d) If a clearing member collects collateral from a client for client cleared trades and this collateral is passed on to the QCCP, the clearing member may recognize this collateral for both the QCCP - clearing member leg and the clearing member - client leg of the client cleared trade. Therefore, initial margins (IMs) as posted by clients to clearing members mitigate the exposure the clearing member has against these clients.

**(B) Default Fund Exposures to QCCPs**

(i) Where a default fund is shared between products or types of business with settlement risk only (e.g., equities and bonds) and products or types of business which give rise to counterparty credit risk, i.e., OTC derivatives, exchange traded derivatives or SFTs, all of the default fund contributions will receive the risk weight determined according to the formulae and methodology set forth below, without apportioning to different classes or types of business or products.

(ii) However, where the default fund contributions from clearing members are segregated by product types and only accessible for specific product types, the capital requirements for those default fund exposures determined according to the formulae and methodology set forth below shall be calculated for each specific product giving rise to counterparty credit risk. In case the QCCP's prefunded own resources are shared among product types, the QCCP will have to allocate those funds to each of the calculations, in proportion to the respective product specific exposure, i.e., EAD.

(iii) Clearing member AIFIs are required to capitalise their exposures arising from default fund contributions to a qualifying CCP by applying the following formula:

- Clearing member AIFIs may apply a risk-weight of 1250% to their default fund exposures to the qualifying CCP, subject to an overall cap on the risk-weighted assets from all its exposures to the QCCP (i.e., including trade exposures) equal to 20% of the trade exposures to the QCCP. More specifically, the Risk Weighted

[60] Where the entity holding such assets or collateral is the QCCP, a risk-weight of 2% applies to collateral included in the definition of trade exposures. The relevant risk-weight of the QCCP will apply to assets or collateral posted for other purposes.

[61] In this section, the word "custodian" may include a trustee, agent, pledgee, secured creditor or any other person that holds property in a way that does not give such person a beneficial interest in such property and will not result in such property being subject to legally-enforceable claims by such persons, creditors, or to a court-ordered stay of the return of such property, should such person become insolvent or bankrupt.

Assets (RWA) for both AIFI i's trade and default fund exposures to each QCCP are equal to[62]:

*Min* {(2% * $TE_i$ + 1250% * $DF_i$); (20% * $TE_i$)}

Where;

$TE_i$ is AIFI i's trade exposure to the QCCP; and

$DF_i$ is AIFI i's pre-funded contribution to the QCCP's default fund.

#### 8.16.3.8 Exposures to Non-qualifying CCPs

(a) AIFIs shall apply the Standardised Approach for credit risk according to the category of the counterparty, to their trade exposure to a non-qualifying CCP[63].

(b) AIFIs shall apply a risk weight of 1250% to their default fund contributions to a non-qualifying CCP.

(c) For the purposes of this section, the default fund contributions of such AIFIs will include both the funded and the unfunded contributions which are liable to be paid should the CCP so require. Where there is a liability for unfunded contributions (i.e., unlimited binding commitments) the Reserve Bank will determine in its Pillar 2 assessments the amount of unfunded commitments to which 1250% risk weight should apply.

### 8.16.4 Failed Transactions

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

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

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

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

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[62] The 2% risk weight on trade exposures does not apply additionally, as it is included in the equation.

[63] In cases where a CCP is to be considered as non-QCCP and the exposure is to be reckoned on CCP, the applicable risk weight will be according to the ratings assigned to the CCPs.

systems in order to track the number of days after the agreed settlement date and calculate the corresponding capital charge.

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

(e) For non-DvP transactions (free deliveries) after the first contractual payment / delivery leg, the AIFI that has made the payment will treat its exposure as a loan if the second leg has not been received by the end of the business day. If the dates when two payment legs are made are the same according to the time zones where each payment is made, it is deemed that they are settled on the same day. For example, if a bank in Tokyo transfers Yen on day X (Japan Standard Time) and receives corresponding US Dollar via CHIPS on day X (US Eastern Standard Time), the settlement is deemed to take place on the same value date. AIFIs shall compute the capital requirement using the counterparty risk weights prescribed in these guidelines. However, if five business days after the second contractual payment / delivery date the second leg has not yet effectively taken place, the AIFI that has made the first payment leg will receive a risk weight of 1250% on the full amount of the value transferred plus replacement cost, if any. This treatment will apply until the second payment / delivery leg is effectively made.

### 8.17 Securitisation Exposures

The treatment of securitisation exposures for capital adequacy shall be as specified in the Master Direction – Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021 dated September 24, 2021[64]. As specified under clause 4 of Master Direction *ibid*, these directions, including those under chapter VI *ibid*, will be applicable to securitisation transactions undertaken subsequent to the issue of these directions. For transactions undertaken before issuance of the aforementioned directions, i.e., prior to September 24, 2021, the treatment of securitisation exposures for capital adequacy would be as per the guidelines issued vide circular no.DBOD.NO.BP.BC.60/21.04.048/2005-06 dated February 1, 2006, as amended from time to time, and as consolidated in para 5.16 of Master Circular no.DBR.No.BP.BC.1/21.06.201/2015-16 on Basel III Capital Regulations dated July 1, 2015.

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

#### 8.18.1 Recognition of External / Third-party CDS Hedges

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

(a) Operational requirements mentioned in paragraph 4 of circular DBOD.BP.BC.No.61/21.06.203/2011-12 dated November 30, 2011 (as amended from time to time) addressed to banks on Prudential Guidelines on Credit Default Swaps (CDS) are met (refer to **Annex 6** of these guidelines);

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

(c) There is no maturity mismatch between the underlying asset and the reference / deliverable obligation. If this condition is not satisfied, then the amount of credit protection to be recognised should be computed as indicated in section 8.18.3 (ii) below.

[64] Master Direction no. DOR.STR.REC.53/21.04.177/2021-22 dated September 24, 2021

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

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

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

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

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

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

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

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

Where:
Pa = value of the credit protection adjusted for maturity mismatch
P = credit protection
t = min (T, residual maturity of the credit protection arrangement) expressed in years
T = min (5, residual maturity of the underlying exposure) expressed in years

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

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

### 8.18.4 Internal Hedges

AIFIs can use CDS contracts to hedge against the credit risk in their existing corporate bonds portfolios. An AIFI can hedge a Banking Book credit risk exposure either by an internal hedge (the protection purchased from the trading desk of the AIFI and held in the

Trading Book) or an external hedge (protection purchased from an eligible third party protection provider). When an AIFI hedges a Banking Book credit risk exposure (corporate bonds) using a CDS booked in its Trading Book (i.e., using an internal hedge), the Banking Book exposure is not deemed to be hedged for capital purposes unless the AIFI transfers the credit risk from the Trading Book to an eligible third party protection provider through a CDS meeting the requirements of section 8.18 vis-à-vis the Banking Book exposure. Where such third party protection is purchased and is recognised as a hedge of a Banking Book exposure for regulatory capital purposes, no capital is required to be maintained on internal and external CDS hedge. In such cases, the external CDS will act as indirect hedge for the Banking Book exposure and the capital adequacy in terms of section 8.18, as applicable for external/ third party hedges, will be applicable.

## 9. External Credit Assessments

### 9.1 Eligible Credit Rating Agencies

**9.1.1** The Reserve Bank has undertaken the detailed process of identifying the eligible credit rating agencies, whose ratings may be used by AIFIs for assigning risk weights for credit risk. In line with the provisions of the Revised Framework[65], where the facility provided by the AIFIs possesses rating assigned by an eligible credit rating agency, the risk weight of the claim will be based on this rating.

**9.1.2** AIFIs may use the ratings of the following domestic credit rating agencies (arranged in alphabetical order) for the purposes of risk weighting their claims for capital adequacy purposes:

(a) ACUITE Ratings & Research Ltd. (Acuité)
(b) Credit Analysis and Research Limited (CARE);
(c) CRISIL Ratings Limited;
(d) ICRA Limited;
(e) India Ratings and Research Private Limited (India Ratings); and
(f) INFOMERICS Valuation and Rating Pvt Ltd. (INFOMERICS)

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

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

### 9.2 Scope of Application of External Ratings

**9.2.1** AIFIs should use the chosen credit rating agencies and their ratings consistently for each type of claim, for both risk weighting and risk management purposes. AIFIs will not be allowed to "cherry pick" the assessments provided by different credit rating agencies and to arbitrarily change the use of credit rating agencies. If an AIFI has decided to use the ratings of some of the chosen credit rating agencies for a given type of claim, it can use only the ratings of those credit rating agencies, despite the fact that some of these claims may be rated by other chosen credit rating agencies whose ratings the AIFI has decided not to use. AIFI shall not use one agency's rating for one corporate bond, while using another agency's rating for another exposure to the same counterparty, unless the respective exposures are rated by only one of the chosen credit rating agencies, whose ratings the AIFI has decided to use. External assessments for one entity within a corporate group cannot be used to risk weight other entities within the same group.

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

**9.2.2** AIFIs shall disclose the names of the credit rating agencies that they use for the risk weighting of their assets, the risk weights associated with the particular rating grades as determined by Reserve Bank through the mapping process for each eligible credit rating agency as well as the aggregated risk weighted assets as required vide **Table DF-4 of Annex 16**.

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

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

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

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

**9.2.7** Cash credit exposures tend to be generally rolled over and also tend to be drawn on an average for a major portion of the sanctioned limits. Hence, even though a cash credit exposure may be sanctioned for period of one year or less, these exposures should be reckoned as long term exposures and accordingly the long term ratings accorded by the chosen credit rating agencies will be relevant. Similarly, AIFIs (if permitted to extend cash credit facility) may use long-term ratings of a counterparty as a proxy for an unrated short-term exposure on the same counterparty subject to strict compliance with the requirements for use of multiple rating assessments and applicability of issue rating to issuer / other claims as indicated in sections 9.4, 9.5, 9.7 and 9.8 below.

### 9.3 Mapping Process

**9.3.1** This Capital Framework recommends development of a mapping process to assign the ratings issued by eligible credit rating agencies to the risk weights available under the Standardised risk weighting framework. The mapping process is required to result in a risk weight assignment consistent with that of the level of credit risk. A mapping of the credit ratings awarded by the chosen domestic credit rating agencies has been furnished below in sections 9.4.1 and 9.5.4, which should be used by AIFIs in assigning risk weights to the various exposures.

### 9.4 Long Term Ratings

**9.4.1** On the basis of the above factors as well as the data made available by the rating agencies, the ratings issued by the chosen domestic credit rating agencies have been mapped to the appropriate risk weights applicable as per the Standardised approach. The rating-risk weight mapping furnished in the Table 10 below shall be adopted by all AIFIs in India:

**Table 10: Risk Weight Mapping of Long Term Ratings of the chosen Domestic Rating Agencies**

| CARE | CRISIL Ratings Limited | India Ratings and Research Private Limited (India Ratings) | ICRA | ACUITE Ratings & Research Ltd. (Acuité) | INFOMERICS | Standardised approach risk weights (in per cent) |
|---|---|---|---|---|---|---|
| CARE AAA | CRISIL AAA | IND AAA | ICRA AAA | Acuité AAA | IVR AAA | 20 |
| CARE AA | CRISIL AA | IND AA | ICRA AA | Acuité AA | IVR AA | 30 |
| CARE A | CRISIL A | IND A | ICRA A | Acuité A | IVR A | 50 |
| CARE BBB | CRISIL BBB | IND BBB | ICRA BBB | Acuité BBB | IVR BBB | 100 |
| CARE BB, CARE B, CARE C & CARE D | CRISIL BB, CRISIL B, CRISIL C & CRISIL D | IND BB, IND B, IND C & IND D | ICRA BB, ICRA B, ICRA C & ICRA D | Acuité BB, Acuité B, Acuité C & Acuité D | IVR BB, IVR B, IVR C & IVR D | 150 |
| Unrated | Unrated | Unrated | Unrated | Unrated | Unrated | 100[$] |

$ The risk weight is 150% in the following two cases:

- if the aggregate exposure from banking system is more than INR 200 crore
- if the aggregate exposure from banking system is more than INR 100 crore for exposures which were rated earlier and subsequently have become unrated.

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

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

### 9.5 Short Term Ratings

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

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

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

**9.5.4** In respect of the issue specific short term ratings the following risk weight mapping shall be adopted by AIFIs:

**Table 11: Risk Weight Mapping of Short Term Ratings of Domestic Rating Agencies**

| CARE | CRISIL Ratings Limited | India Ratings and Research Private Limited (India Ratings) | ICRA | ACUITE Ratings & Research Ltd. (Acuité) | INFOMERICS | Standardised approach risk weights (in per cent) |
|---|---|---|---|---|---|---|
| CARE A1+ | CRISIL A1+ | IND A1+ | ICRA A1+ | Acuité A1+ | IVR A1+ | 20 |
| CARE A1 | CRISIL A1 | IND A1 | ICRA A1 | Acuité A1 | IVR A1 | 30 |
| CARE A2 | CRISIL A2 | IND A2 | ICRA A2 | Acuité A2 | IVR A2 | 50 |
| CARE A3 | CRISIL A3 | IND A3 | ICRA A3 | Acuité A3 | IVR A3 | 100 |
| CARE A4 & D | CRISIL A4 & D | IND A4 & D | ICRA A4 & D | Acuité A4 & D | IVR A4 & D | 150 |
| Unrated | Unrated | Unrated | Unrated | Unrated | Unrated | 100 |

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

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

### 9.6 Use of Unsolicited Ratings

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

### 9.7 Use of Multiple Rating Assessments

AIFIs shall be guided by the following in respect of exposures / obligors having multiple ratings from the chosen credit rating agencies chosen by the AIFI for the purpose of risk weight calculation:

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

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

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

### 9.8 Applicability of 'Issue Rating' to issuer/ other claims

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

(i) In circumstances where the borrower has a specific assessment for an issued debt - but the AIFI's claim is not an investment in this particular debt - the rating applicable to the specific debt (where the rating maps into a risk weight lower than that which applies to an unrated claim) may be applied to the AIFI's unassessed claim only if this claim ranks *pari passu* or senior to the specific rated debt in all respects and the maturity of the unassessed claim is not later than the maturity of the rated claim,[66] except where the rated claim is a short term obligation as specified in section 9.5.2. If not, the rating applicable to the specific debt cannot be used and the unassessed claim will receive the risk weight for unrated claims. Here, it may be noted that the Reserve Bank had advised the External Credit Assessment Institutions (ECAIs) vide letter dated June 4, 2021 to disclose the name of the banks and the corresponding credit facilities rated by them in the PRs issued on rating actions, after obtaining requisite consent from the borrowers. It is advised that a loan rating[67] without the above disclosure by the ECAI shall not be eligible for being reckoned for capital computation by banks. AIFIs shall treat such exposures as unrated and assign applicable risk weights in terms of section 8.8.1 of this Chapter[68].

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

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

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

[67] Please refer to circular No.DOR.STR.REC.71/21.06.201/2022-23 on Review of Prudential Norms – Risk Weights for Exposures to Corporates and NBFCs dated October 10, 2022.

[68] Illustratively, a scenario may be assumed, where a borrower has availed credit facilities from Banks A and B and AIFI C and external rating from an ECAI is obtained only in respect of the credit facility extended by Bank A. If the ECAI has disclosed the name of Bank A and the corresponding credit facility rated by it, then Bank A can reckon the said rating for risk weighting purpose. AIFI C is permitted to derive risk weights for its respective unrated credit facilities subject to conditions stated in section 9.8.1 (i). In the event of ECAI not making the above disclosure, none of the financial institution shall reckon the said rating, and therefore shall apply risk weights of 100 percent or 150 percent as applicable in terms of extant instructions.

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

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

## 10. Credit Risk Mitigation

### 10.1 General Principles

**10.1.1** AIFIs use a number of techniques to mitigate the credit risks to which they are exposed. For example, exposures may be collateralised in whole or in part by cash or securities, deposits from the same counterparty, guarantee of a third party, etc. Credit risk mitigation approach as detailed in this section is applicable to the banking book exposures. This will also be applicable for calculation of the counterparty risk charges for OTC derivatives and repo-style transactions booked in the trading book.

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

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

(ii) The effects of CRM will **not** be double counted. Therefore, no additional supervisory recognition of CRM for regulatory capital purposes will be granted on claims for which an issue-specific rating is used that already reflects that CRM.

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

(iv) While the use of CRM techniques reduces or transfers credit risk, it simultaneously may increase other risks (residual risks). Residual risks include legal, operational, liquidity and market risks. Therefore, it is imperative that AIFIs employ robust procedures and processes to control these risks, including strategy; consideration of the underlying credit; valuation; policies and procedures; systems; control of roll-off risks; and management of concentration risk arising from the AIFI's use of CRM techniques and its interaction with the AIFI's overall credit risk profile. Where these risks are not adequately controlled, the Reserve Bank may impose additional capital charges or take other supervisory actions. The disclosure requirements prescribed in **Table DF-5 of Annex 16** shall also be observed for AIFIs to obtain capital relief in respect of any CRM techniques.

### 10.2 Legal Certainty

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

### 10.3 Credit Risk Mitigation Techniques - Collateralised Transactions

**10.3.1** A Collateralised Transaction is one in which:

(i) AIFIs have a credit exposure and that credit exposure is hedged in whole or in part

by collateral posted by a counterparty or by a third party on behalf of the counterparty. Here, “counterparty” is used to denote a party to whom an AIFI has an on- or off-balance sheet credit exposure.

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

### 10.3.2 Overall framework and minimum conditions

The framework allows AIFIs adoption of either the simple approach, which, similar to the 1988 Accord, substitutes the risk weighting of the collateral for the risk weighting of the counterparty for the collateralised portion of the exposure (generally subject to a 20 per cent floor), or the comprehensive approach, which allows fuller offset of collateral against exposures, by effectively reducing the exposure amount by the value ascribed to the collateral. AIFIs shall adopt the Comprehensive Approach, which allows fuller offset of collateral against exposures, by effectively reducing the exposure amount by the value ascribed to the collateral. Under this approach, AIFIs, which take eligible financial collateral (e.g., cash or securities, more specifically defined below), are allowed to reduce their credit exposure to a counterparty when calculating their capital requirements to take account of the risk mitigating effect of the collateral. Credit risk mitigation is allowed only on an account-by-account basis, even within regulatory retail portfolio. However, before capital relief will be granted the standards set out below shall be met:

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

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

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

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

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

a) the risk to which margin agreements exposes them (such as the volatility and liquidity of the securities exchanged as collateral),

b) the concentration risk to particular types of collateral,

c) the reuse of collateral (both cash and non-cash) including the potential liquidity shortfalls resulting from the reuse of collateral received from counterparties, and

d) the surrender of rights on collateral posted to counterparties.

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

**10.3.4 The Comprehensive Approach**

(i) In the comprehensive approach, when taking collateral, AIFIs will need to calculate their adjusted exposure to a counterparty for capital adequacy purposes in order to take account of the effects of that collateral. AIFIs are required to adjust both the amount of the exposure to the counterparty and the value of any collateral received in support of that counterparty to take account of possible future fluctuations in the value of either, occasioned by market movements. These adjustments are referred to as 'haircuts'. The application of haircuts will produce volatility adjusted amounts for both exposure and collateral. The volatility adjusted amount for the exposure will be higher than the exposure and the volatility adjusted amount for the collateral will be lower than the collateral, unless either side of the transaction is cash. In other words, the 'haircut' for the exposure will be a premium factor and the 'haircut' for the collateral will be a discount factor. It may be noted that the purpose underlying the application of haircut is to capture the market-related volatility inherent in the value of exposures as well as of the eligible financial collaterals. Since the value of credit exposures acquired by AIFIs in the course of their operations, would not be subject to market volatility, (since the loan disbursal / investment would be a "cash" transaction) though the value of eligible financial collateral would be, the haircut stipulated in Table-12 (section 10.3.7) would apply in respect of credit transactions only to the eligible collateral but not to the credit exposure of the AIFI. On the other hand, exposures of AIFIs, arising out of repo-style transactions would require upward adjustment for volatility, as the value of security sold/lent/pledged in the repo transaction, would be subject to market volatility. Hence, such exposures shall attract haircut.

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

(iii) Where the volatility-adjusted exposure amount is greater than the volatility-adjusted collateral amount (including any further adjustment for foreign exchange risk), AIFIs shall calculate their risk-weighted assets as the difference between the two multiplied by the risk weight of the counterparty. The framework for performing calculations of capital requirement is indicated in **section 10.3.6**.

**10.3.5 Eligible Financial Collateral**

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

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

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

(iii) Securities issued by Central and State Governments

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

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

(vi) Debt securities rated by a chosen Credit Rating Agency in respect of which AIFIs should be sufficiently confident about the market liquidity[69] where these are either:

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

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

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

(a) issued by a bank; and

(b) listed on a recognised exchange; and

(c) classified as senior debt; and

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

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

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

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

(a) a price for the units is publicly quoted daily i.e., where the daily NAV is available in public domain; and
(b) Mutual fund is limited to investing in the instruments listed in this section.

### 10.3.6 Calculation of capital requirement

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

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

where:

E* = the exposure value after risk mitigation
E = current value of the exposure for which the collateral qualifies as a risk mitigant
He = haircut appropriate to the exposure
C = the current value of the collateral received
Hc = haircut appropriate to the collateral

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

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

The exposure amount after risk mitigation (i.e., E*) will be multiplied by the risk weight of the counterparty to obtain the risk-weighted asset amount for the collateralised transaction. Illustrative examples calculating the effect of Credit Risk Mitigation is furnished in **Annex 7.**

### 10.3.7 Haircuts

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

(ii) The Standard Supervisory Haircuts (assuming daily mark-to-market, daily re-margining and a 10 business-day holding period)[70], expressed as percentages, would be as furnished in Table 12.

(iii) The ratings indicated in Table 12 represent the ratings assigned by the domestic rating agencies. In the case of exposures toward debt securities issued by foreign Central Governments and foreign corporates, the haircut may be based on ratings of the international rating agencies, as indicated in Table 13.

(iv) Sovereign will include the Reserve Bank and DICGC which are eligible for zero per cent risk weight. Guarantees issued by CGTMSE, CRGFTLIH and individual schemes under NCGTC shall also be included under Sovereign.

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

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

**Table 12: Standard Supervisory Haircuts for Sovereign and other securities which constitute Exposure and Collateral**

| Sl. No. | | Issue Rating for Debt securities | Residual Maturity (in years) | Haircut (in percentage) |
|---|---|---|---|---|
| **A** | **Securities issued / guaranteed by the Government of India and issued by the State Governments (Sovereign securities)** | | | |
| | I | Rating not applicable – as Government securities are not currently rated in India | ≤ 1 year | 0.5 |
| | | | > 1 year and ≤ 5 years | 2 |
| | | | > 5 years | 4 |
| **B** | **Domestic debt securities other than those indicated at Item No. A above including the securities guaranteed by Indian State Governments** | | | |
| | i | AAA to AA<br>A1 | ≤ 1 year | 1 |
| | | | > 1 year and ≤ 5 years | 4 |
| | | | > 5 years | 8 |

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

| | | | | |
|---|---|---|---|---|
| | ii | A to BBB<br>A2, A3 and<br>unrated bank securities as specified in section 10.3.5 (vii) of the circular | ≤ 1 year | 2 |
| | | | > 1 year and ≤ years | 6 |
| | | | > 5 years | 12 |
| | iii | Units of Mutual Funds | | Highest haircut applicable to any of the above securities, in which the eligible mutual fund {cf. section 10.3.5 (viii)} can invest |
| **C** | **Cash in the same currency** | | | 0 |
| **D** | **Gold** | | | 15 |
| | **Securitisation Exposures[71]** | | | |
| | i | AAA to AA | ≤ 1 year | 2 |
| | | | > 1 year and ≤ 5 years | 8 |
| | | | > 5 years | 16 |
| | ii | A to BBB<br>and<br>unrated bank securities as specified in section 10.3.5 (vii) of the circular | ≤ 1 year | 4 |
| | | | > 1 year and ≤ years | 12 |
| | | | > 5 years | 24 |

**Table 13: Standard Supervisory Haircut for Exposures and Collaterals which are obligations of foreign central sovereigns / foreign corporates**

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

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

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

$$H = \sum_i a_i H_i$$

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

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

(ix) **Adjustment for different holding periods:**

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

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

The haircut for the transactions with other than 10 business-days minimum holding period, as indicated above, will have to be adjusted by scaling up/down the haircut for 10 business–days indicated in the Table 12, as per the formula given in section 10.3.7 (xi) below.

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

In case a transaction has margining frequency different from daily margining assumed, the applicable haircut for the transaction will also need to be adjusted by using the formula given in section 10.3.7 (xi) below.

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

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

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

Where;

H = haircut

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

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

$T_M$ = minimum holding period for the type of transaction

**10.3.8 Capital Adequacy Framework for Repo-/Reverse Repo-style transactions.**

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

**(i) Treatment in the books of the borrower of funds:**

(a) Where an AIFI has borrowed funds by selling / lending or posting, as collateral, of securities, the 'Exposure' will be an off-balance sheet exposure equal to the 'market value' of the securities sold/lent as scaled up after applying appropriate haircut. For the purpose, the haircut as per Table 12 would be used as the basis which should be applied by using the formula in section 10.3.7 (xi), to reflect minimum (prescribed) holding period of five business-

days for repo-style transactions and the variations, if any, in the frequency of re-margining, from the daily margining assumed for the standard supervisory haircut. The 'off-balance sheet exposure' will be converted into 'balance sheet' equivalent by applying a credit conversion factor of 100 per cent, as per item 5 in **Table 8** (section 8.16).

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

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

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

**(ii) Treatment in the books of the AIFI of funds:**

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

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

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

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

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

**10.3.8.2** The formula in section 10.3.6 will be adapted as follows to calculate the capital requirements for transactions with bilateral netting agreements. The bilateral netting agreements shall meet the requirements set out in **Annex 17** (part A) of these guidelines.

$$E^* = \max \{0, [(\Sigma(E) - \Sigma(C)) + \Sigma (Es \times Hs) + \Sigma (Efx \times Hfx)]\}$$

where:

$E^*$ = the exposure value after risk mitigation

E = current value of the exposure

C = the value of the collateral received

Es = absolute value of the net position in a given security

Hs = haircut appropriate to Es

Efx = absolute value of the net position in a currency different from the settlement currency

Hfx = haircut appropriate for currency mismatch

The intention here is to obtain a net exposure amount after netting of the exposures and collateral and have an add-on amount reflecting possible price changes for the securities involved in the transactions and for foreign exchange risk if any. The net long or short

position of each security included in the netting agreement will be multiplied by the appropriate haircut. All other rules regarding the calculation of haircuts stated in sections 10.3.7 equivalently apply for AIFIs using bilateral netting agreements for repo-style transactions.

### 10.3.9 Collateralised OTC derivatives transactions

The calculation of the counterparty credit risk charge for an individual contract will be as follows:

counterparty charge = [(RC + add-on) – $C_A$] x r x 9%

where:

RC = the replacement cost,

add-on = the amount for potential future exposure calculated according to section 8.16.3.3,

$C_A$ = the volatility adjusted collateral amount under the comprehensive approach prescribed in sections 10.3.6-10.3.7 or zero if no eligible collateral is applied to the transaction, and

r = the risk weight of the counterparty.

When effective bilateral netting contracts are in place, RC will be the net replacement cost and the add-on will be $A_{Net}$ as calculated according to **Annex 17** (part B) and section 8.16.3.43. The haircut for currency risk (Hfx) should be applied when there is a mismatch between the collateral currency and the settlement currency. Even in the case where there are more than two currencies involved in the exposure, collateral and settlement currency, a single haircut assuming a 10-business day holding period scaled up as necessary depending on the frequency of mark-to-market will be applied.

## 10.4 Credit Risk Mitigation Techniques – On-Balance Sheet Netting

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

Where an AIFI,

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

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

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

(d) monitors and controls its roll-off risks.

it may use the net exposure of loans/advances and deposits as the basis for its capital adequacy calculation in accordance with the formula in **section 10.3.6**. Loans/advances are treated as exposure and deposits as collateral. The haircuts will be zero except when a currency mismatch exists. All the requirements contained in **sections 10.3.6 and 10.6** will also apply.

## 10.5 Credit Risk Mitigation Techniques - Guarantees

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

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

### 10.5.3 Operational requirements for guarantees eligible for being treated as a CRM

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

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

### 10.5.4 Additional operational requirements for guarantees eligible for being treated as a CRM

In addition to the legal certainty requirements in **section 10.2** above, in order for a guarantee to be recognised, the following conditions shall be satisfied:

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

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

(iii) Except as noted in the following sentence, the guarantee covers all types of payments the underlying obligor is expected to make under the documentation governing the transaction, for example notional amount, margin payments etc. Where a guarantee covers payment of principal only, interests and other uncovered payments should be treated as an unsecured amount in accordance with section 10.5.7.

### 10.5.5 Range of Eligible Guarantors (Counter-Guarantors)

Credit protection given by the following entities will be recognised:

(i) Sovereigns, sovereign entities (including BIS, IMF, European Central Bank and European Community as well as those MDBs referred to in **section 8.5**, ECGC and CGTMSE, CRGFTLIH), individual schemes under NCGTC which are backed by explicit Central Government Guarantee, banks and primary dealers with a lower risk weight than the counterparty.

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

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

(iv) In case of securitisation transactions, SPEs cannot be recognised as eligible guarantors.

### 10.5.6 Risk Weights

**10.5.6.1** The protected portion is assigned the risk weight of the protection provider. Exposures covered by State Government guarantees will attract a risk weight of 20 per cent. The uncovered portion of the exposure is assigned the risk weight of the underlying counterparty.
**Provided that** any CRM instrument from which CRM benefits like shifting of exposure/ risk weights etc., are not derived may not be counted as an exposure on the CRM provider.

**10.5.6.2** In case of non-fund based credit facilities provided to a person resident outside India where CRM benefits are not derived and the exposure is shifted to the non-resident person, such exposures to the non-resident person shall attract a minimum risk weight of 150%.

### 10.5.7 Proportional Cover

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

### 10.5.8 Currency Mismatches

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

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

Where;

G = nominal amount of the credit protection
$H_{FX}$ = haircut appropriate for currency mismatch between the credit protection and underlying obligation.

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

### 10.5.9 Sovereign Guarantees and Counter-Guarantees

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

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

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

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

### 10.5.10 ECGC Guaranteed Exposures:

Under the Export Credit insurance on Whole Turnover Basis, the guarantee/insurance cover given by ECGC for export credit exposures ranges between 50% and 75% for pre-shipment credit and 50% to 85% in case of post-shipment credit. However, the ECGC's total liability on account of default by the exporters is capped by an amount specified as Maximum Liability (ML). In this context, it is clarified that risk weight (as given in section 8.2.3 of this Chapter) applicable to the claims on ECGC should be capped to the ML amount specified in the whole turnover policy of the ECGC. The AIFIs are required to proportionately distribute the ECGC maximum liability amount to all individual export credits that are covered by the ECGC Policy. For the covered portion of individual export credits, the AIFIs may apply the risk weight applicable to claims on ECGC. For the remaining portion of individual export credit, the AIFIs may apply the risk weight as per the rating of the counter-party. The Risk Weighted Assets computation can be mathematically represented as under:

| | |
|---|---|
| *Size of individual export credit exposure i* | $A_i$ |
| *Size of individual covered export credit exposure i* | $B_i$ |
| *Sum of individual covered export credit exposures* | $\sum Bi$ |

*Where:*

*i = 1 to n, if total number of exposures is n*

*Maximum Liability Amount* *ML*

*Risk Weight of counter party for exposure i* $RW_i$

*RWA for ECGC Guaranteed Export Credit:*

$$\sum\left[\left(\frac{Bi}{\sum Bi} * ML * 20\%\right) + Ai - \left(\frac{Bi}{\sum Bi} * ML\right) * RWi\right]$$

## 10.6 Maturity Mismatch

**10.6.1** For the purpose of calculating risk-weighted assets, a maturity mismatch occurs when the residual maturity of collateral is less than that of the underlying exposure. Where there is a maturity mismatch and the CRM has an original maturity of less than one year, the CRM is not recognised for capital purposes. In other cases where there is a maturity mismatch, partial recognition is given to the CRM for regulatory capital purposes as detailed below in sections 10.6.2 to 10.6.4. In case of loans collateralised by the AIFI's own deposits, even if the tenor of such deposits is less than three months or deposits have maturity mismatch vis-à-vis the tenor of the loan, the provisions of section 10.6.1 regarding derecognition of collateral would not be attracted provided an explicit consent of the

depositor has been obtained from the depositor (i.e., borrower) for adjusting the maturity proceeds of such deposits against the outstanding loan or for renewal of such deposits till the full repayment of the underlying loan.

### 10.6.2 Definition of Maturity

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

### 10.6.3 Risk Weights for Maturity Mismatches

As outlined in section 10.6.1, collateral with maturity mismatches are only recognised when their original maturities are greater than or equal to one year. As a result, the maturity of collateral for exposures with original maturities of less than one year shall be matched to be recognised. In all cases, collateral with maturity mismatches will no longer be recognised when they have a residual maturity of three months or less.

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

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

where:

Pa = value of the credit protection adjusted for maturity mismatch

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

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

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

### 10.7 Treatment of pools of CRM Techniques

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

## 11. Capital Charge for Market Risk

### 11.1 Introduction

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

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

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

## 11.2 Scope and Coverage of Capital Charge for Market Risks

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

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

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

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

## 11.3 Measurement of Capital Charge for Interest Rate Risk

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

**11.3.2** The capital charge for interest rate related instruments would apply to current market value of these items in AIFI's trading book. Since it is necessary to maintain capital for market risks on an ongoing basis, the trading position should be marked to market on a daily basis. The current market value will be determined as per extant the Reserve Bank guidelines on valuation of investments.

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

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

(a) Specific risk capital charge, computed notionally for the AFS securities treating them as held under HFT category (as computed according to Table 14: Part A / C / E(i) / F / G, as applicable) plus the General Market Risk Capital Charge.

(b) Alternative total capital charge for the AFS category computed notionally treating them as held in the banking book (as computed in accordance with Table 14: Part B / D / E(ii) / F / H, as applicable)

### 11.3.5 Specific Risk

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

| Sr. No. | Nature of debt securities / issuer | Table to be followed |
|---|---|---|
| a. | Central, State and Foreign Central Governments' Bonds:<br>(i) Held in HFT category<br>(ii) Held in AFS category | <br><br>Table 14 – Part A<br>Table 14 – Part B |
| b. | Banks' Bonds:<br>(i) Held in HFT category<br>(ii) Held in AFS category | <br><br>Table 14 – Part C<br>Table 14 – Part D |
| c. | Corporate Bonds (other than Bank Bonds):<br>(i) Held in HFT category<br>(ii) Held in AFS category | <br><br>Table 14 – Part E(i)<br>Table 14 – Part E(ii) |
| d. | Debt mutual fund / exchange traded fund* (ETF) with underlying comprising of<br>(i) Central, State and Foreign Central Governments' bonds<br>(ii) Banks' Bonds and<br>(iii) Corporate Bonds (other than Banks' Bonds) | <br><br>Table 14 – Part B<br><br>Table 14 – Part D<br>Table 14 – Part E(ii) |
| e. | Securitisation ExposureHeld in HFT and AFS categories after September 24, 2021<br>Securitisation ExposureHeld in HFT and AFS categories before September 24, 2021 | Table 14 – Part F<br><br>Table 14 – Part G |
| f. | Non-common Equity Capital Instruments issued by Financial Entities other than Banks<br>(i) Held in HFT category<br>(ii) Held in AFS category | <br><br>Table 14 – Part H<br>Table 14 – Part I |
| g. | Equity Investments in Banks<br>Held in HFT and AFS Categories | <br>Table 17 – Part A |
| h. | Equity Investments in Financial Entities (other than Banks)<br>Held in HFT and AFS Categories | <br><br>Table 17 – Part B |
| i. | Equity Investments in Non-financial (commercial) Entities | Table 17 – Part C |

*Note: In case of debt mutual fund / ETF which contains a mix of the above debt instruments, the specific risk capital charge shall be computed based on the lowest rated debt instrument/ instrument attracting the highest specific risk capital charge in the fund. Debt mutual fund / ETF for which constituent debt details are not available, at least as of each month-end, shall continue to be treated on par with equity for computation of capital charge for market risk as prescribed in paragraph 11.4.

**Table 14 – Part A: Specific Risk Capital Charge for Sovereign securities issued by Indian and foreign sovereigns – Held by AIFIs under the HFT Category**

| Sr. No. | Nature of Investment | Residual Maturity | Specific risk capital (as % of exposure) |
|---|---|---|---|
| **A.** | **Indian Central Government and State Governments** | | |

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

**Table 14 – Part B: Alternative Total Capital Charge for securities issued by Indian and foreign sovereigns - Held by AIFIs under the AFS Category**

| Sr. No. | Nature of Investment | Residual Maturity | Specific risk capital (as % of exposure) |
|---|---|---|---|
| **A.** | **Indian Central Government and State Governments** | | |
| 1. | Investment in Central and State Government Securities | All | 0.00 |
| 2. | Investments in other approved securities guaranteed by Central Government | All | 0.00 |
| 3. | Investments in other approved securities guaranteed by State Government | All | 1.80 |
| 4. | Investment in other securities where payment of interest and repayment of principal are guaranteed by Central Government | All | 0.00 |

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

**Table 14 - Part C: Specific risk capital charge for bonds issued by banks – Held by AIFIs under the HFT category**

| | Residual maturity | Specific risk capital charge (%) | | | |
|---|---|---|---|---|---|
| | | All Scheduled Banks (Commercial Banks, Regional Rural Banks, Local Area Banks and Co-operative Banks) | | All Non-Scheduled Banks (Commercial Banks, Regional Rural Banks, Local Area Banks and Co-operative Banks) | |
| Level of Common Equity Tier 1 capital (CET1) including applicable capital conservation buffer (CCB) (%) of the investee bank under Basel III/Total Capital of other banks (where applicable) | | Investments in capital instruments (other than equity[#]) referred to in section 8.6.1(i) | All other claims | Investments in capital instruments (other than equity[#]) referred to in section 8.6.1(i) | All other Claims |
| 1 | 2 | 3 | 4 | 5 | 6 |
| **For banks which are under Basel III Capital Regulations** | | | | | |
| Applicable Minimum CET1 + Applicable CCB and above | ≤6 months | 1.75 | 0.28 | 1.75 | 1.75 |
| | > 6 months and ≤ 24 months | 7.06 | 1.13 | 7.06 | 7.06 |
| | >24 months | 11.25 | 1.8 | 11.25 | 11.25 |
| Applicable Minimum CET1 + CCB = 75% and <100% of applicable CCB | All Maturities | 13.5 | 4.5 | 22.5 | 13.5 |
| Applicable Minimum CET1 + CCB = 50% and <75% of applicable CCB | All Maturities | 22.5 | 9 | 31.5 | 22.5 |
| Applicable Minimum CET1 + CCB = 0% | All Maturities | 31.5 | 13.5 | 56.25 | 31.5 |

| | Residual maturity | Specific risk capital charge (%) | | | |
|---|---|---|---|---|---|
| | | All Scheduled Banks (Commercial Banks, Regional Rural Banks, Local Area Banks and Co-operative Banks) | | All Non-Scheduled Banks (Commercial Banks, Regional Rural Banks, Local Area Banks and Co-operative Banks) | |
| and <50% of applicable CCB | | | | | |
| Minimum CET1 less than applicable minimum | All Maturities | 56.25 | 56.25 | Full deduction* | 56.25 |
| **For banks which are not under Basel III Capital Regulations** | | | | | |
| 9 and above | ≤6 months | 1.75 | 0.28 | 1.75 | 1.75 |
| | > 6 months and ≤ 24 months | 7.06 | 1.13 | 7.06 | 7.06 |
| | >24 months | 11.25 | 1.8 | 11.25 | 11.25 |
| 6 to < 9 | All Maturities | 13.5 | 4.5 | 22.5 | 13.5 |
| 3 to < 6 | All Maturities | 22.5 | 9 | 31.5 | 22.5 |
| 0 to < 3 | All Maturities | 31.5 | 13.5 | 56.25 | 31.5 |
| Negative | All Maturities | 56.25 | 56.25 | Full deduction* | 56.25 |

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

# refer to section 11.4.4 below for specific risk capital charge on equity instruments.

**Notes:**

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

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

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

1.4*125% =1.75

**Table 14 – Part D: Alternative Total Capital Charge for bonds issued by banks – Held by AIFIs under AFS category (subject to the conditions stipulated in section 11.3.4)**

| | Specific risk capital charge (%) | | | |
|---|---|---|---|---|
| | All Scheduled Banks (Commercial Banks, Regional Rural Banks, Local Area Banks and Co-operative Banks) | | All Non-Scheduled Banks (Commercial Banks, Regional Rural Banks, Local Area Banks and Co-Operative Banks) | |
| Level of Common Equity Tier 1 capital (CET1) including applicable capital conservation buffer (CCB) (%) of the investee bank under Basel III/Total Capital of other banks (where applicable)) | Investments in capital instruments (other than equity[#]) referred to in section 8.6.1(i) | All other claims | Investments in capital instruments (other than equity[#]) referred to in section 8.6.1(i) | All other claims |
| 1 | 2 | 3 | 4 | 5 |
| **For banks which are under Basel III Capital Regulations** | | | | |
| Applicable Minimum CET1 + Applicable CCB and above | 11.25 | 1.8 | 11.25 | 11.25 |
| Applicable Minimum CET1 + CCB = 75% and <100% of applicable CCB | 13.5 | 4.5 | 22.5 | 13.5 |
| Applicable Minimum CET1 + CCB = 50% and <75% of applicable CCB | 22.5 | 9 | 31.5 | 22.5 |
| Applicable Minimum CET1 + CCB = 0% and <50% of applicable CCB | 31.5 | 13.5 | 56.25 | 31.5 |
| Minimum CET1 less than applicable minimum | 56.25 | 56.25 | Full deduction* | 56.25 |
| **For banks which are not under Basel III Capital Regulations** | | | | |
| 9 and above | 11.25 | 1.8 | 11.25 | 11.25 |
| 6 to < 9 | 13.5 | 4.5 | 22.5 | 13.5 |
| 3 to < 6 | 22.5 | 9 | 31.5 | 22.5 |
| 0 to < 3 | 31.5 | 13.5 | 56.25 | 31.5 |
| Negative | 56.25 | 56.25 | Full deduction* | 56.25 |

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

\# refer to section 11.4.4 below for specific risk capital charge on equity instruments

**Notes:**

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

(ii) In case of banks where capital adequacy norms are not applicable at present, the matter of investments in their capital-eligible instruments would not arise for now. However,

the Table above will become applicable to them, if in future they issue any capital instruments where AIFIs are eligible to invest.

**Table 14 – Part E (i)[72]: Specific Risk Capital Charge for Corporate Bonds (Other than bank bonds) – Held by AIFIs under HFT Category**

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

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

**Table 14 – Part E (ii): Alternative Total Capital Charge for Corporate Bonds (Other than bank bonds) – Held by AIFIs under AFS Category**

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

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

**Table 14 – Part F: Specific Risk Capital Charge for Securitisation Exposures – Held by AIFIs under HFT and AFS Category**

For securitisation transactions undertaken subsequent to the issuance of Master Direction – Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021 dated September 24, 2021, specific risk capital requirement of securitisation exposures that are held under HFT and AFS Category shall be calculated according to the revised method as set out in Master Direction *ibid*. Accordingly, an AIFI shall calculate the specific risk capital requirement applicable to each securitisation exposure in trading book by dividing the risk weight calculated as if it were held in the banking book by 11.11, subject to a cap on specific risk capital requirement of 100 per cent.

For transactions undertaken before issuance of the aforementioned Directions, i.e., prior to September 24, 2021, the treatment of securitisation exposures for capital adequacy would be as per Table 14 – Part G provided below.

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

**Table 14 – Part G: Specific Risk Capital Charge for transactions in Securitisation Exposures prior to September 24, 2021 – Held by AIFIs under HFT and AFS Category**

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

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

**Table–14 - Part H: Specific risk capital charge for non-common equity capital instruments issued by financial entities other than banks – Held by AIFIs under the HFT category**

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

* Investments falling under section 8.6.1 (ii) will be deducted following corresponding deduction approach

**Table–14 - Part I: Alternative Total Capital Charge for non-common equity capital instruments issued by financial entities other than banks - Held by AIFIs under the AFS category**

| | Specific risk capital charge (%) |
|---|---|
| | Investments in non- common equity capital instruments of financial entities other than banks referred to in section 8.6.1(i) |
| 1 | 2 |
| Specific risk charge | 11.25 |

**11.3.5.2** AIFIs shall, in addition to computing the counterparty credit risk (CCR) charge for OTC derivatives, as part of capital for credit risk as per the Standardised Approach covered in section 8 above, also compute the specific risk charge for OTC derivatives in the trading book as required in terms of **Annex 8**.

### 11.3.6 General Market Risk

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

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

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

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

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

**11.3.6.2** Separate maturity ladders should be used for each currency and capital charges should be calculated for each currency separately and then summed with no offsetting between positions of opposite sign. In the case of those currencies in which business is insignificant (where the turnover in the respective currency is less than 5 per cent of overall foreign exchange turnover), separate calculations for each currency are not required. The AIFI may, instead, slot within each appropriate time-band, the net long or short position for each currency. However, these individual net positions are to be summed within each time-band, irrespective of whether they are long or short positions, to produce a gross position figure. The gross positions in each time-band will be subject to the assumed change in yield set out in Table-15 with no further offsets.

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

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

(ii) next apply the assumed change in yield to the modified duration of each instrument between 0.6 and 1.0 percentage points depending on the maturity of the instrument (see **Table 15)**;

(iii) slot the resulting capital charge measures into a maturity ladder with the fifteen time bands as set out in **Table 15**;

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

(v) carry forward the net positions in each time-band for horizontal offsetting subject to the disallowances set out in **Table 16**.

**Table–15 - Duration Method – Time Bands and Assumed changes in Yield**

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

**Table–16 - Horizontal Disallowances**

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

**11.3.6.4** The measurement system should include all interest rate derivatives and off balance-sheet instruments in the trading book which react to changes in interest rates, (e.g., forward rate agreements (FRAs), other forward contracts, bond futures, interest rate and cross-currency swaps and forward foreign exchange positions). Options can be treated in a variety of ways as described in **Annex 8**.

### 11.4 Measurement of Capital Charge for Equity Risk

**11.4.1** The capital charge for equities would apply on their current market value in AIFI's trading book. Minimum capital requirement to cover the risk of holding or taking positions in equities in the trading book is set out below. This is applied to all instruments that exhibit market behaviour similar to equities but not to non-convertible preference shares (which are covered by the interest rate risk requirements described earlier). The instruments covered include equity shares, whether voting or non-voting, convertible securities that behave like equities, for example: units of mutual funds (other than debt mutual funds/ETFs mentioned in section 11.3.5), and commitments to buy or sell equity.

**Specific and General Market Risk**

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

**11.4.3** Specific Risk Capital Charge for investment in Security Receipts will be 13.5 per cent (equivalent to 150 per cent risk weight). Since the Security Receipts are by and large illiquid and not traded in the secondary market, there will be no General Market Risk Capital Charge on them.

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

**Table 17 – Part A: Specific risk charge for AIFI's investments in the equity of banks held in HFT and AFS portfolios**

| Level of Common Equity Tier 1 capital (CET1) including applicable capital conservation buffer (CCB) (%) of the investee bank under Basel III/Total Capital for other banks (where applicable) | All Scheduled Banks (Commercial Banks, Regional Rural Banks, Local Area Banks and Co-operative Banks) | | All Non-scheduled Banks (Commercial Banks, Local Area Banks and Co-operative Banks) (in %) | |
|---|---|---|---|---|
| | Equity investments in banks referred to in: | | Equity investments in banks referred to in: | |
| | section 8.6.1(i) | section 8.6.1(ii) | section 8.6.1(i) | section 8.6.1(ii) |
| **For banks which are under Basel III Capital Regulations** | | | | |
| Applicable Minimum CET1 + Applicable CCB and above | 11.25 | 22.5 | 11.25 | 27 |
| Applicable Minimum CET1 + CCB = 75% and <100% of applicable CCB | 13.5 | 27 | 22.5 | 31.5 |
| Applicable Minimum CET1 + CCB = 50% and <75% of applicable CCB | 22.5 | 31.5 | 31.5 | 40.5 |
| Applicable Minimum CET1 + CCB = 0% and <50% of applicable CCB | 31.5 | 40.5 | 56.25 | Full deduction* |
| Minimum CET1 less than applicable minimum | 50 | Full deduction* | Full deduction* | Full deduction* |
| **For banks which are not under Basel III Capital Regulations** | | | | |
| 9 and above | 11.25 | 22.5 | 11.25 | 27 |
| 6 to < 9 | 13.5 | 27 | 22.5 | 31.5 |
| 3 to < 6 | 22.5 | 31.5 | 31.5 | 40.5 |
| 0 to < 3 | 31.5 | 40.5 | 56.25 | Full deduction* |
| Negative | 50 | Full | Full | Full |

| Level of Common Equity Tier 1 capital (CET1) including applicable capital conservation buffer (CCB) (%) of the investee bank under Basel III/Total Capital for other banks (where applicable) | All Scheduled Banks (Commercial Banks, Regional Rural Banks, Local Area Banks and Co-operative Banks) | | All Non-scheduled Banks (Commercial Banks, Local Area Banks and Co-operative Banks) (in %) | |
|---|---|---|---|---|
| | | deduction* | deduction* | deduction* |

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

**Table 17 – Part B: Specific risk charge for AIFI's investments in the equity of financial entities other than banks**

| | Equity investments in financial entities other than banks referred to in: | |
|---|---|---|
| | section 8.6.1(i) | Section 8.6.1(ii) |
| Specific risk charge (%) | 11.25 | 22.5 |

**Table 17 – Part C: Specific risk charge for AIFI's investments in the equity of non-financial (commercial) entities**

| | Equity investments in non-financial entities | |
|---|---|---|
| | where an AIFI does not own more than 10% of the equity capital of investee companies | which are more than 10% of the equity capital of investee companies or which are affiliates of the AIFI (these exposures need not attract general market risk charge) |
| Specific risk charge (%) | 11.25 | 100 |

### 11.5 Measurement of Capital Charge for Foreign Exchange Risk

The AIFI's net open position in each currency should be calculated by summing:

(i) The net spot position (i.e., all asset items less all liability items, including accrued interest, denominated in the currency in question);

(ii) The net forward position (i.e., all amounts to be received less all amounts to be paid under forward foreign exchange transactions, including currency futures and the principal on currency swaps not included in the spot position);

(iii) Guarantees (and similar instruments) that are certain to be called and are likely to be irrecoverable;

(iv) Net future income/expenses not yet accrued but already fully hedged (at the discretion of the reporting AIFI);

(v) Depending on particular accounting conventions in different countries, any other item representing a profit or loss in foreign currencies;

(vi) The net delta-based equivalent of the total book of foreign currency options

Foreign exchange open positions and gold open positions are at present risk-weighted at 100 per cent. Thus, capital charge for market risks in foreign exchange and gold open position is 9 per cent. These open positions, **limits or actual whichever is higher,** would continue to attract capital charge at 9 per cent. This capital charge is in addition to the capital charge for credit risk on the on-balance sheet and off-balance sheet items pertaining to foreign exchange and gold transactions.

### 11.6 Measurement of Capital Charge for Credit Default Swap (CDS) in the Trading Book

#### 11.6.1 General Market Risk

A credit default swap does not normally create a position for general market risk for either the protection buyer or protection seller. However, the present value of premium payable / receivable is sensitive to changes in the interest rates. In order to measure the interest rate risk in premium receivable / payable, the present value of the premium can be treated as a notional position in Government securities of relevant maturity. These positions will attract appropriate capital charge for general market risk. The protection buyer / seller will treat the present value of the premium payable / receivable equivalent to a short / long notional position in Government securities of relevant maturity.

#### 11.6.2 Specific Risk for Exposure to Reference Entity

**11.6.2.1** A CDS creates a notional long / short position for specific risk in the reference asset / obligation for protection seller / protection buyer. For calculating specific risk capital charge, the notional amount of the CDS and its maturity should be used. The specific risk capital charge for CDS positions will be as per Tables below.

**Table 18: Specific Risk Capital Charges for bought and sold CDS positions in the Trading Book: Exposures to entities other than Commercial Real Estate Companies**

| Upto 90 days | | | After 90 days | |
|---|---|---|---|---|
| **Ratings by the ECAI*** | **Residual Maturity of the instrument** | **Capital charge** | **Ratings by the ECAI*** | **Capital charge** |
| AAA to BBB | 6 months or less | 0.28 % | AAA | 1.8 % |
| | Greater than 6 months and up to and including 24 months | 1.14% | AA | 2.7% |
| | Exceeding 24 months | 1.80% | A | 4.5% |
| | | | BBB | 9.0% |
| BB and below | All maturities | 13.5% | BB and below | 13.5% |
| Unrated (if permitted) | All maturities | 9.0% | Unrated (if permitted) | 9.0% |

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

**Table 19: Specific Risk Capital Charges for bought and sold CDS positions in the Trading Book : Exposures to Commercial Real Estate Companies#**

| Ratings by the ECAI* | Residual Maturity of the instrument | Capital charge |
|---|---|---|
| AAA to BBB | 6 months or less | 1.4% |
| | Greater than 6 months and up to and including 24 months | 7.7% |
| | Exceeding 24 months | 9.0% |
| BB and below | All maturities | 9.0% |
| Unrated (if permitted) | All maturities | 9.0% |

# The above table will be applicable for exposures up to 90 days. Capital charge for exposures to Commercial Real Estate Companies beyond 90 days shall be taken at 9.0%, regardless of rating of the reference / deliverable obligation.
* These ratings indicate the ratings assigned by Indian rating agencies / ECAIs or foreign rating agencies. In the case of foreign ECAIs, the rating symbols used here correspond to Standard and Poor. The modifiers "+" or "-" have been subsumed within the main category.

#### *11.6.2.2 Specific Risk Capital Charges for Positions Hedged by CDS[73]*

(i) AIFIs may fully offset the specific risk capital charges when the values of two legs (i.e., long and short in CDS positions) always move in the opposite direction and broadly to the same extent. This would be the case when the two legs consist of **completely identical CDS**. In these cases, no specific risk capital requirement applies to both sides of the CDS positions.

(ii) AIFIs may offset 80 per cent of the specific risk capital charges when the value of two legs (i.e., long and short) always moves in the opposite direction but not broadly to the same extent. This would be the case when a long cash position is hedged by a credit default swap and there is an exact match in terms of the reference / deliverable obligation, and the maturity of both the reference / deliverable obligation and the CDS. In addition, key features of the CDS (e.g., credit event definitions, settlement mechanisms) should not cause the price movement of the CDS to materially deviate from the price movements of the cash position. To the extent that the transaction transfers risk, an 80% specific risk offset will be applied to the side of the transaction with the higher capital charge, while the specific risk requirement on the other side will be zero.

(iii) AIFIs may offset partially the specific risk capital charges when the value of the two legs (i.e. long and short) usually moves in the opposite direction. This would be the case in the following situations:

(a) The position is captured in section 11.6.2.2(ii) but there is an asset mismatch between the cash position and the CDS. However, the underlying asset is included in the (reference / deliverable) obligations in the CDS documentation and meets the requirements in section 8.18.3(i) above.

(b) The position is captured in section 11.6.2.2(ii) but there is maturity mismatch between credit protection and the underlying asset. However, the underlying asset is included in the (reference/ deliverable) obligations in the CDS documentation.

(c) In each of the cases in clauses (a) and (b) above, rather than applying specific risk capital requirements on each side of the transaction (i.e., the credit protection and the underlying asset), only higher of the two capital requirements will apply.

#### 11.6.2.3 *Specific Risk Charge in CDS Positions which are not meant for Hedging*

In cases not captured in section 11.6.2.2, a specific risk capital charge will be assessed against both sides of the positions.

### 11.6.3 Capital Charge for Counterparty Credit Risk

The credit exposure for the purpose of counterparty credit risk on account of CDS transactions in the Trading Book will be calculated according to the Current Exposure

[73] Please refer to paragraph 6.2 of **Annex 6** of these guidelines for details.

Method[74].

#### 11.6.3.1 Protection *Seller*

A protection seller will have exposure to the protection buyer only if the fee/premia is outstanding. In such cases, the counterparty credit risk charge for all single name long CDS positions in the Trading Book will be calculated as the sum of the current marked-to-market value, if positive (zero, if marked-to-market value is negative) and the potential future exposure add-on factors based on table given below. However, for protection seller where the CDS positions are outside netting and margin agreements, the add-on will be capped to the amount of unpaid premia. AIFIs have the option to remove such CDS positions from their legal netting sets and treat them as individual unmargined transactions in order to apply the cap.

| **Table 20: Add-on Factors for Protection Sellers** | |
|---|---|
| | (As % of Notional Principal of CDS) |
| **Type of Reference Obligation** | **Add-on Factor** |
| Obligations rated BBB- and above | 10% |
| Below BBB- and unrated | 20% |

#### 11.6.3.2 Protection Buyer

A CDS contract creates a counterparty exposure on the protection seller on account of the credit event payment. The counterparty credit risk charge for all short CDS positions in the Trading Book will be calculated as the sum of the current marked-to-market value, if positive (zero, if marked-to-market value is negative) and the potential future exposure add-on factors based on table given below:

| **Table 21: Add-on Factors for Protection Buyers** | |
|---|---|
| | (As % of Notional Principal of CDS) |
| **Type of Reference Obligation** | **Add-on Factor** |
| Obligations rated BBB- and above | 10% |
| Below BBB- and unrated | 20% |

#### 11.6.3.3 Capital Charge for Counterparty Risk for Collateralised Transactions in CDS

As mentioned in paragraph 3.3 of the circular IDMD.PCD.No.10/14.03.04/2012-13 dated January 7, 2013, collaterals and margins would be maintained by the individual market

[74] A CDS contract, which is required to be marked-to-market, creates bilateral exposure for the parties to the contract. The mark-to-market value of a CDS contract is the difference between the default-adjusted present value of protection payment (called “protection leg” / “credit leg”) and the present value of premium payable called (“premium leg”). If the value of credit leg is less than the value of the premium leg, then the marked-to-market value for the protection seller in positive. Therefore, the protection seller will have exposure to the counterparty (protection buyer) if the value of premium leg is more than the value of credit leg. In case, no premium is outstanding, the value of premium leg will be zero and the mark-to-market value of the CDS contract will always be negative for the protection seller and therefore, protection seller will not have any exposure to the protection buyer. In no case, the protection seller’s exposure on protection buyer can exceed the amount of the premium unpaid. For the purpose of capital adequacy as well as exposure norms, the measure of counterparty exposures in case of CDS transaction held in Trading Book is the Potential Future Exposure (PFE) which is measured and recognised as per Current Exposure Method.

participants. The counterparty exposure for CDS traded in the OTC market will be calculated as per the Current Exposure Method. Under this method, the calculation of the counterparty credit risk charge for an individual contract, taking into account the collateral, will be as follows:

Counterparty risk capital charge = [(RC + add-on) – CA] x r x 9%

Where;

RC = the replacement cost,

add-on = the amount for potential future exposure calculated according to section 11.6.3 above.

CA = the volatility adjusted amount of eligible collateral under the comprehensive approach prescribed in section 10.3 on "Credit Risk Mitigation Techniques - Collateralised Transactions" of these guidelines, or zero if no eligible collateral is applied to the transaction, and

r = the risk weight of the counterparty.

### 11.6.4 Treatment of Exposures below Materiality Thresholds of CDS

Materiality thresholds on payments below which no payment is made in the event of loss are equivalent to retained first loss positions and should be assigned risk weight of 1250 per cent for capital adequacy purpose by the protection buyer.

## 11.7 Aggregation of the capital charge for Market Risks

As explained earlier capital charges for specific risk and general market risk are to be computed separately before aggregation. For computing the total capital charge and Risk Weighted Assets for market risks, the calculations may be plotted in the following table:

**Proforma**

(₹. in crore)

| Risk Category | Capital charge | Risk Weighted Assets (RWA) |
|---|---|---|
| I. **Interest Rate (a+b)** | | 12.5 times the capital charge |
| a. General market risk | | |
| i) Net position (parallel shift)<br>ii) Horizontal disallowance (curvature)<br>iii) Vertical disallowance (basis)<br>iv) Options | | |
| b. Specific risk | | |
| II. **Equity (a+b)** | | 12.5 times the capital charge |
| a. General market risk | | |
| b. Specific risk | | |
| III. **Foreign Exchange and Gold** | | 12.5 times the capital charge |
| IV. **Total capital charge and RWA for market risks** (I+II+III) | | |

## 11.8 Treatment for Illiquid Positions

### 11.8.1 Prudent Valuation Guidance

(i) This section provides AIFIs with guidance on prudent valuation for positions that are accounted for at fair value. This guidance would be applicable to all positions enumerated in **section 11.2.1** above. It is especially important for positions without actual market prices or observable inputs to valuation, as well as less liquid positions which raise supervisory concerns about prudent valuation. The valuation guidance set forth below is not intended to require AIFIs to change valuation procedures for financial reporting purposes.

(ii) A framework for prudent valuation practices should at a minimum include the following:

#### *11.8.1.1 Systems and Controls:*

AIFIs shall establish and maintain adequate systems and controls sufficient to give management and supervisors the confidence that their valuation estimates are prudent and reliable. These systems shall be integrated with other risk management systems within the organisation (such as credit analysis). Such systems shall include:

(i) Documented policies and procedures for the process of valuation. This includes clearly defined responsibilities of the various areas involved in the determination of the valuation, sources of market information and review of their appropriateness, guidelines for the use of unobservable inputs reflecting the AIFI's assumptions of what market participants would use in pricing the position, frequency of independent valuation, timing of closing prices, procedures for adjusting valuations, end of the month and ad-hoc verification procedures; and

(ii) Clear and independent (i.e., independent of front office) reporting lines for the department accountable for the valuation process.

#### 11.8.1.2 *Valuation Methodologies*:

**(i) Marking to Market**

(a) Marking-to-market is at least the daily valuation of positions at readily available close out prices in orderly transactions that are sourced independently. Examples of readily available close out prices include exchange prices, screen prices, or quotes from several independent reputable brokers.

(b) AIFIs shall mark-to-market as much as possible. The more prudent side of bid/offer should be used unless the institution is a significant market maker in a particular position type and it can close out at mid-market. AIFIs should maximise the use of relevant observable inputs and minimise the use of unobservable inputs when estimating fair value using a valuation technique. However, observable inputs or transactions may not be relevant, such as in a forced liquidation or distressed sale, or transactions may not be observable, such as when markets are inactive. In such cases, the observable data should be considered, but may not be determinative.

**(ii) Marking to Model**

(a) Marking-to model is defined as any valuation which has to be benchmarked, extrapolated or otherwise calculated from a market input. Where marking-to-market is not possible, AIFIs should follow Reserve Bank's extant guidelines on valuation of investments prescribed in Chapter V of these Directions. For investment and derivative positions other than those covered in the Reserve Bank's instructions, the valuation model used by AIFIs shall be demonstrated to be prudent. When marking to valuation model other than that prescribed in the Reserve Bank / FIMMDA guidelines, an extra degree of conservatism is

appropriate. the Reserve Bank will consider the following in assessing whether a mark-to-model valuation is prudent:

- Senior management should be aware of the elements of the trading book or of other fair-valued positions which are subject to mark to model and should understand the materiality of the uncertainty this creates in the reporting of the risk/performance of the business.

- Market inputs should be sourced, to the extent possible, in line with market prices (as discussed above). The appropriateness of the market inputs for the particular position being valued should be reviewed regularly.

- Where available, generally accepted valuation methodologies for particular products should be used as far as possible.

- Where the model is developed by the institution itself, it should be based on appropriate assumptions, which have been assessed and challenged by suitably qualified parties independent of the development process. The model should be developed or approved independently of the front office. It should be independently tested. This includes validating the mathematics, the assumptions and the software implementation.

- There should be formal change control procedures in place and a secure copy of the model should be held and periodically used to check valuations.

- Risk management function/ department should be aware of the weaknesses of the models used and how best to reflect those in the valuation output.

- The model should be subject to periodic review to determine the accuracy of its performance (e.g., assessing continued appropriateness of the assumptions, analysis of P&L versus risk factors, comparison of actual close out values to model outputs).

- Valuation adjustments should be made as appropriate, for example, to cover the uncertainty of the model valuation (see also valuation adjustments in sections 11.8.1.2 (iv) and 11.8.2.1 to 11.8.2.4.)

**(iii) Independent Price Verification**

(a) Independent price verification is distinct from daily mark-to-market. It is the process by which market prices or model inputs are regularly verified for accuracy. While daily marking-to-market may be performed by dealers, verification of market prices or model inputs should be performed by a unit independent of the dealing room, at least monthly (or, depending on the nature of the market/trading activity, more frequently). It need not be performed as frequently as daily mark-to-market, since the objective, i.e., independent, marking of positions should reveal any error or bias in pricing, which should result in the elimination of inaccurate daily marks.

(b) Independent price verification entails a higher standard of accuracy in that the market prices or model inputs are used to determine profit and loss figures, whereas daily market prices are used primarily for management reporting in between reporting dates. For independent price verification, where pricing sources are more subjective, e.g., only one available broker quote, prudent measures such as valuation adjustments may be appropriate.

**(iv) Valuation Adjustments**

(a) As part of their procedures for marking to market, AIFIs shall establish and maintain procedures for considering valuation adjustments. the Reserve Bank would particularly expect AIFIs using third-party valuations to consider whether valuation adjustments are necessary. Such considerations are also necessary when marking to model.

(b) At a minimum, AIFIs should consider the following valuation adjustments while valuing their derivatives portfolios:

- incurred CVA losses[75],
- closeout costs,
- operational risks,
- early termination, investing and funding costs, and
- future administrative costs and,
- where appropriate, model risk.

AIFIs may follow any recognised method/model to compute the above adjustments except provisions against incurred CVA losses. However, AIFIs may use the following formula to calculate incurred CVA loss on derivatives transactions:

$$ICVAL_t = Max\ [0,\{(EE_t * RP_t) - (EE_0 * RP_0)\}]$$

Where;

$ICVAL_t$ = Cumulative Incurred CVA loss at time 't'.

$EE_t$ = Value of counterparty exposure projected after one year from 't' and discounted back to 't' using CEM and a risk free discount rate for one year

$EE_0$ = Counterparty exposure estimated at time '0' using CEM

$RP_t$ = Credit spread of the counterparty as reflected in the CDS or bond prices.

In cases where market based credit spreads are not available, risk premium applicable to the counterparty according to its credit grade as per the internal credit rating system of the AIFI used for pricing/loan approval purposes at time 't' may be used.

$RP_0$ = Credit spread of the counterparty as reflected in the CDS or bond prices.

In cases where market based credit spreads are not available, risk premium applicable to the counterparty according to its credit grade as per the internal credit rating system of the AIFI used for pricing / loan approval purposes at time '0' i.e., the date of the transaction.

**Note:** Some of other terms used above are explained below:

**Close-out costs**

Close-out costs adjustment factors in the cost of eliminating the market risk of the portfolio.

[75] Provisions against incurred CVA losses are akin to specific provisions required on impaired assets and depreciation in case of investments held in the trading book. These provisions will be in addition to the general provisions @ 0.4% required on the positive MTM values. The provisions against incurred CVA losses may be netted off from the exposure value while calculating capital charge for default risk under the Current Exposure Method as required in terms of section 8.16.3.3 (ii).

**Investing and Funding costs**

The "investing and funding costs adjustment" relating to the cost of funding and investing cash flow mismatches at rates different from the rate which models typically assume.

**Administrative costs adjustment**

Administrative costs adjustment relates to the costs that will be incurred to administer the portfolio.

**11.8.2 Adjustment to the current valuation of less liquid positions for regulatory capital purposes:**

**11.8.2.1** AIFIs shall establish and maintain procedures for judging the necessity of and calculating an adjustment to the current valuation of less liquid positions for regulatory capital purposes. This adjustment may be in addition to any changes to the value of the position required for financial reporting purposes and should be designed to reflect the illiquidity of the position. An adjustment to a position's valuation to reflect current illiquidity should be considered whether the position is marked to market using market prices or observable inputs, third-party valuations or marked to model.

**11.8.2.2** Bearing in mind that the assumptions made about liquidity in the market risk capital charge may not be consistent with the AIFI's ability to sell or hedge out less liquid positions where appropriate, AIFIs shall take an adjustment to the current valuation of these positions, and review their continued appropriateness on an on-going basis. Reduced liquidity may have arisen from market events. Additionally, close-out prices for concentrated positions and/or stale positions should be considered in establishing the adjustment. The Reserve Bank has not prescribed any particular methodology for calculating the amount of valuation adjustment on account of illiquid positions. AIFIs shall consider all relevant factors when determining the appropriateness of the adjustment for less liquid positions. These factors may include, but are not limited to, the amount of time it would take to hedge out the position/risks within the position, the average volatility of bid/offer spreads, the availability of independent market quotes (number and identity of market makers), the average and volatility of trading volumes (including trading volumes during periods of market stress), market concentrations, the ageing of positions, the extent to which valuation relies on marking-to-model, and the impact of other model risks not included in section 11.8.2.2. The valuation adjustment on account of illiquidity should be considered irrespective of whether the guidelines issued by FIMMDA have taken into account the illiquidity premium or not, while fixing YTM/spreads for the purpose of valuation.

**11.8.2.3** For complex products including, but not limited to, securitisation exposures, AIFIs shall explicitly assess the need for valuation adjustments to reflect two forms of model risk:

(i) the model risk associated with using a possibly incorrect valuation methodology; and

(ii) the risk associated with using unobservable (and possibly incorrect) calibration parameters in the valuation model.

**11.8.2.4** The adjustment to the current valuation of less liquid positions made under section 11.8.2.2 will not be debited to P&L Account, but will be deducted from Common Equity Tier 1 capital while computing CRAR of the AIFI. The adjustment may exceed those valuation adjustments made under financial reporting/accounting standards and sections 11.8.1.2 (iv).

**11.8.2.5** In calculating the eligible capital for market risk, it will be necessary first to calculate the AIFIs' minimum capital requirement for credit and operational risk and only

afterwards its market risk requirement to establish how much component of capital is available to support market risk.

## 12. Capital Charge for Operational Risk

### 12.1 Definition of Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputational risk. Legal risk includes, but is not limited to, exposure to fines, penalties, or punitive damages resulting from supervisory actions, as well as private settlements.

### 12.2 The Measurement Methodologies

**12.2.1** There are three methods for calculating operational risk capital charges in a continuum of increasing sophistication and risk sensitivity: (i) the Basic Indicator Approach (BIA); (ii) the Standardised Approach (TSA); and (iii) Advanced Measurement Approaches (AMA).

**12.2.2** The AIFIs shall adopt the Basic Indicator Approach (BIA) for calculating the Operational Risk capital charge.

**12.2.3** The Reserve Bank will review the capital requirement produced by the Basic Indicator Approach for general credibility and in the event that credibility is lacking, appropriate supervisory action under Pillar 2 will be considered.

### 12.3 The Basic Indicator Approach

**12.3.1** Under the Basic Indicator Approach, AIFIs shall hold capital for operational risk equal to the average over the previous three years of a fixed percentage (denoted as alpha) of positive annual gross income. Figures for any year in which annual gross income is negative or zero should be excluded from both the numerator and denominator when calculating the average. If negative gross income distorts an AIFI's Pillar 1 capital charge, the Reserve Bank will consider appropriate supervisory action under Pillar 2. The charge may be expressed as follows:

$$\mathbf{KBIA = [\sum (GI_{1...n} \times \alpha \square)]/n}$$

Where:

KBIA = the capital charge under the Basic Indicator Approach
GI = annual gross income, where positive, over the previous three years
n = number of the previous three years for which gross income is positive
α = 15 per cent, which is set by the BCBS , relating the industry wide level of required capital to the industry wide level of the indicator.

**12.3.2** Gross income is defined as "Net interest income" plus "net non-interest income". It is intended that this measure should:

(i) be gross of any provisions (e.g., for unpaid interest) and write-offs made during the year;

(ii) be gross of operating expenses, including fees paid to outsourcing service providers, *in addition to fees paid for services that are outsourced, fees received by AIFIs that provide outsourcing services shall be included in the definition of gross income;*

(iii) exclude reversal during the year in respect of provisions and write-offs made during

the previous year(s);

(iv) exclude income recognised from the disposal of items of movable and immovable property;

(v) exclude realised profits/losses from the sale of securities in the *"held to maturity" category*;

(vi) exclude income from legal settlements in favour of the AIFI;

(vii) exclude other extraordinary or irregular items of income and expenditure; and

(viii) exclude income derived from insurance activities (i.e. income derived by writing insurance policies) and insurance claims in favour of the AIFI.

**12.3.3** AIFIs are advised to compute capital charge for operational risk under the Basic Indicator Approach as follows:

(i) Average of [Gross Income * alpha (α)] for each of the last three financial years, excluding years of negative or zero gross income as mentioned in section 12.3.1 above.

(ii) Gross income = *Net profit (+) Provisions & contingencies (**+)** operating expenses (Schedule 16) (–) items (iii) to (viii) of section 12.3.2.*

(iii) Alpha (α) = 15 per cent

**12.3.4** As a point of entry for capital calculation, no specific criteria for use of the Basic Indicator Approach are set out in these guidelines. Nevertheless, AIFIs using this approach are encouraged to comply with the Basel Committee's guidance on 'Revisions to *Principles for the Sound Management of Operational Ris*k' dated March 31, 2021 and the risk management guidelines prescribed for AIFIs.

**12.3.5** Once the AIFI has calculated the capital charge for operational risk under the Basic Indicator Approach, it has to multiply this with 12.5 and arrive at the notional risk weighted asset (RWA) for operational risk.

## Part B: Supervisory Review and Evaluation Process (SREP)

### 13. Introduction to the SREP under Pillar 2

**13.1** The Capital Adequacy Framework rests on three components or three Pillars. Pillar 1 is the Minimum Capital Ratio while Pillar 2 and Pillar 3 are the Supervisory Review Process (SRP) and Market Discipline, respectively. The guidelines in regard to the SRP and the ICAAP are furnished in this Section. An illustrative outline of the format of the ICAAP document, to be submitted to the Reserve Bank, by AIFIs, is furnished at **Annex 13**.

**13.2** The objective of the SRP is to ensure that AIFIs have adequate capital to support all the risks in their business as also to encourage them to develop and use better risk management techniques for monitoring and managing their risks. This in turn would require a well-defined internal assessment process within AIFIs through which they assure the Reserve Bank that adequate capital is indeed held towards the various risks to which they are exposed to. The process of assurance could also involve an active dialogue between the AIFI and the Reserve Bank so that, when warranted, appropriate intervention could be made to either reduce the risk exposure of the AIFI or augment / restore its capital. Thus, ICAAP is an important component of the SRP.

**13.3** The main aspects to be addressed under the SRP, and therefore, under the ICAAP, would include:

(i) the risks that are not fully captured by the minimum capital ratio prescribed under Pillar 1;
(ii) the risks that are not at all taken into account by the Pillar 1; and
(iii) the factors external to the AIFI.

Since the capital adequacy ratio prescribed by the Reserve Bank under the Pillar 1 of the Framework is only the regulatory **minimum** level, addressing only the three specified risks (viz., credit, market and operational risks), holding additional capital might be necessary for AIFIs, on account of both – the possibility of some under-estimation of risks under the Pillar 1 and the actual risk exposure of an AIFI vis-à-vis the quality of its risk management architecture. **Illustratively**, some of the risks that the AIFIs are generally exposed to but which are not captured or not fully captured in the regulatory CRAR would include:

(i) Interest rate risk in the banking book;
(ii) Credit concentration risk;
(iii) Liquidity risk;
(iv) Settlement risk;
(v) Reputational risk;
(vi) Strategic risk;
(vii) Risk of under-estimation of credit risk under the Standardised approach;
(viii) Model risk i.e., the risk of under-estimation of credit risk under the IRB approaches;
(ix) Risk of weakness in the credit-risk mitigants;
(x) Residual risk of securitisation;
(xi) Cyber security/IT infrastructure risk;
(xii) Human capital risk;
(xiii) Group risk;
(xiv) Outsourcing / vendor management risk;
(xv) Collateral risk

The quantification of currency induced credit risk will form a part of AIFIs' Internal Capital Adequacy Assessment Programme (ICAAP) and AIFIs are expected to address this risk in a

comprehensive manner. The ICAAP should measure the extent of currency induced credit risk[76] the AIFI is exposed to and also concentration of such exposures. AIFIs may also like to perform stress tests under various extreme but plausible exchange rate scenarios under ICAAP. Outcome of ICAAP may lead an AIFI to take appropriate risk management actions like risk reduction, maintenance of more capital or provision, etc.

It is, therefore, only appropriate that the AIFIs make their own assessment of their various risk exposures, through a well-defined internal process, and maintain an adequate capital cushion for such risks.

**13.4** It is recognised that there is no one single approach for conducting the ICAAP and the market consensus in regard to the best practice for undertaking ICAAP is yet to emerge. The methodologies and techniques are still evolving particularly in regard to measurement of non-quantifiable risks, such as reputational and strategic risks. These guidelines, therefore, seek to provide only broad principles to be followed by AIFIs in developing their ICAAP.

**13.5** AIFIs are advised to develop and put in place, with the approval of their Boards, an ICAAP commensurate with their size, level of complexity, risk profile and scope of operations. The ICAAP shall be in addition to an AIFI's calculation of regulatory capital requirements under Pillar 1.

**13.6** The ICAAP document should, *inter alia*, include the capital adequacy assessment and projections of capital requirement for the ensuing year, along with the plans and strategies for meeting the capital requirement. An illustrative outline of a format of the ICAAP document is furnished at **Annex 13**, for guidance of the AIFIs though the ICAAP documents of the AIFIs could vary in length and format, in tune with their size, level of complexity, risk profile and scope of operations.

## 14. Need for Improved Risk Management

**14.1** While financial institutions have faced difficulties over the years for a multitude of reasons, the major causes of serious banking problems continue to be lax credit standards for borrowers and counterparties, poor portfolio risk management, and a lack of attention to changes in economic or other circumstances that can lead to a deterioration in the credit standing of an AIFI's counterparties.

**14.2** The financial market crisis of 2007-08 has underscored the critical importance of effective credit risk management to the long-term success of any financial institution and as a key component of financial stability. It has provided a stark reminder of the need for AIFIs to effectively identify, measure, monitor and control credit risk, as well as to understand how credit risk interacts with other types of risk (including market, liquidity and reputational risk). The essential elements of a comprehensive credit risk management programme include (i) establishing an appropriate credit risk environment; (ii) operating under a sound credit granting process; (iii) maintaining an appropriate credit administration, measurement and monitoring process; and (iv) ensuring adequate controls over credit risk as elaborated in the risk management guidelines prescribed for AIFIs.

**14.3** The Global Financial Crisis has emphasised the importance of effective capital planning and long-term capital maintenance. An AIFI's ability to withstand uncertain market conditions is bolstered by maintaining a strong capital position that accounts for potential

[76] Please refer to circular DBOD.No.BP.BC.85/21.06.200/2013-14 and DBOD.No.BP.BC.116/21.06.200/2013-14 dated January 15, 2014 and June 3, 2014 addressed to banks, respectively.

changes in the AIFI's strategy and volatility in market conditions over time. AIFIs should focus on effective and efficient capital planning, as well as long-term capital maintenance. An effective capital planning process requires an AIFI to assess both the risks to which it is exposed and the risk management processes in place to manage and mitigate those risks; evaluate its capital adequacy relative to its risks; and consider the potential impact on earnings and capital from economic downturns. An AIFI's capital planning process should incorporate rigorous, forward looking stress testing, as discussed below in section 15.10.

## 15. Guidelines for the SREP of the Reserve Bank and the ICAAP of AIFIs

### 15.1 Background

**15.1.1** The Basel capital adequacy framework rests on the following three mutually-reinforcing pillars:

**Pillar 1:** Minimum Capital Requirements - which prescribes a risk-sensitive calculation of capital requirements that, for the first time, explicitly includes operational risk in addition to market and credit risk.

**Pillar 2:** Supervisory Review Process (SRP) - which envisages the establishment of suitable risk management systems in AIFIs and their review by the supervisory authority.

**Pillar 3:** Market Discipline - which seeks to achieve increased transparency through expanded disclosure requirements for AIFIs.

**15.1.2** Following are the four key principles in regard to the SRP envisaged under Pillar 2:

**Principle 1:** AIFIs should have a process for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital levels.

**Principle 2:** Supervisors should review and evaluate AIFIs' internal capital adequacy assessments and strategies, as well as their ability to monitor and ensure their compliance with the regulatory capital ratios. Supervisors should take appropriate supervisory action if they are not satisfied with the result of this process.

**Principle 3:** Supervisors should expect AIFIs to operate above the minimum regulatory capital ratios and should have the ability to require AIFIs to hold capital in excess of the minimum.

**Principle 4:** Supervisors should seek to intervene at an early stage to prevent capital from falling below the minimum levels required to support the risk characteristics of a particular AIFI and should require rapid remedial action if capital is not maintained or restored.

**15.1.3** It would be seen that the principles 1 and 3 relate to the supervisory expectations from AIFIs while the principles 2 and 4 deal with the role of the supervisors under Pillar 2. Pillar 2 (Supervisory Review Process - SRP) requires AIFIs to implement an internal process, called the Internal Capital Adequacy Assessment Process (ICAAP), for assessing their capital adequacy in relation to their risk profiles as well as a strategy for maintaining their capital levels. Pillar 2 also requires the supervisory authorities to subject all AIFIs to an evaluation process, hereafter called Supervisory Review and Evaluation Process (SREP), and to initiate such supervisory measures on that basis, as might be considered necessary. An analysis of the foregoing principles indicates that the following broad responsibilities have been cast on AIFIs and the supervisors:

**AIFIs' responsibilities:**

(i) AIFIs should have in place a process for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital levels (Principle 1)

(ii) AIFIs should operate above the minimum regulatory capital ratios *(Principle 3)*

**Supervisors' responsibilities**

(i) Supervisors should review and evaluate an AIFI's ICAAP. (Principle 2)

(ii) Supervisors should take appropriate action if they are not satisfied with the results of this process. (Principle 2)

(iii) Supervisors should review and evaluate an AIFI's compliance with the regulatory capital ratios. (Principle 2)

(iv) Supervisors should have the ability to require AIFIs to hold capital in excess of the minimum. (Principle 3)

(v) Supervisors should seek to intervene at an early stage to prevent capital from falling below the minimum levels. (Principle 4)

(vi) Supervisors should require rapid remedial action if capital is not maintained or restored. (Principle 4)

**15.1.4** Thus, the ICAAP and SREP are the two important components of Pillar 2 and could be broadly defined as follows:

(i) The ICAAP comprises an AIFI's procedures and measures designed to ensure the following:

(a) An appropriate identification and measurement of risks;

(b) An appropriate level of internal capital in relation to the AIFI's risk profile; and

(c) Application and further development of suitable risk management systems.

(ii) The SREP consists of a review and evaluation process adopted by the supervisor, which covers all the processes and measures defined in the principles listed above. Essentially, these include the review and evaluation of the AIFI's ICAAP, conducting an independent assessment of the AIFI's risk profile, and if necessary, taking appropriate prudential measures and other supervisory actions.

**15.1.5** These guidelines seek to provide broad guidance to AIFIs by outlining the manner in which the SREP would be carried out by the Reserve Bank, the expected scope and design of their ICAAP, and the expectations of the Reserve Bank from AIFIs in regard to implementation of the ICAAP.

## 15.2 Conduct of the SREP by the Reserve Bank

**15.2.1** Capital helps protect individual financial entities, such as banks and AIFIs from insolvency, thereby promoting safety and soundness in the overall financial system. Minimum regulatory capital requirements under Pillar 1 establish a threshold below which a sound AIFI's regulatory capital must not fall. Regulatory capital ratios permit some comparative analysis of capital adequacy across regulated entities because they are based on certain common methodology / assumptions. However, supervisors need to perform a more comprehensive assessment of capital adequacy that considers risks specific to an AIFI, conducting analyses that go beyond minimum regulatory capital requirements.

**15.2.2** The Reserve Bank expects AIFIs to hold capital above their minimum regulatory capital levels, commensurate with their individual risk profiles, to account for all material risks. Under the SREP, the Reserve Bank will assess the overall capital adequacy of an AIFI

through a comprehensive evaluation that takes into account all relevant available information. In determining the extent to which AIFIs should hold capital in excess of the regulatory minimum, the Reserve Bank would take into account the combined implications of an AIFI's compliance with regulatory minimum capital requirements, the quality and results of an AIFI's ICAAP, and supervisory assessment of the AIFI's risk management processes, control systems and other relevant information relating to the AIFI's risk profile and capital position.

**15.2.3** The SREP of AIFIs would, thus, be conducted as part of the Reserve Bank's inspection of AIFIs and in the light of the data in the off-site returns received from AIFIs in the Reserve Bank, in conjunction with the ICAAP document, which is required to be submitted every year by AIFIs to the Reserve Bank (refer to section 15.3.3.7 below). Through the SREP, the Reserve Bank would evaluate the adequacy and efficacy of the ICAAP of AIFIs and the capital requirements derived by them therefrom. While in the course of evaluation, there would be no attempt to reconcile the difference between the regulatory minimum CRAR and the outcome of the ICAAP of an AIFI (as the risks covered under the two processes are different), AIFIs would be expected to demonstrate to the Reserve Bank that the ICAAP adopted by them is fully responsive to their size, level of complexity, scope and scale of operations and the resultant risk profile / exposures, and adequately captures their capital requirements. Such an evaluation of the effectiveness of the ICAAP would help the Reserve Bank in understanding the capital management processes and strategies adopted by AIFIs. If considered necessary, the SREP could also involve a dialogue between the AIFI's top management and the Reserve Bank from time to time. In addition to the periodic reviews, independent external experts may also be commissioned by the Reserve Bank, if deemed necessary, to perform *ad hoc* reviews and comment on specific aspects of the ICAAP process of an AIFI; the nature and extent of such a review shall be determined by the Reserve Bank.

**15.2.4** Pillar 1 capital requirements will include a buffer for uncertainties surrounding the Pillar 1 regime that affect the financial entities as a whole. AIFI-specific uncertainties will be treated under Pillar 2[77]. It is anticipated that such buffers under Pillar 1 will be set to provide reasonable assurance that an AIFI with good internal systems and controls, a well-diversified risk profile and a business profile well covered by the Pillar 1 regime, and which operates with capital equal to Pillar 1 requirements, will meet the minimum goals for soundness embodied in Pillar 1. However, the Reserve Bank may require particular AIFIs to operate with a buffer, over and above the Pillar 1 standard. AIFIs should maintain this buffer for a combination of the following:

(i) Pillar 1 minimums are anticipated to be set to achieve a level of AIFI creditworthiness in markets that is below the level of creditworthiness sought by many AIFIs for their own reasons. For example, most international financial institutions appear to prefer to be highly rated by internationally recognised rating agencies. Thus, AIFIs are likely to choose to operate above Pillar 1 minimums for competitive reasons.

(ii) In the normal course of business, the type and volume of activities will change, as will the different risk exposures, causing fluctuations in the overall capital ratio.

(iii) It may be costly for AIFIs to raise additional capital, especially if this needs to be done quickly or at a time when market conditions are unfavourable.

(iv) For AIFIs to fall below minimum regulatory capital requirements is a serious matter. It

[77] Annex 3 of the Guidelines on Implementation of Basel III Capital Regulations in India issued vide circular DBOD.No.BP.BC.98/21.06.201/2011-2012 dated May 2, 2012.

may place AIFIs in breach of the provisions of the Reserve Bank regulations and / or attract corrective action on the part of the Reserve Bank.

(v) There may be risks, either specific to individual AIFIs, or more generally to the economy at large, that are not taken into account in Pillar 1.[78]

As a part of SREP under Pillar 2, the Reserve Bank may review the risk management measures taken by the AIFI and its adequacy to manage currency induced credit risk[79], especially if exposure to such risks is assessed to be on higher side.

Under the SREP, the Reserve Bank would make an assessment as to whether the AIFI maintains adequate capital cushion to take care of the above situations. Such cushion would generally be reflected in more than minimum capital adequacy ratio maintained by the AIFI.

Under the SREP, the Reserve Bank would also seek to determine whether an AIFI's overall capital remains adequate as the underlying conditions change. Generally, material increases in risk that are not otherwise mitigated should be accompanied by commensurate increases in capital. Conversely, reductions in overall capital (to a level still above regulatory minima) may be appropriate if the Reserve Bank's supervisory assessment leads it to a conclusion that risk has materially declined or that it has been appropriately mitigated. Based on such assessment, the Reserve Bank could consider initiating appropriate supervisory measures to address its supervisory concerns. The measures could include requiring a modification or enhancement of the risk management and internal control processes of an AIFI, a reduction in risk exposures, or any other action as deemed necessary to address the identified supervisory concerns. These measures could also include the stipulation of an AIFI-specific additional capital requirement over and above what has been determined under Pillar 1.

**15.2.5** As and when the advanced approaches envisaged in the Basel capital adequacy framework are permitted to be adopted in India, the SREP would also assess the ongoing compliance by AIFIs with the eligibility criteria for adopting the advanced approaches.

### 15.3 The Structural Aspects of the ICAAP

**15.3.1** This section outlines the broad parameters of the ICAAP that AIFIs shall comply with in designing and implementing their ICAAP.

#### 15.3.2 Every AIFI to have an ICAAP

The ICAAP shall be prepared, on a solo basis, at every tier for each entity within the group, as also at the level of the consolidated AIFI (i.e., a group of entities where the AIFI is the controlling entity).

#### 15.3.3 ICAAP to encompass institution-wide risk profile

##### 15.3.3.1 General firm-wide risk management principles:

Senior management should understand the importance of taking an integrated, firm-wide perspective of an AIFI's risk exposure, in order to support its ability to identify and react to emerging and growing risks in a timely and effective manner. The purpose of this guidance is the need to enhance firm-wide oversight, risk management and controls around AIFIs' capital markets activities, including securitisation, off-balance sheet exposures, structured

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[78] If an AIFI has identified some capital add-on to take care of an identified Pillar 2 risk or inadequately capitalised Pillar 1 risk, that add-on can be translated into risk weighted assets as indicated in this section below, which should be added to the total risk weighted assets of the AIFI. No additional Pillar 2 buffer need be maintained for such identified risks.

[79] Please refer to circular DBOD.No.BP.BC.85/21.06.200/2013-14 and DBOD.No.BP.BC.116/21.06.200/2013-14 dated January 15, 2014 and June 3, 2014 addressed to banks, respectively.

credit and complex trading activities.

A sound risk management system should have the following key features:

(i) Active Board and senior management oversight;

(ii) Appropriate policies, procedures and limits;

(iii) Comprehensive and timely identification, measurement, mitigation, controlling, monitoring and reporting of risks;

(iv) Appropriate management information systems (MIS) at the business and firm-wide level; and

(v) Comprehensive internal controls.

**15.3.3.2 Board and Senior Management Oversight:**

The ultimate responsibility for designing and implementation of the ICAAP lies with the AIFI's Board**.** It is the responsibility of the Board and senior management to define the institution's risk appetite and to ensure that the AIFI's risk management framework includes detailed policies that set specific firm-wide prudential limits on the AIFI's activities, which are consistent with its risk-taking appetite and capacity. In order to determine the overall risk appetite, the Board and senior management must first have an understanding of risk exposures on a firm-wide basis. To achieve this understanding, the appropriate members of senior management shall bring together the perspectives of the key business and control functions. In order to develop an integrated institution-wide perspective on risk, senior management must overcome organisational silos between business lines and share information on market developments, risks and risk mitigation techniques. Senior management should establish a risk management process that is not limited to credit, market, liquidity and operational risks, but incorporates all material risks. This includes reputational and strategic risks, as well as risks that do not appear to be significant in isolation, but when combined with other risks could lead to material losses.

**15.3.3.3** The Board and senior management should possess sufficient knowledge of all major business lines to ensure that appropriate policies, controls and risk monitoring systems are effective. They should have the necessary expertise to understand the capital markets activities in which the AIFI is involved – such as securitisation and off-balance sheet activities – and the associated risks. The Board and senior management should remain informed on an on-going basis about these risks as financial markets, risk management practices and the AIFI's activities evolve. In addition, the Board and senior management should ensure that accountability and lines of authority are clearly delineated. With respect to new or complex products and activities, senior management should understand the underlying assumptions regarding business models, valuation and risk management practices. In addition, senior management should evaluate the potential risk exposure if those assumptions fail. Before embarking on new activities or introducing products new to the institution, the Board and senior management should identify and review the changes in firm-wide risks arising from these potential new products or activities and ensure that the infrastructure and internal controls necessary to manage the related risks are in place. In this review, an AIFI should also consider the possible difficulty in valuing the new products and how they might perform in a stressed economic environment. The Board should ensure that the senior management of the AIFI:

(i) establishes a risk framework in order to assess and appropriately manage the various risk exposures of the AIFI;

(ii) develops a system to monitor the AIFI's risk exposures and to relate them to the AIFI's capital and reserve funds;

(iii) establishes a method to monitor the AIFI's compliance with internal policies, particularly in regard to risk management; and

(iv) effectively communicates all relevant policies and procedures throughout the AIFI.

An AIFI's risk function and its chief risk officer (CRO) or equivalent position should be independent of the individual business lines and report directly to the chief executive officer (CEO) / Managing Director and the institution's Board. In addition, the risk function should highlight to senior management and the Board risk management concerns, such as risk concentrations and violations of risk appetite limits. AIFIs may refer to circular no. DBR.BP.BC.No.65/21.04.103/2016-17 dated April 27, 2017 on "Risk Management Systems – Role of the Chief Risk Officer (CRO)" addressed to banks, as amended from time to time, for, inter alia, the guidelines on the Role of CRO.

**15.3.3.4 Policies, procedures, limits and controls:**

The structure, design and contents of an AIFI's ICAAP should be approved by the Board to ensure that the ICAAP forms an integral part of the management process and decision making culture of the AIFI. Institution-wide risk management programmes should include detailed policies that set specific institution-wide prudential limits on the principal risks relevant to an AIFI's activities. An AIFI's policies and procedures should provide specific guidance for the implementation of broad business strategies and should establish, where appropriate, internal limits for the various types of risks to which the AIFI may be exposed. These limits should consider the AIFI's role in the financial system and be defined in relation to the AIFI's capital, total assets, earnings or, where adequate measures exist, its overall risk level. An AIFI's policies, procedures and limits should:

(i) Provide for adequate and timely identification, measurement, monitoring, control and mitigation of the risks posed by its lending, investing, trading, securitisation, off-balance sheet, fiduciary and other significant activities at the business line and institution-wide levels;

(ii) Ensure that the economic substance of an AIFI's risk exposures, including reputational risk and valuation uncertainty, are fully recognised and incorporated into the AIFI's risk management processes;

(iii) Be consistent with the AIFI's stated goals and objectives, as well as its overall financial strength;

(iv) Clearly delineate accountability and lines of authority across the AIFI's various business activities, and ensure that there is a clear separation between business lines and the risk function;

(v) Escalate and address breaches of internal position limits;

(vi) Provide for the review of new businesses and products by bringing together all relevant risk management, control and business lines to ensure that the AIFI is able to manage and control the activity prior to it being initiated; and

(vii) Include a schedule and process for reviewing the policies, procedures and limits and for updating them as appropriate.

**15.3.3.5 Identifying, measuring, monitoring and reporting of risk:**

(i) An AIFI's MIS should provide the Board and senior management in a clear and concise manner with timely and relevant information concerning their institutions' risk profile. This information should include all risk exposures, including those that are off-balance sheet. Management should understand the assumptions behind and limitations inherent in specific risk measures.

(ii) The key elements necessary for the aggregation of risks are an appropriate infrastructure and MIS that (i) allow for the aggregation of exposures and risk measures

across business lines and (ii) support customised identification of concentrations and emerging risks. MIS developed to achieve this objective should support the ability to evaluate the impact of various types of economic and financial shocks that affect the whole of the financial institution. Further, an AIFI's systems should be flexible enough to incorporate hedging and other risk mitigation actions to be carried out on a firm-wide basis while taking into account the various related basis risks.

(iii) To enable proactive management of risk, the Board and senior management need to ensure that MIS is capable of providing regular, accurate and timely information on the AIFI's aggregate risk profile, as well as the main assumptions used for risk aggregation. MIS should be adaptable and responsive to changes in the AIFI's underlying risk assumptions and should incorporate multiple perspectives of risk exposure to account for uncertainties in risk measurement. In addition, it should be sufficiently flexible so that the institution can generate forward-looking AIFI-wide scenario analyses that capture management's interpretation of evolving market conditions and stressed conditions. Third-party inputs or other tools used within MIS (e.g., credit ratings, risk measures, models) should be subject to initial and ongoing validation.

(iv) An AIFI's MIS should be capable of capturing limit breaches and there should be procedures in place to promptly report such breaches to senior management, as well as to ensure that appropriate follow-up actions are taken. For instance, similar exposures should be aggregated across business platforms (including the banking and trading books) to determine whether there is a concentration or a breach of an internal position limit.

#### 15.3.3.6 Internal controls:

Risk management processes should be frequently monitored and tested by independent control areas and internal, as well as external, auditors. The aim is to ensure that the information on which decisions are based is accurate so that processes fully reflect management policies and that regular reporting, including the reporting of limit breaches and other exception-based reporting, is undertaken effectively. The risk management function of AIFIs shall be independent of the business lines in order to ensure an adequate separation of duties and to avoid conflicts of interest.

Since a sound risk management process provides the basis for ensuring that an AIFI maintains adequate capital, the Board of an AIFI shall set the tolerance level for risk.

#### 15.3.3.7 Submission of the outcome of the ICAAP to the Board and the Reserve Bank

As the ICAAP is an ongoing process, a written record on the outcome of the ICAAP should be periodically submitted by AIFIs to their Board. Such written record of the internal assessment of its capital adequacy should include, *inter alia*, the risks identified, the manner in which those risks are monitored and managed, the impact of the AIFI's changing risk profile on its capital position, details of stress tests/scenario analysis conducted and the resultant capital requirements. The reports shall be sufficiently detailed to allow the Board to evaluate the level and trend of material risk exposures, whether the AIFI maintains adequate capital against the risk exposures and in case of additional capital being needed, the plan for augmenting capital. The Board would be expected make timely adjustments to the strategic plan, as necessary.

Based on the outcome of the ICAAP as submitted to and approved by the Board, the ICAAP Document, in the format furnished at **Annex 13**, should be furnished to the Reserve Bank (i.e., to the CGM-in-Charge, Department of Supervision, Central Office, Mumbai with a copy addressed to Senior Supervisory Manager of the AIFI). The document should reach the Reserve Bank latest by end of the first quarter (i.e., April-June) of the relevant financial year.

### 15.4 Review of the ICAAP Outcomes

The Board shall, at least once a year, assess and document whether the processes relating to the ICAAP implemented by the AIFI successfully achieve the objectives envisaged by the Board. The senior management should also receive and review the reports regularly to evaluate the sensitivity of the key assumptions and to assess the validity of the AIFI's estimated future capital requirements. In the light of such an assessment, appropriate changes in the ICAAP should be instituted to ensure that the underlying objectives are effectively achieved.

### 15.5 ICAAP to be an Integral part of the Management and Decision-making Culture

The ICAAP should form an integral part of the management and decision-making culture of an AIFI. This integration could range from using the ICAAP to internally allocate capital to various business units, to having it play a role in the individual credit decision process and pricing of products or more general business decisions such as expansion plans and budgets. The integration would also mean that ICAAP should enable the AIFI management to assess, on an ongoing basis, the risks that are inherent in their activities and material to the institution.

### 15.6 The Principle of Proportionality

The implementation of ICAAP should be guided by the principle of proportionality. Though AIFIs are encouraged to migrate to and adopt progressively sophisticated approaches in designing their ICAAP, the Reserve Bank expects the degree of sophistication adopted in the ICAAP in regard to risk measurement and management to be commensurate with the nature, scope, scale and the degree of complexity in the AIFI's business operations. The following sections **illustratively** enumerate the broad approach which could be considered by AIFIs with varying levels of complexity in their operations, in formulating their ICAAP.

**15.6.1** In relation to an AIFI that defines its activities and risk management practices as simple, in carrying out its ICAAP, that AIFI could:

(a) identify and consider that AIFI's largest losses over the last 3 to 5 years and whether those losses are likely to recur;

(b) prepare a short list of the most significant risks to which that AIFI is exposed;

(c) consider how that AIFI would act, and the amount of capital that would be absorbed in the event that each of the risks identified were to materialise;

(d) consider how that AIFI's capital requirement might alter under the scenarios in (c) and how its capital requirement might alter in line with its business plans for the next 3 to 5 years; and

(e) document the ranges of capital required in the scenarios identified above and form an overall view on the amount and quality of capital which that AIFI should hold, ensuring that its senior management is involved in arriving at that view.

**15.6.2** In relation to an AIFI that defines its activities and risk management practices as moderately complex, in carrying out its ICAAP, that AIFI could:

(a) having consulted the operational management in each major business line, prepare a comprehensive list of the major risks to which the business is exposed;

(b) estimate, with the aid of historical data, where available, the range and distribution of possible losses which might arise from each of those risks and consider using shock stress tests to provide risk estimates;

(c) consider the extent to which that AIFI's capital requirement adequately captures the risks identified in (a) and (b) above;

(d) for areas in which the capital requirement is either inadequate or does not address a risk, estimate the additional capital needed to protect that AIFI and its customers, in addition to any other risk mitigation action that AIFI plans to take;

(e) consider the risk that the AIFI's own analyses of capital adequacy may be inaccurate and that it may suffer from management weaknesses which affect the effectiveness of its risk management and mitigation;

(f) project that AIFI's business activities forward in detail for one year and in less detail for the next 3 to 5 years, and estimate how that AIFI's capital and capital requirement would alter, assuming that business develops as expected;

(g) assume that business does not develop as expected and consider how that AIFI's capital and capital requirement would alter and what that AIFI's reaction to a range of adverse economic scenarios might be;

(h) document the results obtained from the analyses in (b), (d), (f), and (g) above in a detailed report for that AIFI's top management / Board; and

(i) ensure that systems and processes are in place to review the accuracy of the estimates made in (b), (d), (f) and (g) (i.e., systems for back testing) vis-à-vis the performance / actuals.

**15.6.3** In relation to an AIFI that defines its activities and risk management practices as complex, in carrying out its ICAAP, that AIFI could follow a proportional approach to that AIFI's ICAAP which should cover the issues identified at (a) to (d) in section 15.6.2 above, but is likely also to involve the use of models, most of which will be integrated into its day-to-day management and operations.

Models of the kind referred to above may be linked so as to generate an overall estimate of the amount of capital that an AIFI considers appropriate to hold for its business needs. An AIFI may also link such models to generate information on the economic capital considered desirable for that AIFI. A model which an AIFI uses to generate its target amount of economic capital is known as an economic capital model (ECM). Economic capital is the target amount of capital which optimises the return for an AIFI's stakeholders for a desired level of risk. For example, an AIFI is likely to use value-at-risk (VaR) models for market risk, advanced modelling approaches for credit risk and, possibly, advanced measurement approaches for operational risk. An AIFI might also use economic scenario generators to model stochastically its business forecasts and risks. However, AIFIs would need prior approval of the Reserve Bank for migrating to the advanced approaches envisaged in the Basel Capital Framework.

### 15.7 Regular Independent Review and Validation

The ICAAP should be subject to regular and independent review through an internal or external audit process, separately from the SREP conducted by the Reserve Bank, to ensure that the ICAAP is comprehensive and proportionate to the nature, scope, scale and level of complexity of the AIFI's activities so that it accurately reflects the major sources of risk that the AIFI is exposed to. An AIFI shall ensure appropriate and effective internal control structures, particularly in regard to the risk management processes, in order to monitor the AIFI's continued compliance with internal policies and procedures. As a minimum, an AIFI shall conduct periodic reviews of its risk management processes, which should ensure:

(i) the integrity, accuracy, and reasonableness of the processes;

(ii) the appropriateness of the AIFI's capital assessment process based on the nature, scope, scale and complexity of the AIFI's activities;

(iii) the timely identification of any concentration risk;

(iv) the accuracy and completeness of any data inputs into the AIFI's capital assessment process;

(v) the reasonableness and validity of any assumptions and scenarios used in the capital assessment process; and

(vi) that the AIFI conducts appropriate stress testing;

### 15.8 ICAAP to be a Forward-looking Process

The ICAAP should be forward looking in nature, and thus, should take into account the expected / estimated future developments such as strategic plans, macro-economic factors, etc., including the likely future constraints in the availability and use of capital. At a minimum, the management of an AIFI shall develop and maintain an appropriate strategy that would ensure that the AIFI maintains adequate capital commensurate with the nature, scope, scale, complexity and risks inherent in the AIFI's on-balance-sheet and off-balance-sheet activities, and should demonstrate as to how the strategy dovetails with the macro-economic factors.

Thus, AIFIs shall have an explicit, Board-approved capital plan which should spell out the institution's objectives in regard to level of capital, the time horizon for achieving those objectives, and in broad terms, the capital planning process and then allocate responsibilities for that process.

### 15.9 ICAAP to be a Risk-based Process

The adequacy of an AIFI's capital is a function of its risk profile. AIFIs shall, therefore, set their capital targets which are consistent with their risk profile and operating environment. At a minimum, an AIFI shall have in place a sound ICAAP, which shall include all **material** risk exposures incurred by the AIFI. There are some types of risks (such as reputation risk and strategic risk) which are less readily quantifiable; for such risks, the focus of the ICAAP should be more on qualitative assessment, risk management and mitigation than on quantification of such risks. AIFIs' ICAAP document shall clearly indicate for which risks a quantitative measure is considered warranted, and for which risks a qualitative measure is considered to be the correct approach.

### 15.10 ICAAP to Include Stress Tests and Scenario Analyses

As part of the ICAAP, the management of an AIFI shall, at a minimum, conduct relevant stress tests periodically, particularly in respect of the AIFI's material risk exposures, in order to evaluate the potential vulnerability of the AIFI to some unlikely but plausible events or movements in the market conditions that could have an adverse impact on the AIFI. The use of stress testing framework can provide an AIFI's management a better understanding of the AIFI's likely exposure in extreme circumstances. In this context, the attention is also invited to the risk management guidelines applicable to the AIFIs. The AIFIs are urged to take necessary measures for implementing an appropriate formal stress testing framework which would also meet the stress testing requirements under the ICAAP of the AIFIs.

### 15.11 Use of Capital Models for ICAAP

While there is no single prescribed approach as to how an AIFI should develop its capital model, an AIFI adopting a model-based approach to its ICAAP shall be able to, *inter alia,* demonstrate:

(a) Well documented model specifications, including the methodology / mechanics and the assumptions underpinning the working of the model;

(b) The extent of reliance on the historical data in the model and the system of back testing to be carried out to assess the validity of the outputs of the model vis-à-vis the actual outcomes;

(c) A robust system for independent validation of the model inputs and outputs;

(d) A system of stress testing the model to establish that the model remains valid even under extreme conditions / assumptions;

(e) The level of confidence assigned to the model outputs and its linkage to the AIFI's business strategy;

(f) The adequacy of the requisite skills and resources within the AIFIs to operate, maintain and develop the model.

## 16. Select Operational Aspects of the ICAAP

This Section outlines in somewhat greater detail the scope of the risk universe expected to be normally captured by the AIFIs in their ICAAP.

### 16.1 Identifying and Measuring Material Risks in ICAAP

(i) The first objective of an ICAAP is to identify all material risks. Risks that can be reliably measured and quantified should be treated as rigorously as data and methods allow. The appropriate means and methods to measure and quantify those material risks are likely to vary across AIFIs.

(ii) Some of the risks to which AIFIs are exposed include credit risk, market risk, operational risk, interest rate risk in the banking book, credit concentration risk and liquidity risk (as briefly outlined below). The Reserve Bank has issued guidelines to the AIFIs on various risk management areas from time to time. An AIFI's risk management processes, including its ICAAP, should, therefore, be consistent with this existing body of guidance. However, certain other risks, such as reputational risk and business or strategic risk, may be equally important for an AIFI and, in such cases, should be given same consideration as the more formally defined risk types. For example, an AIFI may be engaged in businesses for which periodic fluctuations in activity levels, combined with relatively high fixed costs, have the potential to create unanticipated losses that must be supported by adequate capital. Additionally, an AIFI might be involved in strategic activities (such as expanding business lines or engaging in acquisitions) that introduce significant elements of risk and for which additional capital would be appropriate.

(iii) Additionally, if AIFIs employ risk mitigation techniques, they should understand the risk to be mitigated and the potential effects of that mitigation, reckoning its enforceability and effectiveness, on the risk profile of the AIFI.

### 16.2 Credit Risk[80]

**16.2.1** AIFIs should have methodologies that enable them to assess the credit risk involved in exposures to individual borrowers or counterparties as well as at the portfolio level. AIFIs should be particularly attentive to identifying credit risk concentrations and ensuring that their effects are adequately assessed. This should include consideration of various types of dependence among exposures, incorporating the credit risk effects of extreme outcomes, stress events, and shocks to the assumptions made about the portfolio and exposure behaviour. AIFIs should also carefully assess concentrations in counterparty credit exposures, including counterparty credit risk exposures emanating from trading in less liquid markets, and determine the effect that these might have on the AIFI's capital adequacy.

**16.2.2** AIFIs should assess exposures, regardless of whether they are rated or unrated[81],

[80] Annex 3 of the Guidelines on Implementation of Basel III Capital Regulations in India issued vide circular DBOD.No.BP.BC.98/21.06.201/2011-2012 dated May 2, 2012.

[81] In such cases it would be in order for AIFIs to derive notional external ratings of the unrated

and determine whether the risk weights applied to such exposures, under the Standardised Approach, are appropriate for their inherent risk. In those instances where an AIFI determines that the inherent risk of such an exposure, particularly if it is unrated, is significantly higher than that implied by the risk weight to which it is assigned, the AIFI should consider the higher degree of credit risk in the evaluation of its overall capital adequacy. For more sophisticated AIFIs, the credit review assessment of capital adequacy, at a minimum, should cover four areas: risk rating systems, portfolio analysis/aggregation, securitisation/complex credit derivatives, and large exposures and risk concentrations.

### 16.2.3 *Counterparty* credit *risk (CCR)*

(i) The AIFIs shall have counterparty credit risk management policies, processes and systems that are conceptually sound and implemented with integrity relative to the sophistication and complexity of an AIFI's holdings of exposures that give rise to counterparty credit risk (CCR). A sound counterparty credit risk management framework shall include the identification, measurement, management, approval and internal reporting of CCR.

(ii) The AIFI's risk management policies shall take account of the market, liquidity, and operational risks that can be associated with CCR and, to the extent practicable, interrelationships among those risks. The AIFIs shall not undertake business with a counterparty without assessing its creditworthiness and shall take due account of both settlement and pre-settlement credit risk. These risks shall be managed as comprehensively as practicable at the counterparty level (aggregating counterparty exposures with other credit exposures) and at the enterprise-wide level.

(iii) The Board and senior management shall be actively involved in the CCR control process and shall regard this as an essential aspect of the business to which significant resources need to be devoted. The daily reports prepared on a firm's exposures to CCR shall be reviewed by a level of management with sufficient seniority and authority to enforce both reductions of positions taken by individual credit managers or traders and reductions in the AIFI's overall CCR exposure.

(iv) The AIFI's CCR management system shall be used in conjunction with internal credit and trading limits.

(v) The measurement of CCR shall include monitoring daily and intra-day usage of credit lines. The AIFI shall measure current exposure gross and net of collateral held where such measures are appropriate and meaningful (e.g., OTC derivatives, margin lending, etc.). Measuring and monitoring peak exposure or potential future exposure (PFE), both the portfolio and counterparty levels is one element of a robust limit monitoring system. AIFIs shall take account of large or concentrated positions, including concentrations by groups of related counterparties, by industry, by market, customer investment strategies, etc.

(vi) The AIFI shall have an appropriate stress testing methodology in place to assess the impact on the counterparty credit risk of abnormal volatilities in market variables driving the counterparty exposures and changes in the creditworthiness of the counterparty. The results of this stress testing shall be reviewed periodically by senior management and shall be reflected in the CCR policies and limits set by management and the Board. Where stress tests reveal particular vulnerability to a given set of circumstances, management should

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exposure by mapping their internal credit risk ratings / grades of the exposure used for pricing purposes with the external ratings scale.

explicitly consider appropriate risk management strategies (e.g., by hedging against that outcome, or reducing the size of the firm's exposures).

(vii) The AIFI shall have a routine in place for ensuring compliance with a documented set of internal policies, controls and procedures concerning the operation of the CCR management system. The firm's CCR management system shall be well documented, for example, through a risk management manual that describes the basic principles of the risk management system and that provides an explanation of the empirical techniques used to measure CCR.

(viii) The AIFI shall conduct an independent review of the CCR management system regularly through its own internal auditing process. This review shall include both the activities of the business credit and trading units and of the independent CCR control unit. A review of the overall CCR management process shall take place at regular intervals (ideally not less than once a year) and shall specifically address, at a minimum:

(a) the adequacy of the documentation of the CCR management system and process;

(b) the organisation of the collateral management unit;

(c) the organisation of the CCR control unit;

(d) the integration of CCR measures into daily risk management;

(e) the approval process for risk pricing models and valuation systems used by front and back- office personnel;

(f) the validation of any significant change in the CCR measurement process;

(g) the scope of counterparty credit risks captured by the risk measurement model;

(h) the integrity of the management information system;

(i) the accuracy and completeness of CCR data;

(j) the accurate reflection of legal terms in collateral and netting agreements into exposure measurements; the verification of the consistency, timeliness and reliability of data sources used to run internal models, including the independence of such data sources;

(k) the accuracy and appropriateness of volatility and correlation assumptions;

(l) the accuracy of valuation and risk transformation calculations; and

(m) the verification of the model's accuracy through frequent back-testing.

(ix) AIFIs should make an assessment as part of their ICAAP as to whether the AIFI's evaluation of the risks contained in the transactions that give rise to CCR and the AIFI's assessment of whether the Current Exposure Method (CEM) captures those risks appropriately and satisfactorily. In cases where, under SREP, it is determined that CEM does not capture the risk inherent in the AIFI's relevant transactions (as could be the case with structured, more complex OTC derivatives), the Reserve Bank may require the AIFI to apply the CEM on a transaction-by-transaction basis (i.e., no netting will be recognized even if it is permissible legally).

### 16.3 Market Risk

An AIFI should be able to identify risks in trading activities resulting from a movement in market prices. This determination should consider factors such as illiquidity of instruments, concentrated positions, one-way markets, non-linear/deep out-of-the money positions, and the potential for significant shifts in correlations. Exercises that incorporate extreme events and shocks should also be tailored to capture key portfolio vulnerabilities to the relevant market developments.

### 16.4 Operational Risk

An AIFI should be able to assess the potential risks resulting from inadequate or failed internal processes, people, and systems, as well as from events external to the AIFI. This assessment should include the effects of extreme events and shocks relating to operational risk. Events could include a sudden increase in failed processes across business units or a significant incidence of failed internal controls.

### 16.5 Interest Rate Risk in the Banking Book (IRRBB)

An AIFI should identify the risks associated with the changing interest rates on its on-balance sheet and off-balance sheet exposures in the banking book from both, a short-term and long-term perspective. This might include the impact of changes due to parallel shocks, yield curve twists, yield curve inversions, changes in the relationships of rates (basis risk), and other relevant scenarios. The AIFI should be able to support its assumptions about the behavioural characteristics of its non-maturity deposits and other assets and liabilities, especially those exposures characterised by embedded optionality. Given the uncertainty in such assumptions, stress testing and scenario analysis should be used in the analysis of interest rate risks. While there could be several approaches to measurement of IRRBB, an illustrative approach for measurement of IRRBB is furnished at **Annex 9**. The AIFIs would, however, be free to adopt any other variant of these approaches or entirely different methodology for computing / quantifying the IRRBB provided the technique is based on objective, verifiable and transparent methodology and criteria.

Reference is also invited to the updated guidelines on IRRBB issued vide circular no. DOR.MRG.REC.102/00-00-009/2022-23 dated February 17, 2023 on 'Governance, measurement and management of Interest Rate Risk in Banking Book'. As mentioned in the circular *ibid*, the date for implementation will be communicated in due course. AIFIs are advised to be in preparedness for measuring, monitoring, and disclosing their exposure to interest rate risk in the banking book in terms of the circular *ibid*. Meanwhile, AIFIs shall submit the disclosures as advised in the circular *ibid*.

### 16.6 Credit Concentration Risk

A risk concentration is any single exposure or a group of exposures with the potential to produce losses large enough (relative to an AIFI's capital, total assets, or overall risk level) to threaten an AIFI's health or ability to maintain its core operations. Risk concentrations have arguably been the single most important cause of major problems in financial systems. Concentration risk resulting from concentrated portfolios could be significant for AIFIs as well.

The following **qualitative criteria** could be adopted by AIFIs to demonstrate that the credit concentration risk is being adequately addressed:

(i) While assessing the exposure to concentration risk, an AIFI should keep in view that the calculations of Basel capital adequacy framework are based on the assumption that an AIFI is well diversified.

(ii) Typically, the AIFIs are sector-specific institutions and have a relatively limited scope for diversifying their assets portfolio. As a result, as compared to banks, these institutions

have higher credit concentration risk. The ICAAPs prepared by these institutions shall address this risk. One way to reduce overall credit concentration risk faced by the AIFIs is to limit their single name concentration by choosing to adopt lower large exposure limits. In addition, the AIFIs could consider diversifying their credit portfolios, inter-alia, along the following dimensions:

(a) Geographical spread within the country
(b) Domestic/ International/ across countries (e.g., in case of EXIM Bank)
(c) Industry segment
(d) Direct Lending/ Refinance
(e) Production Credit/ Marketing Credit/ Investment Credit (e.g., in case of NABARD)
(f) Microfinance/ SMEs/ Mid-corporate/ Large Corporates
(g) Public Sector/ Private Sector Borrowers
(h) Financial sector entities- Public Sector Banks/ Private Sector Banks/ RRBs/ Cooperative Banks, etc.
(i) Residential/ Commercial Real Estate (e.g., in case of NHB)

The sectoral concentration risk and the risk arising from the above mentioned dimensions of credit concentration of the individual AIFI will be specifically evaluated under SREP and the AIFI may be required to hold additional capital to mitigate this risk.

(iii) While the AIFIs' single borrower exposures, the group borrower exposures and capital market exposures are regulated by the exposure norms prescribed by the Reserve Bank in Chapter III of these Directions, there could be concentrations in these portfolios as well. In assessing the degree of credit concentration, therefore, an AIFI shall consider not only the foregoing exposures but also consider the degree of credit concentration in a particular economic sector or geographical area. AIFIs with operational concentration in a few geographical regions, shall also consider the impact of adverse economic developments in that region, and their impact on the asset quality.

(iv) The performance of specialised portfolios may, in some instances, also depend on key individuals / employees of the AIFI. Such a situation could exacerbate the concentration risk because the skills of those individuals, in part, limit the risk arising from a concentrated portfolio. The impact of such key employees / individuals on the concentration risk is likely to be correspondingly greater in smaller AIFIs. In developing its stress tests and scenario analyses, an AIFI shall, therefore, also consider the impact of losing key personnel on its ability to operate normally, as well as the direct impact on its revenues.

As regards the **quantitative criteria** to be used to ensure that credit concentration risk is being adequately addressed, the credit concentration risk calculations shall be performed at the counterparty level (i.e., large exposures), at the portfolio level (i.e., sectoral and geographical concentrations) and at the asset class level (i.e., liability and assets concentrations).

There could be several approaches to the measurement of credit concentration of the AIFIs' portfolio. One of the approaches commonly used for the purpose involves computation of Herfindahl-Hirshman Index (HHI). It may please be noted that the HHI as a measure of concentration risk is only one of the possible methods and the AIFIs would be free to adopt any other appropriate method for the purpose, which has objective and transparent criteria for such measurement.

Risk concentrations should be analysed on both solo and consolidated basis.[82] Risk concentrations should be viewed in the context of a single or a set of closely related risk-

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

drivers that may have different impacts on an AIFI. These concentrations should be integrated when assessing an AIFI's overall risk exposure. An AIFI should consider concentrations that are based on common or correlated risk factors that reflect more subtle or more situation-specific factors than traditional concentrations, such as correlations between market, credit risks and liquidity risk.

The growth of market-based intermediation has increased the possibility that different areas of an AIFI are exposed to a common set of products, risk factors or counterparties. This has created new challenges for risk aggregation and concentration management. Through its risk management processes and MIS, an AIFI should be able to identify and aggregate similar risk exposures across the firm, including across legal entities, asset types (e.g., loans, derivatives and structured products), risk areas (e.g. the trading book) and geographic regions. In addition to the situations described in section 16.6 (ii) above, risk concentrations can arise include:

(a) exposures to a single counterparty, or group of connected counterparties;
(b) exposures to both regulated and non-regulated financial institutions such as hedge funds and private equity firms;
(c) trading exposures/market risk;
    - exposures to counterparties (e.g., hedge funds and hedge counterparties) through the execution or processing of transactions (either product or service);
    - funding sources;
    - assets that are held in the banking book or trading book, such as loans, derivatives and structured products; and
    - off-balance sheet exposures, including guarantees, liquidity lines and other commitments.

Risk concentrations can also arise through a combination of exposures across these broad categories. An AIFI should have an understanding of its institution-wide risk concentrations resulting from similar exposures across its different business lines. Examples of such business lines include subprime exposure in lending books; counterparty exposures; conduit exposures and SIVs; contractual and non-contractual exposures; trading activities; and underwriting pipelines.

Procedures should be in place to communicate risk concentrations to the Board and senior management in a manner that clearly indicates where in the organisation each segment of a risk concentration resides. An AIFI should have credible risk mitigation strategies in place that have senior management approval. This may include altering business strategies, reducing limits or increasing capital buffers in line with the desired risk profile. While it implements risk mitigation strategies, the AIFI should be aware of possible concentrations that might arise as a result of employing risk mitigation techniques.

AIFIs should employ a number of techniques, as appropriate, to measure risk concentrations. These techniques include shocks to various risk factors; use of business level and institution-wide scenarios; and the use of integrated stress testing and economic capital models. Identified concentrations should be measured in a number of ways, including for example consideration of gross versus net exposures, use of notional amounts, and analysis of exposures with and without counterparty hedges. An AIFI should establish internal position limits for concentrations to which it may be exposed. When conducting periodic stress tests an AIFI should incorporate all major risk concentrations and identify and respond to potential changes in market conditions that could adversely impact their performance and capital adequacy.

The assessment of such risks under an AIFI's ICAAP and the supervisory review process should not be a mechanical process, but one in which each AIFI determines, depending on its business model, its own specific vulnerabilities. An appropriate level of capital for risk concentrations should be incorporated in an AIFI's ICAAP, as well as in Pillar 2

assessments. Each AIFI should discuss such issues with its supervisor.

An AIFI should have in place effective internal policies, systems and controls to identify, measure, monitor, manage, control and mitigate its risk concentrations in a timely manner. Not only should normal market conditions be considered, but also the potential build-up of concentrations under stressed market conditions, economic downturns and periods of general market illiquidity. In addition, the AIFI should assess scenarios that consider possible concentrations arising from contractual and non-contractual contingent claims. The scenarios should also combine the potential build-up of pipeline exposures together with the loss of market liquidity and a significant decline in asset values.

### 16.7 Liquidity Risk

An AIFI should understand the risks resulting from its inability to meet its obligations as they come due, because of difficulty in liquidating assets (market liquidity risk) or in obtaining adequate funding (funding liquidity risk). This assessment should include analysis of sources and uses of funds, an understanding of the funding markets in which the AIFI operates, and an assessment of the efficacy of a contingency funding plan for events that could arise.

The financial market crisis underscores the importance of assessing the potential impact of liquidity risk on capital adequacy in an AIFI's ICAAP. Senior management should consider the relationship between liquidity and capital since liquidity risk can impact capital adequacy which, in turn, can aggravate an AIFI's liquidity profile.

A key element in the management of liquidity risk is the need for strong governance of liquidity risk, including the setting of a liquidity risk tolerance by the Board. The risk tolerance should be communicated throughout the AIFI and reflected in the strategy and policies that senior management set to manage liquidity risk. Another facet of liquidity risk management is that an AIFI should appropriately price the costs, benefits and risks of liquidity into the internal pricing, performance measurement, and new product approval process of all significant business activities.

An AIFI is expected to be able to thoroughly identify, measure and control liquidity risks, especially with regard to complex products and contingent commitments (both contractual and non-contractual). This process should involve the ability to project cash flows arising from assets, liabilities and off-balance sheet items over various time horizons, and should ensure diversification in both the tenor and source of funding. An AIFI should utilise early warning indicators to identify the emergence of increased risk or vulnerabilities in its liquidity position or funding needs. It should have the ability to control liquidity risk exposure and funding needs, regardless of its organisation structure, within and across legal entities, business lines, and currencies, taking into account any legal, regulatory and operational limitations to the transferability of liquidity.

While AIFIs typically manage liquidity under "normal" circumstances, they should also be prepared to manage liquidity under "stressed" conditions. An AIFI should perform stress tests or scenario analyses on a regular basis in order to identify and quantify their exposures to possible future liquidity stresses, analysing possible impacts on the institutions' cash flows, liquidity positions, profitability, and solvency. The results of these stress tests should be discussed thoroughly by management, and based on this discussion, should form the basis for taking remedial or mitigating actions to limit the AIFI's exposures, build up a liquidity cushion, and adjust its liquidity profile to fit its risk tolerance. The results of stress tests should also play a key role in shaping the AIFI's contingency funding planning, which should outline policies for managing a range of stress events and clearly sets out strategies for addressing liquidity shortfalls in emergency situations.

As public disclosure increases certainty in the market, improves transparency, facilitates valuation, and strengthens market discipline, it is important that AIFIs publicly disclose information on a regular basis that enables market participants to make informed decisions about the soundness of their liquidity risk management framework and liquidity position.

### 16.8 Off-Balance Sheet Exposures and Securitisation Risk

In light of the wide range of risks arising from securitisation activities, which can be compounded by rapid innovation in securitisation techniques and instruments, minimum capital requirements calculated under Pillar 1 are often insufficient. All risks arising from securitisation, particularly those that are not fully captured under Pillar 1, should be addressed in an AIFI's ICAAP. These risks include:

(i) Credit, market, liquidity and reputational risk of each exposure;

(ii) Potential delinquencies and losses on the underlying securitised exposures;

(iii) Exposures from credit lines or liquidity facilities to special purpose entities;

(iv) Exposures from guarantees provided by monolines and other third parties.

Securitisation exposures should be included in the AIFI's MIS to help ensure that senior management understands the implications of such exposures for liquidity, earnings, risk concentration and capital. More specifically, an AIFI should have the necessary processes in place to capture in a timely manner, updated information on securitisation transactions including market data, if available, and updated performance data from the securitisation trustee or servicer.

### 16.9 Reputational Risk and Implicit Support[83]

#### 16.9.1 Provision of Implicit Support for Securitisation Transactions

(i) Provision of implicit support to a transaction, whether contractual (i.e. credit enhancements provided at the inception of a securitised transaction) or non-contractual (implicit support) can take numerous forms. For instance, contractual support can include over collateralisation, credit derivatives, spread accounts, contractual recourse obligations, subordinated notes, credit risk mitigants provided to a specific tranche, the subordination of fee or interest income or the deferral of margin income, and clean-up calls that exceed 10 per cent of the initial issuance. Examples of implicit support include the purchase of deteriorating credit risk exposures from the underlying pool, the sale of discounted credit risk exposures into the pool of securitised credit risk exposures, the purchase of underlying exposures at above market price or an increase in the first loss position according to the deterioration of the underlying exposures.

(ii) The provision of implicit (or non-contractual) support, as opposed to contractual credit support (i.e., credit enhancements), raises significant supervisory concerns. For traditional securitisation structures the provision of implicit support undermines the clean break criteria, which when satisfied would allow AIFIs to exclude the securitised assets from regulatory capital calculations. By providing implicit support, AIFIs signal to the market that the risk is still with the AIFI and has not in effect been transferred. The institution's capital calculation therefore understates the true risk. Accordingly, national supervisors are expected to take appropriate action when a financial entity provides implicit support.

(iii) When an AIFI has been found to provide implicit support to a securitisation, it will be required to hold capital against all of the underlying exposures associated with the structure as if they had not been securitised. It will also be required to disclose publicly that it was

[83] Annex 3 of the Guidelines on Implementation of Basel III Capital Regulations in India issued vide circular DBOD.No.BP.BC.98/21.06.201/2011-2012 dated May 2, 2012 addressed to banks.

found to have provided non-contractual support, as well as the resulting increase in the capital charge (as noted above). The aim is to require AIFIs to hold capital against exposures for which they assume the credit risk, and to discourage them from providing non-contractual support.

(iv) If an AIFI is found to have provided implicit support on more than one occasion, the AIFI is required to disclose its transgression publicly and the Reserve Bank will take appropriate action that may include, but is not limited to, one or more of the following:

(a) The AIFI may be prevented from gaining favourable capital treatment on securitised assets for a period of time to be determined by the Reserve Bank;

(b) The AIFI may be required to hold capital against all securitised assets as though the AIFI had created a commitment to them, by applying a conversion factor to the risk weight of the underlying assets;

(c) For purposes of capital calculations, the AIFI be required to treat all securitised assets as if they remained on the balance sheet; and

(d) The AIFI may be required by the Reserve Bank to hold regulatory capital in excess of the minimum risk-based capital ratios.

(v) During the SREP, Reserve Bank will determine implicit support and may take appropriate supervisory action to mitigate the effects. Pending any investigation, the AIFI may be prohibited from any capital relief for planned securitisation transactions (moratorium). The action of Reserve Bank will be aimed at changing the AIFI's behaviour with regard to the provision of implicit support, and to correct market perception as to the willingness of the AIFI to provide future recourse beyond contractual obligations.

### 16.9.2 Reputational Risk on Account of Implicit Support

(i) Reputational risk can be defined as the risk arising from negative perception on the part of customers, counterparties, shareholders, investors, debt-holders, market analysts, other relevant parties or regulators that can adversely affect an AIFI's ability to maintain existing, or establish new, business relationships and continued access to sources of funding (e.g., through the interbank or securitisation markets). Reputational risk is multidimensional and reflects the perception of other market participants. Furthermore, it exists throughout the organisation and exposure to reputational risk is essentially a function of the adequacy of the AIFI's internal risk management processes, as well as the manner and efficiency with which management responds to external influences on AIFI-related transactions.

(ii) In general, the AIFIs do not engage in the structuring and sale of highly innovative financial products that may raise reputational risk concerns due to possible mis-selling to clients. However, the AIFIs that have subsidiaries may be called upon to provide unexpected capital or liquidity support to them in case the latter face financial/ liquidity stress. All the AIFIs are statutory organisations owned by government and public sector entities (except IDBI which has shareholding in SIDBI). Owing to such ownership structure, the AIFIs' activities could potentially have implications for the reputation of the Government. The AIFIs need to take into account these factors while conducting their affairs.

(iii) Reputational risk can lead to the provision of implicit support, which may give rise to credit, liquidity, market and legal risk - all of which can have a negative impact on an AIFI's earnings, liquidity and capital position. An AIFI should identify potential sources of reputational risk to which it is exposed. These include the AIFI's business lines, liabilities, affiliated operations, off-balance sheet vehicles and the markets in which it operates. The risks that arise should be incorporated into the AIFI's risk management processes and appropriately addressed in its ICAAP and liquidity contingency plans.

(iv) Reputational risk also may affect an AIFI's liabilities, since market confidence and an AIFI's ability to fund its business are closely related to its reputation. For instance, to avoid damaging its reputation, an AIFI may call its liabilities even though this might negatively affect its liquidity profile. This is particularly true for liabilities that are components of regulatory capital, such as hybrid / subordinated debt. In such cases, an AIFI's capital position is likely to suffer.

(v) AIFI management should have appropriate policies in place to identify sources of reputational risk when entering new markets, products or lines of activities. In addition, an AIFI's stress testing procedures should take account of reputational risk so management has a firm understanding of the consequences and second round effects of reputational risk.

(vi) Once an AIFI identifies potential exposures arising from reputational concerns, it should measure the amount of support it might have to provide (including implicit support of securitisations) or losses it might experience under adverse market conditions. In particular, in order to avoid reputational damages and to maintain market confidence, an AIFI should develop methodologies to measure as precisely as possible the effect of reputational risk in terms of other risk types (eg credit, liquidity, market or operational risk) to which it may be exposed. This could be accomplished by including reputational risk scenarios in regular stress tests. For instance, non-contractual off-balance sheet exposures could be included in the stress tests to determine the effect on an AIFI's credit, market and liquidity risk profiles. Methodologies also could include comparing the actual amount of exposure carried on the balance sheet versus the maximum exposure amount held off-balance sheet, that is, the potential amount to which the AIFI could be exposed.

(vii) An AIFI should pay particular attention to the effects of reputational risk on its overall liquidity position, taking into account both possible increases in the asset side of the balance sheet and possible restrictions on funding, should the loss of reputation result in various counterparties' loss of confidence.

(viii) In contrast to contractual credit exposures, such as guarantees, implicit support is a more subtle form of exposure. Implicit support arises when an AIFI provides post-sale support to a securitisation transaction in excess of any contractual obligation. Implicit support may include any letter of comfort provided by the originator in respect of the present or future liabilities of the SPV. Such non-contractual support exposes an AIFI to the risk of loss, such as loss arising from deterioration in the credit quality of the securitisation's underlying assets.

(ix) By providing implicit support, an AIFI signals to the market that all of the risks inherent in the securitised assets are still held by the organisation and, in effect, had not been transferred. Since the risk arising from the potential provision of implicit support is not captured ex ante under Pillar 1, it shall be considered as part of the Pillar 2 process. In addition, the processes for approving new products or strategic initiatives should consider the potential provision of implicit support and should be incorporated in an AIFI's ICAAP.

### 16.10 Risk Evaluation and Management

An AIFI should conduct analyses of the underlying risks when investing in the structured products (permitted by the Reserve Bank) and shall not solely rely on the external credit ratings assigned to securitisation exposures by the credit rating agencies. An AIFI should be aware that external ratings are a useful starting point for credit analysis, but are no substitute for full and proper understanding of the underlying risk, especially where ratings for certain asset classes have a short history or have been shown to be volatile. Moreover, an AIFI also should conduct credit analysis of the securitisation exposure at acquisition and on an ongoing basis. It should also have in place the necessary quantitative tools, valuation models and stress tests of sufficient sophistication to reliably assess all relevant risks.

When assessing securitisation exposures, an AIFI should ensure that it fully understands the credit quality and risk characteristics of the underlying exposures in structured credit transactions, including any risk concentrations. In addition, an AIFI should review the maturity of the exposures underlying structured credit transactions relative to the issued liabilities in order to assess potential maturity mismatches.

An AIFI should track credit risk in securitisation exposures at the transaction level and across securitisation exposures within each business line and across business lines. It should produce reliable measures of aggregate risk. An AIFI also should track all meaningful concentrations in securitisation exposures, such as name, product or sector concentrations, and feed this information to firm-wide risk aggregation systems that track, for example, credit exposure to a particular obligor.

An AIFI's own assessment of risk needs to be based on a comprehensive understanding of the structure of the securitisation transaction. It should identify the various types of triggers, credit events and other legal provisions that may affect the performance of its on- and off-balance sheet exposures and integrate these triggers and provisions into its funding/liquidity, credit and balance sheet management. The impact of the events or triggers on an AIFI's liquidity and capital position should also be considered.

An AIFI should consider scenarios which may prevent it from securitising its assets as part of its stress testing and identify the potential effect of such exposures on its liquidity, earnings and capital adequacy.

An AIFI should develop prudent contingency plans specifying how it would respond to funding, capital and other pressures that arise when access to securitisation markets is reduced. The contingency plans should also address how the AIFI would address valuation challenges for potentially illiquid positions held for sale or for trading. The risk measures, stress testing results and contingency plans should be incorporated into the AIFI's risk management processes and its ICAAP, and should result in an appropriate level of capital under Pillar 2 in excess of the minimum requirements.

An AIFI that employs risk mitigation techniques should fully understand the risks to be mitigated, the potential effects of that mitigation and whether or not the mitigation is fully effective. This is to help ensure that the AIFI does not understate the true risk in its assessment of capital. In particular, it should consider whether it would provide support to the securitisation structures in stressed scenarios due to the reliance on securitisation as a funding tool.

### 16.11 Valuation Practices

The characteristics of complex structured products, including securitisation transactions, make their valuation inherently difficult due, in part, to the absence of active and liquid markets, the complexity and uniqueness of the cash waterfalls, and the links between valuations and underlying risk factors. The absence of a transparent price from a liquid market means that the valuation shall rely on models or proxy-pricing methodologies, as well as on expert judgment. The outputs of such models and processes are highly sensitive to the inputs and parameter assumptions adopted, which may themselves be subject to estimation error and uncertainty. Moreover, calibration of the valuation methodologies is often complicated by the lack of readily available benchmarks. Therefore, an AIFI is expected to have adequate governance structures and control processes for fair valuing exposures for risk management and financial reporting purposes. The valuation governance structures and related processes should be embedded in the overall governance structure of the AIFI, and consistent for both risk management and reporting purposes. The governance structures and processes are expected to explicitly cover the role of the Board and senior

management. In addition, the Board should receive reports from senior management on the valuation oversight and valuation model performance issues that are brought to senior management for resolution, as well as all significant changes to valuation policies.

An AIFI should also have clear and robust governance structures for the production, assignment and verification of financial instrument valuations. Policies should ensure that the approvals of all valuation methodologies are well documented. In addition, policies and procedures should set forth the range of acceptable practices for the initial pricing, marking-to-market/model, valuation adjustments and periodic independent revaluation. New product approval processes should include all internal stakeholders relevant to risk measurement, risk control, and the assignment and verification of valuations of financial instruments.

An AIFI's control processes for measuring and reporting valuations should be consistently applied across the firm and integrated with risk measurement and management processes. In particular, valuation controls should be applied consistently across similar instruments (risks) and consistent across business lines (books). These controls should be subject to internal audit. Regardless of the booking location of a new product, reviews and approval of valuation methodologies shall be guided by a minimum set of considerations. Furthermore, the valuation/new product approval process should be supported by a transparent, well-documented inventory of acceptable valuation methodologies that are specific to products and businesses.

In order to establish and verify valuations for instruments and transactions in which it engages, an AIFI shall have adequate capacity, including during periods of stress. This capacity should be commensurate with the importance, riskiness and size of these exposures in the context of the business profile of the institution. In addition, for those exposures that represent material risk, an AIFI is expected to have the capacity to produce valuations using alternative methods in the event that primary inputs and approaches become unreliable, unavailable or not relevant due to market discontinuities or illiquidity. An AIFI shall test and review the performance of its models under stress conditions so that it understands the limitations of the models under stress conditions.

The relevance and reliability of valuations is directly related to the quality and reliability of the inputs. An AIFI is expected to apply the accounting guidance provided to determine the relevant market information and other factors likely to have a material effect on an instrument's fair value when selecting the appropriate inputs to use in the valuation process. Where values are determined to be in an active market, an AIFI should maximise the use of relevant observable inputs and minimise the use of unobservable inputs when estimating fair value using a valuation technique. However, where a market is deemed inactive, observable inputs or transactions may not be relevant, such as in a forced liquidation or distress sale, or transactions may not be observable, such as when markets are inactive. In such cases, accounting fair value guidance provides assistance on what should be considered, but may not be determinative. In assessing whether a source is reliable and relevant, an AIFI should consider, among other things:

(i) the frequency and availability of the prices/quotes;

(ii) whether those prices represent actual regularly occurring transactions on an arm's length basis;

(iii) the breadth of the distribution of the data and whether it is generally available to the relevant participants in the market;

(iv) the timeliness of the information relative to the frequency of valuations;

(v) the number of independent sources that produce the quotes/prices;

(vi) whether the quotes/prices are supported by actual transactions;

(vii) the maturity of the market; and

(viii) the similarity between the financial instrument sold in a transaction and the instrument held by the institution.

An AIFI's external reporting should provide timely, relevant, reliable and decision useful information that promotes transparency. Senior management should consider whether disclosures around valuation uncertainty can be made more meaningful. For instance, the AIFI may describe the modelling techniques and the instruments to which they are applied; the sensitivity of fair values to modelling inputs and assumptions; and the impact of stress scenarios on valuations. An AIFI should regularly review its disclosure policies to ensure that the information disclosed continues to be relevant to its business model and products and to current market conditions.

### 16.12 Sound Stress Testing Practices

Stress testing is an important tool that is used by AIFIs as part of their internal risk management that alerts AIFI management to adverse unexpected outcomes related to a broad variety of risks and provides an indication to AIFIs of how much capital might be needed to absorb losses should large shocks occur. Moreover, stress testing supplements other risk management approaches and measures. It plays a particularly important role in:

(i) providing forward looking assessments of risk,

(ii) overcoming limitations of models and historical data,

(iii) supporting internal and external communication,

(iv) feeding into capital and liquidity planning procedures,

(v) informing the setting of a AIFIs' risk tolerance,

(vi) addressing existing or potential, firm-wide risk concentrations, and

(vii) facilitating the development of risk mitigation or contingency plans across a range of stressed conditions.

Stress testing is especially important after long periods of benign risk, when the fading memory of negative economic conditions can lead to complacency and the underpricing of risk, and when innovation leads to the rapid growth of new products for which there is limited or no loss data.

It should be recognised that improvements in stress testing alone cannot address all risk management weaknesses, but as part of a comprehensive approach, stress testing has a leading role to play in strengthening corporate governance and the resilience of individual AIFIs and the financial system.

Stress testing should form an integral part of the overall governance and risk management culture of the AIFI. Board and senior management involvement in setting stress testing objectives, defining scenarios, discussing the results of stress tests, assessing potential actions and decision making is critical in ensuring the appropriate use of stress testing in AIFIs' risk governance and capital planning. Senior management should take an active interest in the development , and operation of, stress testing. The results of stress tests should contribute to strategic decision making and foster internal debate regarding assumptions, such as the cost, risk and speed with which new capital could be raised or what positions could be hedged or sold. Board and senior management involvement in the stress testing program is essential for its effective operation.

An AIFI's capital planning process should incorporate rigorous; forward looking stress testing that identifies possible events or changes in market conditions that could adversely impact the AIFI. AIFIs, under their ICAAPs should examine future capital resources and capital

requirements under adverse scenarios. In particular, the results of forward-looking stress testing should be considered when evaluating the adequacy of an AIFI's capital buffer. Capital adequacy should be assessed under stressed conditions against a variety of capital ratios, including regulatory ratios, as well as ratios based on the AIFI's internal definition of capital resources. In addition, the possibility that a crisis impairs the ability of even a healthy financial entity to raise funds at reasonable cost should be considered.

An AIFI should develop methodologies to measure the effect of reputational risk in terms of other risk types, namely credit, liquidity, market and other risks that they may be exposed to in order to avoid reputational damages and in order to maintain market confidence. This could be done by including reputational risk scenarios in regular stress tests. For instance, including non-contractual off-balance sheet exposures in the stress tests to determine the effect on an AIFI's credit, market and liquidity risk profiles.

An AIFI should carefully assess the risks with respect to commitments to off-balance sheet vehicles and third-party firms related to structured credit securities and the possibility that assets will need to be taken on balance sheet for reputational reasons. Therefore, in its stress testing programme, an AIFI should include scenarios assessing the size and soundness of such vehicles and firms relative to its own financial, liquidity and regulatory capital positions. This analysis should include structural, solvency, liquidity and other risk issues, including the effects of covenants and triggers.

### 16.13 Compensation Practices

Risk management shall be embedded in the culture of an AIFI. It should be a critical focus of the CEO/Managing Director, Chief Risk Officer (CRO), senior management, trading desk and other business line heads and employees in making strategic and day-to-day decisions. For a broad and deep risk management culture to develop and be maintained over time, compensation policies shall not be unduly linked to short term accounting profit generation. Compensation policies should be linked to longer term capital preservation and the financial strength of the firm and should consider risk-adjusted performance measures. In addition, an AIFI should provide adequate disclosure regarding its compensation policies to stakeholders. Each AIFI's board of directors and senior management have the responsibility to mitigate the risks arising from remuneration policies in order to ensure effective firm-wide risk management.

Compensation practices at large financial institutions are one factor among many that contributed to the financial crisis that began in 2007. High short-term profits led to generous bonus payments to employees without adequate regard to the longer-term risks they imposed on their firms. These incentives amplified the excessive risk taking that has threatened the global financial system and left firms with fewer resources to absorb losses as risks materialised. The lack of attention to risk also contributed to the large, in some cases extreme absolute level of compensation in the industry. As a result, to improve compensation practices and strengthen supervision in this area, particularly for systemically important firms, the Financial Stability Board (formerly the Financial Stability Forum) published its Principles for Sound Compensation Practices in April 2009.

An AIFI's Board shall actively oversee the compensation system's design and operation, which should not be controlled primarily by the chief executive officer and management team. Relevant board members and employees shall have independence and expertise in risk management and compensation. In addition, the Board shall monitor and review the compensation system to ensure the system includes adequate controls and operates as intended. The practical operation of the system should be regularly reviewed to ensure compliance with policies and procedures. Compensation outcomes, risk measurements, and risk outcomes should be regularly reviewed for consistency with intentions.

Staff that are engaged in the financial and risk control areas shall be independent, have appropriate authority, and be compensated in a manner that is independent of the business

areas they oversee and commensurate with their key role in the firm. Effective independence and appropriate authority of such staff is necessary to preserve the integrity of financial and risk management's influence on incentive compensation.

Compensation shall be adjusted for all types of risk so that remuneration is balanced between the profit earned and the degree of risk assumed in generating the profit. In general, both quantitative measures and human judgment should play a role in determining the appropriate risk adjustments, including those that are difficult to measure such as liquidity risk and reputation risk.

Compensation outcomes shall be symmetric with risk outcomes and compensation systems should link the size of the bonus pool to the overall performance of the firm. Employees' incentive payments should be linked to the contribution of the individual and business to the firm's overall performance.

Compensation payout schedules shall be sensitive to the time horizon of risks. Profits and losses of different activities of a financial firm are realised over different periods of time. Variable compensation payments should be deferred accordingly. Payments should not be finalised over short periods where risks are realised over long periods. Management should question payouts for income that cannot be realised or whose likelihood of realisation remains uncertain at the time of payout.

The mix of cash, equity and other forms of compensation shall be consistent with risk alignment. The mix will vary depending on the employee's position and role. The firm should be able to explain the rationale for its mix.

The Reserve Bank will review compensation practices in a rigorous and sustained manner and deficiencies, if any, will be addressed promptly with the appropriate supervisory action.

The risk factors discussed above shall not be considered an exhaustive list of those affecting any given AIFI. All relevant factors that present a material source of risk to capital should be incorporated in a well-developed ICAAP. Furthermore, AIFIs should be mindful of the capital adequacy effects of concentrations that may arise within each risk type.

### 16.14 Quantitative and Qualitative Approaches in ICAAP

(i) All measurements of risk incorporate both quantitative and qualitative elements, but to the extent possible, a quantitative approach should form the foundation of an AIFI's measurement framework. In some cases, quantitative tools can include the use of large historical databases; when data are more scarce, an AIFI may choose to rely more heavily on the use of stress testing and scenario analyses. AIFIs should understand when measuring risks that measurement error always exists, and in many cases the error is itself difficult to quantify. In general, an increase in uncertainty related to modeling and business complexity should result in a larger capital cushion.

(ii) Quantitative approaches that focus on most likely outcomes for budgeting, forecasting, or performance measurement purposes may not be fully applicable for capital adequacy because the ICAAP should also take less likely events into account. Stress testing and scenario analysis can be effective in gauging the consequences of outcomes that are unlikely but would have a considerable impact on safety and soundness.

(iii) To the extent that risks cannot be reliably measured with quantitative tools – for example, where measurements of risk are based on scarce data or unproven quantitative methods – qualitative tools, including experience and judgment, may be more heavily utilised. AIFIs should be cognisant that qualitative approaches have their own inherent biases and assumptions that affect risk assessment; accordingly, AIFIs should recognise the biases and assumptions embedded in, and the limitations of, the qualitative approaches used.

### 16.15 Risk Aggregation and Diversification Effects

(i) An effective ICAAP should assess the risks across the entire AIFI. An AIFI choosing to conduct risk aggregation among various risk types or business lines should understand the challenges in such aggregation. In addition, when aggregating risks, AIFIs should ensure that any potential concentrations across more than one risk dimension are addressed, recognising that losses could arise in several risk dimensions at the same time, stemming from the same event or a common set of factors. For example, a localised natural disaster could generate losses from credit, market, and operational risks at the same time.

(ii) In considering the possible effects of diversification, management should be systematic and rigorous in documenting decisions, and in identifying assumptions used in each level of risk aggregation. Assumptions about diversification should be supported by analysis and evidence. The AIFI should have systems capable of aggregating risks based on the AIFI's selected framework. For example, an AIFI calculating correlations within or among risk types should consider data quality and consistency, and the volatility of correlations over time and under stressed market conditions.

(iii) AIFIs may undertake new activities including the ones which are only indirectly related to their statutory mandates. Normally AIFIs would not have prior expertise in these areas. Due care needs to be taken to identify and manage the strategic risks arising from taking new initiatives, e.g., expanding the scope of their refinance activities to a new set of institutions and designing new refinance products, new investment/ financial products, entering into partnership with banks to introduce new products, etc.

## Part C: Market Discipline

### 17. Guidelines on Market Discipline

### 17.1 General

**17.1.1** The purpose of Market discipline is to complement the minimum capital requirements (detailed under Pillar 1) and the supervisory review process (detailed under Pillar 2). The aim is to encourage market discipline by developing a set of disclosure requirements which will allow market participants to assess key pieces of information on the scope of application, capital, risk exposures, risk assessment processes and hence, the capital adequacy of the institution.

**17.1.2** In principle, AIFI's disclosures should be consistent with how senior management and the Board assess and manage the risks of the AIFI. Under Pillar 1, AIFIs use specified approaches / methodologies for measuring the various risks they face and the resulting capital requirements. It is believed that providing disclosures that are based on a common framework is an effective means of informing the market about an AIFI's exposure to those risks and provides a consistent and comprehensive disclosure framework that enhances comparability.

### 17.2 Achieving Appropriate Disclosure

**17.2.1** Market discipline can contribute to a safe and sound banking/financial sector environment. Hence, non-compliance with the prescribed disclosure requirements would attract a penalty, including financial penalty. However, it is not intended that direct additional capital requirements would be a response to non-disclosure, except as indicated below.

**17.2.2** In addition to the general intervention measures, the Basel Capital Adequacy Framework also anticipates a role for specific measures. Where disclosure is a qualifying criterion under Pillar 1 to obtain lower risk weightings and/or to apply specific methodologies, there would be a direct sanction (not being allowed to apply the lower risk weighting or the specific methodology).

### 17.3 Interaction with Accounting Disclosures

It is recognised that the Pillar 3 disclosure framework does not conflict with requirements under accounting standards, which are broader in scope. The BCBS has taken considerable efforts to see that the narrower focus of Pillar 3, which is aimed at disclosure of AIFI capital adequacy, does not conflict with the broader accounting requirements. The Reserve Bank will consider future modifications to the Market Discipline disclosures as necessary in light of its ongoing monitoring of this area and industry developments.

### 17.4 Validation

The disclosures in this manner should be subjected to adequate validation. For example, since information in the annual financial statements would generally be audited, the additional material published with such statements shall be consistent with the audited statements. In addition, supplementary material (such as Management's Discussion and Analysis) that is published should also be subjected to sufficient scrutiny (e.g., internal control assessments, etc.) to satisfy the validation issue. If material is not published under a validation regime, for instance in a stand-alone report or as a section on a website, then management should ensure that appropriate verification of the information takes place, in accordance with the general disclosure principle set out below. In the light of the above, Pillar 3 disclosures will not be required to be audited by an external auditor, unless specified.

### 17.5 Materiality

An AIFI should decide which disclosures are relevant for it based on the materiality concept. Information would be regarded as material if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions. This definition is consistent with International Accounting Standards and with the national accounting framework. The Reserve Bank recognises the need for a qualitative judgment of whether, in light of the particular circumstances, a user of financial information would consider the item to be material (user test). The Reserve Bank does not consider it necessary to set specific thresholds for disclosure as the user test is a useful benchmark for achieving sufficient disclosure. However, with a view to facilitate smooth transition to greater disclosures as well as to promote greater comparability among the AIFIs' Pillar 3 disclosures, the materiality thresholds have been prescribed for certain limited disclosures. Notwithstanding the above, AIFIs are encouraged to apply the user test to these specific disclosures and where considered necessary make disclosures below the specified thresholds also.

### 17.6 Proprietary and Confidential Information

Proprietary information encompasses information (for example on products or systems), that if shared with competitors would render an AIFI's investment in these products/systems less valuable, and hence would undermine its competitive position. Information about customers is often confidential, in that it is provided under the terms of a legal agreement or counterparty relationship. This has an impact on what AIFIs should reveal in terms of information about their customer base, as well as details on their internal arrangements, for instance methodologies used, parameter estimates, data etc. The Reserve Bank believes that the requirements set out below strike an appropriate balance between the need for meaningful disclosure and the protection of proprietary and confidential information.

### 17.7 General Disclosure Principle

AIFIs should have a formal disclosure policy approved by the Board that addresses the AIFI's approach for determining what disclosures it will make and the internal controls over the disclosure process. In addition, AIFIs should implement a process for assessing the appropriateness of their disclosures, including validation and frequency.

### 17.8 Implementation Date

The AIFIs shall make their first set of disclosures under Basel III with reference to the position as of June 30, 2024 (September 30, 2024 in case of NHB).

### 17.9 Scope and Frequency of Disclosures

**17.9.1** Pillar 3 applies at the top consolidated level of the group to which the Capital Adequacy Framework applies.

**17.9.2** AIFIs are required to make Pillar 3 disclosures[84] at least on a half yearly basis, irrespective of whether financial statements are audited, with the exception of following disclosures:

(i) Table DF-2: Capital Adequacy;

(ii) Table DF-3: Credit Risk: General Disclosures for All AIFIs; and

(iii) Table DF-4: Credit Risk: Disclosures for Portfolios subject to the Standardised Approach.

The disclosures as indicated at (i), (ii) and (iii) above will be made at least on a quarterly

[84] Please refer to **Annex 16** for detailed Pillar 3 disclosure templates.

basis by AIFIs.

**17.9.3** All disclosures shall either be included in an AIFI's published financial results / statements or, at a minimum, shall be disclosed on AIFI's website. If an AIFI finds it operationally inconvenient to make these disclosures along with published financial results / statements, the AIFI shall provide in these financial results / statements, a direct link to where the Pillar 3 disclosures can be found on the AIFI's website. The Pillar 3 disclosures should be made concurrent with publication of financial results / statements.

**17.9.4** However, AIFIs may note that in the case of main features template (as indicated in section 17.13.7) and provision of the full terms and conditions of capital instruments (as indicated in section 17.13.8), AIFIs are required to update these disclosures concurrently whenever a new capital instrument is issued and included in capital or whenever there is a redemption, conversion / write-down or other material change in the nature of an existing capital instrument.

### 17.10 Regulatory Disclosure Section

**17.10.1** AIFIs are required to make disclosures in the format as specified in **Annex 16** of this Chapter. AIFIs have to maintain a 'Regulatory Disclosures Section' on their websites, where all the information relating to disclosures will be made available to the market participants. The direct link to this page should be prominently provided on the home page of an AIFI's website and it should be easily accessible. This requirement is essentially to ensure that the relevance / benefit of Pillar 3 disclosures is not diminished by the challenge of finding the disclosure in the first place.

**17.10.2** An archive for at least three years of all templates relating to prior reporting periods should be made available by AIFIs on their websites.

### 17.11 Pillar 3 under Basel III Framework

**17.11.1** The Pillar 3 disclosure requirements under Basel III Framework are set out in the form of following templates:

#### 17.11.1.1 Disclosure Template

A common template which will be used by AIFIs to report the details of their regulatory capital. It is designed to meet the Basel III requirement to disclose all regulatory adjustments. The template enhances consistency and comparability in the disclosure of the elements of capital between AIFIs and across jurisdictions.

#### 17.11.1.2 Reconciliation Requirements

In order to meet the reconciliation requirements as envisaged under Basel III, a three-step approach has been devised. This step-by-step approach to reconciliation ensures that the Basel III requirement to provide a full reconciliation of all regulatory capital elements back to the published financial statements is met in a consistent manner.

#### 17.11.1.3 Main Features Template

A common template has been designed to capture the main features of all regulatory capital instruments issued by an AIFI at one place. This disclosure requirement is intended to meet the Basel III requirement to provide a description of the main features of capital instruments.

#### 17.11.1.4 Other Disclosure Requirements

This disclosure enables AIFIs in meeting the Basel III requirement to provide the full terms and conditions of capital instruments on their websites.

**17.11.1.5** Pillar 3 disclosure requirements also include certain aspects that are not specifically required to compute capital requirements under Pillar 1. It may be noted that beyond disclosure requirements as set forth in these guidelines, AIFIs are responsible for conveying their actual risk profile to market participants. The information AIFIs disclose shall be adequate to fulfill this objective. In addition to the specific disclosure requirements as set out in the guidelines, AIFIs should also make additional disclosures in the following areas:

(i) Securitisation exposures in the trading book;
(ii) Sponsorship of off-balance sheet vehicles;
(iii) Valuation with regard to securitisation exposures; and
(iv) Pipeline and warehousing risks with regard to securitisation exposures.

### 17.12 Disclosure Template

**17.12.1** The common template which AIFIs should use is set out in **Table DF-11 of Annex 16**, along with explanations. The template is designed to capture the capital positions of AIFIs.

**17.12.2** It may be noted that AIFIs should not add or delete any rows / columns from the common reporting template. This is essential to ensure that there is no divergence in reporting templates across financial entities falling under the Basel III framework across jurisdictions which could undermine the objectives of consistency and comparability of their regulatory capital.

**17.12.3** The Basel Committee has suggested that in cases where the national implementation of Basel III rules[85] applies a more conservative definition of an element (e.g., components and criteria of regulatory capital, regulatory adjustments etc.), national authorities may choose between one of the two approaches listed below for the purpose of disclosure:

***Approach 1:*** In the national version of the template, AIFIs are required to maintain the same definitions[86] of all rows. Further, AIFIs will have to report the impact of the more conservative national definition in the rows exclusively designated for national specific adjustments.

***Approach 2:*** In the national version of the template, AIFIs are required to use the definitions of elements as implemented in that jurisdiction[87], clearly labelling them as being different from the Basel III minimum definition[88], and AIFIs are required to separately disclose the impact of each of these different definitions in the notes to the template.

**17.12.4** The aim of both the approaches is to provide all the information necessary to enable market participants to calculate the capital of AIFIs on a common basis. In the Indian context, Approach 2 appears to be more practical and less burdensome for AIFIs than the Approach 1. Under the Approach 2, AIFIs have to furnish data based on the definition of capital / regulatory adjustments as implemented in India. The difference with the Basel III minimum can be separately disclosed and explained in notes to the templates. This way of

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[85] As defined in the DBOD.No.BP.BC.98/21.06.201/2011-12 dated May 2, 2012 addressed to banks on Guidelines on Implementation of Basel III Capital Regulations in India.
[86] Basel III: A global regulatory framework for more resilient banks and banking systems, December 2010 (rev June 2011).
[87] As defined in the DBOD.No.BP.BC.98/21.06.201/2011-12 dated May 2, 2012 addressed to banks on Guidelines on Implementation of Basel III Capital Regulations in India.
[88] Basel III: A global regulatory framework for more resilient banks and banking systems, December 2010 (rev June 2011).

disclosure will be more relevant and comprehensible to a larger number of users of disclosures more specifically, the domestic users. At the same time, information provided in the notes to the templates to indicate differences from Basel III minimum will help facilitate cross-jurisdictional comparison of AIFIs' capital, should users desire. Accordingly, the disclosure templates have been customised, keeping in view the consistency and comparability of disclosures.

### 17.13 Reconciliation Requirements

**17.13.1** AIFIs will be required to disclose a full reconciliation of all regulatory capital elements back to the balance sheet in the audited (or unaudited) financial statements. This requirement aims to address disconnect, if any, present in an AIFI's disclosure between the numbers used for the calculation of regulatory capital and the numbers used in the balance sheet.

**17.13.2** AIFIs will have to follow a three step approach to show the link between their balance sheet and the numbers which are used in the composition of capital disclosure template set out in **Annex 16 (Table DF-11)**. The three steps are explained below and also illustrated in **Table DF-12 of Annex 16**:

**Step 1:** AIFIs are required to disclose the reported balance sheet under the regulatory scope of consolidation[89] (**Table DF-12 of Annex 16**);

**Step 2:** AIFIs will have to expand the lines of the balance sheet under regulatory scope of consolidation (**Table DF-12 of Annex 16**) to display all components which are used in the composition of capital disclosure template (**Table DF-11 of Annex 16**); and

**Step 3:** Finally, AIFIs will have to map each of the components that are disclosed in Step 2 to the composition of capital disclosure template set out in **Table DF-11 of Annex 16**.

#### 17.13.3 *Step 1:* Disclose *the reported balance sheet under the regulatory scope of consolidation*

(i) The scope of consolidation for accounting purposes is often different from that applied for the regulatory purposes. Usually, there will be difference between the financial statements of an AIFI specifically, the AIFI's balance sheet in published financial statements and the balance sheet considered for the calculation of regulatory capital. Therefore, the reconciliation process involves disclosing how the balance sheet changes when the regulatory scope of consolidation is applied for the purpose of calculation of regulatory capital on a consolidated basis.

(ii) Accordingly, AIFIs are required to disclose the list of the legal entities which have been included within accounting scope of consolidation but excluded from the regulatory scope of consolidation. This is intended to enable market participants and supervisors to investigate the risks posed by unconsolidated entities (e.g., unconsolidated subsidiaries). Similarly, AIFIs are required to list the legal entities which have been included in the regulatory consolidation but not in the accounting scope of consolidation. Finally, it is possible that some entities are included in both the regulatory scope of consolidation and accounting scope of consolidation, but the method of consolidation differs between these two scopes. In such cases, AIFIs are required to list these legal entities and explain the differences in the consolidation methods.

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[89] Regulatory scope of consolidation is explained in section 6 of this Chapter.

(iii) If the scope of regulatory consolidation and accounting consolidation is identical for a particular group, it would not be required to undertake Step 1. The group would state that there is no difference between the regulatory consolidation and the accounting consolidation and move to Step 2.

(iv) In addition to the above requirements, AIFIs shall disclose for each legal entity, its total balance sheet assets, total balance sheet equity (as stated on the accounting balance sheet of the legal entity), method of consolidation and a description of the principle activities of the entity. These disclosures are required to be made as indicated in the revised templates namely **Table DF-1: Scope of Application of Annex 16.**

### *17.13.4 Step 2: Expand the lines of the regulatory balance sheet to display all of the components used in the definition of capital disclosure template (Table DF-11 of Annex 16)*

(i) Many of the elements used in the calculation of regulatory capital may not be readily identified from the face of the balance sheet. This requires that AIFIs should expand the rows of the balance sheet under regulatory scope of consolidation such that all the components used in the definition of capital disclosure template (**Table DF-11 of Annex 16***)* are displayed separately.

(ii) For example, paid-up share capital may be reported as one line on the balance sheet. However, some elements of this may meet the requirements for inclusion in Common Equity Tier 1 (CET1) capital and other elements may only meet the requirements for Additional Tier 1 (AT1) or Tier 2 (T2) capital, or may not meet the requirements for inclusion in regulatory capital at all. Therefore, if an AIFI has some amount of paid-up capital which goes into the calculation of CET1 and some amount which goes into the calculation of AT1, it should expand the 'paid-up share capital' line of the balance sheet in the following way:

| Paid-up share capital | | Ref |
|---|---|---|
| of which amount eligible for CET1 | | e |
| of which amount eligible for AT1 | | f |

(iii) In addition, as illustrated above, each element of the expanded balance sheet shall be given a reference number / letter for use in Step 3.

(iv) Another example is regulatory adjustments of the deduction of intangible assets. *Firstly,* there could be a possibility that the intangible assets may not be readily identifiable in the balance sheet. There is a possibility that the amount on the balance sheet may combine goodwill and other intangibles. *Secondly,* the amount to be deducted is net of any related deferred tax liability. This deferred tax liability is likely to be reported in combination with other deferred tax liabilities which have no relation to goodwill or intangibles. Therefore, the AIFI should expand the balance sheet in the following way:

| Goodwill and intangible assets | | Ref |
|---|---|---|
| of which goodwill | | a |
| of which other intangibles | | b |

| Current and deferred tax liabilities (DTLs) | | Ref |
|---|---|---|
| of which DTLs related to goodwill | | c |
| of which DTLs related to other intangible assets | | d |

(v) AIFIs will need to expand elements of the balance sheet only to the extent required to reach the components which are used in the definition of capital disclosure template. For example, if entire paid-up capital of the AIFI met the requirements to be included in CET1, the AIFI would not need to expand this line.

***17.13.5 Step 3: Map each of the components that are disclosed in Step 2 to the composition of capital disclosure templates***

(i) When reporting the disclosure template (i.e., ***Table DF-11 of Annex 16***), an AIFI is required to use the reference numbers / letters from Step 2 to show the source of every input.

(ii) For example, if the composition of capital disclosure template (**Table DF-11 of Annex 16**) includes the line 'goodwill net of related deferred tax liability', then next to this item the AIFI should put 'a - c'. This is required to illustrate that how these components of the balance sheet under the regulatory scope of consolidation have been used to calculate this item in the disclosure template.

**17.13.6** The three step approach is flexible and offers the following benefits:

(i) the level of disclosure is proportionate, varying with the complexity of the balance sheet of the reporting AIFI (i.e., AIFIs are not subject to a fixed template. An AIFI may skip a step if there is no further information added by that step);

(ii) supervisors and market participants can trace the origin of the elements of the regulatory capital back to their exact location on the balance sheet under the regulatory scope of consolidation; and

(iii) the approach is flexible enough to be used under any accounting standards. AIFIs are required to map all the components of the regulatory capital disclosure templates back to the balance sheet under the regulatory scope of consolidation, regardless of where the accounting standards require the source to be reported on the balance sheet.

**17.13.7 Main Features Template**

**17.13.7.1** AIFIs are required to complete a 'main features template' to ensure consistency and comparability of disclosures of the main features of capital instruments. AIFIs are required to disclose a description of the main features of capital instruments issued by them. Besides, AIFIs will also be required to make available the full terms and conditions of their capital instruments (section 17.13.8 below). The requirement of separately disclosing main features of capital instruments is intended to provide an overview of the capital structure. Many times, it may not be possible for the users to extract key features of capital instruments with ease from the full disclosure of terms and conditions of capital instruments.

**17.13.7.2** This template represents the minimum level of summary disclosure which are required to be reported in respect of each regulatory capital instrument issued. The main feature disclosure template is set out in **Table DF-13 of Annex 16** along with a description of each of the items to be reported. Some of the key aspects of the 'Main Features Template' are as under:

(i) it is designed to be completed by AIFIs from when the Basel III capital regulations come into effect.

(ii) AIFIs are required to report each capital instrument (including common shares) in a separate column of the template, such that the completed template would provide a 'main features report' that summarises all of the regulatory capital instruments of the group.

**17.13.7.3** AIFIs are required to keep the completed main features report up-to-date. AIFIs should ensure that the report is updated and made publicly available, whenever a capital instrument is issued or repaid and whenever there is redemption, conversion / write-down or other material change in the nature of an existing capital instrument.

### 17.13.8 Other Disclosure Requirements

In addition to the disclosure requirements set out in above sections, AIFIs are required to make the following disclosure in respect of the composition of capital:

(i) Full Terms and Conditions: AIFIs are required to make available on their websites[90] the full terms and conditions of all instruments included in regulatory capital. The requirement for AIFIs to make available the full terms and conditions of instruments on their websites will allow supervisors and market participants to investigate the specific features of individual capital instruments.

(ii) AIFIs are required to keep the terms and conditions of all capital instruments up-to-date **(Table DF-14 of Annex 16)**. Whenever there is a change in the terms and conditions of a capital instrument, AIFIs should update them promptly and make publicly available such updated disclosure.

## 17.14 The Disclosure Templates

All Pillar 3 disclosure templates as set out in these guidelines are furnished in tabular form in **Annex 16**. Additional relevant definitions and explanations are also provided for the Pillar 3 disclosures.

[90] Please refer to section 17.10 of this Chapter.

## Part D: Leverage Ratio Framework[91]

### 18. Leverage Ratio

### 18.1 Rationale and Objective

An underlying cause of the global financial crisis was the build-up of excessive on- and off-balance sheet leverage in the banking system. In many cases, banks built up excessive leverage while apparently maintaining strong risk-based capital ratios. During the most severe part of the crisis, the banking sector was forced by the market to reduce its leverage in a manner that amplified downward pressure on asset prices. This deleveraging process exacerbated the feedback loop between losses, falling bank capital and contraction in credit availability. Therefore, under Basel III, a simple, transparent, non-risk based leverage ratio has been introduced. The leverage ratio is calibrated to act as a credible supplementary measure to the risk based capital requirements and is intended to achieve the following objectives:

(i) constrain the build-up of leverage in the banking sector to avoid destabilising deleveraging processes which can damage the broader financial system and the economy; and

(ii) reinforce the risk-based requirements with a simple, non-risk based "backstop" measure.

### 18.2 Definition, Minimum Requirement and Scope of Application of the Leverage Ratio

#### *18.2.1 Definition and* minimum *requirement*

(i) The Basel III leverage ratio is defined as the capital measure (the numerator) divided by the exposure measure (the denominator), with this ratio expressed as a percentage

$$Leverage\ Ratio = \frac{Capital\ Measure}{Exposure\ Measure}$$

(ii) AIFIs shall maintain minimum leverage ratio of 4%. Both the capital measure and the exposure measure along with Leverage Ratio are to be disclosed on a quarter-end basis. However, AIFIs must meet the minimum Leverage Ratio requirement at all times (on an ongoing basis).

#### *18.2.2 Scope of consolidation*

(i) The Basel III leverage ratio framework follows the same scope of regulatory consolidation as is used for the risk-based capital framework[92].

(ii) *Treatment of investments in the capital of banking, financial, insurance and commercial entities that are outside the regulatory scope of consolidation*: in cases where a banking, financial, insurance or commercial entity is outside the scope of regulatory consolidation, only the investment in the capital of such entities (i.e., only the carrying value

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[91] Please refer to Annex 5 of Guidelines on Implementation of Basel III Capital Regulations in India issued vide circular DBOD.No.BP.BC.98/21.06.201/2011-12 dated May 2, 2012 addresses to banks.

[92] Please refer to section 6: Scope of Application of Capital Adequacy Framework. Please also refer to circulars DBOD.No.BP.BC.72/21.04.018/2001-02 dated February 25, 2003 addressed to banks and DBOD.No.FSD.BC.46/24.01.028/2006-07 dated December 12, 2006 addresses to banks.

of the investment, as opposed to the underlying assets and other exposures of the investee) is to be included in the leverage ratio exposure measure. However, investments in the capital of such entities that are deducted from Tier 1 capital (i.e., either deduction from Common Equity Tier 1 capital or deduction from Additional Tier 1 capital following corresponding deduction approach) as set out in section 7.5 – Regulatory Adjustments / Deductions[93] of this Chapter may be excluded from the leverage ratio exposure measure.

### 18.3 Capital Measure

The capital measure for the leverage ratio is the Tier 1 capital of the risk-based capital framework[94], taking into account various regulatory adjustments / deductions and the transitional arrangements. In other words, the capital measure used for the leverage ratio at any particular point in time is the Tier 1 capital measure applying at that time under the risk-based framework.

### 18.4 Exposure Measure

#### 18.4.1 General Measurement Principles

(i) The exposure measure for the leverage ratio should generally follow the accounting value, subject to the following:

(ii) On-balance sheet, non-derivative exposures are included in the exposure measure net of specific provisions or accounting valuation adjustments (e.g., accounting credit valuation adjustments, prudent valuation adjustments for AFS and HFT positions);

(iii) netting of loans and deposits is not allowed.

(iv) Unless specified differently below, AIFIs shall not take account of physical or financial collateral, guarantees or other credit risk mitigation techniques to reduce the exposure measure.

(v) An AIFI's total exposure measure is the sum of the following exposures:

(a) on-balance sheet exposures;

(b) derivative exposures;

(c) securities financing transaction (SFT) exposures; and

(d) off- balance sheet (OBS) items.

The specific treatments for these four main exposure types are defined in sections 18.4.2 to 18.4.5 below.

#### 18.4.2 On-balance sheet exposures

**18.4.2.1** AIFIs shall include all balance sheet assets in their exposure measure, including on-balance sheet derivatives collateral and collateral for SFTs, with the exception of on-balance sheet derivative and SFT assets that are covered in sections 18.4.3 and 18.4.4 below[95].

**18.4.2.2** However, to ensure consistency, balance sheet assets deducted from Tier 1 capital as set out in section 7.4 - Regulatory Adjustments / Deductions may be deducted

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[93] Regulatory adjustments / deductions as indicated in section 7.5.

[94] Tier 1 capital as defined in section 7: Composition of regulatory capital.

[95] Where an AIFI according to its operative accounting framework recognises fiduciary assets on the balance sheet, these assets can be excluded from the leverage ratio exposure measure provided that the assets meet the IFRS 9 criteria for derecognition and, where applicable, IFRS 10 for deconsolidation. When disclosing the leverage ratio, AIFIs must also disclose the extent of such de-recognised fiduciary items.

from the exposure measure. For example, where a banking, financial or insurance entity is not included in the regulatory scope of consolidation (as set out in section 18.2.2), the amount of any investment in the capital of that entity that is totally or partially deducted from CET1 capital or from Additional Tier 1 capital of the AIFI (in terms of sections 6.2.2 and 7.5.2(C) of this Chapter) may also be deducted from the exposure measure.

**18.4.2.3** Liability items shall not be deducted from the exposure measure. For example, gains/losses on fair valued liabilities or accounting value adjustments on derivative liabilities due to changes in the AIFI's own credit risk as described in section 7.4.5 shall not be deducted from the exposure measure.

### 18.4.3 Derivative exposures

**18.4.3.1** ***Treatment of*** **derivatives*:*** Derivatives create two types of exposure:

(i) an exposure arising from the underlying of the derivative contract; and

(ii) a counterparty credit risk (CCR) exposure.

The leverage ratio framework uses the method set out below to capture both of these exposure types.

**18.4.3.2** AIFIs shall calculate their derivative exposures[96], including where an AIFI sells protection using a credit derivative, as the replacement cost (RC)[97] for the current exposure plus an add-on for *potential* future exposure (PFE), as described in section 18.4.3.3 below. If the derivative exposure is covered by an eligible bilateral netting contract as specified in the **Annex 17** (part B), an alternative treatment as indicated in section 18.4.3.4 below may be applied[98]. Written credit derivatives are subject to an additional treatment, as set out in sections 18.4.3.10 to 18.4.3.12 below.

**18.4.3.3** For a single derivative contract, not covered by an eligible bilateral netting contract as specified in **Annex 17** (part B), the amount to be included in the exposure measure is determined as follows:

exposure measure = replacement cost (RC) + add-on

*where;*

RC = the replacement cost of the contract (obtained by marking to market), where the contract has a positive value.

add-on = an amount for PFE over the remaining life of the contract calculated by applying an add-on factor to the notional principal amount of the derivative. The add-on factors are given in Table 9 of section 8.16.3.3 and Tables 20 & 21 of section 11.6.3.

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[96] This approach makes reference to the Current Exposure Method (CEM) to calculate CCR exposure amounts associated with derivative exposures. AIFIs operating in India may continue to use CEM until advised otherwise by the Reserve Bank.

[97] If, under the relevant accounting standards, there is no accounting measure of exposure for certain derivative instruments because they are held (completely) off-balance sheet, the AIFI must use the sum of positive fair values of these derivatives as the replacement cost.

[98] These netting rules are with the exception of cross-product netting i.e. cross-product netting is not permitted in determining the leverage ratio exposure measure. However, where an AIFI has a cross-product netting agreement in place that meets the eligibility criteria of **Annex 17** (part B) it may choose to perform netting separately in each product category provided that all other conditions for netting in this product category that are applicable to the Basel III leverage ratio are met.

**18.4.3.4** ***Bilateral* netting*:*** when an eligible bilateral netting contract is in place as specified in **Annex 17** (part B), the RC for the set of derivative exposures covered by the contract will be the sum of net replacement cost and the add-on factors as described in section 18.4.3.3 above will be $A_{Net}$ as calculated below:

(a) Credit exposure on bilaterally netted forward transactions will be calculated as the sum of the net mark-to-market replacement cost, if positive, plus an add-on based on the notional underlying principal. The add-on for netted transactions ($A_{Net}$) will equal the weighted average of the gross add-on ($A_{Gross}$) and the gross add-on adjusted by the ratio of net current replacement cost to gross current replacement cost (NGR). This is expressed through the following formula:

$$A_{Net} = 0.4 \cdot A_{Gross} + 0.6 \cdot NGR \cdot A_{Gross}$$

*where:*

NGR = level of net replacement cost/level of gross replacement cost for transactions subject to legally enforceable netting agreements[99]

$A_{Gross}$ = sum of individual add-on amounts (calculated by multiplying the notional principal amount by the appropriate add-on factors set out in Table 9 of section 8.16.3.3 and Tables 20 & 21 of section 11.6.3) of all transactions subject to legally enforceable netting agreements with one counterparty.

(b) For the purposes of calculating potential future credit exposure to a netting counterparty for forward foreign exchange contracts and other similar contracts in which the notional principal amount is equivalent to cash flows, the notional principal is defined as the net receipts falling due on each value date in each currency. The reason for this is that offsetting contracts in the same currency maturing on the same date will have lower potential future exposure as well as lower current exposure.

**18.4.3.5** ***Treatment of related collateral:*** collateral received in connection with derivative contracts has two countervailing effects on leverage:

(i) it reduces counterparty exposure; but
(ii) it can also increase the economic resources at the disposal of the AIFI, as the AIFI can use the collateral to leverage itself.

**18.4.3.6** Collateral received in connection with derivative contracts does not necessarily reduce the leverage inherent in an AIFI's derivatives position, which is generally the case if the settlement exposure arising from the underlying derivative contract is not reduced. As a general rule, collateral received may not be netted against derivative exposures whether or not netting is permitted under the AIFI's operative accounting or risk-based framework. Therefore, it is advised that when calculating the exposure amount by applying sections 18.4.3.2 to 18.4.3.4 above, an AIFI shall not reduce the exposure amount by any collateral received from the counterparty.

**18.4.3.7** Similarly, with regard to collateral provided, AIFIs shall gross up their exposure measure by the amount of any derivatives collateral provided where the effect of providing collateral has reduced the value of their balance sheet assets under their operative accounting framework.

[99] AIFIs must calculate NGR on a counterparty by counterparty basis for all transactions that are subject to legally enforceable netting agreements

**18.4.3.8** ***Treatment of cash variation margin:*** in the treatment of derivative exposures for the purpose of the leverage ratio, the cash portion of variation margin exchanged between counterparties may be viewed as a form of pre-settlement payment, if the following conditions are met:

(i) For trades not cleared through a qualifying central counterparty (QCCP), the cash received by the recipient counterparty is not segregated[100].

(ii) Variation margin is calculated and exchanged on a daily basis based on mark-to-market valuation of derivatives positions[101].

(iii) The cash variation margin is received in the same currency as the currency of settlement of the derivative contract[102].

(iv) Variation margin exchanged is the full amount that would be necessary to fully extinguish the mark-to-market exposure of the derivative subject to the threshold and minimum transfer amounts applicable to the counterparty[103].

(v) Derivatives transactions and variation margins are covered by a single master netting agreement (MNA)[104,105] between the legal entities that are the counterparties in the derivatives transaction. The MNA shall explicitly stipulate that the counterparties agree to settle net any payment obligations covered by such a netting agreement, taking into account any variation margin received or provided if a credit event occurs involving either counterparty. The MNA shall be legally enforceable and effective[106] in all relevant jurisdictions, including in the event of default and bankruptcy or insolvency.

**18.4.3.9** If the conditions in section 18.4.3.8 are met, the cash portion of variation margin received may be used to reduce the replacement cost portion of the leverage ratio exposure measure, and the receivables assets from cash variation margin provided may be deducted from the leverage ratio exposure measure as follows:

(i) In the case of cash variation margin received, the receiving AIFI may reduce the replacement cost (but not the add-on portion) of the exposure amount of the derivative asset by the amount of cash received if the positive mark-to-market value of the derivative contract(s) has not already been reduced by the same amount of cash variation margin

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[100] Cash variation margin would satisfy the non-segregation criterion if the recipient counterparty has no restrictions on the ability to use the cash received (i.e. the cash variation margin received is used as its own cash). Further, this criterion would be met if the cash received by the recipient counterparty is not required to be segregated by law, regulation, or any agreement with the counterparty.

[101] To meet this criterion, derivative positions must be valued daily and cash variation margin must be transferred daily to the counterparty or to the counterparty's account, as appropriate.

[102] For this paragraph, currency of settlement means any currency of settlement specified in the derivative contract, governing qualifying master netting agreement (MNA), or the credit support annex (CSA) to the qualifying MNA.

[103] Cash variation margin exchanged on the morning of the subsequent trading day based on the previous, end-of-day market values would meet this criterion, provided that the variation margin exchanged is the full amount that would be necessary to fully extinguish the mark-to-market exposure of the derivative subject to applicable threshold and minimum transfer amounts.

[104] A Master MNA may be deemed to be a single MNA for this purpose.

[105] To the extent that the criteria in this section include the term "master netting agreement", this term should be read as including any "netting agreement" that provides legally enforceable rights of offsets. This is to take account of the fact that no standardisation has currently emerged for netting agreements employed by CCPs.

[106] A master netting agreement (MNA) is deemed to meet this criterion if it satisfies the conditions as specified in **Annex 17** (part B).

received under the AIFI's operative accounting standard.

(ii) In the case of cash variation margin provided to a counterparty, the posting AIFI may deduct the resulting receivable from its leverage ratio exposure measure, where the cash variation margin has been recognised as an asset under the AIFI's operative accounting framework.

Cash variation margin may not be used to reduce the PFE amount (including the calculation of the net-to-gross ratio (NGR) as defined in 18.4.3.4).

**18.4.3.10** ***Additional*** **treatment** ***for written credit derivatives:*** in addition to the CCR exposure arising from the fair value of the contracts, written credit derivatives create a notional credit exposure arising from the creditworthiness of the reference entity. It is therefore appropriate to treat written credit derivatives consistently with cash instruments (e.g., loans, bonds) for the purposes of the exposure measure.

**18.4.3.11** In order to capture the credit exposure to the underlying reference entity, in addition to the above CCR treatment for derivatives and related collateral, the effective notional amount[107] referenced by a written credit derivative is to be included in the exposure measure. The effective notional amount of a written credit derivative may be reduced by any negative change in fair value amount that has been incorporated into the calculation of Tier 1 capital with respect to the written credit derivative[108]. The resulting amount may be further reduced by the effective notional amount of a purchased credit derivative on the same reference name[109,110] provided:

(i) the credit protection purchased is on a reference obligation which ranks *pari passu* with or is junior to the underlying reference obligation of the written credit derivative in the case of single name credit derivatives[111]; and

(ii) the remaining maturity of the credit protection purchased is equal to or greater than the remaining maturity of the written credit derivative.

**18.4.3.12** Since written credit derivatives are included in the exposure measure at their

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[107] The effective notional amount is obtained by adjusting the notional amount to reflect the true exposure of contracts that are leveraged or otherwise enhanced by the structure of the transaction.

[108] A negative change in fair value is meant to refer to a negative fair value of a credit derivative that is recognised in Tier 1 capital. This treatment is consistent with the rationale that the effective notional amounts included in the exposure measure may be capped at the level of the maximum potential loss, which means the maximum potential loss at the reporting date is the notional amount of the credit derivative minus any negative fair value that has already reduced Tier 1 capital. For example, if a written credit derivative had a positive fair value of 20 on one date and has a negative fair value of 10 on a subsequent reporting date, the effective notional amount of the credit derivative may be reduced by 10. The effective notional amount cannot be reduced by 30. However, if at the subsequent reporting date the credit derivative has a positive fair value of 5, the effective notional amount cannot be reduced at all.

[109] Two reference names are considered identical only if they refer to the same legal entity. For single-name credit derivatives, protection purchased that references a subordinated position may offset protection sold on a more senior position of the same reference entity as long as a credit event on the senior reference asset would result in a credit event on the subordinated reference asset.

[110] The effective notional amount of a written credit derivative may be reduced by any negative change in fair value reflected in the AIFI's Tier 1 capital provided the effective notional amount of the offsetting purchased credit protection is also reduced by any resulting positive change in fair value reflected in Tier 1 capital.

[111] For tranched products if applicable, the purchased protection must be on a reference obligation with the same level of seniority.

effective notional amounts, and are also subject to add-on amounts for PFE, the exposure measure for written credit derivatives may be overstated. AIFIs may therefore choose to deduct the individual PFE add-on amount relating to a written credit derivative (which is not offset according to section 18.4.3.11 and whose effective notional amount is included in the exposure measure) from their gross add-on in sections 18.4.3.2 to 18.4.3.4[112].

### 18.4.4 Securities financing transaction exposures

**18.4.4.1** SFTs[113] are included in the exposure measure according to the treatment described in the following sections. The treatment recognises that secured lending and borrowing in the form of SFTs is an important source of leverage, and ensures consistent international implementation by providing a common measure for dealing with the main differences in the operative accounting frameworks.

**18.4.4.2** ***General treatment (AIFI acting as principal)*****:** the sum of the amounts in clauses (i) and (ii) below are to be included in the leverage ratio exposure measure:

(i) Gross SFT assets[114] recognised for accounting purposes (i.e., with no recognition of accounting netting),[115] adjusted as follows:

(a) excluding from the exposure measure the value of any securities received under an SFT, where the AIFI has recognised the securities as an asset on its balance sheet[116]; and

(b) cash payables and cash receivables in SFTs with the same counterparty may be measured net if all the following criteria are met:

- Transactions have the same explicit final settlement date;

- The right to set off the amount owed to the counterparty with the amount owed by the counterparty is legally enforceable both currently in the normal course of business and in the event of: (i) default; (ii) insolvency; and (iii) bankruptcy; and

- The counterparties intend to settle net, settle simultaneously, or the transactions are subject to a settlement mechanism that results in the functional equivalent of net settlement, that is, the cash flows of the

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[112] In these cases, where effective bilateral netting contracts are in place, and when calculating $A_{Net} = 0.4 \cdot A_{Gross} + 0.6 \cdot NGR \cdot A_{Gross}$ as per sections 18.4.3.2 to 18.4.3.4, $A_{Gross}$ may be reduced by the individual add-on amounts (i.e. notionals multiplied by the appropriate add-on factors) which relate to written credit derivatives whose notional amounts are included in the leverage ratio exposure measure. However, no adjustments must be made to NGR. Where effective bilateral netting contracts are not in place, the PFE add-on may be set to zero in order to avoid the double-counting described in this section.

[113] SFTs are transactions such as repurchase agreements, reverse repurchase agreements, security lending and borrowing, and margin lending transactions, where the value of the transactions depends on market valuations and the transactions are often subject to margin agreements.

[114] For SFT assets subject to novation and cleared through QCCPs, "gross SFT assets recognised for accounting purposes" are replaced by the final contractual exposure, given that pre-existing contracts have been replaced by new legal obligations through the novation process.

[115] Gross SFT assets recognised for accounting purposes must not recognise any *accounting* netting of cash payables against cash receivables (e.g. as currently permitted under the IFRS and US GAAP accounting frameworks). This regulatory treatment has the benefit of avoiding inconsistencies from netting which may arise across different accounting regimes.

[116] This may apply, for example, under US GAAP where securities received under an SFT may be recognised as assets if the recipient has the right to rehypothecate but has not done so.

transactions are equivalent, in effect, to a single net amount on the settlement date. To achieve such equivalence, both transactions are settled through the same settlement system and the settlement arrangements are supported by cash and/or intraday credit facilities intended to ensure that settlement of both transactions will occur by the end of the business day and the linkages to collateral flows do not result in the unwinding of net cash settlement[117],[118].

(ii) A measure of CCR calculated as the current exposure without an add-on for PFE, calculated as follows:

(a) Where a qualifying MNA[119] is in place, the current exposure (E*) is the greater of zero and the total fair value of securities and cash lent to a counterparty for all transactions included in the qualifying MNA ($\sum E_i$), less the total fair value of cash and securities received from the counterparty for those transactions ($\sum C_i$). This is illustrated in the following formula:

$$E^* = \max \{0, [\sum E_i - \sum C_i]\}$$

(b) Where no qualifying MNA is in place, the current exposure for transactions with a counterparty shall be calculated on a transaction by transaction basis: that is, each transaction is treated as its own netting set, as shown in the following formula:

$$E_i^* = \max \{0, [E_i - C_i]\}$$

**18.4.4.3** ***Sale accounting transactions:*** leverage may remain with the AIFI of the security in an SFT whether or not sale accounting is achieved under the operative accounting framework. As such, where sale accounting is achieved for an SFT under the AIFI's operative accounting framework, the AIFI shall reverse all sales-related accounting entries, and then calculate its exposure as if the SFT had been treated as a financing transaction under the operative accounting framework (i.e., the AIFI shall include the sum of amounts in sub-clauses (i) and (ii) of section 18.4.4.2 for such an SFT) for the purposes of determining its exposure measure.

**18.4.4.4** ***AIFI acting as agent:*** an AIFI acting as agent in an SFT generally provides an indemnity or guarantee to only one of the two parties involved, and only for the difference between the value of the security or cash its customer has lent and the value of collateral the borrower has provided. In this situation, the AIFI is exposed to the counterparty of its customer for the difference in values rather than to the full exposure to the underlying

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[117] This latter condition ensures that any issues arising from the securities leg of the SFTs do not interfere with the completion of the net settlement of the cash receivables and payables.

[118] To achieve functional equivalence, all transactions must be settled through the same settlement mechanism. The failure of any single securities transaction in the settlement mechanism should delay settlement of only the matching cash leg or create an obligation to the settlement mechanism, supported by an associated credit facility. Further, if there is a failure of the securities leg of a transaction in such a mechanism at the end of the window for settlement in the settlement mechanism, then this transaction and its matching cash leg must be split out from the netting set and treated gross for the purposes of the Basel III leverage ratio exposure measure. Specifically, the criteria in this section are not intended to preclude a Delivery-versus-Payment (DVP) settlement mechanism or other type of settlement mechanism, provided that the settlement mechanism meets the functional requirements set out in this section. For example, a settlement mechanism may meet these functional requirements if any failed transaction (that is, the securities that failed to transfer and the related cash receivable or payable) can be re-entered in the settlement mechanism until they are settled.

[119] A "qualifying" MNA is one that meets the requirements under **Annex 17** part A.

security or cash of the transaction (as is the case where the AIFI is one of the principals in the transaction). Where the AIFI does not own/control the underlying cash or security resource, that resource cannot be leveraged by the AIFI.

**18.4.4.5** Where an AIFI acting as agent in an SFT provides an indemnity or guarantee to a customer or counterparty for any difference between the value of the security or cash the customer has lent and the value of collateral the borrower has provided, then the AIFI will be required to calculate its exposure measure by applying only clause (ii) of section 18.4.4.2[120].

**18.4.4.6** An AIFI acting as agent in an SFT and providing an indemnity or guarantee to a customer or counterparty will be considered eligible for the exceptional treatment set out in section 18.4.4.5 only if the AIFI's exposure to the transaction is limited to the guaranteed difference between the value of the security or cash its customer has lent and the value of the collateral the borrower has provided. In situations where the AIFI is further economically exposed (i.e., beyond the guarantee for the difference) to the underlying security or cash in the transaction[121], a further exposure equal to the full amount of the security or cash shall be included in the exposure measure.

**18.4.4.7** An illustrative example of exposure measure for SFT transactions are furnished in **Annex 12**.

### 18.4.5 Off-balance sheet items

**18.4.5.1** This section explains the treatment of off-balance sheet (OBS) items into the leverage ratio exposure measure. OBS items include commitments (including liquidity facilities), whether or not unconditionally cancellable, direct credit substitutes, acceptances, standby letters of credit, trade letters of credit, etc.

**18.4.5.2** In the risk-based capital framework, OBS items are converted under the standardised approach into credit exposure equivalents through the use of credit conversion factors (CCFs)[122]. For the purpose of determining the exposure amount of OBS items for the leverage ratio, the CCFs set out in the following sections shall be applied to the notional amount[123].

(i) Commitments other than securitisation liquidity facilities with an original maturity up to one year and commitments with an original maturity over one year will receive a CCF of 20% and 50%, respectively. However, any commitments that are unconditionally cancellable at any time by the AIFI without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness, will receive a 10% CCF.

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[120] Where, in addition to the conditions in sections 18.4.4.4 to 18.4.4.6, an AIFI acting as an agent in an SFT does not provide an indemnity or guarantee to any of the involved parties, the AIFI is not exposed to the SFT and therefore need not recognise those SFTs in its exposure measure.

[121] For example, due to the AIFI managing collateral received in the AIFI's name or on its own account rather than on the customer's or borrower's account (e.g., by on-lending or managing unsegregated collateral, cash or securities).

[122] Please refer to section 8.16.2.

[123] These correspond to the CCFs of the standardised approach for credit risk under section 8.16.2 (including Table 8), subject to a floor of 10%. The floor of 10% will affect commitments that are unconditionally cancellable at any time by the AIFI without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness. These may receive a 0% CCF under the risk-based capital framework. For any OBS item not specifically mentioned under section 18.4.5.2, the applicable CCF for that item will be as indicated in the section 8.16.2 above.

(ii) Direct credit substitutes, e.g., general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptances) will receive a CCF of 100%.

(iii) Forward asset purchases, forward deposits and partly paid shares and securities, which represent commitments with certain drawdown, will receive a CCF of 100%.

(iv) Certain transaction-related contingent items (e.g., performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions) will receive a CCF of 50%.

(v) Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs) will receive a CCF of 50%.

(vi) For short-term self-liquidating trade letters of credit arising from the movement of goods (e.g., documentary credits collateralised by the underlying shipment), a 20% CCF will be applied to both issuing and confirming AIFIs.

(vii) Where there is an undertaking to provide a commitment on an OBS item, AIFIs should apply the lower of the two applicable CCFs.

(viii) All off-balance sheet securitisation exposures will receive a CCF of 100% conversion factor.

### 18.5 Disclosure and Reporting requirements

**18.5.1** AIFIs are required to publicly disclose their Basel III leverage ratio on a consolidated basis and also report their leverage ratio to the Reserve Bank (Department of Supervision) along with detailed calculations of capital and exposure measures on a quarterly basis.

**18.5.2** To enable market participants to reconcile leverage ratio disclosures with AIFIs' published financial statements from period to period, and to compare the capital adequacy of AIFIs, it is important that AIFIs adopt a consistent and common disclosure of the main components of the leverage ratio, while also reconciling these disclosures with their published financial statements.

**18.5.3** To facilitate consistency and ease of use of disclosures relating to the composition of the leverage ratio, and to mitigate the risk of inconsistent formats undermining the objective of enhanced disclosure, AIFIs should publish their leverage ratio according to a common set of templates.

**18.5.4** The public disclosure requirements include:

(i) a **summary comparison table** that provides a comparison of AIFIs' total accounting assets amounts and leverage ratio exposures;

(ii) a **common disclosure template** that provides a breakdown of the main leverage ratio regulatory elements;

(iii) a **reconciliation requirement** that details the source(s) of material differences between AIFIs' total balance sheet assets in their financial statements and on-balance sheet exposures in the common disclosure template; and

(iv) **other disclosures** as set out below.

**18.5.5** AIFIs shall also report their leverage ratio to the Reserve Bank (Department of Supervision) along with detailed calculations of capital and exposure measures on a quarterly basis.

### 18.5.6 Implementation date, frequency and location of disclosure

**18.5.6.1** AIFIs are required to make disclosure of the leverage ratio and its components from the date of publication of their first set of financial statements / results on or after April 1, 2024 (July 1, 2024 for NHB). Accordingly, the first such disclosure should be made for the quarter ending June 30, 2024 (September 30, 2024 for NHB).

**18.5.6.2** With the exception of the mandatory quarterly frequency requirement in section 18.5.6.3 below, detailed disclosures required according to section 18.6 shall be made by AIFIs, irrespective of whether financial statements are audited, at least on a half yearly basis (i.e., as on September 30 and March 31 of a financial year), along with other Pillar 3 disclosures as required in terms of section 17.9.

**18.5.6.3** As the leverage ratio is an important supplementary measure to the risk-based capital requirements, the same Pillar 3 disclosure requirement also applies to the leverage ratio. Therefore, AIFIs, at a minimum, shall disclose the following three items on a quarterly basis, irrespective of whether financial statements are audited:

(i) Tier 1 capital (as per section 18.3);

(ii) Exposure measure (as per section 18.4); and

(iii) Leverage ratio (as per section 18.2).

At a minimum, these disclosures should be made on a quarter-end basis (i.e., as on June 30, September 30, December 31 and March 31 of a financial year), along with the figures of the prior three quarter-ends.

**18.5.6.4** The location of leverage ratio disclosures should be as stipulated for Pillar 3 disclosures in terms of sections 17.9.3 and 17.10. However, specific to leverage ratio disclosures, AIFIs have to make available on their websites, an ongoing archive of all reconciliation templates, disclosure templates and explanatory tables relating to prior reporting periods, instead of an archive for at least three years as required in case of Pillar 3 disclosures.

### 18.6 Disclosure templates

The summary comparison table (**Table: DF-16**), common disclosure template (**Table: DF-17**) and explanatory table, qualitative reconciliation and other requirements are set out in the **Annex 16**: Pillar 3 disclosure requirements. Together, these ensure transparency between the values used for the calculation of the Basel III leverage ratio and the values used in AIFIs' published financial statements.

**Annex 1**
**[section 7.2.3]**

**Criteria for Classification as Common Shares (Paid-up Equity Capital) for Regulatory Purposes –AIFIs**

1. All common shares should ideally be the voting shares. However, in rare cases, where AIFIs need to issue non-voting common shares as part of Common Equity Tier 1 capital, they must be identical to voting common shares of the issuing AIFI in all respects except the absence of voting rights. Limit on voting rights will be applicable based on the provisions of respective statutes governing individual AIFIs.

2. Represents the most subordinated claim in liquidation of the AIFI.

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

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

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

6. Distributions are paid out of distributable items. 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 an AIFI is unable to pay distributions that exceed the level of distributable items). As regards 'distributable items', it is clarified that the dividend on common shares will be paid out of current year's profit only.

7. There are no circumstances under which the distributions are obligatory. Non-payment is therefore not an event of default.

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

9. It is the paid up capital that takes the first and proportionately greatest share of any losses as they occur[124]. Within the highest quality capital, each instrument absorbs losses on a going concern basis proportionately and *pari passu* with all the others.

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

11. The paid up amount is classified as equity under the relevant accounting standards.

[124] In cases where capital instruments have a permanent write-down feature, this criterion is still deemed to be met by common shares.

12. It is directly issued and paid up and the AIFI cannot directly or indirectly have funded the purchase of the instrument. AIFIs should also not extend loans against their own shares as this would be construed as indirect funding of its own capital.

13. The paid up amount is neither secured nor covered by a guarantee of the issuer or related entity[125] nor subject to any other arrangement that legally or economically enhances the seniority of the claim.

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

15. Paid up capital is clearly and separately disclosed in the AIFI's balance sheet.

[125] A related entity can include a parent company, a sister company, a subsidiary or any other affiliate. A holding company is a related entity irrespective of whether it forms part of the consolidated AIFI.

**Annex 2**
**[section 7.2.4]**

**Criteria for Inclusion of Perpetual Non-cumulative Preference Shares (PNCPS) in Additional Tier 1 Capital**

The PNCPS will be issued subject to extant legal provisions only in Indian rupees and should meet the following terms and conditions to qualify for inclusion in Additional Tier 1 Capital for capital adequacy purposes:

**1. Terms of Issue of Instruments**

**1.1 Paid up Status**

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

**1.2 Amount**

The amount of PNCPS to be raised may be decided by the Board of AIFIs.

**1.3 Limits**

While complying with minimum Tier 1 of 7% of risk weighted assets, an AIFI cannot admit, Perpetual Non-Cumulative Preference Shares (PNCPS) together with Perpetual Debt Instruments (PDI) in Additional Tier 1 Capital, more than 1.5% of risk weighted assets. However, once this minimum total Tier 1 capital has been complied with, any additional PNCPS and PDI issued by the AIFI can be included in Total Tier 1 capital reported. Excess PNCPS and PDI can be reckoned to comply with Tier 2 capital if the latter is less than 2% of RWAs i.e., while complying with minimum Total Capital of 9% of risk weighted assets.

**1.4 Maturity Period**

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

**1.5 Rate of Dividend**

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

**1.6 Optionality**

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

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

(b) To exercise a call option an AIFI must receive prior approval of the Reserve Bank (Department of Regulation); and

(c) An AIFI shall not do anything which creates an expectation that the call will be exercised[126]. For example, to preclude such expectation of the instrument

[126] If an AIFI were to call a capital instrument and replace it with an instrument that is more costly

being called, the dividend / coupon reset date need not be co-terminus with the call date. AIFIs may, at their discretion, consider having an appropriate gap between dividend / coupon reset date and call date; and

(d) AIFIs shall not exercise a call unless:

(i) They replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the AIFI[127]; or

(ii) The AIFI demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.[128]

The use of tax event and regulatory event calls may be permitted. However, exercise of the calls on account of these events is subject to the requirements set out in points (b) to (d) of criterion 1.6. The Reserve Bank will permit the AIFI to exercise the call only if the Reserve Bank is convinced that the AIFI was not in a position to anticipate these events at the time of issuance of PNCPS.

To illustrate, if there is a change in tax treatment which makes the capital instrument with tax deductible coupons into an instrument with non-tax deductible coupons, then the AIFI would have the option (not obligation) to repurchase the instrument. In such a situation, an AIFI 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 AIFI 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 the Reserve Bank. However, AIFIs may not create an expectation / signal an early redemption / maturity of the regulatory capital instrument.

**1.7 Repurchase / Buy-back / Redemption**

(i) Principal of the instruments may be repaid (e.g., through repurchase or redemption) only with prior approval of the Reserve Bank and AIFIs should not assume or create market expectations that supervisory approval will be given ( this repurchase / buy-back /redemption of the principal is in a situation other than in the event of exercise of call option by the AIFI. 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 AIFI).

(ii) AIFIs may repurchase / buy-back / redeem the instruments only if:

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

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

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

[127] Replacement issues can be concurrent with but not after the instrument is called.

[128] Here, minimum refers to Common Equity Tier 1 of 5.5% of RWAs and Total Capital of 9.0% of RWAs including any additional capital requirement identified under Pillar 2.

### 1.8 Dividend Discretion

(i) The AIFI must have full discretion at all times to cancel distributions/payments;[129]

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

(iii) AIFIs must have full access to cancelled payments to meet obligations as they fall due;

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

(v) Dividends must be paid out of distributable items. As regards 'distributable items', it is clarified that the dividend on perpetual non-cumulative preference shares (PNCPS) will be paid out of current year's profit only.

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

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

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

- attempt to stop payment on another instrument where the payments on this other instrument were not also fully discretionary;
- prevent distributions to shareholders for a period that extends beyond the point in time that dividends/coupons on the Additional Tier 1 instrument are resumed;
- impede the normal operation of the AIFI or any restructuring activity (including acquisitions/disposals).

A stopper may act to prohibit actions that are equivalent to the payment of a dividend, such

[129] 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 AIFI 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 AIFI to make distributions/payments in kind.

as the AIFI undertaking discretionary share buybacks, **if otherwise permitted**.

### 1.9 Treatment in Insolvency

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

### 1.10 Loss Absorption Features

PNCPS should have principal loss absorption through either (i) conversion to common shares at an objective pre-specified trigger point or (ii) a write-down mechanism which allocates losses to the instrument at a pre-specified trigger point. The write-down will have the following effects:

(a) Reduce the claim of the instrument in liquidation;

(b) Reduce the amount re-paid when a call is exercised; and

(c) Partially or fully reduce dividend payments on the instrument.

Various criteria for loss absorption through conversion / write-down / write-off on breach of pre-specified trigger and at the point of non-viability are furnished in **Annex 14.**

### 1.11 Prohibition on Purchase / Funding of PNCPS

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

### 1.12 Re-capitalisation

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

### 1.13 Reporting of Non-payment of Dividends

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

### 1.14 Seniority of Claim

The claims of the investors in instruments shall be

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

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

### 1.15 Investment in Instruments Raised in Indian Rupees by Foreign Entities/ NRIs

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

holding of Preference Shares and equity shares in AIFIs will be subject to the statutory / regulatory limit.

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

### 1.16 Reporting of Issuances

(i) AIFIs issuing PNCPS shall submit a report to the Chief General Manager-in-charge, Department of Regulation, Central Office, Reserve Bank, Mumbai giving details of the debt raised as per the format prescribed below duly certified by the compliance officer of the AIFI, soon after the issue is completed.

| **Format- 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 | |

(ii) The issue-wise details of amount raised as PNCPS qualifying for Additional Tier 1 capital by the AIFIs from FIIs / NRIs are required to be reported within 30 days of the issue to the Chief General Manager, Reserve Bank, Foreign Exchange Department, Foreign Investment Division, Central Office, Mumbai in the **proforma** given at the end of this **Annex**. The details of the secondary market sales / purchases by FIIs and the NRIs in these instruments on the floor of the stock exchange shall be reported by the custodians and designated banks, respectively, to the Reserve Bank through the soft copy of the LEC Returns, on a daily basis, as prescribed in Schedule 2 and 3 of the FEMA Notification No.20 dated 3rd May 2000, as amended from time to time.

### 1.17 Investment in Additional Tier 1 Capital Instruments (PNCPS) Issued by Banks/ Other AIFIs

(i) An AIFI's investment in PNCPS issued by other banks and AIFIs will be reckoned along with the investment in other instruments eligible for capital status while computing compliance with the overall ceiling of 10% of investing AIFI's capital funds.

(ii) AIFI's investments in PNCPS issued by banks / other AIFIs will attract risk weight as provided in sections 8.6 and 11.3.5 of this Chapter, whichever applicable for capital adequacy purposes.

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

### 1.18 Classification in the Balance Sheet

PNCPS will be classified as capital and shown under 'Schedule - Capital' of the Balance sheet.

### 1.19 PNCPS to Retail Investors[130]

With a view to enhancing investor education relating to risk characteristics of regulatory capital requirements, AIFIs issuing PNCPS to retail investors, subject to approval of their Board, should adhere to the following conditions:

(a) 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 AIFI] as disclosed in the Draft Shelf Prospectus, Shelf Prospectus and Tranche Document**".*

(b) All the publicity material, application form and other communication with the investor should 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 should 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.

**Reporting Format**

**Details of Investments by FIIs and NRIs in Perpetual Non-Cumulative Preference Shares qualifying as Additional Tier 1 capital**

(a) Name of the AIFI:

(b) Total issue size / amount raised (in Rupees):

(c) Date of issue:

| FIIs | | | NRIs | | |
|---|---|---|---|---|---|
| No of FIIs | Amount raised | | No. of NRIs | Amount raised | |
| | in Rupees | as a percentage of the total issue size | | in Rupees | as a percentage of the total issue size |
| | | | | | |
| | | | | | |

It is certified that

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

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

Authorised Signatory

Date

Seal of the AIFI

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[130] Please refer to circular DBOD.BP.BC.38/21.06.201/2014-15 dated September 1, 2014 addressed to banks on Implementation of Basel III Capital Regulations in India – Amendments.

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**Annex 3**
**(section 7.2.4)**

## Criteria for Inclusion of Perpetual Debt Instruments (PDI) in Additional Tier 1 Capital

The Perpetual Debt Instruments that may be issued as bonds or debentures by AIFIs should meet the following terms and conditions to qualify for inclusion in Additional Tier 1 Capital for capital adequacy purposes:

### 1. Terms of Issue of Instruments Denominated in Indian Rupees

### 1.1 Paid-in Status

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

### 1.2 Amount

The amount of PDI to be raised may be decided by the Board of AIFIs.

### 1.3 Limits

While complying with minimum Tier 1 of 7% of risk weighted assets, an AIFI cannot admit, Perpetual Debt Instruments (PDI) together with Perpetual Non-Cumulative Preference Shares (PNCPS) in Additional Tier 1 Capital, more than 1.5% of risk weighted assets. However, once this minimum total Tier 1 capital has been complied with, any additional PNCPS and PDI issued by the AIFI can be included in Total Tier 1 capital reported. Excess PNCPS and PDI can be reckoned to comply with Tier 2 capital if the latter is less than 2% of RWAs i.e., while complying with minimum Total Capital of 9% of risk weighted assets.

### 1.4 Maturity Period

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

### 1.5 Rate of Interest

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

### 1.6 Optionality

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

a. The call option on the instrument is permissible after the instrument has run for at least five years;

b. To exercise a call option an AIFI must receive prior approval of the Reserve Bank (Department of Regulation);

c. An AIFI 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. AIFIs may, at their discretion, consider having an appropriate gap between dividend / coupon reset date and call date; and

d. AIFIs shall not exercise a call unless:

(i) They replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the AIFI[131]; or

(ii) The AIFI demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.[132]

The use of tax event and regulatory event calls may be permitted. However, exercise of the calls on account of these events is subject to the requirements set out in points (b) to (d) of criterion 1.6. The Reserve Bank will permit the AIFI to exercise the call only if the Reserve Bank is convinced that the AIFI was not in a position to anticipate these events at the time of issuance of PDIs.

To illustrate, if there is a change in tax treatment which makes the capital instrument with tax deductible coupons into an instrument with non-tax deductible coupons, then the AIFI would have the option (not obligation) to repurchase the instrument. In such a situation, an AIFI 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 AIFI 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 the Reserve Bank. However, AIFIs may not create an expectation / signal an early redemption / maturity of the regulatory capital instrument.

**1.7 Repurchase / Buy-back / Redemption**

(i) Principal of the instruments may be repaid (e.g., through repurchase or redemption) only with prior approval of the Reserve Bank and AIFIs should not assume or create market expectations that supervisory approval will be given (this repurchase / buy-back /redemption of the principal is in a situation other than in the event of exercise of call option by the AIFI. 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 AIFI).

(ii) AIFIs may repurchase / buy-back / redemption only if:

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

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

[131] Replacement issues can be concurrent with but not after the instrument is called.

[132] Minimum refers to Common Equity Tier 1 of 5.5% of RWAs and Total capital of 9.0% of RWAs including additional capital requirements identified under Pillar 2.

**1.8 Coupon Discretion**

(i) The AIFI must have full discretion at all times to cancel distributions/payments[133]

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

(iii) AIFIs must have full access to cancelled payments to meet obligations as they fall due

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

(v) Coupons must 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:

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

(ii) Reserves representing appropriation of net profits, including statutory reserves, and excluding share premium, revaluation reserve, foreign currency translation reserve, investment reserve and reserves created on amalgamation.

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

If the aggregate of: (a) profits in the current year; (b) profits brought forward from the previous years and (c) permissible reserves as at (ii) above, excluding statutory reserves, net of accumulated losses and deferred revenue expenditure are less than the amount of coupon, only then the AIFI shall make appropriation from the statutory reserves. In such cases, AIFIs are required to report to the Reserve Bank within twenty-one days from the date of such appropriation.

However, payment of coupons on PDIs from the reserves is subject to the issuing AIFI meeting minimum regulatory requirements for CET1, Tier 1 and Total Capital ratios.

In order to meet the eligibility criteria for perpetual debt instruments, AIFIs shall ensure and indicate in their offer documents that they have full discretion at all times to cancel distributions / payments.

(vi) the interest shall not be cumulative.

(vii) The instrument cannot have a credit sensitive coupon feature, i.e., a dividend that is reset periodically based in whole or in part on the AIFIs' credit standing. For this purpose, any reference rate including a broad index which is sensitive to changes to the AIFI's own creditworthiness and / or to changes in the credit worthiness of the wider financial sector will be treated as a credit sensitive reference rate. AIFIs

[133] 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 AIFI 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 AIFI to make distributions/payments in kind.

desirous of offering floating reference rate may take prior approval of the Reserve Bank (DOR) as regards permissibility of such reference rates.

(viii) In general, it may be in order for AIFIs to have dividend stopper arrangement that stop dividend payments on common shares in the event the holders of AT1 instruments are not paid dividend/coupon. However, dividend stoppers must not impede the full discretion that AIFI must have at all times to cancel distributions/payments on the Additional Tier 1 instrument, nor must they act in a way that could hinder the re-capitalisation of the AIFI. For example, it would not be permitted for a stopper on an Additional Tier 1 instrument to:

- attempt to stop payment on another instrument where the payments on this other instrument were not also fully discretionary;
- prevent distributions to shareholders for a period that extends beyond the point in time that dividends/coupons on the Additional Tier 1 instrument are resumed;
- impede the normal operation of the AIFI or any restructuring activity (including acquisitions/disposals).

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

### 1.9 Treatment in Insolvency

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

### 1.10 Loss Absorption Features

PDIs may be classified as liabilities for accounting purposes (not for the purpose of insolvency as indicated in paragraph 1.9 above). In such cases, these instruments must have principal loss absorption through either (i) conversion to common shares at an objective pre-specified trigger point or (ii) a write-down mechanism which allocates losses to the instrument at a pre-specified trigger point. The write-down will have the following effects:

(a) Reduce the claim of the instrument in liquidation;
(b) Reduce the amount re-paid when a call is exercised; and
(c) Partially or fully reduce coupon payments on the instrument.

Various criteria for loss absorption through conversion / write-down / write-off on breach of pre-specified trigger and at the point of non-viability are furnished in **Annex 14.**

### 1.11 Prohibition on Purchase / Funding of Instruments

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

### 1.12 Re-capitalisation

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

### 1.13 Reporting of Non-payment of Coupons

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

### 1.14 Seniority of Claim

The claims of the investors in instruments shall be

(i) superior to the claims of investors in equity shares and perpetual non-cumulative preference shares;

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

(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 AIFI creditors.

### 1.15 Investment in Instruments Raised in Indian Rupees by Foreign Entities/NRIs

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

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

### 1.16 Terms of Issue of Instruments Denominated in Foreign Currency / Rupee Denominated Bonds Overseas

AIFIs may augment their 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 applicable FEMA guidelines and requirements mentioned below:

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

(ii) Not more than 49% of the eligible amount can be issued in foreign currency and/or in rupee denominated bonds overseas (Illustration given in the below table). “Eligible amount” in this context shall mean the higher of:

(a) 1.5% of RWA or

(b) Total Additional Tier 1 capital

as on March 31 of the previous financial year

**Illustration on the "eligible amount" that can be raised**

Considering that the AIFI has RWAs of ₹.1000 crore as on March 31 of previous financial year

| | Scenario | Maximum amount of AT1 bonds that can be raised overseas (in foreign currency and/or in rupee denominated bonds overseas) |
|---|---|---|
| Case I | The AIFI had AT1 capital of less than or equal to 1.5% of RWAs as on March 31 of the previous financial year. Illustratively, the AIFI did not have any AT1 capital as on March 31 of the previous financial year. | Equals ₹. 7.35 crore (49% of 1.5% of RWAs). |
| Case II | The AIFI had AT1 capital more than 1.5% of RWAs as on March 31 of previous financial year. Illustratively, the AIFI had AT1 capital of ₹. 50 crore as on March 31 of the previous financial year. | Equals 49% of ₹. 50 crore i.e., ₹ 24.5 crore (49% of total AT1 capital as it is more than 1.5% of RWAs). |

*Note:* The amount of AT1 capital recognised for inclusion in Tier 1 capital will be subject to the limits mentioned in section 7.2.2 and para 1.3 of **Annex 3** to these Directions.

(iii) Instruments issued in foreign currency shall be outside the existing limit for foreign currency borrowings by Authorised Dealers, stipulated in terms of FMRD Master Direction No. 1/2016-17 dated July 5, 2016 on Risk Management and Inter-Bank Dealings as updated from time to time.

(iv) AIFIs raising PDIs overseas shall obtain and keep on record a legal opinion from an advocate/ attorney practising in the relevant legal jurisdiction, that the terms and conditions of issue of the instrument are in conformity with these Directions and can be enforced in the concerned legal jurisdiction and the applicable laws there do not stand in the way of enforcement of those conditions.

### 1.17 Reporting of Issuances

AIFIs issuing PDIs shall submit a report to the Chief General Manager-in-charge, Department of Regulation, Reserve Bank, Mumbai giving details of the debt raised as per the format prescribed below duly certified by the compliance officer of the AIFI, soon after the issue is completed.

| Format- 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 | |

### 1.18 Investment in Additional Tier 1 Debt Capital Instruments (PDIs) Issued by other AIFIs /Banks

(i) An AIFI's investment in debt instruments issued by banks and other AIFIs will be reckoned along with the investment in other instruments eligible for capital status while computing compliance with the overall ceiling of 10% for cross holding of capital among banks/AIFIs prescribed under Exposure Norms applicable to AIFIs and also subject to cross holding limits.

(ii) AIFI's investments in debt instruments issued by banks will attract risk weight for capital adequacy purposes, as prescribed in sections 8.6 and 11.3.5 of this Chapter, whichever applicable.

### 1.19 Classification in the Balance Sheet

The amount raised by way of issue of debt capital instrument may be classified under 'Schedule - Borrowings' in the Balance Sheet.[134]

### 1.20 Perpetual Debt Instruments to Retail Investors[135]

With a view to enhancing investor education relating to risk characteristics of regulatory capital requirements, AIFIs issuing Perpetual Debt Instruments to retail investors, subject to approval of their Board, should adhere to the following conditions:

(a) For floating rate instruments, AIFIs should not use its Fixed Deposit rate as benchmark.

(b) The requirement for specific sign-off as quoted below, from the investors for having understood the features and risks of the instrument may be 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 AIFI] as disclosed in the Draft Shelf Prospectus, Shelf Prospectus and Tranche Document** ".*

(c) All the publicity material, application form and other communication with the investor should clearly state in bold letters (**with font size 14**) how a Perpetual Debt Instrument is different from fixed deposit particularly that it is not covered by deposit insurance. In addition, the loss absorbency features of the instrument should 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.

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[134] Please refer to circular DBOD.No.BP.BC.81/21.01.002/2009-10 dated March 30, 2010 addressed to banks.

[135] Please refer to circular DBOD.BP.BC.38/21.06.201/2014-15 dated September 1, 2014 addressed to banks on Implementation of Basel III Capital Regulations in India – Amendments.

**Annex 4**
**(section 7.2.5)**

## Criteria for Inclusion of Debt Capital Instruments as Tier 2 Capital

The Tier 2 debt capital instruments that may be issued as bonds / debentures by AIFIs should meet the following terms and conditions to qualify for inclusion as Tier 2 Capital for capital adequacy purposes[136]:

### 1. Terms of Issue of Instruments Denominated in Indian Rupees

#### 1.1 Paid-in Status

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

#### 1.2 Amount

The amount of these debt instruments to be raised may be decided by the Board of AIFIs.

#### 1.3 Maturity Period

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

#### 1.4 Discount

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

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

#### 1.5 Rate of Interest

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

(ii) The instrument cannot have a credit sensitive coupon feature, i.e., a coupon that is reset periodically based in whole or in part on the AIFIs' credit standing. AIFIs desirous of offering floating reference rate may take prior approval of the Reserve Bank (DOR) as regards permissibility of such reference rates.

#### 1.6 Optionality

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

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[136] The criteria relating to loss absorbency through conversion / write-down / write-off at the point of non-viability are furnished in **Annex 14**.

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

(b) An AIFI 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. AIFIs may, at their discretion, consider having an appropriate gap between dividend / coupon reset date and call date; and

(c) AIFIs shall not exercise a call unless:

    (i) They replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the AIFI[137]; or

    (ii) The AIFI demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.[138]

The use of tax event and regulatory event calls may be permitted. However, exercise of the calls on account of these events is subject to the requirements set out in points (a) to (c) of criterion 1.6. An AIFI shall be permitted to exercise the call only if the Reserve Bank is convinced that the AIFI was not in a position to anticipate these events at the time of issuance of these instruments as explained in case of Additional Tier 1 instruments.

### 1.7 Treatment in Bankruptcy / Liquidation

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

### 1.8 Prohibition on Purchase / Funding of Instruments

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

### 1.9 Reporting of Non-payment of Coupons

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

### 1.10 Seniority of Claim

The claims of the investors in instruments shall be

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

(ii) subordinate to the claims of all depositors and general creditors of the AIFI; and

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[137] Replacement issues can be concurrent with but not after the instrument is called.

[138] Minimum refers to Common Equity ratio of 5.5% of RWAs and Total capital ratio of 9.0% of RWAs including any additional capital requirement identified under Pillar 2.

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

### 1.11 Investment in Instruments Raised in Indian Rupees by Foreign Entities/NRIs

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

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

**(iii) <u>Issuance of rupee denominated bonds overseas by Indian banks</u>**

AIFIs shall be 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 applicable FEMA guidelines.

### 1.12 Terms of Issue of Tier 2 Debt Capital Instruments in Foreign Currency

AIFIs 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:

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

(ii) The total outstanding amount of Tier 2 Instruments in foreign currency shall not exceed 25% of the unimpaired Tier 1 capital. This eligible amount will be computed with reference to the amount of Tier 1 capital as on March 31 of the previous financial year, after deduction of goodwill and other intangible assets but before the deduction of investments, as per section 7.5.2 of this Chapter.

(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 5, 2016.

(iv) AIFIs raising Tier 2 bonds overseas shall obtain and keep on record a legal opinion from an advocate/ attorney practising in the relevant legal jurisdiction, that the terms and conditions of issue of the instrument are in conformity with these Directions and can be enforced in the concerned legal jurisdiction and the applicable laws there do not stand in the way of enforcement of those conditions.

### 1.13 Reporting of Issuances

AIFIs issuing debt instruments shall submit a report to the Chief General Manager-in-Charge, Department of Regulation, Central Office, Reserve Bank, Mumbai giving details of the debt raised as per the format prescribed below duly certified by the compliance officer of the AIFI, soon after the issue is completed.

| **Format- 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 | |

### 1.14 Investment in Tier 2 Debt Capital Instruments Issued by other AIFIs/ Banks/

(i) An AIFI's investment in Tier 2 debt instruments issued by banks and other AIFIs will be reckoned along with the investment in other instruments eligible for capital status while computing compliance with the overall ceiling of 10% for cross holding of capital among banks/FIs prescribed under Exposure Norms applicable to AIFIs and also subject to cross holding limits.

(ii) AIFI's investments in Tier 2 instruments issued by banks/ other AIFIs will attract risk weight as per sections 8.6 and 11.3.5 of this Chapter, whichever applicable for capital adequacy purposes.

### 1.15 Classification in the Balance Sheet

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

### 1.16 Debt Capital Instruments to Retail Investors[139,140]

With a view to enhancing investor education relating to risk characteristics of regulatory capital requirements, AIFIs issuing subordinated debt to retail investors, subject to approval of their Board, should adhere to the following conditions:

(a) For floating rate instruments, AIFIs should not use its Fixed Deposit rate as benchmark.

(b) The requirement for specific sign-off as quoted below, from the investors for having understood the features and risks of the instrument may be 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 AIFI ] as disclosed in the Draft Shelf Prospectus, Shelf Prospectus and Tranche Document*** *".*

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[139] Please refer to circular DBOD.BP.BC.No.69/21.01.002/2009-10 dated January 13, 2010 addressed to banks.

[140] Please also refer to the circular DBOD.BP.BC.No.72/21.01.002/2012-13 dated January 24, 2013 addressed to banks on 'Retail Issue of Subordinated Debt for Raising Tier 2 Capital', in terms of which banks were advised that with a view to deepening the corporate bond market in India through enhanced retail participation, banks, while issuing subordinated debt for raising Tier 2 capital, are encouraged to consider the option of raising such funds through public issue to retail investors. However, while doing so AIFIs are advised to adhere to the conditions prescribed in circular dated January 13, 2010 addressed to banks so as to ensure that the investor is aware of the risk characteristics of regulatory capital instruments.

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

**Annex 5**
**(section 7.2.5)**

**Criteria for Inclusion of Perpetual Cumulative Preference Shares (PCPS)/ Redeemable Non-Cumulative Preference Shares (RNCPS) / Redeemable Cumulative Preference Shares (RCPS) as Part of Tier 2 Capital**

## 1 Terms of Issue of Instruments[141]

### 1.1 Paid-in Status

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

### 1.2 Amount

The amount to be raised may be decided by the Board of AIFIs.

### 1.3 Maturity Period

These instruments could be either perpetual (PCPS) or dated (RNCPS and RCPS) instruments with a fixed maturity of minimum five years and there should be no step-ups or other incentives to redeem. The perpetual instruments shall be cumulative. The dated instruments could be cumulative or non-cumulative.

### 1.4 Amortisation

The Redeemable Preference Shares (both cumulative and non-cumulative) shall be subjected to a progressive discount for capital adequacy purposes over the last five years of their tenor, as they approach maturity as indicated in the table below for being eligible for inclusion in Tier 2 capital.

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

### 1.5 Coupon

The coupon payable to the investors may be either at a fixed rate or at a floating rate referenced to a market determined rupee interest benchmark rate. AIFIs desirous of offering floating reference rate may take prior approval of the Reserve Bank (DOR) as regards permissibility of such reference rates.

### 1.6 Optionality

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

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[141] The criteria relating to loss absorbency through conversion / write-down / write-off at the point of non-viability are furnished in **Annex 14**.

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

(b) To exercise a call option an AIFI must receive prior approval of the Reserve Bank (Department of Regulation); and

(c) An AIFI 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. AIFIs may, at their discretion, consider having an appropriate gap between dividend / coupon reset date and call date; and

(d) AIFIs shall not exercise a call unless:

(i) They replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the AIFI[142]; or

(ii) The AIFI demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.[143]

The use of tax event and regulatory event calls may be permitted. However, exercise of the calls on account of these events is subject to the requirements set out in points (b) to (d) of criterion 1.6. The Reserve Bank will permit the AIFI to exercise the call only if the Reserve Bank is convinced that the AIFI was not in a position to anticipate these events at the time of issuance of these instruments as explained in case of Additional Tier 1 instruments.

### 1.7 Treatment in Bankruptcy / Liquidation

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

### 1.8 Prohibition on Purchase / Funding

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

### 1.9 Reporting of Non-payment of Coupon

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

### 1.10 Seniority of Claim

The claims of the investors in instruments shall be:

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

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[142]Replacement issues can be concurrent with but not after the instrument is called.
[143]Minimum refers to Common Equity ratio of 5.5% of RWAs and Total capital ratio of 9.0% of RWAs including any additional capital requirement identified under Pillar 2.

(ii) subordinate to the claims of all depositors and general creditors of the AIFI; and

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

### 1.11 Investment in Instruments Raised in Indian Rupees by Foreign Entities/NRIs

(i) Investment by FIIs and NRIs shall be within an overall limit of 49% and 24% of the issue respectively, subject to the investment by each FII not exceeding 10% of the issue and investment by each NRI not exceeding 5% of the issue. Investment by FIIs in these instruments shall be outside the ECB limit for rupee denominated corporate debt as fixed by Government of India from time to time. However, investment by FIIs in these instruments will be subject to separate ceiling of USD 500 million. The overall non-resident holding of Preference Shares and equity shares in public sector banks will be subject to the statutory / regulatory limit.

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

### 1.12 Reporting of Issuances

AIFIs issuing these instruments shall submit a report to the Chief General Manager-in-Charge, Department of Regulation, Central Office, Reserve Bank, Mumbai giving details of the debt raised as per the format prescribed below duly certified by the compliance officer of the AIFI, soon after the issue is completed.

| **Format- 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 | |

### 1.13 Investment in these Instruments Issued by other AIFIs/ Banks

(i) An AIFI's investment in these instruments issued by banks and other AIFIs will be reckoned along with the investment in other instruments eligible for capital status while computing compliance with the overall ceiling of 10% of investing AIFI's total capital funds prescribed under Exposure Norms applicable to AIFIs and also subject to cross holding limits.

(ii) AIFI's investments in these instruments issued by banks / other AIFIs will attract risk weight for capital adequacy purposes as provided vide sections 8.6 and 11.3.5 of this Chapter, whichever applicable.

### 1.14 Classification in the Balance Sheet

These instruments will be classified as ‘Borrowings’ under the Balance Sheet.

### 1.15 PCPS/RNCPS/RCPS to Retail Investors[144]

With a view to enhancing investor education relating to risk characteristics of regulatory capital requirements, AIFIs issuing PCPS/RNCPS/RCPS to retail investors, subject to approval of their Board, should adhere to the following conditions:

(a) 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 AIFI] as disclosed in the Draft Shelf Prospectus, Shelf Prospectus and Tranche Document** ".*

(b) All the publicity material, application form and other communication with the investor should clearly state in bold letters (**with font size 14**) how a PCPS/RNCPS/RCPS is different from common shares / fixed deposit particularly that it is not covered by deposit insurance. In addition, the loss absorbency features of the instrument should 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.

[144] Please refer to circular DBOD.BP.BC.38/21.06.201/2014-15 dated September 1, 2014 addressed to banks on Implementation of Basel III Capital Regulations in India – Amendments.

**Annex 6**
**(section 8.18)**

## Prudential Guidelines on Credit Default Swaps (CDS)

### 1. Introduction

AIFIs can undertake transactions in CDS in terms of Master Direction – Reserve Bank of India (Credit Derivatives) Directions, 2022. As users, AIFIs can buy CDS to hedge a Banking Book or Trading Book exposure. The prudential guidelines dealing with CDS are dealt with in the following paragraphs.

### 2. Definitions

The expressions/definitions unless defined in this Master Direction shall have the same meaning as have been assigned to them under Master Direction – Reserve Bank of India (Credit Derivatives) Directions, 2022.

### 3. Classification of CDS into Trading Book and Banking Book Positions

For the purpose of capital adequacy for CDS transactions, Trading Book would comprise *Held for Trading* positions and Banking Book would comprise *Held to Maturity* and *Available for Sale* positions. A CDS being a financial derivative will be classified in the Trading Book except when it is contracted and designated as a hedge for a Banking Book exposure. Thus, the CDS positions held in the Trading Book would include positions which:

(a) are meant for hedging the exposures in the Trading Book;
(b) are held for short-term resale; and
(c) are taken by the AIFI with the intention of benefiting in the short-term from the actual and / or expected differences between their buying and selling prices

CDS positions meant for hedging Banking Book exposures will be classified in the Banking Book. However, all CDS positions, either in Banking Book or Trading Book, should be marked-to-market. All CDS positions should meet the operational requirements indicated in paragraph 4 below.

### 4. Operational requirements for CDS to be recognised as eligible External / Third-party hedges for Trading Book and Banking Book

(a) A CDS contract should represent a direct claim on the protection provider and should be explicitly referenced to specific exposure, so that the extent of the cover is clearly defined and incontrovertible.

(b) Other than non-payment by a protection purchaser of premium in respect of the credit protection contract it should be irrevocable.

(c) There should be no clause in the contract that would allow the protection provider unilaterally to cancel the credit cover or that would increase the effective cost of cover as a result of deteriorating credit quality in the hedged exposure.

(d) The CDS contract should be unconditional; there should be no clause in the protection contract outside the direct control of the AIFI (protection buyer) that could prevent the protection provider from being obliged to pay out in a timely manner in the event that the

original counterparty fails to make the payment(s) due.

(e) The credit events specified by the contracting parties should at a minimum cover:

(i) failure to pay the amounts due under terms of the underlying obligation that are in effect at the time of such failure (with a grace period that is closely in line with the grace period in the underlying obligation);

(ii) bankruptcy, insolvency or inability of the obligor to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due, and analogous events; and

(iii) restructuring of the underlying obligation involving forgiveness or postponement of principal, interest or fees that results in a credit loss event (i.e., charge-off, specific provision or other similar debit to the profit and loss account);

(iv) when the restructuring of the underlying obligation is not covered by the CDS, but the other requirements in paragraph 4 are met, partial recognition of the CDS will be allowed. If the amount of the CDS is less than or equal to the amount of the underlying obligation, 60% of the amount of the hedge can be recognised as covered. If the amount of the CDS is larger than that of the underlying obligation, then the amount of eligible hedge is capped at 60% of the amount of the underlying obligation.

(f) If the CDS specifies deliverable obligations that are different from the underlying obligation, the resultant asset mismatch will be governed under paragraph (k) below.

(g) The CDS shall not terminate prior to expiration of any grace period required for a default on the underlying obligation to occur as a result of a failure to pay[145].

(h) The CDS allowing for cash settlement are recognised for capital purposes insofar as a robust valuation process is in place in order to estimate loss reliably. There should be a clearly specified period for obtaining post-credit event valuations of the underlying obligation. If the reference obligation specified in the CDS for purposes of cash settlement is different than the underlying obligation, the resultant asset mismatch will be governed under paragraph (k) below.

(i) If the protection purchaser's right/ability to transfer the underlying obligation to the protection provider is required for settlement, the terms of the underlying obligation should provide that any required consent to such transfer may not be unreasonably withheld.

(j) The identity of the parties responsible for determining whether a credit event has occurred should be clearly defined. This determination should not be the sole responsibility of the protection seller. The protection buyer should have the right/ability to inform the protection provider of the occurrence of a credit event.

(k) A mismatch between the underlying obligation and the reference obligation or deliverable obligation under the CDS (i.e., the obligation used for purposes of determining cash settlement value or the deliverable obligation) is permissible if (1) the reference obligation or deliverable obligation ranks *pari passu* with or is junior to the underlying obligation, and (2) the underlying obligation and reference obligation or deliverable obligation share the same

[145] The maturity of the underlying exposure and the maturity of the hedge should be defined conservatively. The effective maturity of the underlying should be gauged as the longest possible remaining time before the counterparty is scheduled to fulfill its obligation, taking into account any applicable grace period.

obligor (i.e., the same legal entity) and legally enforceable cross-default or cross-acceleration clauses are in place.

(l) A mismatch between the underlying obligation and the obligation used for purposes of determining whether a credit event has occurred is permissible if (1) the latter obligation ranks *pari passu* with or is junior to the underlying obligation, and (2) the underlying obligation and reference obligation share the same obligor (i.e., the same legal entity) and legally enforceable cross-default or cross acceleration clauses are in place.

## 5. Capital Adequacy Requirement for CDS Positions in the Banking Book

### 5.1 Recognition of External/Third-party CDS Hedges

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

(a) Operational requirements mentioned in paragraph 4 are met;

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

(c) There is no maturity mismatch between the underlying asset and the reference / deliverable obligation. If this condition is not satisfied, then the amount of credit protection to be recognised should be computed as indicated in paragraph 5.1.3 (ii) below.

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

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

(i) **Asset mismatches**

Asset mismatch will arise if the underlying asset is different from the reference asset or deliverable obligation. Protection will be reckoned as available by the protection buyer only if the mismatched assets meet the requirements specified in paragraph 4 (k) above.

(ii) **Maturity mismatches**

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

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

b. If the residual maturity of the credit derivative contract is **three months** or more

protection proportional to the period for which it is available will be recognised. When there is a maturity mismatch the following adjustment will be applied.

**Pa = P x (t- .25) ÷ (T- .25)**
Where:

Pa = value of the credit protection adjusted for maturity mismatch
P = credit protection
t = min (T, residual maturity of the credit protection arrangement) expressed in years
T = min (5, residual maturity of the underlying exposure) expressed in years

***Example:*** *Suppose the underlying asset is a corporate bond of Face Value of Rs. 100 where the residual maturity is of 5 years and the residual maturity of the CDS is 4 years. The amount of credit protection is computed as under:*

*100 * {(4-.25) ÷ (5-.25)} = 100*(3.75÷ 4.75) = 78.95*

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

### 5.2 Internal Hedges

AIFIs can use CDS contracts to hedge against the credit risk in their existing corporate bonds portfolios. An AIFI can hedge a Banking Book credit risk exposure either by an internal hedge (the protection purchased from the trading desk of the AIFI and held in the Trading Book) or an external hedge (protection purchased from an eligible third party protection provider). When an AIFI hedges a Banking Book credit risk exposure (corporate bonds) using a CDS booked in its Trading Book (i.e., using an internal hedge), the Banking Book exposure is not deemed to be hedged for capital purposes unless the AIFI transfers the credit risk from the Trading Book to an eligible third party protection provider through a CDS meeting the requirements of paragraph 5.1 vis-à-vis the Banking Book exposure. Where such third party protection is purchased and is recognised as a hedge of a Banking Book exposure for regulatory capital purposes, no capital is required to be maintained on internal and external CDS hedge. In such cases, the external CDS will act as indirect hedge for the Banking Book exposure and the capital adequacy in terms of paragraph 5.1, as applicable for external / third party hedges, will be applicable.

## 6. Capital Adequacy for CDS in the Trading Book

### 6.1 General Market Risk

A credit default swap does not normally create a position for general market risk for either the protection buyer or protection seller. However, the present value of premium payable / receivable is sensitive to changes in the interest rates. In order to measure the interest rate risk in premium receivable/payable, the present value of the premium can be treated as a notional position in Government securities of relevant maturity. These positions will attract appropriate capital charge for general market risk. The protection buyer / seller will treat the present value of the premium payable / receivable equivalent to a short / long notional position in Government securities of relevant maturity.

### 6.2 Specific Risk for Exposure to Reference Entity

A CDS creates a notional long / short position for specific risk in the reference asset / obligation for protection seller / protection buyer. For calculating specific risk capital charge, the notional amount of the CDS and its maturity should be used. The specific risk capital charge for CDS positions will be as per Table-1 and Table-2 below.

**Table-1: Specific risk capital charges for bought and sold CDS positions in the Trading Book: Exposures to entities <u>other than</u> Commercial Real Estate Companies/ NBFC-ND-SI**

| Upto 90 days | | | After 90 days | |
|---|---|---|---|---|
| **Ratings by the ECAI*** | **Residual Maturity of the instrument** | **Capital charge** | **Ratings by the ECAI*** | **Capital charge** |
| AAA to BBB | 6 months or less | 0.28 % | AAA | 1.8 % |
| | Greater than 6 months and up to and including 24 months | 1.14% | AA | 2.7% |
| | Exceeding 24 months | 1.80% | A | 4.5% |
| | | | BBB | 9.0% |
| BB and below | All maturities | 13.5% | BB and below | 13.5% |
| Unrated (if permitted) | All maturities | 9.0% | Unrated (if permitted) | 9.0% |

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

**Table-2: Specific risk capital charges for bought and sold CDS positions in the Trading Book: Exposures to Commercial Real Estate Companies/ NBFC-ND-SI#**

| Ratings by the ECAI* | Residual Maturity of the instrument | Capital charge |
|---|---|---|
| AAA to BBB | 6 months or less | 1.4% |
| | Greater than 6 months and up to and including 24 months | 7.7% |
| | Exceeding 24 months | 9.0% |
| BB and below | All maturities | 9.0% |
| Unrated (if permitted) | All maturities | 9.0% |

# The above table will be applicable for exposures upto 90 days. Capital charge for exposures to Commercial Real Estate Companies / NBFC-ND-SI beyond 90 days shall be taken at 9.0%, regardless of rating of the reference /deliverable obligation.

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

### 6.2.1 Specific Risk Capital Charges for Positions Hedged by CDS[146]

(i) AIFIs may fully offset the specific risk capital charges when the values of two legs (i.e., long and short in CDS positions) always move in the opposite direction and broadly to the same extent. This would be the case when the two legs consist of **completely identical CDS**. In these cases, no specific risk capital requirement applies to both sides of the CDS positions.

(ii) AIFIs may offset 80 per cent of the specific risk capital charges when the value of two legs (i.e., long and short) always moves in the opposite direction but not broadly to the same extent[147]. This would be the case when a long cash position is hedged by a credit default swap and there is an exact match in terms of the reference / deliverable obligation, and the maturity of both the reference / deliverable obligation and the CDS. In addition, key features of the CDS (e.g., credit event definitions, settlement mechanisms) should not cause the price movement of the CDS to materially deviate from the price movements of the cash position. To the extent that the transaction transfers risk, an 80% specific risk offset will be applied to the side of the transaction with the higher capital charge, while the specific risk requirement on the other side will be zero[148].

(iii) AIFIs may offset partially the specific risk capital charges when the value of the two legs (i.e., long and short) usually moves in the opposite direction. This would be the case in the following situations:

(a) The position is captured in paragraph 6.2.1 (ii) but there is an asset mismatch between the cash position and the CDS. However, the underlying asset is included in the (reference / deliverable) obligations in the CDS documentation and meets the requirements of paragraph 4 (k).

(b) The position is captured in paragraph 6.2.1 (ii) but there is maturity mismatch between credit protection and the underlying asset. However, the underlying asset is included in the (reference / deliverable) obligations in the CDS documentation.

(c) In each of the cases in paragraph (a) and (b) above, rather than applying specific risk capital requirements on each side of the transaction (i.e., the credit protection and the underlying asset), only higher of the two capital requirements will apply.

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[146] This paragraph will be applicable only in those cases where a CDS position is explicitly meant for hedging a Trading Book exposure. In other words, an AIFI cannot treat a CDS position as a hedge against any other Trading Book exposure if it was not intended to be as such *ab initio.*

[147] A cash position in corporate bond in Trading Book hedged by a CDS position, even where the reference obligation and the underlying bonds are the same, will not qualify for 100% offset because a CDS cannot guarantee a 100% match between the market value of CDS and the appreciation / depreciation in the underlying bond at all times. This paragraph will apply only when two legs consist of completely identical CDS instruments.

[148] For example, if specific risk charge on long position (corporate bond) comes to Rs.1000 and that on the short position (credit protection bought through CDS) comes to Rs.700, there will be no capital change on the short position and the long position will attract specific risk capital charge of Rs.200 (1000-80% of 1000). AIFIs will not be allowed to offset specific risk charges between two opposite CDS positions which are not completely identical.

### 6.2.2 Specific Risk Charge in CDS Positions which are not meant for Hedging

In cases not captured in paragraph 6.2.1, a specific risk capital charge will be assessed against both sides of the positions.

## 7. Capital Charge for Counterparty Credit Risk

The credit exposure for the purpose of counterparty credit risk on account of CDS transactions in the Trading Book will be calculated according to the Current Exposure Method[149] under Basel framework.

### 7.1 Protection Seller

A protection seller will have exposure to the protection buyer only if the fee / premia are outstanding. In such cases, the counterparty credit risk charge for all single name long CDS positions in the Trading Book will be calculated as the sum of the current marked-to-market value, if positive (zero, if marked-to-market value is negative) and the potential future exposure add-on factors based on Table 3 given below. However, for protection seller where the CDS positions are outside netting and margin agreements, the add-on will be capped to the amount of unpaid premia. AIFIs have the option to remove such CDS positions from their legal netting sets and treat them as individual unmargined transactions in order to apply the cap.

**Table 3: Add-on factors for Protection sellers**

(As % of Notional Principal of CDS)

| Type of Reference Obligation[150] | Add-on factor |
|---|---|
| Obligations rated BBB- and above | 10% |
| Below BBB- and unrated | 20% |

### 7.2 Protection Buyer

A CDS contract creates a counterparty exposure on the protection seller on account of the credit event payment. The counterparty credit risk charge for all short CDS positions in the Trading Book will be calculated as the sum of the current marked-to-market value, if positive (zero, if marked-to-market value is negative) and the potential future exposure add-on factors based on Table 4 given below:

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[149] A CDS contract, which is required to be marked-to-market, creates bilateral exposure for the parties to the contract. The mark-to-market value of a CDS contract is the difference between the default-adjusted present value of protection payment (called “protection leg” / “credit leg”) and the present value of premium payable called (“premium leg”). If the value of credit leg is less than the value of the premium leg, then the marked-to-market value for the protection seller in positive. Therefore, the protection seller will have exposure to the counterparty (protection buyer) if the value of premium leg is more than the value of credit leg. In case, no premium is outstanding, the value of premium leg will be zero and the mark-to-market value of the CDS contract will always be negative for the protection seller and therefore, protection seller will not have any exposure to the protection buyer. In no case, the protection seller’s exposure on protection buyer can exceed the amount of the premium unpaid. For the purpose of capital adequacy as well as exposure norms, the measure of counterparty exposures in case of CDS transaction held in Trading Book is the Potential Future Exposure (PFE) which is measured and recognised as per Current Exposure Method.

[150] The add-on factors will be the same regardless of maturity of the reference obligations or CDS contract.

**Table 4: Add-on factors for Protection Buyers**

(As % of Notional Principal of CDS)

| Type of Reference Obligation[151] | Add-on factor |
|---|---|
| Obligations rated BBB- and above | 10% |
| Below BBB- and unrated | 20% |

### 7.3 Capital Charge for Counterparty risk for Collateralised Transactions in CDS

The counterparty exposure for CDS traded in the OTC market will be calculated as per the Current Exposure Method. Under this method, the calculation of the counterparty credit risk charge for an individual contract, taking into account the collateral, will be as follows:

Counterparty risk capital charge = [(RC + add-on) – CA] x r x 9%
where:

RC = the replacement cost,

add-on = the amount for potential future exposure calculated according to paragraph 7 above.

CA = the volatility adjusted amount of eligible collateral under the comprehensive approach prescribed in section 10.3 “Credit Risk Mitigation Techniques- Collateralised Transactions” of these guidelines, or zero if no eligible collateral is applied to the transaction, and

r = the risk weight of the counterparty.

## 8. Treatment of Exposures Below Materiality Thresholds

Materiality thresholds on payments below which no payment is made in the event of loss are equivalent to retained first loss positions and should be assigned risk weight of 1250% for capital adequacy purpose by the protection buyer.

## 9. General Provisions Requirements

At present, general provisions (standard asset provisions) are required only for Loans and Advances and the positive marked-to-market values of derivatives contracts. For all CDS positions including the hedged positions, both in the Banking Book and Trading Book, AIFIs should hold general provisions for gross positive marked-to-market values of the CDS contracts.

## 10. Prudential Treatment Post-Credit Event

### 10.1 Protection Buyer

In case the credit event payment is not received within the period as stipulated in the CDS contract, the protection buyer shall ignore the credit protection of the CDS and reckon the credit exposure on the underlying asset and maintain appropriate level of capital and provisions as warranted for the exposure. On receipt of the credit event payment, (a) the

[151] The add-on factors will be the same regardless of maturity of the reference obligations or CDS contract.

underlying asset shall be removed from the books if it has been delivered to the protection seller or (b) the book value of the underlying asset shall be reduced to the extent of credit event payment received if the credit event payment does not fully cover the book value of the underlying asset and appropriate provisions shall be maintained for the reduced value.

### 10.2 Protection Seller

**10.2.1** From the date of credit event and until the credit event payment in accordance with the CDS contract, the protection seller shall debit the Profit and Loss account and recognise a liability to pay to the protection buyer, for an amount equal to fair value of the contract (notional of credit protection less expected recovery value). In case, the fair value of the deliverable obligation (in case of physical settlement) / reference obligation (in case of cash settlement) is not available after the date of the credit event, then until the time that value is available, the protection seller should debit the Profit and Loss account for the full amount of the protection sold and recognise a liability to pay to the protection buyer equal to that amount.

**10.2.2** In case of physical settlement, after the credit event payment, the protection seller shall recognise the assets received, if any, from the protection buyer at the fair value. These investments will be classified as non-performing investments and valued in terms of "Prudential Norms for Classification, Valuation and Operation of Investment Portfolio" prescribed in Chapter V of these Directions. Thereafter, the protection seller shall subject these assets to the appropriate prudential treatment as applicable to corporate bonds.

## 11. Exposure Norms

**11.1** For the present, the CDS is primarily intended to provide an avenue to investors for hedging credit risk in the corporate bonds, after they have invested in the bonds. It should, therefore, not be used as a substitute for a guarantee. Accordingly, an AIFI should not sell credit protection by writing a CDS on a corporate bond on the date of its issuance in the primary market or undertake, before or at the time of issuance of the bonds, to write such protection in future[152].

**11.2** Exposure on account of all CDS contracts will be aggregated and combined with other on-balance sheet and off-balance sheet exposures against the reference entity for the purpose of complying with the exposure norms.

### 11.3 Protection Seller

(i) A protection seller will recognise an exposure to the reference entity of the CDS contract equal to the amount of credit protection sold, subject to paragraph (ii) below.

(ii) If a market maker has two completely identical opposite positions in CDS forming a hedged position which qualifies for capital adequacy treatment in terms of paragraph 6.2.1(i), no exposure would be reckoned against the reference entity.

(iii) Protection seller will also recognise an exposure to the counterparty equal to the total credit exposure calculated under Current Exposure Method as prescribed in Basel II framework in the case of all CDS positions held in the Trading Book.

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[152] As per extant instructions issued by the Reserve Bank, banks are not permitted to guarantee the repayment of principal and/or interest due on corporate bonds. Considering this restriction, AIFIs' writing credit protection through CDS on a corporate bond on the date of its issuance or undertaking, before or at the time of issuance, to write such protection in future, will be deemed to be a violation of the said instructions.

### 11.4 Protection Buyer

(i) In respect of obligations hedged in the Banking Book as indicated in paragraph 5.1 and Trading Book as indicated in paragraph 6.2.1 (ii), the protection buyer will not reckon any exposure on the reference entity. The exposure will be deemed to have been transferred on the protection seller to the extent of protection available.

(ii) In all other cases where the obligations in Banking Book or Trading Book are hedged by CDS positions, the protection buyer will continue to reckon the exposure on the reference entity equal to the outstanding position of the underlying asset.

(iii) For all bought CDS positions (hedged and un-hedged) held in Trading Book, the protection buyer will also reckon exposure on the counterparties to the CDS contracts as measured by the Current Exposure Method.

(iv) The protection buyer needs to adhere to all the criteria required for transferring the exposures fully to the protection seller in terms of paragraph (i) above on an on-going basis so as to qualify for exposure relief on the underlying asset. In case any of these criteria are not met subsequently, the AIFI will have to reckon the exposure on the underlying asset. Therefore, AIFIs should restrict the total exposure to an obligor including that covered by way of various unfunded credit protections (guarantees, LCs, standby LCs, CDS, etc.) within an internal exposure ceiling considered appropriate by the Board of the AIFI in such a way that it does not breach the single / group borrower exposure limit prescribed by the Reserve Bank. In case of the event of any breach in the single / group borrower exposure limit, the entire exposure in excess of the limit will be risk weighted at 1250%. In order to ensure that consequent upon such a treatment, the AIFI does not breach the minimum capital requirement prescribed by the Reserve Bank, it should keep sufficient cushion in capital in case it assumes exposures in excess of normal exposure limit.

(v) In respect of bought CDS positions held in Trading Book which are not meant for hedging, the protection buyer will not reckon any exposure against the reference entity[153].

## 12. Reporting Requirements

AIFIs should report “total exposure” in all cases where they have assumed exposures against borrowers in excess of the normal single / group exposure limits due to the credit protections obtained by them through CDS, guarantees or any other instruments of credit risk transfer, to the Department of Supervision (DOS) on a quarterly basis.

[153] In a CDS transaction, the protection buyer does not suffer a loss when reference entity defaults; it rather gains in such a situation.

**Annex 7**
**(section 10.3.6)**

## Part – A

### Illustrations on Credit Risk Mitigation (Loan- Exposures)
### Calculation of Exposure amount for collateralised transactions

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

Where,

$E^*$ = Exposure value after risk mitigation

$E$ = Current value of the exposure

$H_e$ = Haircut appropriate to the exposure

$C$ = Current value of the collateral received

$H_c$ = Haircut appropriate to the collateral

$H_{FX}$ = Haircut appropriate for currency mismatch between the collateral and exposure

| **Sly. No.** | **Particulars** | **Case I** | **Case 2** | **Case 3** | **Case 4** | **Case 5** |
|---|---|---|---|---|---|---|
| **(1)** | **(2)** | **(3)** | **(4)** | **(5)** | **(6)** | **(7)** |
| 1 | **Exposure** | **100** | **100** | **100** | **100** | **100** |
| 2 | Maturity of the exposure | 2 | 3 | 6 | 3 | 3 |
| 3 | Nature of the exposure | Corporate Loan | Corporate Loan | Corporate Loan | Corporate Loan | Corporate Loan |
| 4 | Currency | INR | INR | USD | INR | INR |
| 5 | Exposure in rupees | 100 | 100 | 4000 (Row 1 x exch. rate##) | 100 | 100 |
| 6 | Rating of exposure | BB | A | BBB- | AA | B- |
| | Applicable Risk weight | 150 | 50 | 100@ | 30 | 150 |
| 7 | Haircut for exposure* | 0 | 0 | 0 | 0 | 0 |
| 8 | **Collateral** | 100 | 100 | 4000 | 2 | 100 |
| 9 | Currency | INR | INR | INR | USD | INR |
| 10 | **Collateral in Rs.** | **100** | **100** | **4000** | **80** (Row 1 x Exch. Rate) | **100** |
| 11 | Residual maturity of collateral (years) | 2 | 3 | 6 | 3 | 5 |
| 12 | Nature of collateral | Sovereign (GoI) Security | Bank Bonds | Corporate Bonds | Foreign Corporate Bonds | Units of Mutual Funds |

| | | | | | | |
|---|---|---|---|---|---|---|
| 13 | Rating of Collateral | NA | Unrated | BBB | AAA (S & P) | AA |
| 14 | Haircut for collateral (%) | 0.02 | 0.06 | 0.12 | 0.04 | 0.08 |
| 15 | Haircut for currency mismatches ( %) [section 10.3.7 (vi) of circular] | 0 | 0 | 0.08 | 0.08 | 0 |
| 16 | Total Haircut on collateral [Row 10 x (row 14+15)] | 2 | 6 | 800 | 9.6 | 8.0 |
| 17 | Collateral after haircut ( Row 10 - Row 16) | 98 | 94 | 3200 | 70.4 | 92 |
| 18 | **Net Exposure (Row 5 – Row 17 )** | **2** | **6** | **800** | **29.6** | **8** |
| 19 | Risk weight ( %) | 150 | 50 | 100@ | 30 | 150 |
| 20 | **RWA (Row 18 x 19)** | **3** | **3** | **800** | **8.88** | **12** |

## Exchange rate assumed to be 1 USD = Rs.40

# Not applicable

@ In case of long term ratings, as per section 9.4.2 of the Chapter, where "+" or "-" notation is attached to the rating, the corresponding main rating category risk weight is to be used. Hence risk weight is 100 per cent.

( * ) Haircut for exposure is taken as zero because the loans are not marked to market and hence are not volatile

Case 4: Haircut applicable as per Table – 12 (section 10.3.7) of this Chapter

Case 5: It is assumed that the Mutual Fund meets the criteria specified in section 10.3.5(viii) and has investments in the securities all of which have residual maturity of more than five years are rated AA and above – which would attract a haircut of eight per cent in terms of Table 12 (section 10.3.7).

## Part - B

### Illustrations on computation of capital charge for Counterparty Credit Risk (CCR) – Repo Transactions

An illustration showing computation of total capital charge for a repo transaction comprising the capital charge for CCR and Credit/Market risk for the underlying security, under Basel-II is furnished below:

**A. Particulars of a Repo Transaction:**

Let us assume the following parameters of a hypothetical repo transaction:

| | |
|---|---|
| **Type of the Security** | GOI security |
| **Residual Maturity** | 5 years |
| **Coupon** | 6 % |
| **Current Market Value** | Rs.1050 |
| **Cash borrowed** | Rs.1000 |
| **Modified Duration of the security** | 4.5 years |
| **Assumed frequency of margining** | Daily |
| **Haircut for security** | 2%<br>(Cf. Item A(i), Table 12 Circular) |
| **Haircut on cash** | Zero<br>(Cf. Item C in Table 12 of the Circular) |
| **Minimum holding period** | 5 business-days<br>(section 10.3.7 (ix) of the Circular) |
| **Change in yield for computing the capital charge for general market risk** | 0.7 % p.a.<br>(Cf. Zone 3 in Table 15 of the Circular) |

**B. Computation of total capital charge comprising the capital charge for Counterparty Credit Risk (CCR) and Credit / Market risk for the underlying security**

**B.1 In the books of the borrower of funds (for the off-balance sheet exposure due to lending of the security under repo)**

(In this case, the security lent is the exposure of the security AIFI while cash borrowed is the collateral)

| Sl.No. | Items | Particulars | Amount (in Rs.) |
|---|---|---|---|
| **A.** | **Capital Charge for CCR** | | |
| 1. | Exposure | MV of the security | 1050 |
| 2. | CCF for Exposure | 100 % | |
| 3. | On-Balance Sheet Credit Equivalent | 1050 * 100 % | 1050 |
| 4. | Haircut | 1.4 % @ | |
| 5. | *Exposure adjusted for haircut as per Table 12 of the circular* | 1050 * 1.014 | 1064.70 |
| 6. | Collateral for the security lent | Cash | 1000 |
| 7. | Haircut for exposure | 0 % | |
| 8. | *Collateral adjusted for haircut* | 1000 * 1.00 | 1000 |
| 9. | Net Exposure ( 5- 8) | 1064.70 – 1000 | 64.70 |
| 10. | Risk weight (for a Scheduled CRAR-compliant bank) | 20 % | |
| 11. | Risk weighted assets for CCR (9 x 10) | **64.70 * 20 %** | **12.94** |

| | | | |
|---|---|---|---|
| 12. | Capital Charge for CCR (11 x 9%) | 12.94 * 0.09 | 1.16 |
| **B.** | **Capital for Credit/ market Risk of the security** | | |
| 1. | Capital for credit risk<br>(if the security is held under HTM) | Credit risk | Zero<br>(Being Govt. security) |
| 2. | Capital for market risk<br>(if the security is held under AFS / HFT) | Specific Risk | Zero<br>(Being Govt. security) |
| | | General Market Risk<br>(4.5 * 0.7 % * 1050)<br>{Modified duration * assumed yield change (%) * market value of security} | 33.07 |
| **Total capital required<br>(for CCR + credit risk + specific risk + general market risk)** | | | 34.23 |

@ The supervisory haircut of 2 per cent has been scaled down using the formula indicated in section 10.3.7 of the circular.

**B.2 In the books of the AIFI of funds (for the on-balance sheet exposure due to lending of funds under repo)**

(In this case, the cash lent is the exposure and the security borrowed is collateral)

| Sl.No | Items | Particulars | Amount (in Rs.) |
|---|---|---|---|
| **A.** | **Capital Charge for CCR** | | |
| 1. | Exposure | Cash | 1000 |
| 2. | Haircut for exposure | 0 % | |
| 3. | *Exposure adjusted for haircut as per Table 12 of the circular* | 1000 * 1.00 | 1000 |
| 4. | Collateral for the cash lent | Market value of the security | 1050 |
| 5. | Haircut for collateral | 1.4 % @ | |
| 6. | *Collateral adjusted for haircut* | 1050 * 0.986 | 1035.30 |
| 7. | Net Exposure ( 3 - 6) | Max {1000 -1035.30} | 0 |
| 8. | Risk weight (for a Scheduled CRAR-compliant bank) | 20 % | |
| 9. | Risk weighted assets for CCR ( 7 x 8) | **0 * 20 %** | **0** |
| 10. | Capital Charge for CCR | 0 | **0** |
| **B.** | **Capital for Credit/ market Risk of the security** | | |
| 1. | Capital for credit risk<br>(if the security is held under HTM) | Credit Risk | Not applicable, as it is maintained by the borrower of funds |
| 2. | Capital for market risk<br>(if the security is held under AFS/HFT) | Specific Risk | Not applicable, as it is maintained by the borrower of funds |
| | | General Market Risk | Not applicable, as it is maintained by the borrower of funds |

@ The supervisory haircut of 2 per cent has been scaled down using the formula indicated in section 10.3.7 of the circular.

**Annex 8**
**(section 11.3.6.4)**

**Measurement of capital charge for Market Risks in respect of Interest Rate Derivatives and Options**

## A. Interest Rate Derivatives

The measurement system should include all interest rate derivatives and off-balance-sheet instruments in the trading book, which react to changes in interest rates, (e.g., forward rate agreements (FRAs), other forward contracts, bond futures, interest rate and cross-currency swaps and forward foreign exchange positions). Options can be treated in a variety of ways as described in para B.1 below. A summary of the rules for dealing with interest rate derivatives is set out in the Table at the end of this section.

### 1. Calculation of positions

The derivatives should be converted into positions in the relevant underlying and be subjected to specific and general market risk charges as described in the guidelines. In order to calculate the capital charge, the amounts reported should be the market value of the principal amount of the underlying or of the notional underlying. For instruments where the apparent notional amount differs from the effective notional amount, AIFIs shall use the effective notional amount.

### (a) Futures and Forward Contracts, including Forward Rate Agreements

These instruments are treated as a combination of a long and a short position in a notional government security. The maturity of a future or a FRA will be the period until delivery or exercise of the contract, plus - where applicable - the life of the underlying instrument. *For example, a long position in a June three-month interest rate future (taken in April) is to be reported as a long position in a government security with a maturity of five months and a short position in a government security with a maturity of two months.* Where a range of deliverable instruments may be delivered to fulfill the contract, the AIFI has flexibility to elect which deliverable security goes into the duration ladder but should take account of any conversion factor defined by the exchange.

### (b) Swaps

Swaps will be treated as two notional positions in government securities with relevant maturities. *For example, an interest rate swap under which an AIFI is receiving floating rate interest and paying fixed will be treated as a long position in a floating rate instrument of maturity equivalent to the period until the next interest fixing and a short position in a fixed-rate instrument of maturity equivalent to the residual life of the swap.* For swaps that pay or receive a fixed or floating interest rate against some other reference price, e.g., a stock index, the interest rate component should be slotted into the appropriate repricing maturity category, with the equity component being included in the equity framework.
Separate legs of cross-currency swaps are to be reported in the relevant maturity ladders for the currencies concerned.

### 2. Calculation of capital charges for derivatives under the Standardised Methodology

### (a) Allowable offsetting of Matched Positions

The following may be excluded from the interest rate maturity framework altogether (for both specific and general market risk);

- Long and short positions (both actual and notional) in identical instruments with exactly the same issuer, coupon, currency and maturity.

- A matched position in a future or forward and its corresponding underlying may also be fully offset, (the leg representing the time to expiry of the future should however be reported) and thus excluded from the calculation.

When the future or the forward comprises a range of deliverable instruments, offsetting of positions in the future or forward contract and its underlying is only permissible in cases where there is a readily identifiable underlying security which is most profitable for the trader with a short position to deliver. The price of this security, sometimes called the "cheapest-to-deliver", and the price of the future or forward contract should in such cases move in close alignment.

No offsetting will be allowed between positions in different currencies; the separate legs of cross-currency swaps or forward foreign exchange deals are to be treated as notional positions in the relevant instruments and included in the appropriate calculation for each currency.

In addition, opposite positions in the same category of instruments can in certain circumstances be regarded as matched and allowed to offset fully. To qualify for this treatment the positions must relate to the same underlying instruments, be of the same nominal value and be denominated in the same currency. In addition:

- for Futures: offsetting positions in the notional or underlying instruments to which the futures contract relates must be for identical products and mature within seven days of each other;

- for Swaps and FRAs: the reference rate (for floating rate positions) must be identical and the coupon closely matched (i.e., within 15 basis points); and

- for Swaps, FRAs and Forwards: the next interest fixing date or, for fixed coupon positions or forwards, the residual maturity must correspond within the following limits:

    - less than one month hence: same day;
    - between one month and one year hence: within seven days;
    - over one year hence: within thirty days.

AIFIs with large swap books may use alternative formulae for these swaps to calculate the positions to be included in the duration ladder. The method would be to calculate the sensitivity of the net present value implied by the change in yield used in the duration method and allocate these sensitivities into the time-bands set out in Table 15 in section 11.3.6.3 of this Chapter.

**(b) Specific Risk**

Interest rate and currency swaps, FRAs, forward foreign exchange contracts and interest rate futures will not be subject to a specific risk charge. This exemption also applies to futures on an interest rate index. However, in the case of futures contracts where the underlying is a debt security, or an index representing a basket of debt securities, a specific risk charge will apply according to the credit risk of the issuer as set out in paragraphs above.

**(c) General Market Risk**

General market risk applies to positions in all derivative products in the same manner as for cash positions, subject only to an exemption for fully or very closely matched positions in

identical instruments as defined in paragraphs above. The various categories of instruments should be slotted into the maturity ladder and treated according to the rules identified earlier.

**Table A - Summary of Treatment of Interest Rate Derivatives**

| Instrument | Specific risk charge | General Market risk charge |
|---|---|---|
| **Exchange-traded Future** | | |
| - Government debt security | No | Yes, as two positions |
| - Corporate debt security | Yes | Yes, as two positions |
| - Index on interest rates | No | Yes, as two positions |
| **OTC Forward** | | |
| - Government debt security | No | Yes, as two positions |
| - Corporate debt security | Yes | Yes, as two positions |
| - Index on interest rates | No | Yes, as two positions |
| **FRAs, Swaps** | No | Yes, as two positions |
| **Forward Foreign Exchange** | No | Yes, as one position in each currency |
| **Options** | | |
| - Government debt security | No | |
| - Corporate debt security | Yes | |
| - Index on interest rates | No | |
| - FRAs, Swaps | No | |

**B. <u>Treatment of Options</u>**

1. Alternative approaches for measuring price risk for options are permissible as under:

- those AIFIs which solely use purchased options[154] will be free to use the simplified approach described in Section I below;
- those AIFIs which also write options will be expected to use one of the intermediate approaches as set out in Section II below.

2. In the ***simplified approach***, the positions for the options and the associated underlying, cash or forward, are not subject to the standardised methodology but rather are "carved-out" and subject to separately calculated capital charges that incorporate both general market risk and specific risk. The risk numbers thus generated are then added to the capital charges for the relevant category, i.e., interest rate related instruments, equities, and foreign exchange as described in sections 11.3 to 11.5 of this Chapter. The *delta-plus method* uses the sensitivity parameters or "Greek letters" associated with options to measure their market risk and capital requirements. Under this method, the delta-equivalent position of each option becomes part of the standardised methodology set out in sections 11.3 to 11.5 of this Chapter with the delta-equivalent amount subject to the applicable general market risk charges. Separate capital charges are then applied to the gamma and Vega risks of the option positions. The ***scenario approach*** uses simulation techniques to calculate changes in the value of an options portfolio for changes in the level and volatility of its associated

[154] Unless all their written option positions are hedged by perfectly matched long positions in exactly the same options, in which case no capital charge for market risk is required

underlyings. Under this approach, the general market risk charge is determined by the scenario "grid" (i.e., the specified combination of underlying and volatility changes) that produces the largest loss. For the delta-plus method and the scenario approach the specific risk capital charges are determined separately by multiplying the delta-equivalent of each option by the specific risk weights set out in sections 11.3 to 11.4 of this Chapter.

**I. Simplified Approach**

3. AIFIs which handle a limited range of purchased options only will be free to use the simplified approach set out in Table B below, for particular trades. As an example of how the calculation would work, if a holder of 100 shares currently valued at Rs.10 each holds an equivalent put option with a strike price of Rs.11, the capital charge would be: Rs.1,000 x 18 per cent (i.e., 9 per cent specific plus 9 per cent general market risk) = Rs.180, less the amount the option is in the money (Rs.11 – Rs.10) x 100 = Rs.100, i.e., the capital charge would be Rs.80. A similar methodology applies for options whose underlying is a foreign currency or an interest rate related instrument.

**Table B - *Simplified approach: capital charges***

| Position | Treatment |
|---|---|
| Long cash and Long put<br>Or<br>Short cash and Long call | The capital charge will be the market value of the underlying security[155] multiplied by the sum of specific and general market risk charges[156] for the underlying less the amount the option is in the money (if any) bounded at zero[157] |
| Long call<br>Or<br>Long put | The capital charge will be the lesser of:<br>(i) the market value of the underlying security multiplied by the sum of specific and general market risk charges[3] for the underlying<br>(ii) the market value of the option[158] |

**II. Intermediate Approaches**

**(a) Delta-plus Method**

4. AIFIs which write options will be allowed to include delta-weighted options positions within the standardised methodology set out in section 11.3 to 11.5 of this Chapter. Such options should be reported as a position equal to the market value of the underlying multiplied by the delta.

However, since delta does not sufficiently cover the risks associated with options positions, AIFIs will also be required to measure gamma (which measures the rate of change of delta) and Vega (which measures the sensitivity of the value of an option with respect to a change

[155] In some cases such as foreign exchange, it may be unclear which side is the "underlying security"; this should be taken to be the asset which would be received if the option were exercised. In addition the nominal value should be used for items where the market value of the underlying instrument could be zero, e.g., caps and floors, swaptions etc.

[156] Some options (e.g., where the underlying is an interest rate or a currency) bear no specific risk, but specific risk will be present in the case of options on certain interest rate-related instruments (e.g., options on a corporate debt security or corporate bond index; see Section B for the relevant capital charges) and for options on equities and stock indices (see Section C). The charge under this measure for currency options will be 9 per cent.

[157] For options with a residual maturity of more than six months, the strike price should be compared with the forward, not current, price. An AIFI unable to do this must take the in-the-money amount to be zero.

[158] Where the position does not fall within the trading book (i.e., options on certain foreign exchange or commodities positions not belonging to the trading book), it may be acceptable to use the book value instead.

in volatility) sensitivities in order to calculate the total capital charge. These sensitivities will be calculated according to an approved exchange model or to the AIFI's proprietary options pricing model subject to oversight by the Reserve Bank[159].

5. Delta-weighted positions with *debt securities or interest rates as the underlying* will be slotted into the interest rate time-bands, as set out in **Table 15** of section 11.3 of this Chapter**,** under the following procedure. A two-legged approach should be used as for other derivatives, requiring one entry at the time the underlying contract takes effect and a second at the time the underlying contract matures. For instance, a bought call option on a June three-month interest-rate future will in April be considered, on the basis of its delta-equivalent value, to be a long position with a maturity of five months and a short position with a maturity of two months[160]. The written option will be similarly slotted as a long position with a maturity of two months and a short position with a maturity of five months. Floating rate instruments with caps or floors will be treated as a combination of floating rate securities and a series of European-style options. For example, the holder of a three-year floating rate bond indexed to a six month reference rate with a cap of 15 per cent will treat it as:

(i) a debt security that reprices in six months; and

(ii) a series of five written call options on a FRA with a reference rate of 15 per cent, each with a negative sign at the time the underlying FRA takes effect and a positive sign at the time the underlying FRA matures[161].

6. The capital charge for *options with equities as the underlying* will also be based on the delta-weighted positions which will be incorporated in the measure of market risk described in section 11.4 of this Chapter. For purposes of this calculation each national market is to be treated as a separate underlying. The capital charge for *options on foreign exchange and gold positions* will be based on the method set out in section 11.5 of this Chapter. For delta risk, the net delta-based equivalent of the foreign currency and gold options will be incorporated into the measurement of the exposure for the respective currency (or gold) position.

7. In addition to the above capital charges arising from delta risk, there will be further capital charges for *gamma* and for *Vega risk.* AIFIs using the delta-plus method will be required to calculate the gamma and Vega for each option position (including hedge positions) separately. The capital charges should be calculated in the following way:

(i) for ***each individual option*** a "gamma impact" should be calculated according to a Taylor series expansion as:

Gamma impact = ½ x Gamma x $VU^2$
where VU = Variation of the underlying of the option.

(ii) VU will be ***calculated*** as follows:

- for interest rate options if the underlying is a bond, the price sensitivity should be worked out as explained. An equivalent calculation should be carried out where the underlying is an interest rate.
- for options on equities and equity indices; which are not permitted at present,

[159] The Reserve Bank may wish to require AIFIs doing business in certain classes of exotic options (e.g., barriers, digitals) or in options "at-the-money" that are close to expiry to use either the scenario approach or the internal models alternative, both of which can accommodate more detailed revaluation approaches.

[160] Two-months call option on a bond future, where delivery of the bond takes place in September, would be considered in April as being long the bond and short a five-month deposit, both positions being delta-weighted.

[161] The rules applying to closely-matched positions set out in paragraph 2 (a) of this Annex will also apply in this respect.

the market value of the underlying should be multiplied by 9 per cent[162];

- for foreign exchange and gold options: the market value of the underlying should be multiplied by 9 per cent;

(iii) For the ***purpose*** of this calculation the following positions should be treated as ***the same underlying***:

- for interest rates,[163] each time-band as set out in Table 15 of this Chapter;[164]
- for equities and stock indices, each national market;
- for foreign currencies and gold, each currency pair and gold;

(iv) Each ***option*** on the same underlying will have a gamma impact that is either positive or negative. These individual gamma impacts will be summed, resulting in a net gamma impact for each underlying that is either positive or negative. Only those net gamma impacts that are negative will be included in the capital calculation.

(v) The total gamma capital charge will be the sum of the absolute value of the net negative gamma impacts as calculated above.

(vi) For ***volatility risk,*** AIFIs will be required to calculate the capital charges by multiplying the sum of the Vegas for all options on the same underlying, as defined above, by a proportional shift in volatility of ± 25 per cent.

(vii) The ***total capital charge*** for Vega risk will be the sum of the absolute value of the individual capital charges that have been calculated for Vega risk.

**(b) Scenario Approach**

8. More sophisticated AIFIs will also have the right to base the market risk capital charge for options portfolios and associated hedging positions on *scenario matrix analysis*. This will be accomplished by specifying a fixed range of changes in the option portfolio's risk factors and calculating changes in the value of the option portfolio at various points along this "grid". For the purpose of calculating the capital charge, the AIFI will revalue the option portfolio using matrices for simultaneous changes in the option's underlying rate or price and in the volatility of that rate or price. A different matrix will be set up for each individual underlying as defined in paragraph 7 above. As an alternative, at the discretion of each national authority, AIFIs which are significant traders in options for interest rate options will be permitted to base the calculation on a minimum of six sets of time-bands. When using this method, not more than three of the time-bands as defined in section 11.3 of this Chapter should be combined into any one set.

9. The options and related hedging positions will be evaluated over a specified range above and below the current value of the underlying. The range for interest rates is consistent with the assumed changes in yield in Table - 15 of section 11.3 of this Chapter. Those AIFIs using the alternative method for interest rate options set out in paragraph 8 above should use, for each set of time-bands, the highest of the assumed changes in yield applicable to the group to which the time-bands belong.[165] The other ranges are ±9 per cent

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[162] The basic rules set out here for interest rate and equity options do not attempt to capture specific risk when calculating gamma capital charges. However, the Reserve Bank may require specific AIFIs to do so.

[163] Positions have to be slotted into separate maturity ladders by currency.

[164] AIFIs using the duration method should use the time-bands as set out in Table 16 of this Chapter.

[165] If, for example, the time-bands 3 to 4 years, 4 to 5 years and 5 to 7 years are combined, the highest assumed change in yield of these three bands would be 0.75.

for equities and ±9 per cent for foreign exchange and gold. For all risk categories, at least seven observations (including the current observation) should be used to divide the range into equally spaced intervals.

10. The second dimension of the matrix entails a change in the volatility of the underlying rate or price. A single change in the volatility of the underlying rate or price equal to a shift in volatility of + 25 per cent and - 25 per cent is expected to be sufficient in most cases. As circumstances warrant, however, the Reserve Bank may choose to require that a different change in volatility be used and / or that intermediate points on the grid be calculated.

11. After calculating the matrix, each cell contains the net profit or loss of the option and the underlying hedge instrument. The capital charge for each underlying will then be calculated as the largest loss contained in the matrix.

12. In drawing up these intermediate approaches it has been sought to cover the major risks associated with options. In doing so, it is conscious that so far as specific risk is concerned, only the delta-related elements are captured; to capture other risks would necessitate a much more complex regime. On the other hand, in other areas the simplifying assumptions used have resulted in a relatively conservative treatment of certain options positions.

13. Besides the options risks mentioned above, the Reserve Bank is conscious of the other risks also associated with options, e.g., rho (rate of change of the value of the option with respect to the interest rate) and theta (rate of change of the value of the option with respect to time). While not proposing a measurement system for those risks at present, it expects AIFIs undertaking significant options business at the very least to monitor such risks closely. Additionally, AIFIs will be permitted to incorporate rho into their capital calculations for interest rate risk, if they wish to do so.

**Annex 9**
**(section 16.5)**

## An Illustrative Approach for Measurement of Interest Rate Risk in the Banking Book (IRRBB) under Pillar 2

The AIFIs are required to measure the interest rate risk in the banking book (IRRBB) and hold capital commensurate with it. If supervisors determine that AIFIs are not holding capital commensurate with the level of interest rate risk, they must require the AIFI to reduce its risk, to hold a specific additional amount of capital or some combination of the two. To comply with the requirements of Pillar 2 relating to IRRBB, the guidelines on Pillar 2 issued by many regulators contain definite provisions indicating the approach adopted by the supervisors to assess the level of interest rate risk in the banking book and the action to be taken in case the level of interest rate risk found is significant.

### 2. The approach prescribed in the BCBS Paper on "Principles for the Management and Supervision of Interest Rate Risk"

The main components of the approach prescribed in the above mentioned supporting document are as under:

a) The assessment should take into account both the earnings perspective and economic value perspective of interest rate risk.

b) The impact on income or the economic value of equity should be calculated by applying a notional interest rate shock of 200 basis points.

c) The usual methods followed in measuring the interest rate risk are:

***a) Earnings perspective***

Gap Analysis, simulation techniques and Internal Models based on VaR

***b) Economic perspective***

Gap analysis combined with duration gap analysis, simulation techniques and Internal Models based on VaR

### 3. Methods for measurement of the IRRBB

3.1 Impact on Earnings

The major methods used for computing the impact on earnings are the Gap Analysis, Simulations and VaR based Techniques. AIFIs may use the Gap Reports to assess the impact of adverse movements in the interest rate on income through gap method. However, the AIFIs may use the simulations also. The AIFIs may calculate the impact on the earnings by gap analysis or any other method with the assumed change in yield on 200 bps over one year. However, no capital needs to be allocated for the impact on the earnings.

3.2.1 *Method indicated in the BCBS Paper on "Principles for the Management and Supervision of Interest Rate Risk"*

The following steps are involved in this approach:

a) The variables such as maturity/re-pricing date, coupon rate, frequency, principal amount for each item of asset/liability (for each category of asset / liability) are generated.

b) The longs and shorts in each time band are offset.

c) The resulting short and long positions are weighted by a factor that is designed to reflect the sensitivity of the positions in the different time bands to an assumed change in interest rates. These factors are based on an assumed parallel shift of 200 basis points throughout the time spectrum, and on a proxy of modified duration of positions situated at the middle of each time band and yielding 5 per cent.

d) The resulting weighted positions are summed up, offsetting longs and shorts, leading to the net short- or long-weighted position.

e) The weighted position is seen in relation to capital.

For details AIFIs may refer to the **Annex 3 and 4** of captioned paper issued by the BCBS[166].

3.2.2 Other techniques for Interest rate risk measurement

The AIFIs can also follow different versions / variations of the above techniques or entirely different techniques to measure the IRRBB if they find them conceptually sound. In this context, **Annex 1 and 2** of the BCBS paper referred to above provide broad details of interest rate risk measurement techniques and overview of some of the factors which the supervisory authorities might consider in obtaining and analysing the information on individual AIFI's exposures to interest rate risk.

## 4. Suggested approach for measuring the impact of IRRBB on capital

**4.1** If the supervisor feels that the AIFI is not holding capital commensurate with the level of IRRBB, it may either require the AIFI to reduce the risk or allocate additional capital or a combination of the two.

**4.2** The AIFIs can decide, with the approval of the Board, on the appropriate level of interest rate risk in the banking book which they would like to carry keeping in view their capital level, interest rate management skills and the ability to re-balance the banking book portfolios quickly in case of adverse movement in the interest rates. The AIFIs may be required to hold additional capital if the level of interest rate risk is considered, by the Reserve Bank, to be high in relation to their capital level or the quality of interest rate risk management framework obtaining in the AIFI. While the AIFIs may on their own decide to hold additional capital towards IRRBB keeping in view the IRR management skills and the ability to re-balance the portfolios quickly in case of adverse movement in the interest rates, the amount of exact capital add-on, if considered necessary, will be decided by the Reserve Bank as part of the SREP, in consultation with the AIFI.

## 5. Limit setting

The AIFIs would be well advised to consider setting the internal limits for controlling their IRRBB. The following are some of the indicative ways for setting the limits:

a) Internal limits could be fixed in terms of the maximum decline in earnings (as a percentage of the base-scenario income) or decline in capital (as a percentage of the base-scenario capital position) as a result of 200 or 300 basis point interest-rate shock.
b) The limits could also be placed in terms of PV01 value (present value of a basis point) of the net position of the AIFI as a percentage of net worth/capital of the AIFI.

[166] Principles for the Management and Supervision of Interest Rate Risk (July 2004).

**Annex 10**
**(section 7.5.2)**

## Investments in the Capital of Banking, Financial and Insurance Entities which are Outside the Scope of Regulatory Consolidation

### PART A: Details of Regulatory Capital Structure of an AIFI

(Rs. 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** |

### PART B: Details of Capital Structure and AIFI's Investments in Unconsolidated Entities

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

### PART C: Regulatory Adjustments on Account of Investments in Entities where AIFI Does not own more than 10% of the Issued Common Share Capital of the Entity

| **C-1: Bifurcation of Investments of AIFI into Trading and Banking Book** | | | | |
|---|---|---|---|---|
| | Common Equity | Additional Tier 1 | Tier 2 | Total investments |
| Total investments in A & B held in Banking Book | 11 | 6 | 10 | **27** |
| Total investments in A & B held in Trading Book | 15 | 4 | 5 | **24** |
| Total of Banking and Trading Book Investments in A & B | **26** | **10** | **15** | **51** |

| C-2: Regulatory adjustments | |
|---|---|
| AIFI's aggregate investment in Common Equity of A & B | 26 |
| AIFI's aggregate investment in Additional Tier 1 capital of A & B | 10 |
| AIFI's aggregate investment in Tier 2 capital of A & B | 15 |
| **Total of** AIFI's **investment in A and B** | **51** |
| AIFI common equity | 400 |
| 10% of AIFI's common equity | 40 |
| AIFI's total holdings in capital instruments of A & B in excess of 10% of AIFIs 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 AIFI's investment is more than 10% of their common shares capital. | |

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

## PART D: Regulatory Adjustments on Account of Significant Investments in the Capital of Banking, Financial and Insurance Entities which are outside the Scope of Regulatory Consolidation

| | |
|---|---|
| AIFI's aggregate investment in Common Equity of C & D | 45 |
| AIFI's aggregate investment in Additional Tier 1 capital of C & D | 15 |
| AIFI's aggregate investment in Tier 2 capital of C & D | 5 |
| **Total of AIFI's investment in C and D** | **65** |
| AIFI's common equity | 400 |
| 10% of AIFI's common equity | 40 |
| AIFI'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 AIFI (excess over 10%) | 5 |
| Amount to be deducted from Additional Tier 1 of the AIFI (all Additional Tier 1 investments to be deducted) | 15 |

| | |
|---|---|
| Amount to be deducted from Tier 2 of the AIFI (all Tier 2 investments to be deducted) | 5 |
| **Total deduction** | **25** |
| Common equity investments of the AIFI in C & D to be risk weighted (upto 10%) | 40 |

**PART E: Total Regulatory Capital of the AIFI after Regulatory Adjustments**

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

**Annex 11**
**(section 8.16.3.4)**

## CALCULATION OF CVA RISK CAPITAL CHARGE

(Rs. in crore)

| Derivatives | Counter party | Notional principal of trades whose MTM is negative | Notional principal of trades whose MTM is positive | Total Notional Principal (column 3+4) | Weighted average residual maturity | Positive MTM value of trades (column 4) | PFE | Total current credit exposure as per CEM | External rating of counter party |
|---|---|---|---|---|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| Interest rate swaps | A | 150 | 150 | 300 | 1.85 years | 1.5 | 1% | 4.5 | A (risk weight 50%) |
| Currency swaps | B | 300 | 200 | 500 | 5.01 years | 2.8 | 10% | 52.8 | AAA (risk weight 20%) |

**Formula to be used for calculation of capital charge for CVA risk:**

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

- $B_i$ is the notional of purchased single name CDS hedges - nil
- $B_{ind}$ is the full notional of one or more index CDS of purchased protection, used to hedge CVA risk. - nil
- $w_{ind}$ is the weight applicable to index hedges - nil
- $Mi^{hedge}$ is the maturity of the hedge instrument with notional Bi
- $M_i$ is the effective maturity of the transactions with counterparty 'i'
- $EAD_i^{total}$ is the exposure at default of counterparty 'i' (summed across its netting sets). For non-IMM AIFIs the exposure should be discounted by applying the factor: (1-exp(-0.05*Mi))/(0.05*Mi).
- h = 1 year

**Assumptions:**

- Applicable coupon rate on both legs of swap with exchange of coupon at yearly intervals for swap with counterparty A = 6% p.a.
- Applicable coupon rate on both legs of swap with exchange of coupon at yearly intervals for swap with counterparty =7% p.a.

**Calculation:**

Discount factor to be applied to counterparty A: $(1-\exp(-0.05*M_A))/(0.05*M_A)$

= 0.95551

Discounted $EAD_A$ = 4.5*0.95551=4.2981

Discount factor to be applied to counterparty B: $(1-\exp(-0.05*M_B))/(0.05*M_B)$

=0.8846

Discounted $EAD_B$ = 52.8*0.8846=46.7061

$K= 2.33*1*[\{(0.5*.008*(1.85*4.2981-0) + (0.5*0.007*(5.01*46.7061-0))-0\}^2+$

$(0.75*0.008^2*(1.85*4.2981-0)^2 + (0.75*0.007^2*(5.01*46.7061-0)^2]^{1/2}$

= 2.33*1.66 = 3.86

Therefore, total capital charge for CVA risk on portfolio basis = Rs. 3.86 crore

**Annex 12**
**(section 18.4.4)**

## Calculation of SFT Exposure for the Purpose of Leverage Ratio

**Illustrative Balance Sheets of AIFIs**

**AIFI A**

| **Liabilities** | | **Assets** | |
|---|---|---|---|
| Item | Amount | Item | Amount |
| | | Cash | 100 |
| Capital | 153 | Securities | 53 |
| **Total** | **153** | **Total** | **153** |

**AIFI B**

| **Liabilities** | | **Assets** | |
|---|---|---|---|
| Item | Amount | Item | Amount |
| | | cash | 0 |
| Capital | 104 | Securities | 104 |
| **Total** | **104** | **Total** | **104** |

**SFT Transactions**

| **Reverse Repo of AIFI A with Bank/AIFI B** | **AIFI A lends cash of 100 to Bank/AIFI B against security of 104** | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Capital | 153 | Cash | 0 | Capital | 104 | Cash | 100 |
| | | | Securities | 53 | | | Securities | 104 |
| | | | Receivable SFT | 100 | Payable SFT | 100 | | |
| | **Total** | **153** | **Total** | **153** | **Total** | **100** | **Total** | **204** |

| **Repo of Bank A with Bank/AIFI B** | **Bank A borrows cash of 50 from Bank/AIFI B against security of 53** | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Capital | 153 | Cash | 50 | Capital | 104 | Cash | 50 |
| | | | Securities | 53 | | | Securities | 104 |
| | Payable SFT | 50 | Receivable SFT | 100 | Payable SFT | 100 | Receivable SFT | 50 |
| | **Total** | **203** | **Total** | **203** | **Total** | **204** | **Total** | **204** |

**Leverage Ratio Exposure**

| | **AIFI A** | | **Bank/AIFI B** | |
|---|---|---|---|---|
| Item | Exposure where netting of SFT exposures is not permissible | Exposure where netting of SFT exposures is permissible | Exposure where netting of SFT exposures is not permissible | Exposure where netting of SFT exposures is permissible |
| On-balance sheet items | **103** | **103** | **154** | **154** |
| Gross SFT assets | **100** | 100 | **50** | 50 |
| Netted amount of Gross SFT assets | - | **50*** | - | **0*** |

| | | | | |
|---|---|---|---|---|
| CCR exposure for SFT assets | **3** | **0**[#] | **4** | **1**[#] |
| Total SFT exposures | **103** | **50** | **54** | **1** |
| **Total Exposures** | **206** | **153** | **208** | **155** |

* Max((SFT receivable -SFT payable),0), #CCR exposure = Max((total cash/securities receivable - total cash/securities payable), 0)

**Annex 13**
**(section 15.3.3.7)**

## An illustrative outline of the ICAAP Document

### 1. What is an ICAAP document?

The ICAAP Document would be a comprehensive Paper furnishing detailed information on the ongoing assessment of the AIFI's entire spectrum of risks, how the AIFI intends to mitigate those risks and how much current and future capital is necessary for the AIFI, reckoning other mitigating factors. The purpose of the ICAAP document is to apprise the Board of the AIFI on these aspects as also to explain to the Reserve Bank the AIFI's internal capital adequacy assessment process and the AIFIs' approach to capital management. The ICAAP could also be based on the existing internal documentation of the AIFI.

The ICAAP document submitted to the Reserve Bank should be formally approved by the AIFI's Board. It is expected that the document would be prepared in a format that would be easily understood at the senior levels of management and would contain all the relevant information necessary for the AIFI and the Reserve Bank to make an informed judgment as to the appropriate capital level of the AIFI and its risk management approach. Where appropriate, technical information on risk measurement methodologies, capital models, if any, used and all other work carried out to validate the approach (e.g., Board papers and minutes, internal or external reviews) could be furnished to the Reserve Bank as appendices to the ICAAP Document.

### 2. Contents

The ICAAP Document should contain the following sections:

I. Executive Summary
II. Background
III. Summary of current and projected financial and capital positions
IV. Capital Adequacy
V. Key sensitivities and future scenarios
VI. Aggregation and diversification
VII. Testing and adoption of the ICAAP
VIII. Use of the ICAAP within the AIFI

### I. Executive Summary

The purpose of the Executive Summary is to present an overview of the ICAAP methodology and results. This overview would typically include:

a) the purpose of the report and the regulated entities within a group that are covered by the ICAAP;

b) the main findings of the ICAAP analysis:

   i. how much and what composition of internal capital the AIFI considers it should hold as compared with the minimum CRAR requirement (CRAR) under 'Pillar 1' calculation, and

   ii. the adequacy of the AIFI's risk management processes;

c) a summary of the financial position of the AIFI, including the strategic position of the AIFI, its balance sheet strength, and future profitability;

d) brief descriptions of the capital raising and dividend plan including how the AIFI intends to manage its capital in the days ahead and for what purposes;

e) commentary on the most material risks to which the AIFI is exposed, why the level of risk is considered acceptable or, if it is not, what mitigating actions are planned;

f) commentary on major issues where further analysis and decisions are required; and

g) who has carried out the assessment, how it has been challenged / validated / stress tested, and who has approved it.

## II. Background

This section would cover the relevant organisational and historical financial data for the AIFI. e.g., group structure (legal and operational), operating profit, profit before tax, profit after tax, dividends, shareholders' funds, capital funds held vis-à-vis the regulatory requirements, customer deposits, deposits by AIFIs, total assets, and any conclusions that can be drawn from trends in the data which may have implications for the AIFI's future.

## III. Summary of current and projected financial and capital positions

This section would explain the present financial position of the AIFI and expected changes to the current business profile, the environment in which it expects to operate, its projected business plans (by appropriate lines of business), projected financial position, and future planned sources of capital.

The starting balance sheet used as reference and date as of which the assessment is carried out should be indicated.

The projected financial position could reckon both the projected capital available and projected capital requirements based on envisaged business plans. These might then provide a basis against which adverse scenarios might be compared.

## IV. Capital Adequacy

This section might start with a description of the AIFI's risk appetite, in quantitative terms, as approved by the AIFI's Board and used in the ICAAP. It would be necessary to clearly spell out in the document whether what is being presented represents the AIFI's view of the amount of capital required to meet minimum **regulatory needs or** whether represents the amount of capital that an AIFI believes it would need **to meet its business plans**. For instance, it should be clearly brought out whether the capital required is based on a particular credit rating desired by the AIFI or includes buffers for strategic purposes or seeks to minimise the chance of breaching regulatory requirements. Where economic capital models are used for internal capital assessment, the confidence level, time horizon, and description of the event to which the confidence level relates, should also be enumerated. Where scenario analyses or other means are used for capital assessment, then the basis / rationale for selecting the chosen severity of scenarios used, should also be included.

The section would then include a detailed review of the capital adequacy of the AIFI.

The information provided would include the following elements:

IV.1 Timing

- the effective date of the ICAAP calculations together with details of any events between this date and the date of submission to the Board / the Reserve Bank which would materially impact the ICAAP calculations together with their effects; and
- details of, and rationale for, the time period selected for which capital requirement has been assessed.

IV.2 Risks Analysed

- an identification of the major risks faced by the AIFI in each of the following categories:
    a) credit risk
    b) market risk
    c) operational risk
    d) liquidity risk
    e) concentration risk
    f) interest rate risk in the banking book
    g) residual risk of securitisation
    h) strategic risk
    i) business risk
    j) reputation risk
    k) group risk
    l) pension obligation risk
    m) other residual risk; and
    n) any other risks that might have been identified
- for each of these risks, an explanation of how the risk has been assessed and to the extent possible, the **quantitative results** of that assessment;
- where some of these risks have been highlighted in the report of the Reserve Bank's on-site inspection of the AIFI, an explanation of how the AIFI has mitigated these;
- where relevant, a comparison of the Reserve Bank-assessed CRAR during on-site inspection with the results of the CRAR calculations of the AIFI under the ICAAP;
- a clear articulation of the AIFI's risk appetite, in quantitative terms, by risk category and the extent of its consistency (its 'fit') with the overall assessment of AIFI's various risks; and
- where relevant, an explanation of any other methods, apart from capital, used by the AIFI to mitigate the risks.

IV.3 Methodology and Assumptions

A description of how assessments for each of the major risks have been approached and the main assumptions made.

For instance, AIFIs may choose to base their ICAAP on the results of the CRAR calculation with the capital for additional risks (e.g., concentration risk, interest rate risk in the banking book, etc.) assessed separately and added to the Pillar 1 computations. Alternatively, AIFIs could choose to base their ICAAP on internal models for all risks, including those covered under the CRAR (i.e., Credit, Market and Operational Risks).

The description here would make clear which risks are covered by which modelling or calculation approach. This would include details of the methodology and process used to calculate risks in each of the categories identified and reason for choosing the method used in each case.

Where the AIFI uses an internal model for the quantification of its risks, this section should explain for each of those models:

- the key assumptions and parameters within the capital modelling work and background information on the derivation of any key assumptions;
- how parameters have been chosen, including the historical period used and the calibration process;
- the limitations of the model;

- the sensitivity of the model to changes in those key assumptions or parameters chosen; and
- the validation work undertaken to ensure the continuing adequacy of the model.

Where stress tests or scenario analyses have been used to validate, supplement, or probe the results of other modelling approaches, then this section should provide:

- details of simulations to capture risks not well estimated by the AIFI's internal capital model (e.g., non-linear products, concentrations, illiquidity and shifts in correlations in a crisis period);
- details of the quantitative results of stress tests and scenario analyses the AIFI carried out and the confidence levels and key assumptions behind those analyses, including, the distribution of outcomes obtained for the main individual risk factors;
- details of the range of combined adverse scenarios which have been applied, how these were derived and the resulting capital requirements; and
- where applicable, details of any additional business-unit-specific or business-plan-specific stress tests selected.

IV.4 Capital Transferability

In case of AIFIs with conglomerate structure, details of any restrictions on the management's ability to transfer capital into or out of the business(es) arising from, for example, by contractual, commercial, regulatory or statutory constraints that apply, should be furnished. Any restrictions applicable and flexibilities available for distribution of dividend by the entities in the Group could also be enumerated. In case of overseas subsidiaries of the AIFIs, the regulatory restrictions would include the minimum regulatory capital level acceptable to the host-country regulator of the subsidiary, after declaration of dividend.

## V. Firm-wide risk oversight and specific aspects of risk management [167]

V.1 Risk Management System in the AIFI

This section would describe the risk management infrastructure within the AIFI along the following lines:

- The oversight of Board and senior management
- Policies, Procedures and Limits
- Identification, measurement, mitigation, controlling and reporting of risks
- MIS at the firm wide level
- Internal controls

V.2 Off-balance Sheet Exposures with a focus on Securitisation

This section would comprehensively discuss and analyse underlying risks inherent in the off-balance sheet exposures particularly its investment in structured products. When assessing securitisation exposures, AIFI should thoroughly analyse the credit quality and risk characteristics of the underlying exposures. This section should also comprehensively explain the maturity of the exposures underlying securitisation transactions relative to issued liabilities in order to assess potential maturity mismatches.

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

V.3 Assessment of Reputational Risk and Implicit Support

This section should discuss the possibilities of reputational risk leading to provision of implicit support, which might give rise to credit, market and legal risks. This section should thoroughly discuss potential sources of reputational risk to the AIFI.

V. 4 Assessment of valuation and Liquidity Risk

This section would describe the governance structures and control processes for valuing exposures for risk management and financial reporting purposes, with a special focus on valuation of illiquid positions. This section will have relevant details leading to establishment and verification of valuations for instruments and transactions in which it engages.

V. 5 Stress Testing practices

This section would explain the role of Board and senior management in setting stress testing objectives, defining scenarios, discussing the results of stress tests, assessing potential actions and decision making on the basis of results of stress tests. This section would also describe the rigorous and forward looking stress testing that identifies possible events or changes in market conditions that could adversely the AIFI. The Reserve Bank would assess the effectiveness of AIFIs' stress testing programme in identifying relevant vulnerabilities.

V. 6 Sound compensation practices

This section should describe the compensation practices followed by the AIFI and how far the compensation practices are linked to long-term capital preservation and the financial strength of the firm. The calculation of risk-adjusted performance measure for the employees and its link, if any, with the compensation should clearly be disclosed in this section.

**VI. Key sensitivities and future scenarios**

This section would explain how an AIFI would be affected by an economic recession or downswings in the business cycle or markets relevant to its activities. The Reserve Bank would like to be apprised as to how an AIFI would manage its business and capital so as to survive a recession while meeting the minimum regulatory standards. The analysis would include future financial projections for, say, three to five years based on business plans and solvency calculations.

For the purpose of this analysis, the severity of the recession reckoned should typically be one that occurs only once in a 25 year period. The time horizon would be from the day of the ICAAP calculation to at least the deepest part of the recession envisaged.

Typical scenarios would include:

- how an economic downturn would affect:
    - the AIFI's capital funds and future earnings; and
    - the AIFI's CRAR taking into account future changes in its projected balance sheet.
- In both cases, it would be helpful if these projections show separately the effects of management actions to change the AIFI's business strategy and the implementation of contingency plans.

- projections of the future CRAR would include the effect of changes in the credit quality of the AIFI's credit risk counterparties (including migration in their ratings during a recession) and the AIFI's capital and its credit risk capital requirement;
- an assessment by the AIFI of any other capital planning actions to enable it to continue to meet its regulatory capital requirements throughout a recession such as new capital injections from related companies or new share issues;
- This section would also explain which key macroeconomic factors are being stressed, and how those have been identified as drivers of the AIFI's earnings. The AIFI would also explain how the macroeconomic factors affect the key parameters of the internal model by demonstrating, for instance, how the relationship between the two has been established.

**VII. Management Actions**

This section would elaborate on the management actions assumed in deriving the ICAAP, in particular:

- the quantitative impact of management actions – sensitivity testing of key management actions and revised ICAAP figures with management actions excluded.
- evidence of management actions implemented in the past during similar periods of economic stress.

**VII. Aggregation and Diversification**

This section would describe how the results of the various separate risk assessments are brought together and an overall view taken on capital adequacy. At a technical level, this would, therefore, require some method to be used to combine the various risks using some appropriate quantitative techniques. At the broader level, the overall reasonableness of the detailed quantification approaches might be compared with the results of an analysis of capital planning and a view taken by senior management as to the overall level of capital that is considered appropriate.

- In enumerating the process of technical aggregation, the following aspects could be covered:

  i) any allowance made for diversification, including any assumed correlations within risks and between risks and how such correlations have been assessed, including in stressed conditions;

  ii) the justification for any credit taken for diversification benefits between legal entities, and the justification for the free movement of capital, if any assumed, between them in times of financial stress;

  iii) the impact of diversification benefits with management actions excluded. It might be helpful to work out revised ICAAP figures with all correlations set to '1' i.e., no diversification; and similar figures with all correlations set to '0' i.e., assuming all risks are independent i.e., full diversification.

- As regards the overall assessment, this should describe how the AIFI has arrived at its overall assessment of the capital it needs taking into account such matters as:

  i) the inherent uncertainty in any modelling approach;

  ii) weaknesses in the AIFI's risk management procedures, systems or controls;

  iii) the differences between regulatory capital and internal capital; and

iv) the differing purposes that capital serves: shareholder returns, rating objectives for the AIFI as a whole or for certain debt instruments the AIFI has issued, avoidance of regulatory intervention, protection against uncertain events, depositor protection, working capital, capital held for strategic acquisitions, etc.

## VIII. Testing and Adoption of the ICAAP

This section would describe the extent of challenging and testing that the ICAAP has been subjected to. It would thus include the testing and control processes applied to the ICAAP models and calculations. It should also describe the process of review of the test results by the senior management or the Board and the approval of the results by them. A copy of any relevant report placed before the senior management or the Board of the AIFI in this regard, along with their response, could be attached to the ICAAP Document sent to the Reserve Bank.

Details of the reliance placed on any external service providers or consultants in the testing process, for instance, for generating economic scenarios, could also be detailed here.

In addition, a copy of any report obtained from an external reviewer or internal audit should also be sent to the Reserve Bank.

## IX. Use of the ICAAP within the AIFI

This section would contain information to demonstrate the extent to which the concept of capital management is embedded within the AIFI, including the extent and use of capital modelling or scenario analyses and stress testing within the AIFI's capital management policy. For instance, use of ICAAP in setting pricing and charges and the level and nature of future business, could be an indicator in this regard.

This section could also include a statement of the AIFI's actual operating philosophy on capital management and how this fits in to the ICAAP Document submitted. For instance, differences in risk appetite used in preparing the ICAAP Document vis-à-vis that used for business decisions might be discussed.

Lastly, the AIFIs may also furnish the details of any anticipated future refinements envisaged in the ICAAP (highlighting those aspects which are work-in-progress) apart from any other information that the AIFI believes would be helpful to the Reserve Bank in reviewing the ICAAP Document.

**Annex 14**
**(section 7.2.4)**

## Minimum Requirements to Ensure Loss Absorbency of Additional Tier 1 Instruments at Pre-specified Trigger and of All Non-equity Regulatory Capital Instruments at the Point of Non-viability[168]

### 1. Introduction

**1.1** As indicated in section 7.2.4 of this Chapter, under Basel III non-common equity elements to be included in Tier 1 capital should absorb losses while the AIFI remains a going concern. Towards this end, one of the important criteria for Additional Tier 1 instruments is that these instruments should have principal loss absorption through either (i) conversion into common shares or (ii) a write-down mechanism, which allocates losses to the instrument at an objective pre-specified trigger point.

**1.2** During the financial crisis a number of distressed banks were rescued by the public sector injecting funds in the form of common equity and other forms of Tier 1 capital. While this had the effect of supporting depositors it also meant that Tier 2 capital instruments (mainly subordinated debt), and in some cases Tier 1 instruments, did not absorb losses incurred by certain large internationally-active banks that would have failed had the public sector not provided support. Therefore, Basel III requires that the terms and conditions of all non-common Tier 1 and Tier 2 capital instruments issued by an AIFI must have a provision that requires such instruments, at the option of the relevant authority, to either be written off or converted into common equity upon the occurrence of the trigger event.

**1.3** Therefore, in order for an instrument issued by an AIFI to be included in Additional (i.e., non-common) Tier 1 or in Tier 2 capital, in addition to criteria for individual types of non-equity regulatory capital instruments mentioned in **Annex 2, 3, 4 and 5,** it must also meet or exceed minimum requirements set out in the following paragraphs.

### 2. Loss Absorption of Additional Tier 1 (AT1) Instruments at the Pre-specified Trigger

#### *I. Loss Absorption Features*

**2.1** One of the criteria for AT1 capital instruments[169] requires that these instruments should have principal loss absorption at an objective pre-specified trigger point through either:

(i) conversion to common shares, or
(ii) a write-down mechanism which allocates losses to the instrument.

The write-down will have the following effects:

(a) reduce the claim of the instrument in liquidation;
(b) reduce the amount re-paid when a call is exercised; and
(c) partially or fully reduce coupon/dividend payments on the instrument.

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[168] Please refer to paragraph 2 of the circular DBOD.No.BP.BC.38/21.06.201/2014-15 dated September 1, 2014 addressed to banks on Implementation of Basel III Capital Regulations in India- Amendments.

[169] Please refer to the Appendices 4 & 5 of the circular DBOD.No.BP.BC.98 /21.06.201/2011-12 dated May 2, 2012 addressed to banks on 'Guidelines on Implementation of Basel III Capital Regulations in India'.

**2.2** Accordingly, AIFIs may issue AT1 instruments with either conversion[170] or write-down (temporary or permanent)[171] mechanism.

### *II. Level of Pre-specified Trigger and Amount of Equity to be Created by Conversion / Write-down*

**2.3** The pre-specified trigger for loss absorption through conversion / write-down of Additional Tier 1 instruments (PNCPS and PDI) must be at least Common Equity Tier 1 capital of 6.125% of RWAs. The write-down of any Common Equity Tier 1 capital shall not be required before a write-down of any Additional Tier 1 capital instrument.

**2.4** The conversion / write-down mechanism (temporary or permanent) which allocates losses to the Additional Tier 1 instruments (AT1) instruments must generate Common Equity Tier 1 (CET1) under applicable Indian Accounting Standards. The instrument will receive recognition in AT1 capital only upto the extent of minimum level of CET1 generated (i.e., net of contingent liability recognised under the Indian Accounting Standards, potential tax liabilities, etc., if any) by a full write-down / conversion of the instrument.

**2.5** AIFIs shall obtain and keep on their records a certificate from the statutory auditors clearly stating that the conversion / write-down mechanism chosen by the AIFI for a particular AT1 issuance is able to generate CET1 under the prevailing accounting standards[172]. Further, AIFIs shall also obtain and keep on their records an external legal opinion confirming that the conversion or write-down of Additional Tier 1 capital instrument at the pre-specified trigger by the issuing AIFI is legally enforceable.

**2.6** The aggregate amount to be written-down / converted for all AT1 instruments on breaching the trigger level must be at least the amount needed to immediately return the AIFI's CET1 ratio to the trigger level or, if this is not possible, the full principal value of the instruments. Further, the issuer should have full discretion to determine the amount of AT1 instruments to be converted / written-down subject to the amount of conversion/write-down not exceeding the amount which would be required to bring the CET1 ratio to 5.5% of RWAs.

**2.7** The conversion / write-down may be allowed more than once in case an AIFI hits the pre-specified trigger level subsequent to the first conversion / write-down which was partial.

**2.8** The conversion / write-down of AT1 instruments are primarily intended to replenish the equity in the event it is depleted by losses. Therefore, AIFIs should not use conversion / write-down of AT1 instruments to support expansion of balance sheet by incurring further obligations / booking assets. Accordingly, an AIFI whose Common Equity ratio slips below 8% due to losses and is still above 6.125% i.e., trigger point, should seek to expand its

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[170] Conversion means conversion to common shares.

[171] When a paid-up instrument is fully and permanently written-down, it ceases to exist resulting in extinguishment of a liability of an AIFI (a non-common equity instrument) and creates CET1. A temporary write-down is different from a conversion and a permanent write-down i.e., the original instrument may not be fully extinguished. Generally, the par value of the instrument is written-down (decrease) on the occurrence of the trigger event and which may be written-up (increase) back to its original value in future depending upon the conditions prescribed in the terms and conditions of the instrument. The amount shown on the balance sheet subsequent to temporary write-down may depend on the precise features of the instrument and the prevailing accounting standards.

[172] Auditors certificate would be required not only at the time of issuance of the instruments, but also whenever there is a change in accounting norms / standards which may affect the ability of the loss absorbency mechanism of the instrument to create CET1)

balance sheet further only by raising fresh equity from its existing shareholders or market and the internal accruals. However, fresh exposures can be taken to the extent of amortization of the existing ones. If any expansion in exposures, such as due to draw down of sanctioned borrowing limits, is inevitable, this should be compensated within the shortest possible time by reducing other exposures[173]. The AIFI should maintain proper records to facilitate verification of these transactions by its internal auditors, statutory auditors and Inspecting Officers of the Reserve Bank.

### *III. Treatment of AT1 Instruments in the event of Winding-Up, Amalgamation, Acquisition, Re-Constitution etc. of the AIFI*

**2.9** If an AIFI goes into liquidation before the AT1 instruments have been written-down/ converted, these instruments will absorb losses in accordance with the order of seniority indicated in the offer document and as per usual legal provisions governing priority of charges.

**2.10** If an AIFI goes into liquidation after the AT1 instruments have been written-down, the holders of these instruments will have no claim on the proceeds of liquidation.

**2.11** If an AIFI is amalgamated with any other institution before the AT1 instruments have been written-down/converted, these instruments will become part of the corresponding categories of regulatory capital of the new institutions emerging after the merger.

**2.12** If an AIFI is amalgamated with any other institution after the AT1 instruments have been written-down temporarily, the amalgamated entity can write-up these instruments as per its discretion.

**2.13** If an AIFI is amalgamated with any other institution after the non-equity regulatory capital instruments have been written-down permanently, these cannot be written-up by the amalgamated entity.

**2.14** If the relevant authorities decide to reconstitute an AIFI or amalgamate an AIFI with any other institution, such an AIFI will be deemed as non-viable or approaching non-viability and both the pre-specified trigger and the trigger at the point of non-viability[174] for conversion / write-down of AT1 instruments will be activated. Accordingly, the AT1 instruments will be fully converted / written-down permanently before amalgamation / reconstitution in accordance with these rules.

### *IV. Fixation of Conversion Price, Capping of Number of Shares / Voting Rights*

**2.15** AIFIs may issue AT1 instruments with conversion features either based on price fixed at the time of issuance or based on the market price prevailing at the time of conversion[175].

**2.16** There will be possibility of the debt holders receiving a large number of shares in the event the share price is very low at the time of conversion. Thus, debt holders will end up holding the number of shares and attached voting rights exceeding the legally permissible limits. AIFIs should therefore, always keep sufficient headroom to accommodate the

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[173] For the purpose of determination of breach of trigger, the fresh equity, if any, raised after slippage of CET1 below 8% will not be subtracted. In other words, if CET1 of the AIFI now is above the trigger level though it would have been below the trigger had it not raised the fresh equity which it did, the trigger will not be treated as breached.

[174] As described in subsequent paragraph 3 of this Annex.

[175] Market price here does not mean the price prevailing on the date of conversion; AIFIs can use any pricing formula such as weighted average price of shares during a particular period before conversion.

additional equity due to conversion without breaching any of the statutory / regulatory ceilings especially that for maximum private shareholdings and maximum voting rights per investors / group of related investors. In order to achieve this, AIFIs should cap the number of shares and / or voting rights in accordance with relevant laws and regulations on Ownership and Governance of AIFIs. AIFIs should adequately incorporate these features in the terms and conditions of the instruments in the offer document. In exceptional circumstances, if the breach is inevitable, the AIFI should immediately inform the Reserve Bank (Department of Regulation) about it. The investors will be required to bring the shareholdings below the statutory / regulatory ceilings within the specific time frame as determined by the Reserve Bank.

**2.17** In the case of unlisted AIFIs, the conversion price should be determined based on the fair value of the AIFI's common shares to be estimated according to a mutually acceptable methodology which should be in conformity with the standard market practice for valuation of shares of unlisted companies.

**2.18** In order to ensure the criteria that the issuing AIFI must maintain at all times all prior authorisation necessary to immediately issue the relevant number of shares specified in the instrument's terms and conditions should the trigger event occur, the capital clause of each AIFI will have to be suitably modified to take care of conversion aspects.

### *V. Order of Conversion / Write-down of Various Types of AT1 Instruments*

**2.19** AIFIs should clearly indicate in the offer document, the order of conversion / write-down of the instrument in question vis-à-vis other capital instruments which the AIFI has already issued or may issue in future, based on the advice of its legal counsels.

## 3. Minimum Requirements to Ensure Loss Absorbency of Non-equity Regulatory Capital Instruments at the Point of Non-Viability

### *I. Mode of Loss Absorption and Trigger Event*

**3.1** The terms and conditions of all non-common equity Tier 1 and Tier 2 capital instruments issued by AIFIs in India must have a provision that requires such instruments, at the option of the Reserve Bank, to either be written off or converted into common equity upon the occurrence of the trigger event, called the 'Point of Non-Viability (PONV) Trigger' stipulated below:

*(i) The PONV Trigger event is the earlier of:*

a. a decision that a conversion[176] or write-off[177], without which the firm would become non-viable, is necessary, as determined by the Reserve Bank; and

b. the decision to make a public sector injection of capital, or equivalent support, without which the firm would have become non-viable, as determined by the relevant authority.

The Write-off of any Common Equity Tier 1 capital shall not be required before the write-off of any Non-equity (Additional Tier 1 and Tier 2) regulatory capital instrument.

(ii) Such a decision would invariably imply that the write-off or issuance of any new shares as a result of conversion consequent upon the trigger event must occur prior to any public sector injection of capital so that the capital provided by the public sector is not diluted. As such, the contractual terms and conditions of an instrument must not provide for

[176] Conversion means full conversion to common shares.
[177] Write-off means fully and permanently write-off.

any residual claims on the issuer which are senior to ordinary shares of the AIFI (or group entity where applicable), following a trigger event and when conversion or write-off is undertaken.

(iii) Any compensation paid to the instrument holders as a result of the write-off[178] must be paid immediately in the form of common shares.

(iv) The issuing AIFI must maintain at all times all prior authorisation necessary to immediately issue the relevant number of shares specified in the instrument's terms and conditions should the trigger event occur.

(v) In order to ensure that these requirements are met, AIFIs shall obtain and keep on their records an external legal opinion confirming that the conversion or write-off feature of non-equity capital instruments (Additional Tier 1 or Tier 2) by the Reserve Bank at the point of non-viability is legally enforceable. Further, the legal opinion should also confirm that there are no legal impediments to the conversion of the instrument into ordinary shares of the AIFI (or a group entity, where applicable) or write-off upon a trigger event. The Reserve Bank may also require the AIFI to submit additional information in order to ensure that such instruments are eligible for inclusion into regulatory capital.

### *II. A Non-viable AIFI*

**3.2** For the purpose of these guidelines, a non-viable AIFI will be:

An AIFI which, owing to its financial and other difficulties, may no longer remain a going concern on its own in the opinion of the Reserve Bank unless appropriate measures are taken to revive its operations and thus, enable it to continue as a going concern. The difficulties faced by an AIFI should be such that these are likely to result in financial losses and raising the Common Equity Tier 1 capital of the AIFI should be considered as the most appropriate way to prevent the AIFI from turning non-viable. Such measures would include write-off / conversion of non-equity regulatory capital into common shares in combination with or without other measures as considered appropriate by the Reserve Bank[179].

### *III. Restoring Viability*

**3.3** An AIFI facing financial difficulties and approaching a PONV will be deemed to achieve viability if within a reasonable time in the opinion of the Reserve Bank, it will be able to come out of the present difficulties if appropriate measures are taken to revive it. The measures including augmentation of equity capital through write-off/conversion/public sector injection of funds are likely to:

a. Restore depositors'/investors' confidence;
b. Improve rating /creditworthiness of the AIFI and thereby improve its borrowing capacity and liquidity and reduce cost of funds; and
c. Augment the resource base to fund balance sheet growth in the case of fresh injection of funds.

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[178] Compensation in the form of common shares may be viewed as the simultaneous occurrence of (a) permanent write-off of the original instrument; and (b) creation of new common shares issued in lieu of non-equity capital instrument which is written-off, as compensation for its extinguishment. The precise mechanism may vary under the accounting standards. No compensation (i.e., zero common shares) is paid in case of full and permanent write-off.

[179] In rare situations, an AIFI may also become non-viable due to non-financial problems, such as conduct of affairs of the AIFI in a manner which is detrimental to the interest of depositors, serious corporate governance issues, etc. In such situations raising capital is not considered a part of the solution and therefore, may not attract provisions of this framework.

### *IV. Other Requirements to be met by the Non-common Equity Capital Instruments so as to Absorb Losses at the PONV*

**3.4** Instruments may be issued with either of the following features:

a. conversion; or

b. permanent write-off

**3.5** The amount of non-equity capital to be converted / written-off will be determined by the Reserve Bank.

**3.6** The provisions regarding treatment of AT1 instruments in the event of winding-up, amalgamation, acquisition, re-constitution etc. of the AIFI as given in paragraphs 2.10 to 2.15 will also be applicable to all non-common equity capital instruments (AT1 and Tier 2 capital instruments) when these events take place after conversion/write-off at the PONV.

**3.7** The provisions regarding fixation of conversion price, capping of number of shares/voting rights applicable to AT1 instruments in terms of paragraphs 2.16 to 2.19 above will also be applicable for conversion of all non-common equity capital instruments (AT1 and Tier 2 capital instruments) at the PONV.

**3.8** The provisions regarding order of conversion/write-down of AT1 instruments as given in paragraph 2.20 above will also be applicable for conversion/ write-off of all non-common equity capital instruments (AT1 and Tier 2 capital instruments) at the PONV.

### *V. Criteria to Determine the PONV*

**3.9** The above framework will be invoked when an AIFI is adjudged by the Reserve Bank to be approaching the point of non-viability, or has already reached the point of non-viability, but in the views of the Reserve Bank:

a) there is a possibility that a timely intervention in form of capital support, with or without other supporting interventions, is likely to rescue the AIFI; and

b) if left unattended, the weaknesses would inflict financial losses on the AIFI and, thus, cause decline in its common equity level.

**3.10** The purpose of write-off and / or conversion of non-equity regulatory capital elements will be to shore up the capital level of the AIFI. The Reserve Bank would follow a two-stage approach to determine the non-viability of an AIFI. The **Stage 1** assessment would consist of purely objective and quantifiable criteria to indicate that there is a *prima facie* case of an AIFI approaching non-viability and, therefore, a closer examination of the AIFI's financial situation is warranted. The **Stage 2** assessment would consist of supplementary subjective criteria which, in conjunction with the Stage 1 information, would help in determining whether the AIFI is about to become non-viable. These criteria would be evaluated together and not in isolation.

**3.11** Once the PONV is confirmed, the next step would be to decide whether rescue of the AIFI would be through write-off/conversion alone or write-off/conversion in conjunction with a public sector injection of funds.

**3.12** The trigger at PONV will be evaluated both at consolidated and solo level and breach at either level will trigger conversion / write-off.

**3.13** As the capital adequacy is applicable both at solo and consolidated levels, the **minority interests** in respect of capital instruments issued by subsidiaries of AIFIs including overseas subsidiaries, if any, can be included in the consolidated capital of the group only if these instruments have pre-specified triggers (in case of AT1 capital instruments) / loss absorbency at the PONV[180] (for all non-common equity capital instruments). In addition, where an AIFI wishes the instrument issued by its subsidiary to be included in the consolidated group's capital in addition to its solo capital, the terms and conditions of that instrument must specify an additional trigger event.

*This additional trigger event is the earlier of:*

(1) a decision that a conversion or write-off, without which the AIFI or the subsidiary would become non-viable, is necessary, as determined by the Reserve Bank; and

(2) the decision to make a public sector injection of capital, or equivalent support, without which the AIFI or the subsidiary would have become non-viable, as determined by the Reserve Bank. Such a decision would invariably imply that the write-off or issuance of any new shares as a result of conversion consequent upon the trigger event must occur prior to any public sector injection of capital so that the capital provided by the public sector is not diluted.

**3.14** In such cases, the subsidiary should obtain its regulator's approval/no-objection for allowing the capital instrument to be converted/written-off at the additional trigger point referred to in paragraph 3.13 above.

**3.15** Any common shares paid as compensation to the holders of the instrument must be common shares of either the issuing subsidiary or the parent AIFI (including any successor in resolution).

[180] The cost to the parent of its investment in each subsidiary and the parent's portion of equity of each subsidiary, at the date on which investment in each subsidiary is made, is eliminated as per AS-21. So, in case of wholly-owned subsidiaries, it would not matter whether or not it has same characteristics as the AIFI's capital. However, in the case of less than wholly owned subsidiaries (or in the case of non-equity regulatory capital of the wholly owned subsidiaries, if issued to the third parties), minority interests constitute additional capital for the banking group over and above what is counted at solo level; therefore, it should be admitted only when it (and consequently the entire capital in that category) has the same characteristics as the AIFI's capital.

**Annex 15**
**(section 7.3.5)**

## Calculation of Minority Interest - Illustrative Example

This Annex illustrates the treatment of minority interest and other capital issued out of subsidiaries to third parties, which is set out in section 7.3 of this Chapter.

A group for this purpose consists of two legal entities that are both banks. Bank P is the parent and Bank S is the subsidiary and their unconsolidated balance sheets are set out below:

| **Bank P Balance Sheet** | | **Bank S Balance Sheet** | |
|---|---|---|---|
| **Assets** | | **Assets** | |
| Loans to customers | 100 | Loans to customers | 150 |
| Investment in CET1 of Bank S | 7 | | |
| Investment in the AT1 of Bank S | 4 | | |
| Investment in the T2 of Bank S | 2 | | |
| **Total** | **113** | **Total** | **150** |
| **Liabilities and equity** | | **Liabilities and equity** | |
| Depositors | 70 | Depositors | 127 |
| Tier 2 | 10 | Tier 2 | 8 |
| Additional Tier 1 | 7 | Additional Tier 1 | 5 |
| Common equity | 26 | Common equity | 10 |
| **Total** | **113** | **Total** | **150** |

The balance sheet of Bank P shows that in addition to its loans to customers, it owns 70% of the common shares of Bank S, 80% of the Additional Tier 1 of Bank S and 25% of the Tier 2 capital of Bank S.

The ownership of the capital of Bank S is therefore as follows:

| **Capital issued by Bank S** | | | |
|---|---|---|---|
| | **Amount issued to parent (Bank P)** | **Amount issued to third parties** | **Total** |
| Common Equity Tier 1 (CET1) | 7 | 3 | 10 |
| Additional Tier 1 (AT1) | 4 | 1 | 5 |
| ***Tier 1 (T1)*** | ***11*** | ***4*** | ***15*** |
| Tier 2 (T2) | 2 | 6 | 8 |
| ***Total capital (TC)*** | ***13*** | ***10*** | ***23*** |

| Consolidated Balance Sheet | | |
|---|---|---|
| **Assets** | | Remarks |
| Loans to customers | 250 | Investments of P in S aggregating Rs.13 will be cancelled during accounting consolidation. |
| **Liabilities and equity** | | |
| Depositors | 197 | |
| Tier 2 issued by subsidiary to third parties | 6 | (8-2) |
| Tier 2 issued by parent | 10 | |
| Additional Tier 1 issued by subsidiary to third parties | 1 | (5-4) |
| Additional Tier 1 issued by parent | 7 | |
| Common equity issued by subsidiary to third parties (i.e., minority interest) | 3 | (10-7) |
| Common equity issued by parent | 26 | |
| **Total** | **250** | |

For illustrative purposes Bank S is assumed to have risk weighted assets of 100 against the actual value of assets of 150. In this example, the minimum capital requirements of Bank S and the subsidiary's contribution to the consolidated requirements are the same. This means that it is subject to the following minimum plus capital conservation buffer requirements and has the following surplus capital:

| Minimum and surplus capital of Bank S | | | |
|---|---|---|---|
| | **Minimum plus capital conservation buffer required[181]** | **Actual capital available** | **Surplus** (3-2) |
| 1 | 2 | 3 | 4 |
| Common Equity Tier 1capital | 7.0<br>(= 7.0% of 100) | 10 | 3.0 |
| Tier 1 capital | 8.5<br>(= 8.5% of 100) | 15<br>(10+5) | 6.5 |
| Total capital | 10.5<br>(= 10.5% of 100) | 23<br>(10+5+8) | 12.5 |

The following table illustrates how to calculate the amount of capital issued by Bank S to include in consolidated capital, following the calculation procedure set out in section 7.3.4 of this Chapter:

[181] Illustration is based on Basel III minima as indicated in the BCBS document 'Basel III: A global regulatory framework for more resilient banks and banking systems issued in December 2010 (rev June 2011)' The Common Equity Tier 1 in the example should be read to include issued common shares plus retained earnings and reserves in Bank S.

| Bank S: Amount of capital issued to third parties included in consolidated capital | | | | | |
|---|---|---|---|---|---|
| | **Total amount issued (a)** | **Amount issued to third parties (b)** | **Surplus (c)** | **Surplus attributable to third parties (i.e., amount excluded from consolidated capital) (d) = (c) * (b)/(a)** | **Amount included in consolidated capital (e) = (b) – (d)** |
| Common Equity Tier 1 capital | 10 | 3 | 3.0 | 0.90 | 2.10 |
| Tier 1 capital | 15 | 4 | 6.5 | 1.73 | 2.27 |
| Total capital | 23 | 10 | 12.5 | 5.43 | 4.57 |

The following table summarises the components of capital for the consolidated group based on the amounts calculated in the table above. Additional Tier 1 is calculated as the difference between Common Equity Tier 1 and Tier 1 and Tier 2 is the difference between Total Capital and Tier 1.

| | **Total amount issued by parent (all of which is to be included in consolidated capital)** | **Amount issued by subsidiaries to third parties to be included in consolidated capital** | **Total amount issued by parent and subsidiary to be included in consolidated capital** |
|---|---|---|---|
| Common Equity Tier 1 capital | 26 | 2.10 | 28.10 |
| *Additional Tier 1 capital* | *7* | *0.17* | *7.17* |
| Tier 1 capital | 33 | 2.27 | 35.27 |
| *Tier 2 capital* | *10* | *2.30* | *12.30* |
| Total capital | 43 | 4.57 | 47.57 |

**Annex 16**
**(section 17.14 & 18.6)**

**Pillar 3 Disclosure Requirements**

## 1. Scope of Application and Capital Adequacy

### Table DF-1: Scope of Application

**Name of the head of the group to which the framework applies**_____

| Name of the entity / Country of incorporation | Whether the entity is included under accounting scope of consolidation (yes / no) | Explain the method of consolidation | Whether the entity is included under regulatory scope of consolidation [182] (yes / no) | Explain the method of consolidation | Explain the reasons for difference in the method of consolidation | Explain the reasons if consolidated under only one of the scopes of consolidation [183] |
|---|---|---|---|---|---|---|
| | | | | | | |
| | | | | | | |

**(i) Qualitative Disclosures:**

**a. List of group entities considered for consolidation**

**b. List of group entities not considered for consolidation both under the accounting and regulatory scope of consolidation**

| Name of the entity / country of incorporation | Principle activity of the entity | Total balance sheet equity (as stated in the accounting balance sheet of the legal entity) | % of AIFI's holding in the total equity | Regulatory treatment of AIFI's investments in the capital instruments of the entity | Total balance sheet assets (as stated in the accounting balance sheet of the legal entity) |
|---|---|---|---|---|---|
| | | | | | |
| | | | | | |

**(ii) Quantitative Disclosures:**

**c. List of group entities considered for consolidation**

| Name of the entity / country of incorporation | Principle activity of the | Total balance sheet equity *(as stated in the* | Total balance sheet assets *(as stated in the* |
|---|---|---|---|

[182] If the entity is not consolidated in such a way as to result in its assets being included in the calculation of consolidated risk-weighted assets of the group, then such an entity is considered as outside the regulatory scope of consolidation.

[183] Also explain the treatment given i.e., deduction or risk weighting of investments under regulatory scope of consolidation.

| | | | |
|---|---|---|---|
| *(as indicated in (i)a. above)* | entity | *accounting balance sheet of the legal entity)* | *accounting balance sheet of the legal entity)* |
| | | | |

**d. The aggregate amount of capital deficiencies[184] in all subsidiaries which are not included in the regulatory scope of consolidation i.e., that are deducted:**

| Name of the subsidiaries / country of incorporation | Principle activity of the entity | Total balance sheet equity *(as stated in the accounting balance sheet of the legal entity)* | % of AIFI's holding in the total equity | Capital deficiencies |
|---|---|---|---|---|
| | | | | |
| | | | | |

**e. The aggregate amounts (e.g., current book value) of the AIFI's total interests in insurance entities, which are risk-weighted:**

| Name of the insurance entities / country of incorporation | Principle activity of the entity | Total balance sheet equity *(as stated in the accounting balance sheet of the legal entity)* | % of AIFI's holding in the total equity / proportion of voting power | Quantitative impact on regulatory capital of using risk weighting method versus using the full deduction method |
|---|---|---|---|---|
| | | | | |
| | | | | |

**f. Any restrictions or impediments on transfer of funds or regulatory capital within the group:**

**Table DF-2: Capital Adequacy**

| |
|---|
| **Qualitative disclosures**<br>(a) A summary discussion of the AIFI's approach to assessing the adequacy of its capital to support current and future activities |
| **Quantitative disclosures**<br>(b) Capital requirements for credit risk:<br>• Portfolios subject to standardised approach<br>• Securitisation exposures |
| € Capital requirements for market risk:<br>• Standardised duration approach;<br>- Interest rate risk<br>- Foreign exchange risk (including gold)<br>- Equity risk |
| (d) Capital requirements for operational risk:<br>• Basic Indicator Approach |
| (e) Common Equity Tier 1, Tier 1and Total Capital ratios: |

[184] A capital deficiency is the amount by which actual capital is less than the regulatory capital requirement. Any deficiencies which have been deducted on a group level in addition to the investment in such subsidiaries are not to be included in the aggregate capital deficiency.

| |
|---|
| • For the top consolidated group; and<br>• For significant subsidiaries (stand alone or sub-consolidated depending on how the Framework is applied) |

## 2. Risk exposure and assessment

The risks to which AIFIs are exposed and the techniques that AIFIs use to identify, measure, monitor and control those risks are important factors market participants consider in their assessment of an institution. In this section, several key risks are considered: credit risk, market risk, and interest rate risk in the banking book and operational risk. Also included in this section are disclosures relating to credit risk mitigation and asset securitisation, both of which alter the risk profile of the institution. Where applicable, separate disclosures are set out for AIFIs using different approaches to the assessment of regulatory capital.

### 2.1 General qualitative disclosure requirement

For each separate risk area (e.g., credit, market, operational, banking book interest rate risk) AIFIs must describe their risk management objectives and policies, including:

(i) strategies and processes;
(ii) the structure and organisation of the relevant risk management function;
(iii) the scope and nature of risk reporting and/or measurement systems;
(iv) policies for hedging and/or mitigating risk and strategies and processes for monitoring the continuing effectiveness of hedges/mitigants.

**Credit risk**

General disclosures of credit risk provide market participants with a range of information about overall credit exposure and need not necessarily be based on information prepared for regulatory purposes. Disclosures on the capital assessment techniques give information on the specific nature of the exposures, the means of capital assessment and data to assess the reliability of the information disclosed.

**Table DF-3: Credit Risk: General Disclosures for All AIFIs**

| |
|---|
| **Qualitative Disclosures**<br>(a) The general qualitative disclosure requirement with respect to credit risk, including:<br>• Definitions of past due and impaired (for accounting purposes);<br>• Discussion of the AIFI's credit risk management policy; |
| **Quantitative Disclosures**<br>(b) Total gross credit risk exposures[185], Fund based and Non-fund based separately.<br>(c) Geographic distribution of exposures[186], Fund based and Non-fund based separately<br>• Overseas<br>• Domestic<br>(d) Industry[187] type distribution of exposures, fund based and non-fund based separately<br>(e) Residual contractual maturity breakdown of assets,[188]<br>(f) Amount of NPAs (Gross)<br>• Substandard<br>• Doubtful 1 |

[185] That is after accounting offsets in accordance with the applicable accounting regime and without taking into account the effects of credit risk mitigation techniques, e.g., collateral and netting.
[186] That is, on the same basis as adopted for Segment Reporting adopted for compliance with AS 17.
[187] The industries break-up may be provided on the same lines as prescribed for DSB returns of banks. If the exposure to any particular industry is more than 5 per cent of the gross credit exposure as computed under (b) above it should be disclosed separately.
[188] AIFIs shall use the same maturity bands as used for reporting positions in the ALM returns.

- Doubtful 2
- Doubtful 3
- Loss

(g) Net NPAs

(h) NPA Ratios

- Gross NPAs to gross advances
- Net NPAs to net advances

(i) Movement of NPAs (Gross)

- Opening balance
- Additions
- Reductions
- Closing balance

(j) Movement of provisions (Separate disclosure shall be made for specific provisions and general provisions held by the AIFI with a description of each type of provisions held**)**

- Opening balance
- Provisions made during the period
- Write-off
- Write-back of excess provisions
- Any other adjustments, including transfers between provisions
- Closing balance

In addition, write-offs and recoveries that have been booked directly to the income statement should be disclosed separately.

(k) Amount of Non-Performing Investments

(l) Amount of provisions held for non-performing investments

(m) Movement of provisions for depreciation on investments

- Opening balance
- Provisions made during the period
- Write-off
- Write-back of excess provisions
- Closing balance

(n) By major industry or counterparty type:

- Amount of NPAs and if available, past due loans, provided separately;
- Specific and general provisions; and
- Specific provisions and write-offs during the current period.

In addition, AIFIs are encouraged also to provide an analysis of the ageing of past-due loans.

(o) Amount of NPAs and, if available, past due loans provided separately broken down by significant geographic areas including, if practical, the amounts of specific and general provisions related to each geographical area. The portion of general provisions that is not allocated to a geographical area should be disclosed separately.

**Table DF-4 - Credit Risk: Disclosures for Portfolios Subject to the Standardised Approach**

**Qualitative Disclosures**

(a) For portfolios under the standardised approach:

- Names of credit rating agencies used, plus reasons for any changes;
- Types of exposure for which each agency is used; and
- A description of the process used to transfer public issue ratings onto comparable assets in the banking book;

| **Quantitative Disclosures** |
|---|
| (b) For exposure[189] amounts after risk mitigation subject to the standardised approach, amount of an AIFI's outstandings (rated and unrated) in the following three major risk buckets as well as those that are deducted;<br>• Below 100 % risk weight<br>• 100 % risk weight<br>• More than 100 % risk weight<br>• Deducted |

**Table DF-5: Credit Risk Mitigation: Disclosures for Standardised Approaches [190]**

| **Qualitative Disclosures** |
|---|
| (a) The general qualitative disclosure requirement with respect to credit risk mitigation including:<br>***a) Policies and processes for, and an indication of the extent to which the AIFI makes use of, on- and off-balance sheet netting;***<br>• policies and processes for collateral valuation and management;<br>• a description of the main types of collateral taken by the AIFI;<br>• the main types of guarantor counterparty and their credit worthiness; and<br>• information about (market or credit) risk concentrations within the mitigation taken |
| ***Quantitative Disclosures***<br>***(b) For each separately disclosed credit risk portfolio the total exposure (after, where applicable, on- or off balance sheet netting) that is covered by eligible financial collateral after the application of haircuts.***<br>***(c) For each separately disclosed portfolio the total exposure (after, where applicable, on- or off-balance sheet netting) that is covered by guarantees/credit derivatives (whenever specifically permitted by the Reserve Bank)*** |

**Table DF-6: Securitisation Exposures: Disclosure for Standardised Approach**

| **Qualitative Disclosures** | |
|---|---|
| (a) | The general qualitative disclosure requirement with respect to securitisation including a discussion of:<br>• the AIFI's objectives in relation to securitisation activity, including the extent to which these activities transfer credit risk of the underlying securitised exposures away from the AIFI to other entities.<br>• the nature of other risks (e.g., liquidity risk) inherent in securitised assets;<br>• the various roles played by the AIFI in the securitisation process (For example: originator, investor, servicer, provider of credit enhancement, liquidity provider, swap provider[@], protection provider[#]) and an indication of the extent of the AIFI's involvement in each of them;<br>• a description of the processes in place to monitor changes in the credit and market risk of securitisation exposures (for example, how the behaviour of the underlying assets impacts securitisation exposures).<br>• a description of the AIFI's policy governing the use of credit risk mitigation to mitigate the risks retained through securitisation exposures; |

[189] As defined for disclosures in Table DF-3.

[190] At a minimum, AIFIs must give the disclosures in this Table in relation to credit risk mitigation that has been recognised for the purposes of reducing capital requirements under this Framework. Where relevant, AIFIs are encouraged to give further information about mitigants that have not been recognised for that purpose.

| | |
|---|---|
| | [@] An AIFI may have provided support to a securitisation structure in the form of an interest rate swap or currency swap to mitigate the interest rate/currency risk of the underlying assets, if permitted as per regulatory rules.<br>[#] An AIFI may provide credit protection to a securitisation transaction through guarantees, credit derivatives or any other similar product, if permitted as per regulatory rules. |
| (b) | **Summary of the AIFI's accounting policies for securitisation activities, including**:<br>• whether the transactions are treated as sales or financings;<br>• methods and key assumptions (including inputs) applied in valuing positions retained or purchased<br>• changes in methods and key assumptions from the previous period and impact of the changes;<br>• policies for recognising liabilities on the balance sheet for arrangements that could require the AIFI to provide financial support for securitised assets. |
| (c) | In the banking book, the names of ECAIs used for securitisations and the types of securitisation exposure for which each agency is used. |
| **Quantitative disclosures: Banking Book** | |
| (d) | The total amount of exposures securitised by the AIFI. |
| (e) | For exposures securitised losses recognised by the AIFI during the current period broken by the exposure type (e.g., housing loans etc. detailed by underlying security) |
| (f) | Amount of assets intended to be securitised within a year |
| (g) | Of (f), amount of assets originated within a year before securitisation. |
| (h) | The total amount of exposures securitised (by exposure type) and unrecognised gain or losses on sale by exposure type. |
| (i) | Aggregate amount of:<br>• on-balance sheet securitisation exposures retained or purchased broken down by exposure type and<br>• off-balance sheet securitisation exposures broken down by exposure type |
| (j) | (i) Aggregate amount of securitisation exposures retained or purchased and the associated capital charges, broken down between exposures and further broken down into different risk weight bands for each regulatory capital approach<br>(ii) Exposures that have been deducted entirely from Tier 1 capital, credit enhancing I/Os deducted from total capital, and other exposures deducted from total capital (by exposure type). |
| **Quantitative Disclosures: Trading book** | |
| (k) | Aggregate amount of exposures securitised by the AIFI for which the AIFI has retained some exposures and which is subject to the market risk approach, by exposure type. |
| (l) | Aggregate amount of:<br>• on-balance sheet securitisation exposures retained or purchased broken down by exposure type; and<br>• off-balance sheet securitisation exposures broken down by exposure type. |
| (m) | **Aggregate amount of securitisation exposures retained or purchased separately for**:<br>• securitisation exposures retained or purchased subject to Comprehensive Risk Measure for specific risk; and<br>• securitisation exposures subject to the securitisation framework for specific risk broken down into different risk weight bands. |

| | |
|---|---|
| (n) | Aggregate amount of:<br>• the capital requirements for the securitisation exposures, subject to the securitisation framework broken down into different risk weight bands.<br>• securitisation exposures that are deducted entirely from Tier 1 capital, credit enhancing I/Os deducted from total capital, and other exposures deducted from total capital(by exposure type). |

**Table DF-7: Market Risk in Trading Book**

| |
|---|
| **Qualitative disclosures**<br>(a) The general qualitative disclosure requirement for market risk including the portfolios covered by the standardised approach. |
| **Quantitative disclosures**<br>(b) The capital requirements for:<br>• interest rate risk;<br>• equity position risk; and<br>• foreign exchange risk; |

**Table DF-8: Operational Risk**

| |
|---|
| **Qualitative disclosures**<br>• The general qualitative disclosure requirement for operational risk. |

**Table DF-9: Interest Rate Risk in the Banking Book (IRRBB)**

| |
|---|
| **Qualitative Disclosures**<br>(a) The general qualitative disclosure requirement including the nature of IRRBB and key assumptions, including assumptions regarding loan prepayments and behaviour of non-maturity deposits, and frequency of IRRBB measurement. |
| **Quantitative Disclosures**<br>(b) The increase (decline) in earnings and economic value (or relevant measure used by management) for upward and downward rate shocks according to management's method for measuring IRRBB, broken down by currency (where the turnover is more than 5% of the total turnover). |

**Table DF-10: General Disclosure for Exposures Related to Counterparty Credit Risk**

| | | |
|---|---|---|
| **Qualitative Disclosures** | (a) | The general qualitative disclosure requirement with respect to derivatives and CCR, including:<br>• Discussion of methodology used to assign economic capital and credit limits for counterparty credit exposures;<br>• Discussion of policies for securing collateral and establishing credit reserves;<br>• Discussion of policies with respect to wrong-way risk |

| | | |
|---|---|---|
| | | exposures;<br>• Discussion of the impact of the amount of collateral the AIFI would have to provide given a credit rating downgrade. |
| **Quantitative Disclosures** | (b) | Gross positive fair value of contracts, netting benefits, netted current credit exposure, collateral held (including type, e.g., cash, government securities, etc.), and net derivatives credit exposure[191]. Also report measures for exposure at default, or exposure amount, under CEM. The notional value of credit derivative hedges, and the distribution of current credit exposure by types of credit exposure[192]. |
| | (c) | Credit derivative transactions that create exposures to CCR (notional value), segregated between use for the institution's own credit portfolio, as well as in its intermediation activities, including the distribution of the credit derivatives products used[193], broken down further by protection bought and sold within each product group |

## 3 Composition of Capital Disclosure Templates

### 3.1 Disclosure Template

(i) The template is designed to capture the capital positions of AIFIs.

(ii) The reconciliation requirement in terms of section 17.13 of this Chapter results in the decomposition of certain regulatory adjustments. For example, the disclosure template below includes the adjustment of 'Goodwill net of related tax liability'. The requirements will lead to the disclosure of both the goodwill component and the related tax liability component of this regulatory adjustment.

(iii) Certain rows of the template are shaded as explained below:

a. each dark grey row introduces a new section detailing a certain component of regulatory capital.
b. the light grey rows with no thick border represent the sum cells in the relevant section.
c. the light grey rows with a thick border show the main components of regulatory capital and the capital ratios.

Also provided along with the Table, an explanation of each line of the template, with references to the appropriate sections of the text of this Chapter.

[191] *Net credit exposure* is the credit exposure on derivatives transactions after considering both the benefits from legally enforceable netting agreements and collateral arrangements. The notional amount of credit derivative hedges alerts market participants to an additional source of credit risk mitigation.
[192] For example, interest rate contracts, FX contracts, credit derivatives, and other contracts.
[193] For example, credit default swaps.

**Table DF-11: Composition of Capital**

**Template to be used by AIFIs**

(Rs. in million)

| Basel III common disclosure template to be used by AIFIs | | | |
|---|---|---|---|
| **Common Equity Tier 1 capital: instruments and reserves** | | | Ref No |
| 1) | Directly issued qualifying common share capital plus related stock surplus (share premium) | | |
| 2) | Retained earnings | | |
| 3) | Accumulated other comprehensive income (and other reserves) | | |
| 4) | *Directly issued capital subject to phase out from CET1 (only applicable to non-joint stock companies[194])* | | |
| 5) | Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1) | | |
| 6) | **Common Equity Tier 1 capital before regulatory adjustments** | | |
| **Common Equity Tier 1 capital: regulatory adjustments** | | | |
| 7) | Prudential valuation adjustments | | |
| 8) | Goodwill (net of related tax liability) | | |
| 9) | Intangibles (net of related tax liability) | | |
| 10) | Deferred tax assets | | |
| 11) | Cash-flow hedge reserve | | |
| 12) | Shortfall of provisions to expected losses | | |
| 13) | Securitisation gain on sale | | |
| 14) | Gains and losses due to changes in own credit risk on fair valued liabilities | | |
| 15) | Defined-benefit pension fund net assets | | |
| 16) | Investments in own shares (if not already netted off paid-up capital on reported balance sheet) | | |
| 17) | Reciprocal cross-holdings in common equity | | |
| 18) | Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, | | |

[194] Not Applicable to AIFIs.

| | | | |
|---|---|---|---|
| | where the AIFI does not own more than 10% of the issued share capital (amount above 10% threshold) | | |
| 19) | Significant investments in the common stock of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions (amount above 10% threshold)[195] | | |
| 20) | Mortgage servicing rights[196] (amount above 10% threshold) | | |
| 21) | Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability) | | |
| 22) | Amount exceeding the 15% threshold | | |
| 23) | *of which: significant investments in the common stock of financial entities* | | |
| 24) | *of which: mortgage servicing rights* | | |
| 25) | *of which: deferred tax assets arising from temporary differences* | | |
| 26) | National specific regulatory adjustments[197] (26a+26b+26c+26d) | | |
| 26a) | *of which:* Investments in the equity capital of unconsolidated insurance subsidiaries | | |
| 26b) | *of which:* Investments in the equity capital of unconsolidated non-financial subsidiaries[198] | | |
| 26c) | *of which:* Shortfall in the equity capital of majority owned financial entities which have not been consolidated with the AIFI[199] | | |
| 26d) | *of which:* Unamortised pension funds expenditures | | |
| 27) | Regulatory adjustments applied to Common Equity Tier 1 due to insufficient Additional Tier 1 and Tier 2 to cover deductions | | |
| 28) | **Total regulatory adjustments to Common equity Tier 1** | | |
| 29) | **Common Equity Tier 1 capital (CET1)** | | |
| **Additional Tier 1 capital: instruments** | | | |
| 30) | Directly issued qualifying Additional Tier 1 instruments plus related stock surplus (share premium) (31+32) | | |
| 31) | of which: classified as equity under applicable accounting standards (Perpetual Non-Cumulative Preference Shares) | | |
| 32) | of which: classified as liabilities under applicable accounting standards (Perpetual debt Instruments) | | |
| 33) | *Directly issued capital instruments subject to phase out from Additional Tier 1* | | |
| 34) | Additional Tier 1 instruments (and CET1 instruments not included in row 5) issued by subsidiaries and held by third parties (amount allowed in group AT1) | | |

[195] Only significant investments other than in the insurance and non-financial subsidiaries should be reported here. The insurance and non-financial subsidiaries are not consolidated for the purpose of capital adequacy. The equity and other regulatory capital investments in insurance subsidiaries are fully deducted from consolidated regulatory capital of the group. However, in terms of Basel III rules text of the Basel Committee, insurance subsidiaries are included under significant investments and thus, deducted based on 10% threshold rule instead of full deduction.

[196] Not applicable in Indian context.

[197] Adjustments which are not specific to the Basel III regulatory adjustments (as prescribed by the Basel Committee) will be reported under this row. However, regulatory adjustments which are linked to Basel III i.e., where there is a change in the definition of the Basel III regulatory adjustments, the impact of these changes will be explained in the Notes of this disclosure template.

[198] Non-financial subsidiaries are not consolidated for the purpose of capital adequacy. The equity and other regulatory capital investments in the non-financial subsidiaries are deducted from consolidated regulatory capital of the group. These investments are not required to be deducted fully from capital under Basel III rules text of the Basel Committee.

[199]Please refer to section 6.2.5 of this Chapter. Please also refer to the Paragraph 34 of the Basel II Framework issued by the Basel Committee (June 2006). Though this is not national specific adjustment, it is reported here.

| | | | |
|---|---|---|---|
| 35) | *of which: instruments issued by subsidiaries subject to phase out* | | |
| 36) | **Additional Tier 1 capital before regulatory adjustments** | | |
| **Additional Tier 1 capital: regulatory adjustments** | | | |
| 37) | Investments in own Additional Tier 1 instruments | | |
| 38) | Reciprocal cross-holdings in Additional Tier 1 instruments | | |
| 39) | Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the AIFI does not own more than 10% of the issued common share capital of the entity (amount above 10% threshold) | | |
| 40) | Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)[200] | | |
| 41) | National specific regulatory adjustments (41a+41b) | | |
| 41a) | *of which:* Investments in the Additional Tier 1 capital of unconsolidated insurance subsidiaries | | |
| 41b) | *of which:* Shortfall in the Additional Tier 1 capital of majority owned financial entities which have not been consolidated with the AIFI | | |
| 42) | Regulatory adjustments applied to Additional Tier 1 due to insufficient Tier 2 to cover deductions | | |
| 43) | **Total regulatory adjustments to Additional Tier 1 capital** | | |
| 44) | **Additional Tier 1 capital (AT1)** | | |
| 45) | **Tier 1 capital (T1 = CET1 + AT1) (29 + 44)** | | |
| **Tier 2 capital: instruments and provisions** | | | |
| 46) | Directly issued qualifying Tier 2 instruments plus related stock surplus | | |
| 47) | *Directly issued capital instruments subject to phase out from Tier 2* | | |
| 48) | Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties (amount allowed in group Tier 2) | | |
| 49) | *of which: instruments issued by subsidiaries subject to phase out* | | |
| 50) | Provisions[201] | | |
| 51) | **Tier 2 capital before regulatory adjustments** | | |
| **Tier 2 capital: regulatory adjustments** | | | |
| 52) | Investments in own Tier 2 instruments | | |
| 53) | Reciprocal cross-holdings in Tier 2 instruments | | |
| 54) | Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the AIFI does not own more than 10% of the issued common share capital of the entity (amount above the 10% threshold) | | |
| 55) | Significant investments[202] in the capital banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions) | | |
| 56) | National specific regulatory adjustments (56a+56b) | | |
| 56a) | *of which:* Investments in the Tier 2 capital of unconsolidated insurance subsidiaries | | |
| 56b) | *of which:* Shortfall in the Tier 2 capital of majority owned financial entities which have not been consolidated with the AIFI | | |
| 57) | **Total regulatory adjustments to Tier 2 capital** | | |
| 58) | **Tier 2 capital (T2)** | | |
| 59) | **Total capital (TC = T1 + T2) (45 + 58)** | | |

[200] Please refer to Footnote 198 above.

[201] Eligible Provisions and revaluation Reserves in terms of section 7.2.5 of this Chapter, both to be reported and break-up of these two items to be furnished in Notes.

[202] Please refer to Footnote 198 above.

| | | | |
|---|---|---|---|
| 60) | **Total risk weighted assets (60a + 60b + 60c)** | | |
| 60a) | *of which: total credit risk weighted assets* | | |
| 60b) | *of which: total market risk weighted assets* | | |
| 60c) | *of which: total operational risk weighted assets* | | |
| **Capital ratios and buffers** | | | |
| 61) | Common Equity Tier 1 (as a percentage of risk weighted assets) | | |
| 62) | Tier 1 (as a percentage of risk weighted assets) | | |
| 63) | Total capital (as a percentage of risk weighted assets) | | |
| 64) | NA | | |
| 65) | *NA* | | |
| 66) | *NA* | | |
| 67) | *NA* | | |
| 68) | NA | | |
| **National minima (if different from Basel III)** | | | |
| 69) | National Common Equity Tier 1 minimum ratio (if different from Basel III minimum) | | |
| 70) | National Tier 1 minimum ratio (if different from Basel III minimum) | | |
| 71) | National total capital minimum ratio (if different from Basel III minimum) | | |
| **Amounts below the thresholds for deduction (before risk weighting)** | | | |
| 72) | Non-significant investments in the capital of other financial entities | | |
| 73) | Significant investments in the common stock of financial entities | | |
| 74) | Mortgage servicing rights (net of related tax liability) | | |
| 75) | Deferred tax assets arising from temporary differences (net of related tax liability) | | |
| **Applicable caps on the inclusion of provisions in Tier 2** | | | |
| 76) | Provisions eligible for inclusion in Tier 2 in respect of exposures subject to standardised approach (prior to application of cap) | | |
| 77) | Cap on inclusion of provisions in Tier 2 under standardised approach | | |
| 78) | Provisions eligible for inclusion in Tier 2 in respect of exposures subject to internal ratings-based approach (prior to application of cap) | | |
| 79) | Cap for inclusion of provisions in Tier 2 under internal ratings-based approach | | |
| ***Capital instruments subject to phase-out arrangements*** | | | |
| 80) | *Current cap on CET1 instruments subject to phase out arrangements* | | |
| 81) | *Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)* | | |
| 82) | *Current cap on AT1 instruments subject to phase out arrangements* | | |
| 83) | *Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)* | | |
| 84) | *Current cap on T2 instruments subject to phase out arrangements* | | |
| 85) | *Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)* | | |

**Notes to the Template**

| Row No. of the template | Particular | (Rs. in million) |
|---|---|---|
| 10 | Deferred tax assets associated with accumulated losses | |
| | Deferred tax assets (excluding those associated with accumulated losses) net of Deferred tax liability | |
| | Total as indicated in row 10 | |
| 19 | If investments in insurance subsidiaries are not deducted fully from capital and instead considered under 10% threshold for deduction, the resultant increase in the capital of AIFI | |

| | | |
|---|---|---|
| | of which: Increase in Common Equity Tier 1 capital | |
| | of which: Increase in Additional Tier 1 capital | |
| | of which: Increase in Tier 2 capital | |
| 26b | If investments in the equity capital of unconsolidated non-financial subsidiaries are not deducted and hence, risk weighted then: | |
| | (i) Increase in Common Equity Tier 1 capital | |
| | (ii) Increase in risk weighted assets | |
| 50 | Eligible Provisions included in Tier 2 capital | |
| | Eligible Revaluation Reserves included in Tier 2 capital | |
| | Total of row 50 | |

| **Explanation of each row of the Common Disclosure Template** | |
|---|---|
| **Row No.** | **Explanation** |
| 1) | Instruments issued by the parent AIFI of the reporting group which meet all of the CET1 entry criteria set out in section 7.2.3 (read with **Annex 1**) of this Chapter. This should be equal to the sum of common shares (and related surplus only) which must meet the common shares criteria. Other paid-up capital elements must be excluded. All minority interest must be excluded. |
| 2) | Retained earnings, prior to all regulatory adjustments in accordance with section 7.2.3 of this Chapter. |
| 3) | Accumulated other comprehensive income and other disclosed reserves, prior to all regulatory adjustments. |
| 4) | AIFIs must report zero in this row. |
| 5) | Common share capital issued by subsidiaries and held by third parties. Only the amount that is eligible for inclusion in group CET1 should be reported here, as determined by the application of section 7.3.4 of this Chapter (Also see **Annex 15** of this Chapter for illustration). |
| 6) | Sum of rows 1 to 5. |
| 7) | Valuation adjustments according to the requirements of section 11.8 of this Chapter |
| 8) | Goodwill net of related tax liability, as set out in section 7.4.1 of this Chapter |
| 9) | Intangibles (net of related tax liability), as set out in section 7.4.1 of this Chapter |
| 10) | Deferred tax assets (net of related tax liability), as set out in section 7.4.2 of this Chapter r |
| 11) | The element of the cash-flow hedge reserve described in section 7.4.3 of t this Chapter |
| 12) | Not relevant |
| 13) | Securitisation gain on sale as described in section 7.4.4 of this Chapter |
| 14) | Gains and losses due to changes in own credit risk on fair valued liabilities as described in section 7.4.5 of this Chapter |
| 15) | Defined benefit pension fund net assets, the amount to be deducted, as set out in sections 7.4.6 of this Chapter |
| 16) | Not relevant |
| 17) | Reciprocal cross-holdings in common equity as set out in section 7.5.2(A) of this Chapter |
| 18) | Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation where the AIFI does not own more than 10% of the issued share capital (amount above 10% threshold), amount to be deducted from CET1 in accordance with section 7.5.2(B) of this Chapter |
| 19) | Significant investments in the common stock of banking, financial and insurance entities that are outside the scope of regulatory consolidation (amount above 10% threshold), amount to be deducted from CET1 in accordance with section 7.5.2(C) of this Chapter |
| 20) | Not relevant |
| 21) | Not relevant |
| 22) | Not relevant |

| | |
|---|---|
| 23) | Not relevant |
| 24) | Not relevant |
| 25) | Not relevant |
| 26) | Any national specific regulatory adjustments that are required by national authorities to be applied to CET1 in addition to the Basel III minimum set of adjustments [i.e., in terms of December 2010 (rev June 2011) document issued by the Basel Committee on Banking Supervision]. |
| 27) | Regulatory adjustments applied to Common Equity Tier 1 due to insufficient Additional Tier 1 to cover deductions. If the amount reported in row 43 exceeds the amount reported in row 36 the excess is to be reported here. |
| 28) | Total regulatory adjustments to Common equity Tier 1, to be calculated as the sum of rows 7 to 22 plus row 26 and 27. |
| 29) | Common Equity Tier 1 capital (CET1), to be calculated as row 6 minus row 28. |
| 30) | Instruments that meet all of the AT1 entry criteria set out in section 7.2.4. All instruments issued of subsidiaries of the consolidated group should be excluded from this row. |
| 31) | The amount in row 30 classified as equity under applicable Accounting Standards. |
| 32) | The amount in row 30 classified as liabilities under applicable Accounting Standards. |
| 33) | Directly issued capital instruments subject to phase out from Additional Tier 1 in accordance with the requirements of section 7.5 of this Chapter |
| 34) | Additional Tier 1 instruments (and CET1 instruments not included in row 5) issued by subsidiaries and held by third parties, the amount allowed in group AT1 in accordance with section 7.3.4 of this Chapter (please see **Annex 15** for illustration). |
| 35) | The amount reported in row 34 that relates to instruments subject to phase out from AT1 in accordance with the requirements of section 7.5 of this Chapter |
| 36) | The sum of rows 30, 33 and 34. |
| 37) | Not relevant |
| 38) | Reciprocal cross-holdings in Additional Tier 1 instruments, amount to be deducted from AT1 in accordance with section 7.5.2 (A) of this Chapter |
| 39) | Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation where the AIFI does not own more than 10% of the issued common share capital of the entity (net of eligible short positions), amount to be deducted from AT1 in accordance with section 7.5.2(B) of this Chapter |
| 40) | Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions), amount to be deducted from AT1 in accordance with section 7.5.2(C) of this Chapter |
| 41) | Any national specific regulatory adjustments that are required by national authorities to be applied to Additional Tier 1 in addition to the Basel III minimum set of adjustments [i.e., in terms of December 2010 (rev June 2011) document issued by the Basel Committee on Banking Supervision. |
| 42) | Regulatory adjustments applied to Additional Tier 1 due to insufficient Tier 2 to cover deductions. If the amount reported in row 57 exceeds the amount reported in row 51 the excess is to be reported here. |
| 43) | The sum of rows 37 to 42. |
| 44) | Additional Tier 1 capital, to be calculated as row 36 minus row 43. |
| 45) | Tier 1 capital, to be calculated as row 29 plus row 44. |
| 46) | Instruments that meet all of the Tier 2 entry criteria set out in section 7.2.5 of this Chapter. All instruments issued of subsidiaries of the consolidated group should be excluded from this row. Provisions and Revaluation Reserves should not be included in Tier 2 in this row. |
| 47) | Directly issued capital instruments subject to phase out from Tier 2 in accordance with the requirements of section 7.5 of this Chapter |
| 48) | Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 32) issued by subsidiaries and held by third parties (amount allowed in group Tier 2) in accordance with section 7.3.4 of this Chapter |

| | |
|---|---|
| 49) | The amount reported in row 48 that relates to instruments subject to phase out from Tier 2 in accordance with the requirements of section 7.5 of this Chapter |
| 50) | Provisions and Revaluation Reserves included in Tier 2 calculated in accordance with section 7.2.5 of this Chapter |
| 51) | The sum of rows 46 to 48 and row 50. |
| 52) | Not relevant |
| 53) | Reciprocal cross-holdings in Tier 2 instruments, amount to be deducted from Tier 2 in accordance with section 7.5.2(A) of this Chapter |
| 54) | Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation where the AIFI does not own more than 10% of the issued common share capital of the entity (net of eligible short positions), amount to be deducted from Tier 2 in accordance with section 7.5.2(B) of this Chapter |
| 55) | Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions), amount to be deducted from Tier 2 in accordance with section 7.5.2(C) of this Chapter |
| 56) | Any national specific regulatory adjustments that are required by national authorities to be applied to Tier 2 in addition to the Basel III minimum set of adjustments [i.e., in terms of December 2010 (rev June 2011) document issued by the Basel Committee on Banking Supervision]. |
| 57) | The sum of rows 52 to 56. |
| 58) | Tier 2 capital, to be calculated as row 51 minus row 57. |
| 59) | Total capital, to be calculated as row 45 plus row 58. |
| 60) | Total risk weighted assets of the reporting group. Details to be furnished under rows 60a, 60b and 60c. |
| 61) | Common Equity Tier 1ratio (as a percentage of risk weighted assets), to be calculated as row 29 divided by row 60 (expressed as a percentage). |
| 62) | Tier 1 ratio (as a percentage of risk weighted assets), to be calculated as row 45 divided by row 60 (expressed as a percentage). |
| 63) | Total capital ratio (as a percentage of risk weighted assets), to be calculated as row 59 divided by row 60 (expressed as a percentage). |
| 64) | Not relevant |
| 65) | Not relevant |
| 66) | Not relevant |
| 67) | Not relevant |
| 68) | Not relevant |
| 69) | National Common Equity Tier 1 minimum ratio (if different from Basel III minimum). 5.5% should be reported. |
| 70) | National Tier 1 minimum ratio (if different from Basel III minimum). 7% should be reported. |
| 71) | National total capital minimum ratio (if different from Basel III minimum). 9% should be reported. |
| 72) | Non-significant investments in the capital of other financial entities, the total amount of such holdings that are not reported in row 18, row 39 and row 54. |
| 73) | Significant investments in the common stock of financial entities, the total amount of such holdings that are not reported in row 19 |
| 74) | Mortgage servicing rights, the total amount of such holdings that are not reported in row 19 and row 23. - Not Applicable in India. |
| 75) | Deferred tax assets arising from temporary differences, the total amount of such holdings that are not reported in row 21 and row 25. |
| 76) | Provisions eligible for inclusion in Tier 2 in respect of exposures subject to standardised approach calculated in accordance section 7.2.5 of this Chapter, prior to the application of the cap. |
| 77) | Cap on inclusion of provisions in Tier 2 under standardised approach calculated in accordance section 7.2.5 of this Chapter. |
| 78) | Provisions eligible for inclusion in Tier 2 in respect of exposures subject to internal |

| | |
|---|---|
| | ratings-based approach calculated in accordance section 7.2.5 of this Chapter. |
| 79) | Cap for inclusion of provisions in Tier 2 under internal ratings-based approach calculated in accordance section 7.2.5 of this Chapter |
| 80) | Current cap on CET1 instruments subject to phase out arrangements see section 7.5 of this Chapter |
| 81) | Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities), see section 7.5 of this Chapter |
| 82) | Current cap on AT1 instruments subject to phase out arrangements see section 7.5 of this Chapter |
| 83) | Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities) see section 7.5 of this Chapter |
| 84) | Current cap on T2 instruments subject to phase out arrangements see section 7.5 of this Chapter |
| 85) | Amount excluded from T2 due to cap (excess over cap after redemptions and maturities) see section 7.5 of this Chapter |

### 3.2 Three Step Approach to Reconciliation Requirements

**Step 1**

Under Step 1, AIFIs are required to take their balance sheet in their financial statements (numbers reported the middle column below) and report the numbers when the regulatory scope of consolidation is applied (numbers reported in the right hand column below). If there are rows in the regulatory consolidation balance sheet that are not present in the published financial statements, AIFIs are required to give a value of zero in the middle column and furnish the corresponding amount in the column meant for regulatory scope of consolidation. AIFIs may however, indicate what the exact treatment is for such amount in the balance sheet.

**Table DF-12: Composition of Capital- Reconciliation Requirements**

(₹ in million)

| | | **Balance sheet as in financial statements** | **Balance sheet under regulatory scope of consolidation** |
|---|---|---|---|
| | | **As on reporting date** | **As on reporting date** |
| **A** | **Capital & Liabilities** | | |
| i | Paid-up Capital | | |
| | Reserves & Surplus | | |
| | Minority Interest | | |
| | Total Capital | | |
| ii | Deposits | | |
| | *of which*: Deposits from banks | | |
| | *of which*: Customer deposits | | |
| | *of which*: Other deposits (pl. specify) | | |
| iii | Borrowings | | |
| | *of which:* From the Reserve Bank of India | | |
| | *of which:* From banks | | |
| | *of which:* From other institutions & agencies | | |
| | *of which:* Others (pl. specify) | | |
| | *of which:* Capital instruments | | |
| iv | Other liabilities & provisions | | |
| | **Total** | | |
| | | | |

| | | Balance sheet as in financial statements | Balance sheet under regulatory scope of consolidation |
|---|---|---|---|
| | | As on reporting date | As on reporting date |
| **B** | **Assets** | | |
| i | Cash and balances with the Reserve Bank of India | | |
| | Balance with banks and money at call and short notice | | |
| ii | Investments: | | |
| | *of which:* Government securities | | |
| | *of which:* Other approved securities | | |
| | *of which:* Shares | | |
| | *of which:* Debentures & Bonds | | |
| | *of which:* Subsidiaries / Joint Ventures / Associates | | |
| | *of which:* Others (Commercial Papers, Mutual Funds etc.) | | |
| iii | Loans and advances | | |
| | *of which:* Loans and advances to banks | | |
| | *of which:* Loans and advances to customers | | |
| iv | Fixed assets | | |
| v | Other assets | | |
| | *of which:* Goodwill and intangible assets | | |
| | *of which:* Deferred tax assets | | |
| vi | Goodwill on consolidation | | |
| vii | Debit balance in Profit & Loss account | | |
| | **Total Assets** | | |

**Step 2**

Under Step 2 AIFIs are required to expand the regulatory-scope balance sheet (revealed in Step 1) to identify all the elements that are used in the definition of capital disclosure template set out in Table DF-11). Set out below are some examples of elements that may need to be expanded for a particular group. The more complex the balance sheet of the AIFI, the more items would need to be disclosed. Each element must be given a reference number/letter that can be used in Step 3.

(₹ in million)

| | | Balance sheet as in financial statements | Balance sheet under regulatory scope of consolidation |
|---|---|---|---|
| | | As on reporting date | As on reporting date |
| **A** | **Capital & Liabilities** | | |
| i | Paid-up Capital | | |
| | *of which:* Amount eligible for CET1 | | e |
| | *of which:* Amount eligible for AT1 | | f |
| | Reserves & Surplus | | |
| | Minority Interest | | |
| | Total Capital | | |

| | | Balance sheet as in financial statements | Balance sheet under regulatory scope of consolidation |
|---|---|---|---|
| | | As on reporting date | As on reporting date |
| ii | Deposits | | |
| | *of which:* Deposits from banks | | |
| | *of which:* Customer deposits | | |
| | *of which:* Other deposits (pl. specify) | | |
| iii | Borrowings | | |
| | *of which:* From the Reserve Bank of India | | |
| | *of which:* From banks | | |
| | *of which:* From other institutions & agencies | | |
| | *of which:* Others (pl. specify) | | |
| | *of which:* Capital instruments | | |
| iv | Other liabilities & provisions | | |
| | *of which:* DTLs related to goodwill | | c |
| | *of which:* DTLs related to intangible assets | | d |
| | **Total** | | |
| | | | |
| **B** | **Assets** | | |
| i | Cash and balances with the Reserve Bank of India | | |
| | Balance with banks and money at call and short notice | | |
| ii | Investments | | |
| | *of which:* Government securities | | |
| | *of which:* Other approved securities | | |
| | *of which:* Shares | | |
| | *of which:* Debentures & Bonds | | |
| | *of which:* Subsidiaries / Joint Ventures / Associates | | |
| | *of which:* Others (Commercial Papers, Mutual Funds etc.) | | |
| iii | Loans and advances | | |
| | *of which:* Loans and advances to banks | | |
| | *of which:* Loans and advances to customers | | |
| iv | Fixed assets | | |
| v | Other assets | | |
| | *of which:* Goodwill and intangible assets<br>*Out of which:* | | |
| | Goodwill | | a |
| | Other intangibles (excluding MSRs) | | b |
| | Deferred tax assets | | |

| | | Balance sheet as in financial statements | Balance sheet under regulatory scope of consolidation |
|---|---|---|---|
| | | **As on reporting date** | **As on reporting date** |
| vi | Goodwill on consolidation | | |
| vii | Debit balance in Profit & Loss account | | |
| | **Total Assets** | | |

**Step 3: Under Step 3 AIFIs are required to complete a column added to the Table DF-11 disclosure template to show the source of every input.**

(i) For example, the definition of capital disclosure template includes the line "goodwill net of related deferred tax liability". Next to the disclosure of this item in the disclosure template under Table DF-11, the AIFI would be required to put 'a – c' to show that row 8 of the template has been calculated as the difference between component 'a' of the balance sheet under the regulatory scope of consolidation, illustrated in step 2, and component 'c'.

| Extract of Basel III common disclosure template (with added column) – Table DF-11* | | | |
|---|---|---|---|
| **Common Equity Tier 1 capital: instruments and reserves** | | | |
| | | Component of regulatory capital reported by AIFI | Source based on reference numbers/letters of the balance sheet under the regulatory scope of consolidation from step 2 |
| 1 | Directly issued qualifying common share (and equivalent for non-joint stock companies) capital plus related stock surplus | | e |
| *2* | Retained earnings | | |
| *3* | Accumulated other comprehensive income (and other reserves) | | |
| *4* | Directly issued capital subject to phase out from CET1 (only applicable to non-joint stock companies) | | |
| *5* | Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1) | | |
| 6 | **Common Equity Tier 1 capital before regulatory adjustments** | | |
| 7 | Prudential valuation adjustments | | |
| 8 | Goodwill (net of related tax liability) | | a-c |

*This table is not a separate disclosure requirement. Rather, this extract indicates how step 3 would be reflected in Table DF-11.

### 3.3 Main Features Template

(i) Template which AIFIs must use to ensure that the key features of regulatory capital instruments are disclosed is set out below. AIFIs will be required to complete all of the shaded cells for each outstanding regulatory capital instrument (AIFIs should insert "NA" if the question is not applicable).

**Table DF-13: Main Features of Regulatory Capital Instruments**

| | **Disclosure template for main features of regulatory capital instruments** | |
|---|---|---|
| 1 | Issuer | |
| 2 | Unique identifier (e.g., CUSIP, ISIN or Bloomberg identifier for private placement) | |
| 3 | Governing law(s) of the instrument | |
| | *Regulatory treatment* | |
| 4 | Basel III rules | |
| 5 | Eligible at solo/group/ group & solo | |
| 6 | Instrument type | |
| 7 | Amount recognised in regulatory capital (Rs. in million, as of most recent reporting date) | |
| 8 | Par value of instrument | |
| 9 | Accounting classification | |
| 10 | Original date of issuance | |
| 11 | Perpetual or dated | |
| 12 | Original maturity date | |
| 13 | Issuer call subject to prior supervisory approval | |
| 14 | Optional call date, contingent call dates and redemption amount | |
| 15 | Subsequent call dates, if applicable | |
| 16 | *Coupons / dividends* | |
| | Fixed or floating dividend/coupon | |
| 17 | Coupon rate and any related index | |
| 18 | Existence of a dividend stopper | |
| 19 | Fully discretionary, partially discretionary or mandatory | |
| 20 | Existence of step up or other incentive to redeem | |
| 21 | Noncumulative or cumulative | |
| 22 | Convertible or non-convertible | |
| 23 | If convertible, conversion trigger(s) | |
| 24 | If convertible, fully or partially | |
| 25 | If convertible, conversion rate | |
| 26 | If convertible, mandatory or optional conversion | |
| 27 | If convertible, specify instrument type convertible into | |
| 28 | If convertible, specify issuer of instrument it converts into | |
| 29 | Write-down feature | |
| 30 | If write-down, write-down trigger(s) | |
| 31 | If write-down, full or partial | |
| 32 | If write-down, permanent or temporary | |
| 33 | If temporary write-down, description of write-up mechanism | |
| 34 | Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument) | |
| 35 | Non-compliant transitioned features | |
| 36 | If yes, specify non-compliant features | |

(ii) Using the reference numbers in the left column of the table above, the following table provides a more detailed explanation of what AIFIs would be required to report in each of the

grey cells, including, where relevant, the list of options contained in the spread sheet's drop down menu.

| Further explanation of items in main features disclosure template | |
|---|---|
| 1 | Identifies issuer legal entity.<br>*Free text* |
| 2 | Unique identifier (e.g., CUSIP, ISIN or Bloomberg identifier for private placement)<br>*Free text* |
| 3 | Specifies the governing law(s) of the instrument<br>*Free text* |
| 4 | Specifies regulatory capital treatment under Basel III rules<br>*Select from menu: [Common Equity Tier 1] [Additional Tier 1] [Tier 2]* |
| 5 | Specifies the level(s) within the group at which the instrument is included in capital.<br>*Select from menu: [Solo] [Group] [Solo and Group]* |
| 6 | Specifies instrument type, varying by jurisdiction. Helps provide more granular understanding of features, particularly during transition.<br>*Select from menu: [Common Shares] [Perpetual Non-cumulative Preference Shares] [Perpetual Debt Instruments] [Upper Tier 2 Capital Instruments] [Perpetual Cumulative Preference Shares] [ Redeemable Non-cumulative Preference Shares] [Redeemable Cumulative Preference Shares] [Tier 2 Debt Instruments] [Others- specify]* |
| 7 | Specifies amount recognised in regulatory capital.<br>*Free text* |
| 8 | Par value of instrument<br>*Free text* |
| 9 | Specifies accounting classification. Helps to assess loss absorbency.<br>*Select from menu:*<br>*[Shareholders' equity] [Liability ] [Non-controlling interest in consolidated subsidiary]* |
| 10 | Specifies date of issuance.<br>*Free text* |
| 11 | Specifies whether dated or perpetual.<br>*Select from menu: [Perpetual] [Dated]* |
| 12 | For dated instrument, specifies original maturity date (day, month and year). For perpetual instrument put "no maturity".<br>*Free text* |
| 13 | Specifies whether there is an issuer call option. Helps to assess permanence.<br>*Select from menu: [Yes] [No]* |
| 14 | For instrument with issuer call option, specifies first date of call if the instrument has a call option on a specific date (day, month and year) and, in addition, specifies if the instrument has a tax and/or regulatory event call. Also specifies the redemption price. Helps to assess permanence.<br>*Free text* |
| 15 | Specifies the existence and frequency of subsequent call dates, if applicable. Helps to assess permanence.<br>*Free text* |
| 16 | Specifies whether the coupon/dividend is fixed over the life of the instrument, floating over the life of the instrument, currently fixed but will move to a floating rate in the future, currently floating but will move to a fixed rate in the future.<br>*Select from menu: [Fixed], [Floating] [Fixed to floating], [Floating to fixed]* |
| 17 | Specifies the coupon rate of the instrument and any related index that the coupon/dividend rate references.<br>*Free text* |
| 18 | Specifies whether the non-payment of a coupon or dividend on the instrument prohibits the payment of dividends on common shares (i.e., whether there is a dividend stopper).<br>*Select from menu: [Yes], [No]* |
| 19 | Specifies whether the issuer has full discretion, partial discretion or no discretion over |

| | |
|---|---|
| | whether a coupon/dividend is paid. If the AIFI has full discretion to cancel coupon/dividend payments under all circumstances it must select “fully discretionary” (including when there is a dividend stopper that does not have the effect of preventing the AIFI from cancelling payments on the instrument). If there are conditions that must be met before payment can be cancelled (e.g., capital below a certain threshold), the AIFI must select “partially discretionary”. If the AIFI is unable to cancel the payment outside of insolvency the AIFI must select “mandatory”.<br>*Select from menu: [Fully discretionary] [Partially discretionary] [Mandatory]* |
| 20 | Specifies whether there is a step-up or other incentive to redeem.<br>*Select from menu: [Yes] [No]* |
| 21 | Specifies whether dividends / coupons are cumulative or noncumulative.<br>*Select from menu: [Noncumulative] [Cumulative]* |
| 22 | Specifies whether instrument is convertible or not. Helps to assess loss absorbency.<br>*Select from menu: [Convertible] [Nonconvertible]* |
| 23 | Specifies the conditions under which the instrument will convert, including point of non-viability. Where one or more authorities have the ability to trigger conversion, the authorities should be listed. For each of the authorities it should be stated whether it is the terms of the contract of the instrument that provide the legal basis for the authority to trigger conversion (a contractual approach) or whether the legal basis is provided by statutory means (a statutory approach).<br>*Free text* |
| 24 | Specifies whether the instrument will always convert fully, may convert fully or partially, or will always convert partially<br>*Select from menu: [Always Fully] [Fully or Partially] [Always partially]* |
| 25 | Specifies rate of conversion into the more loss absorbent instrument. Helps to assess the degree of loss absorbency.<br>*Free text* |
| 26 | For convertible instruments, specifies whether conversion is mandatory or optional. Helps to assess loss absorbency.<br>*Select from menu: [Mandatory] [Optional] [NA]* |
| 27 | For convertible instruments, specifies instrument type convertible into. Helps to assess loss absorbency.<br>*Select from menu: [Common Equity Tier 1] [Additional Tier 1] [Tier 2] [Other]* |
| 28 | If convertible, specify issuer of instrument into which it converts.<br>*Free text* |
| 29 | Specifies whether there is a write down feature. Helps to assess loss absorbency.<br>*Select from menu: [Yes] [No]* |
| 30 | Specifies the trigger at which write-down occurs, including point of non-viability. Where one or more authorities have the ability to trigger write-down, the authorities should be listed. For each of the authorities it should be stated whether it is the terms of the contract of the instrument that provide the legal basis for the authority to trigger write-down (a contractual approach) or whether the legal basis is provided by statutory means (a statutory approach).<br>*Free text* |
| 31 | Specifies whether the instrument will always be written down fully, may be written down partially, or will always be written down partially. Helps assess the level of loss absorbency at write-down.<br>*Select from menu: [Always Fully] [Fully or Partially] [Always partially]* |
| 32 | For write down instrument, specifies whether write down is permanent or temporary. Helps to assess loss absorbency.<br>*Select from menu: [Permanent] [Temporary] [NA]* |
| 33 | For instrument that has a temporary write-down, description of write-up mechanism.<br>*Free text* |
| 34 | Specifies instrument to which it is most immediately subordinate. Helps to assess loss absorbency on gone-concern basis. Where applicable, AIFIs should specify the column |

| | |
|---|---|
| | numbers of the instruments in the completed main features template to which the instrument is most immediately subordinate.<br>*Free text* |
| 35 | Specifies whether there are non-compliant features.<br>*Select from menu: [Yes] [No]* |
| 36 | If there are non-compliant features, AIFIs to specify which ones. Helps to assess instrument loss absorbency.<br>*Free text* |

### 3.4 Full Terms and Conditions of Regulatory Capital Instruments

Under this template, AIFIs are required to disclose the full terms and conditions of all instruments included in the regulatory capital

**Table DF-14: Full Terms and Conditions of Regulatory Capital Instruments**

| Instruments | Full Terms and Conditions |
|---|---|
| | |
| | |

### 3.5 Disclosure Requirements for Remuneration

Please refer to the 'Guidelines on Compensation of Whole Time Directors/ Chief Executive Officers/ Material Risk Takers and Control Function staff' issued vide circular DOR.Appt.BC.No.23/29.67.001/2019-20 dated November 4, 2019 addressed to All Private Sector Banks (including Local Area Banks, Small Finance Banks, Payments Banks) and Foreign Banks operating in India. Private sector AIFIs, if any, shall be required to make disclosure on remuneration on an annual basis at the minimum, in their Annual Financial Statements as per the template given below:

**Table DF-15: Disclosure Requirements for Remuneration**

| Remuneration | | |
|---|---|---|
| **Qualitative disclosures** | (a) | Information relating to the bodies that oversee remuneration. Disclosure should include:<br>• Name, composition and mandate of the main body overseeing remuneration.<br>• External consultants whose advice has been sought, the body by which they were commissioned, and in what areas of the remuneration process.<br>• A description of the scope of the AIFI's remuneration policy (eg. by regions, business lines), including the extent to which it is applicable to foreign subsidiaries and branches.<br>• A description of the type of employees covered and number of such employees. |

| | | |
|---|---|---|
| | (b) | Information relating to the design and structure of remuneration processes. Disclosure should include:<br>• An overview of the key features and objectives of remuneration policy.<br>• Whether the remuneration committee reviewed the firm's remuneration policy during the past year, and if so, an overview of any changes that were made.<br>• A discussion of how the AIFI ensures that risk and compliance employees are remunerated independently of the businesses they oversee. |
| | (c) | Description of the ways in which current and future risks are taken into account in the remuneration processes. Disclosure should include :<br>• An overview of the key risks that the AIFI takes into account when implementing remuneration measures.<br>• An overview of the nature and type of key measures used to take account of these risks, including risk difficult to measure (values need not be disclosed).<br>• A discussion of the ways in which these measures affect remuneration.<br>• A discussion of how the nature and type of these measures have changed over the past year and reasons for the changes, as well as the impact of changes on remuneration. |
| | (d) | Description of the ways in which the AIFI seeks to link performance during a performance measurement period with levels of remuneration.<br>Disclosure should include:<br>• An overview of main performance metrics for AIFI, top level business lines and individuals**.**<br>• A discussion of how amounts of individual remuneration are linked to the AIFI-wide and individual performance.<br>• A discussion of the measures the AIFI will in general implement to adjust remuneration in the event that performance metrics are weak. This should include the AIFI's criteria for determining 'weak' performance metrics. |
| | (e) | Description of the ways in which the AIFI seeks to adjust remuneration to take account of the longer term performance. Disclosure should include:<br>• A discussion of the AIFI's policy on deferral and vesting of variable remuneration and, if the fraction of variable remuneration that is deferred differs across employees or groups of employees, a description of the factors that determine the fraction and their relative importance.<br>• A discussion of the AIFI's policy and criteria for adjusting deferred remuneration before vesting and (if permitted by national law) after |

| | | | |
|---|---|---|---|
| | (f) | Description of the different forms of variable remuneration that the AIFI utilizes and the rationale for using these different forms.<br>Disclosure should include:<br>• An overview of the forms of variable remuneration offered.<br>• A discussion of the use of different forms of variable remuneration and, if the mix of different forms of variable remuneration differs across employees or group of employees, a description of the factors that determine the mix and their relative importance. | |
| **Quantitative disclosures** (The quantitative disclosures should only cover Whole Time Directors / Chief Executive Officer / Other Risk Takers) | (g) | * | Number of meetings held by the main body overseeing remuneration during the financial year and remuneration paid to its member. |
| | (h) | * | Number of employees having received a variable remuneration award during the financial year. |
| | | * | Number and total amount of sign-on awards made during the financial year. |
| | | * | Number and total amount of guaranteed bonuses awarded during the financial year. |
| | | * | Details of severance pay, in addition to accrued benefits, if any. |
| | (i) | * | Total amount of outstanding deferred remuneration, split into cash, shares and share-linked instruments and other forms. |
| | | * | Total amount of deferred remuneration paid out in the financial year. |
| | (j) | * | Breakdown of amount of remuneration awards for the financial year to show<br>• fixed and variable,<br>• deferred and non-deferred<br>• different forms used |
| | (k) | * | Total amount of outstanding deferred remuneration and retained remuneration exposed to ex post explicit and / or implicit adjustments. |
| | | * | Total amount of reductions during the financial year due to ex-post explicit adjustments. |
| | | * | Total amount of reductions during the financial year due to ex-post implicit adjustments. |
| | (l) | | Number of Material Risk Takers identified |
| | (m) | * | Number of cases where malus has been exercised |
| | | * | Number of cases where clawback has been exercised |
| | | * | Number of cases where malus and clawback have been exercised |
| General Quantitative Disclosures | (n) | | The mean pay for the AIFI as a whole (excluding sub-staff) and the deviation of the pay of each of its Whole Time Directors (WTDs) from the mean pay. |

**Table DF-16: Equities – Disclosure for Banking Book Positions**

| | |
|---|---|
| **Qualitative Disclosures** | |
| 1 | The general qualitative disclosure requirement (Para 2.1 of this annex) with respect to equity risk, including:<br>• differentiation between holdings on which capital gains are expected and those taken under other objectives including for relationship and strategic reasons; and<br>• discussion of important policies covering the valuation and accounting of equity holdings in the banking book. This includes the accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation as well as significant changes in these practices. |
| **Quantitative Disclosures** | |
| 1 | Value disclosed in the balance sheet of investments, as well as the fair value of those investments; for quoted securities, a comparison to publicly quoted share values where the share price is materially different from fair value. |
| 2 | The types and nature of investments, including the amount that can be classified as:<br>• Publicly traded; and<br>• Privately held. |
| 3 | The cumulative realised gains (losses) arising from sales and liquidations in the reporting period. |
| 4 | Total unrealised gains (losses)[203] |
| 5 | Total latent revaluation gains (losses)[204] |
| 6 | Any amounts of the above included in Tier 1 and/or Tier 2 capital. |
| 7 | Capital requirements broken down by appropriate equity groupings, consistent with the AIFI's methodology, as well as the aggregate amounts and the type of equity investments subject to any supervisory transition or grandfathering provisions regarding regulatory capital requirements. |

## 4. Leverage Ratio Disclosures

(i) The scope of consolidation of the Basel III leverage ratio as set out in section 18.2.2 may be different from the scope of consolidation of the published financial statements. Also, there may be differences between the measurement criteria of assets on the accounting balance sheet in the published financial statements relative to measurement criteria of the leverage ratio (e.g., due to differences of eligible hedges, netting or the recognition of credit risk mitigation). Further, in order to adequately capture embedded leverage, the framework incorporates both on- and off-balance sheet exposures.

(ii) The templates set out below are designed to be flexible enough to be used under any accounting standard, and are consistent yet proportionate, varying with the complexity of the balance sheet of the reporting AIFI[205].

[203] Unrealised gains (losses) recognised in the balance sheet but not through the profit and loss account.

[204] Unrealised gains (losses) not recognised either in the balance sheet or through the profit and loss account.

[205] Specifically, a common template is set out. However, with respect to reconciliation, AIFIs are to qualitatively reconcile any material difference between total balance sheet assets in their

### 4.1 Summary comparison table

**4.1.1** Applying values at the end of period (e.g., quarter-end), AIFIs must report a reconciliation of their balance sheet assets from their published financial statements with the leverage ratio exposure measure as shown in Table DF-17 below. Specifically:

- line 1 should show the AIFI's total consolidated assets as per published financial statements;
- line 2 should show adjustments related to investments in banking, financial, insurance or commercial entities that are consolidated for accounting purposes, but outside the scope of regulatory consolidation as set out in sections 18.2.2 and 18.4.2.2;
- line 3 should show adjustments related to any fiduciary assets recognised on the balance sheet pursuant to the AIFI's operative accounting framework but excluded from the leverage ratio exposure measure, as described in footnote 112 of this Chapter;
- lines 4 and 5 should show adjustments related to derivative financial instruments and securities financing transactions (i.e., repos and other similar secured lending), respectively;
- line 6 should show the credit equivalent amount of OBS items, as determined under section 18.4.5.2;
- line 7 should show any other adjustments; and
- line 8 should show the leverage ratio exposure, which should be the sum of the previous items. This should also be consistent with line 22 of Table DF-18 below.

**Table DF-17- Summary comparison of accounting assets vs. leverage ratio exposure measure**

| | | |
|---|---|---|
| | Item | (Rs. In Million) |
| 1 | Total consolidated assets as per published financial statements | |
| 2 | Adjustment for investments in banking, financial, insurance or commercial entities that are consolidated for accounting purposes but outside the scope of regulatory consolidation | |
| 3 | Adjustment for fiduciary assets recognized on the balance sheet pursuant to the operative accounting framework but excluded from the leverage ratio exposure measure | |
| 4 | Adjustments for derivative financial instruments | |
| 5 | Adjustment for securities financing transactions (i.e., repos and similar secured lending) | |
| 6 | Adjustment for off-balance sheet items (i.e., conversion to credit equivalent amounts of off- balance sheet exposures) | |

reported financial statements and on-balance sheet exposures as prescribed in the leverage ratio.

| | | |
|---|---|---|
| 7 | Other adjustments | |
| **8** | **Leverage ratio exposure** | |

### 4.2 Common disclosure template and explanatory table, reconciliation and other requirements

**4.2.1** AIFIs must report, in accordance with Table DF-18 below, and applying values at the end of period (e.g., quarter-end), a breakdown of the following exposures under the leverage ratio framework: (i) on-balance sheet exposures; (ii) derivative exposures; (iii) SFT exposures; and (iv) OBS items. AIFIs must also report their Tier 1 capital, total exposures and the leverage ratio.

**4.2.2** The Basel III leverage ratio for the quarter, expressed as a percentage and calculated according to section 18.2, is to be reported in line 22.

**4.2.3** *Reconciliation with public financial statements:* AIFIs are required to disclose and detail the source of material differences between their total balance sheet assets (net of on-balance sheet derivative and SFT assets) as reported in their financial statements and their on-balance sheet exposures in line 1 of the common disclosure template.

**4.2.4** *Material periodic changes in the leverage ratio:* AIFIs are required to explain the key drivers of material changes in their Basel III leverage ratio observed from the end of the previous reporting period to the end of the current reporting period (whether these changes stem from changes in the numerator and/or from changes in the denominator).

**Table DF-18: Leverage ratio common disclosure template**

| | Item | Leverage ratio framework (₹. In million) |
|---|---|---|
| On-balance sheet exposures | | |
| 1 | On-balance sheet items (excluding derivatives and SFTs, but including collateral) | |
| 2 | (Asset amounts deducted in determining Basel III Tier 1 capital) | |
| 3 | **Total on-balance sheet exposures** (excluding derivatives and SFTs) (sum of lines 1 and 2) | |
| Derivative exposures | | |
| 4 | Replacement cost associated with all *derivatives* transactions (i.e., net of eligible cash variation margin) | |
| 5 | Add-on amounts for PFE associated with *all* derivatives transactions | |
| 6 | Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the operative accounting framework | |
| 7 | (Deductions of receivables assets for cash variation margin provided in derivatives transactions) | |
| 8 | (Exempted CCP leg of client-cleared trade exposures) | |
| 9 | Adjusted effective notional amount of written credit derivatives | |

| | | |
|---|---|---|
| 10 | (Adjusted effective notional offsets and add-on deductions for written credit derivatives) | |
| 11 | **Total derivative exposures (sum of lines 4 to 10)** | |
| Securities financing transaction exposures | | |
| 12 | Gross SFT *assets* (with no recognition of netting), after adjusting for sale accounting transactions | |
| 13 | (Netted amounts of cash payables and cash receivables of gross SFT assets) | |
| 14 | CCR exposure for SFT assets | |
| 15 | Agent transaction exposures | |
| 16 | **Total securities financing transaction exposures (sum of lines 12 to 15)** | |
| Other off-balance sheet exposures | | |
| 17 | Off-balance sheet exposure at gross notional amount | |
| 18 | (Adjustments for conversion to credit equivalent amounts) | |
| 19 | **Off-balance sheet items (sum of lines 17 and 18)** | |
| **Capital and total exposures** | | |
| 20 | **Tier 1 capital** | |
| 21 | **Total exposures (sum of lines 3, 11, 16 and 19)** | |
| **Leverage ratio** | | |
| 22 | **Basel III leverage ratio** | |

4.2.5 The following table sets out explanations for each row of the disclosure template referencing the relevant sections of the Basel III leverage ratio framework detailed in this document.

| **Explanation of each row of the common disclosure template** | |
|---|---|
| Row number | Explanation |
| 1 | On-balance sheet assets according to section 18.4.2.1. |
| 2 | Deductions from Basel III Tier 1 capital determined by sections 18.2.2 and 18.4.2.2 and excluded from the leverage ratio exposure measure, reported as negative amounts. |
| 3 | Sum of lines 1 and 2. |
| 4 | Replacement cost (RC) associated with *all* derivatives transactions, net of cash variation margin received and with, where applicable, bilateral netting according to sections 18.4.3.2-18.4.3.4 and 18.4.3.9. |
| 5 | Add-on amount for all derivative exposures according to sections 18.4.3.2-18.4.3.4 |
| 6 | Grossed-up amount for collateral provided according to section 18.4.3.7 |
| 7 | Deductions of receivables assets from cash variation margin provided in derivatives transactions according to section 18.4.3.9, reported as negative amounts. |
| 8 | Exempted trade exposures associated with the CCP leg of derivatives transactions resulting from client-cleared transactions according to paragraph 18.4.3.10, reported as negative amounts. |

| | |
|---|---|
| 9 | Adjusted effective notional amount (i.e., the effective notional amount reduced by any negative change in fair value) for written credit derivatives according to section 18.4.3.11. |
| 10 | Adjusted effective notional offsets of written credit derivatives according to section 18.4.3.11 and deducted add-on amounts relating to written credit derivatives according to section 18.4.3.12, reported as negative amounts. |
| 11 | Sum of lines 4–10. |
| 12 | Gross SFT assets with no recognition of any netting other than novation with QCCPs, removing certain securities received as determined by section 18.4.4.2 (A) and adjusting for any sales accounting transactions as determined by section 18.4.4.3. |
| 13 | Cash payables and cash receivables of gross SFT assets netted according to section 18.4.4.2 (A), reported as negative amounts. |
| 14 | Measure of counterparty credit risk for SFTs as determined by section 18.4.4.2 (B). |
| 15 | Agent transaction exposure amount determined according to sections 18.4.4.4-18.4.4.6 |
| 16 | Sum of lines 12–15. |
| 17 | Total off-balance sheet exposure amounts on a gross notional basis, before any adjustment for credit conversion factors according to section 18.4.5.2. |
| 18 | Reduction in gross amount of off-balance sheet exposures due to the application of credit conversion factors in section 18.4.5.2. |
| 19 | Sum of lines 17 and 18. |
| 20 | Tier 1 capital as determined by section 18.3. |
| 21 | Sum of lines 3, 11, 16 and 19. |
| 22 | Basel III leverage ratio according to paragraph 4.2.2 of **Annex 16**. |

4.2.6 To ensure that the summary comparison table, common disclosure template and explanatory table remain comparable across jurisdictions, there should be no adjustments made by AIFIs to disclose their leverage ratio. AIFIs are not permitted to add, delete or change the definitions of any rows from the summary comparison table and common disclosure template implemented in their jurisdiction. This will prevent a divergence of tables and templates that could undermine the objectives of consistency and comparability.

**Annex 17**
(**section 8.16.3.7**)

## Requirements for Recognition of Net Replacement Cost in Close-out Netting Sets

### A. For repo-style transactions

The effects of bilateral netting agreements covering repo-style transactions will be recognised on a counterparty-by-counterparty basis if the agreements are legally enforceable in each relevant jurisdiction upon the occurrence of an event of default and regardless of whether the counterparty is insolvent or bankrupt. In addition, netting agreements must:

a) provide the non-defaulting party the right to terminate and close-out in a timely manner all transactions under the agreement upon an event of default, including in the event of insolvency or bankruptcy of the counterparty;

b) provide for the netting of gains and losses on transactions (including the value of any collateral) terminated and closed out under it so that a single net amount is owed by one party to the other;

c) allow for the prompt liquidation or setoff of collateral upon the event of default; and

d) be, together with the rights arising from the provisions required in (a) to (c) above, legally enforceable in each relevant jurisdiction upon the occurrence of an event of default and regardless of the counterparty's insolvency or bankruptcy.

e) Netting across positions in the banking and trading book will only be recognised when the netted transactions fulfil the following conditions:

(i) All transactions are marked to market daily[206]; and
(ii) The collateral instruments used in the transactions are recognised as eligible financial collateral in the banking book.

### B. For Derivatives transactions

(a) AIFIs may net transactions subject to novation under which any obligation between an AIFI and its counterparty to deliver a given currency on a given value date is automatically amalgamated with all other obligations for the same currency and value date, legally substituting one single amount for the previous gross obligations.

(b) AIFIs may also net transactions subject to any legally valid form of bilateral netting not covered in (a), including other forms of novation.

(c) In both cases (a) and (b), an AIFI will need to satisfy that it has:

(i) A netting contract or agreement with the counterparty which creates a single legal obligation, covering all included transactions, such that the AIFI would have either a claim to receive or obligation to pay only the net sum of the positive and negative mark-to-market values of included individual transactions in the event a counterparty fails to perform due to any of the following: default, bankruptcy, liquidation or similar circumstances;

(ii) Written and reasoned legal opinions that, in the event of a legal challenge, the relevant courts and administrative authorities would find the AIFI's exposure to be such a net amount under:

- The law of the jurisdiction in which the counterparty is chartered and, if the foreign branch of a counterparty is involved, then also under the law of the jurisdiction in which the branch is located;

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[206] The holding period for the haircuts will depend as in other repo-style transactions on the frequency of margining.

- The law that governs the individual transactions; and
- The law that governs any contract or agreement necessary to effect the netting.

(iii) Procedures in place to ensure that the legal characteristics of netting arrangements are kept under review in the light of possible changes in relevant law.

(d) Contracts containing walkaway clauses will not be eligible for netting for the purpose of calculating capital requirements under these guidelines. A walkaway clause is a provision which permits a non-defaulting counterparty to make only limited payments or no payment at all, to the estate of a defaulter, even if the defaulter is a net creditor.

## Chapter III – Exposure Norms

### Part A – Large Exposures Framework

Exposure limits is one of the tools deployed by regulators and financial entities to manage concentration risk. The instructions contained in this Chapter cover the prudential norms on credit as well as capital market exposures of the AIFIs.

### 19. Scope and Applicability

**19.1** AIFIs shall apply the exposure norms on an ongoing basis and in the same manner as applied for the risk-based capital requirements, i.e. (a) consolidated (Group[207]) level and (b) solo level. These norms deal with only the counterparty exposures but not with the sector / industry exposures.

### 19.2 Exemptions

**19.2.1** An AIFI's exposure to all its counterparties shall be subject to the exposure limits except for those listed below:

**(i)** The refinance portfolios of AIFIs.
**Provided that** the AIFIs shall frame a policy approved by its Board to determine credit exposure limits in respect of their refinancing portfolio. The policy framed and assessments made under such a policy shall be subject to supervisory scrutiny.

(ii) Exposures to the Government of India and State Governments which are eligible for zero per cent risk weight under Chapter II of these Directions

(iii) Exposures to the Reserve Bank

(iv) Exposures where principal and interest are fully guaranteed by the Government of India

(v) Exposures secured by financial instruments issued by the Government of India, to the extent that the eligibility criteria for recognition of the credit risk mitigation (CRM) are met in terms of section 22 of this Chapter

(vi) Intra-day exposures to banks

(vii) AIFIs' clearing activities related exposures to QCCPs as detailed in section 24 of these Directions

**19.2.2** Where two (or more) entities falling outside the scope of the sovereign exemption are controlled by or are economically dependent on an entity that falls within the scope of the sovereign exemption {section 19.2.1 (ii) and (iii)}, and are otherwise not connected, those entities will not be deemed to constitute a group of connected counterparties.

### 20. Exposure Ceilings

**20.1 Single Counterparty:** The sum of all the exposure values of an AIFI to a single counterparty must not be higher than 20 per cent of the AIFI's available eligible capital base at all times.

**Provided that** Board of the AIFI may allow additional 5 per cent exposure beyond 20 per cent but at no time higher than 25 per cent of the AIFI's eligible capital base, subject to the following conditions:

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[207] This requires that AIFIs shall apply LE framework at the consolidated group level, after consolidating the assets and liabilities of its subsidiaries / joint ventures / associates (including overseas operations through AIFI's branches) etc., except those engaged in insurance and any non-financial activities.

(i) AIFIs shall put in place a specific Board approved policy setting out conditions under which exposure beyond 20 per cent may be considered; and

(ii) AIFI shall record in writing the exceptional reasons for which exposure beyond 20 per cent is being allowed for each specific case.

**Provided further that** an AIFI may exceed the exposure limit by 5 per cent of its Tier I capital for exposure to a single counterparty, if the additional exposure is on account of infrastructure 'loan and/ or investment'.
**Provided further that** single counterparty limit shall not exceed 25 per cent in any case for the AIFI.

**20.2 Group of Connected Counterparties:** The sum of all exposure values of an AIFI to a group of connected counterparties shall not be higher than 25 per cent of the AIFI's available eligible capital base at all times.
**Provided that** an AIFI may exceed the exposure limit by 10 per cent of its Tier I capital for exposure to a group of connected counterparties, if the additional exposure is on account of infrastructure 'loan and/ or investment'.

**20.3** The eligible capital base for the purposes under this Chapter is the effective amount of Tier 1 capital fulfilling the criteria defined under Chapter II of these Directions as per the last audited balance sheet.

**20.4** The infusion of capital after the published balance sheet date may also be taken into account for the purpose of exposure norms. Further, profits accrued during the year will be reckoned as Tier I capital for the purpose after making necessary adjustments as prescribed under Chapter II of these Directions.
**Provided that** AIFIs shall obtain an external auditor's certificate on completion of the infusion of capital and submit the same to the Reserve Bank (Department of Supervision) before reckoning the additions to eligible capital base.

**21. Definition of connected counterparties**

**21.1** In some cases, an AIFI may have exposures to a group of counterparties with specific relationships or dependencies such that, were one of the counterparties to fail, all of the counterparties would very likely fail. Such a group of connected counterparties shall be treated as a single counterparty. The sum of the AIFI's exposure to all the individual entities included within a group of connected counterparties shall be subject to the exposure limits, as mentioned at section 20.1 above, and to the regulatory reporting requirements.

**21.2** Two or more natural or legal persons shall be deemed to be a group of connected counterparties if at least one of the following criteria is satisfied:

(i) *Control relationship:* one of the counterparties, directly or indirectly, has control over the other(s) or the counterparties are, directly or indirectly, controlled by a third party (AIFI may or may not have exposure towards this third party). In case of financial problems of the controlling entity, it is highly likely that the controlling entity could make use of its ability to extract capital and/or liquidity from the controlled entity, thereby weakening the financial position of the latter. Financial problems could be transferred to the controlled entity, with the result that both the controlling entity and the controlled entity would experience financial problems (domino effect). From the prudential perspective, these types of clients (connected by control) form a single risk.

(ii) *Economic interdependence:* if one of the counterparties were to experience financial problems, in particular funding or repayment difficulties, the other(s), as a result, would also be likely to encounter funding or repayment difficulties.
**Provided that** in order to avoid cases where a thorough investigation of economic interdependencies will not be proportionate to the size of the exposures, *AIFIs shall identify possible connected counterparties on the basis of economic interdependence in all cases where the sum of all exposures to one individual counterparty exceeds 5 per cent of the*

*eligible capital base, and not in other cases.*

**21.3** In order to establish the existence of a group of connected counterparties, AIFIs shall assess the relationship amongst counterparties with reference to (i) and (ii) above.

**Provided that** if one entity owns more than 50 percent of the voting rights of the other entity, AIFIs shall automatically consider that the control relationship criterion (section 21.2(i) above) is satisfied.

**Provided further that** AIFIs shall assess connectedness between counterparties based on "control" using the following evidences:

(i) Voting agreements (e.g., control of a majority of voting rights pursuant to an agreement with other shareholders);

(ii) Significant influence on the appointment or dismissal of an entity's administrative, management or supervisory body, such as the right to appoint or remove a majority of members in those bodies, or the fact that a majority of members have been appointed solely as a result of the exercise of an individual entity's voting rights;

(iii) Significant influence on senior management, e.g., an entity has the power, pursuant to a contract or otherwise, to exercise a controlling influence over the management or policies of another entity (e.g., through consent rights over key decisions, to decide on the strategy or direct the activities of an entity, to decide on crucial transactions such as transfer of profit or loss);

(iv) AIFIs shall also assess the above criteria with respect to a common third party (such as holding company), irrespective of whether the AIFI has exposure to that entity or not.

**21.4** AIFIs shall also refer to criteria specified in the extant accounting standards for further qualitative guidance when determining control.

**21.5** While determining control relationship, AIFIs shall also examine cases where clients have common owners, shareholders or managers; for example, horizontal groups where an undertaking is related to one or more other undertakings because they all have the same shareholder structure without a single controlling shareholder or because they are managed on a unified basis. This management may be pursuant to a contract concluded between the undertakings, or to provisions in the memoranda or articles of association of those undertakings, or if the administrative management or supervisory bodies of the undertaking and of one or more other undertakings consist, for the major part, of the same persons.

**21.6** Where control has been established based on any of the above criteria, in exceptional cases, AIFIs shall have an option to demonstrate to the Reserve Bank (e.g., existence of control between counterparties due to specific circumstances and corporate governance safeguards) that such control does not necessarily result in the entities concerned constituting a group of connected counterparties. For example, in specific cases where a special purpose entity (SPE) that is controlled by another client (e.g., an originator) is fully ring-fenced and bankruptcy remote (i.e., arrangements exist to the effect that assets of SPE are not available to lenders of parent undertaking in the event of insolvency of the parent undertaking) – so that there is no possible channel of contagion. Hence no single risk exists between the special purpose entity and the controlling parent entity.

**21.7** In establishing connectedness based on economic interdependence, AIFIs shall consider, at a minimum, the following criteria:

(i) Where 50 per cent or more of one counterparty's gross receipts or gross expenditures (on an annual basis) is derived from transactions with the other counterparty;

(ii) Where one counterparty has fully or partly guaranteed the exposure of the other counterparty, or is liable by other means, and the exposure is so significant that the guarantor is likely to default if a claim occurs;

(iii) Where a significant part of one counterparty's production/output is sold to another counterparty, which cannot easily be replaced by other customers;

(iv) When the expected source of funds to repay the loans of both counterparties is the same and neither counterparty has another independent source of income from which the loan may be serviced and fully repaid;

(v) Where it is likely that the financial problems of one counterparty would cause difficulties for the other counterparties in terms of full and timely repayment of liabilities;

(vi) Where the insolvency or default of one counterparty is likely to be associated with the insolvency or default of the other(s);

(vii) When two or more counterparties rely on the same source for the majority of their funding and, in the event of the common provider's default, an alternative provider cannot be found - in this case, the funding problems of one counterparty are likely to spread to another due to a one-way or two-way dependence on the same main funding source.

Illustrations are provided in **Annex 18**.

**21.8** However, it is possible that there shall be circumstances where some of these criteria do not automatically imply an economic dependence that results in two or more counterparties being connected. In such a scenario, the AIFI shall not be required to combine these counterparties to form a group of connected counterparties.
**Provided that** the AIFI can demonstrate that a counterparty which is economically closely related to another counterparty shall be able to overcome financial difficulties, or even the second counterparty's default, by finding alternative business partners or funding sources within an appropriate time period.

**21.9 Relation between interconnectedness through control and interconnectedness through economic dependency:** Group of counterparties based on control and economic interdependence are to be assessed separately. However, there may be situations where the two types of dependencies are interlinked and could therefore exist within one group of connected counterparties in such a way that all relevant clients constitute a single risk. Risk of contagion is present irrespective of type of connectedness (i.e., control or economic interdependence) between counterparties. The chain of contagion leading to possible default of all entities concerned is the relevant factor for the grouping and needs to be assessed in each individual case. Illustrations are given in **Annex 19**.

**21.10** AIFIs shall frame Board approved policies for determining connectedness among counterparties using the criteria mentioned above. The policies are subject to supervisory scrutiny.

## 22. Values of Exposure

**22.1** An exposure to a counterparty shall constitute both on and off-balance sheet exposures which shall be calculated according to the method prescribed for capital computation under Chapter II of these Directions. The exposures shall be permitted to be offset with credit risk mitigation techniques permitted as at section 10 in Chapter II of these Directions. Off-balance sheet items shall be converted into credit exposure equivalents through the use of credit conversion factors (CCFs) by applying the CCFs set out in section 8.16 in Chapter II of these Directions, with a floor of 10 percent.

### 22.2 Recognition of exposures to CRM providers

(i) Where an AIFI reduces its exposure to the original counterparty on account of an eligible CRM instrument provided by another counterparty (CRM provider) with respect to that exposure, it must also recognise an exposure to the CRM provider. The amount assigned to the CRM provider will be the amount by which the exposure to the original counterparty is reduced (except in the cases defined in clause (ii) below).

(ii) When the credit protection takes the form of a credit default swap (CDS) and either the CDS provider or the referenced entity is not a financial entity, the amount to be assigned to the credit protection provider is not the amount by which the exposure to the original counterparty is reduced but will be equal to the counterparty credit risk exposure value calculated as per the the extant method prescribed for the counterparty credit risk in Chapter II of these Directions.

*Note:* For the purpose of this paragraph, financial entities comprise:

(a) Regulated financial institutions, defined as a parent and its subsidiaries where any substantial legal entity in the consolidated group is supervised by a regulator that imposes prudential requirements consistent with international norms. These include, but are not limited to, prudentially regulated insurance companies, broker/dealers, banks; and

(b) Unregulated financial institutions, defined as legal entities whose main business includes: the management of financial assets, lending, factoring, leasing, provision of credit enhancements, securitisation, investments, financial custody, central counterparty services, proprietary trading and other financial services activities identified by supervisors.

### 22.3 Exposures to banks

The exposures to banks (excluding refinance exposure), except intra-day exposures, shall be subject to the large exposure limit of 25 per cent of an AIFI's Tier 1 capital.

### 22.4 Collective Investment Undertakings (CIUs), securitisation vehicles and other structures - adoption of "Look Through Approach" (LTA)

**22.4.1** There are cases when a structure lies between the AIFI and its exposures, that is, the AIFI invests in structures which themselves have exposures to assets underlying the structures (hereafter referred to as the "underlying assets"). Such structures include funds[208], securitisations and other structures[209] with underlying assets. AIFIs shall assign such exposure amount to specific counterparties of the underlying assets following the LTA described below. Illustrative example is provided in **Annex 20**.

**22.4.2** An AIFI shall be permitted to assign the exposure amount to the structure itself, defined as a distinct counterparty

**Provided that** it can demonstrate that the AIFI's exposure amount to each underlying asset of the structure is smaller than 0.25% of its eligible capital base, considering only those exposure to underlying assets that result from the investment in the structure itself and using the exposure value calculated according to section 22.4.7 and 22.4.8. In this case, an AIFI is not required to look through the structure to identify the underlying assets.

**22.4.3** An AIFI shall look through the structure and in the case of underlying assets for which the underlying exposure value is equal to or above 0.25% of its eligible capital base, the counterparty corresponding to each of the underlying assets shall be identified so that these underlying exposures can be added to any other direct or indirect exposure to the same counterparty. The AIFI's exposure amount to the underlying assets that are below 0.25 per cent of the AIFI's eligible capital base shall be assigned to the structure itself (ie., partial look-through is permitted).

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[208] such as mutual funds, alternative investment funds

[209] such as investment in security receipts, real estate investment trusts, infrastructure investment trusts

**22.4.4** If an AIFI is unable to identify the underlying assets of a structure:

(i) where the total amount of an AIFI's exposures to a structure does not exceed 0.25 per cent of its eligible capital base, it shall assign the total exposure amount to the structure itself, as a distinct counterparty.

(ii) Otherwise (i.e., if the exposure to the structure equals or exceeds 0.25 per cent of its eligible capital base), it shall assign this total exposure amount to the 'unknown client'.

**Provided that** the exposure limits shall apply on the aggregate of all such exposures to 'unknown clients' as if they are a single counterparty.

**22.4.5** Where the LTA is not required (section 22.4.2 above), an AIFI shall demonstrate that regulatory arbitrage considerations have not influenced the decision whether to look through or not – e.g. that the AIFI has not circumvented the exposure limits by investing in several individually immaterial transactions with identical underlying assets.

**22.4.6** If LTA need not be applied, an AIFI's exposure to the structure shall be the nominal amount it invests in the structure.

**22.4.7** *Any structure where all investors rank pari passu (e.g., CIU)* - When the LTA is required according to the sections above, the exposure value assigned to a counterparty is equal to the pro rata share that the AIFI holds in the structure multiplied by the value of the underlying asset in the structure. Thus, an AIFI holding a ₹1 investment in a structure, which invests in 20 assets each with a value of ₹5, shall assign an exposure of ₹0.05 to each of the counterparties. An exposure to such counterparty shall be added to any other direct or indirect exposures the AIFI has to that counterparty.

**22.4.8** *Any structure with different seniority levels among investors (e.g., securitisation vehicles)* - When the LTA (in terms of sections above) is required for an investment in a structure with different levels of seniority, the exposure value to a counterparty shall be measured for each tranche within the structure, assuming a pro rata distribution of losses amongst investors in a single tranche. To compute the exposure value to the underlying asset, an AIFI shall:

(i) first, consider the lower of the value of the tranche in which the AIFI has invested and the nominal value of each underlying asset included in the underlying portfolio of assets

(ii) second, apply the pro rata share of the AIFI's investment in the tranche to the value determined in the first step above.

**22.4.9 Identification of additional risks**

(i) While taking exposures to structures, AIFIs shall identify such third parties which may constitute an additional risk factor, and which are inherent in the structure itself rather than in the underlying assets. Such a third party could be a risk factor for more than one structure that an AIFI invests in. Examples of roles played by third parties include originator, fund manager, liquidity provider and credit protection provider. The Reserve Bank as a part of its Pillar 2 supervisory review and evaluation process will look into this aspect and if required specify a specific course of action which may either include reduction in exposure or raising of additional capital.

(ii) It is conceivable that an AIFI may consider multiple third parties to be potential drivers of additional risk. In this case, the AIFI shall assign the exposure resulting from the investment in the relevant structures to each of the third parties.

**23. Exposures to NBFCs**

**23.1** AIFIs' exposures to NBFCs (excluding refinance exposure) shall be subject to the single and group of connected counterparty limits prescribed under section 20 above.

**23.2** AIFIs shall not be permitted to provide finance to NBFCs for the following activities:

(a) Bills discounted / rediscounted by NBFCs except those arising from sale of

commercial vehicles including light commercial vehicles subject to normal lending safeguards;
(b) Investments made by NBFCs in shares, debentures, etc., of a current nature (i.e., stock-in-trade);
(c) Investments of NBFCs in and advances to subsidiaries, group companies or other entities; and
(d) Investments of NBFCs in, and inter-corporate loans / deposits to / in other companies.
(e) Bridge loans in any form to any category of NBFCs (including RNBCs)

**24. Exposures to Central Counterparties**

**24.1** AIFIs' clearing exposure to QCCPs shall be exempt from the large exposure framework. However, these exposures shall be subject to the regulatory reporting requirements as prescribed in section 25.

**24.2** In the case of non-QCCPs, AIFIs shall measure their exposure as a sum of both the clearing exposures described in section 24.4 and the non-clearing exposures described in section 24.5, and the same shall be subject to the large exposure limit of 25 per cent of the eligible capital base.

**24.3** The concept of connected counterparties described in section 21 does not apply in the context of exposures to CCPs that are specifically related to clearing activities.

**24.4 Calculation of exposures related to clearing activities:** AIFIs must identify exposures to a CCP related to clearing activities and sum together these exposures. The AIFI must determine the counterparty to which exposures must be assigned by applying the provisions of the risk-based capital requirements. Exposures related to clearing activities are listed in the table below together with the exposure value to be used:

| | |
|---|---|
| **Trade exposures** | The exposure value of trade exposures shall be calculated using the exposure measures prescribed in other parts of this framework for the respective type of exposures. |
| **Segregated initial margin** | The exposure value is 0[210]. |
| **Non-segregated initial margin** | The exposure value is the nominal amount of initial margin posted. |
| **Pre-funded default fund contributions** | Nominal amount of the funded contribution |
| **Unfunded default fund contributions** | The exposure value is 0 |

**24.5 Other exposures:** Other types of exposures that are not directly related to clearing services provided by the CCP, such as equity stake[211], funding facilities, credit facilities, guarantees etc., must be measured according to the rules set out in this framework, as for any other type of counterparty. These exposures will be added together and be subjected to the large exposure limit of 25 per cent of the eligible capital base.

**25. Reporting System and Disclosures**

**25.1** AIFIs shall undertake an annual review of the implementation of exposure

[210] When the initial margin (IM) posted is bankruptcy-remote from the CCP – in the sense that it is segregated from the CCP's own accounts, e.g., when the IM is held by a third-party custodian – this amount cannot be lost by the AIFI if the CCP defaults; therefore, the IM posted by the AIFI can be exempted from the large exposure limit.

[211] If equity stakes in a CCP are deducted from the capital on which the large exposure limit is based, these must not be included as exposure to the CCP.

management measures and place the same before their Boards by the end of June (September in the case of NHB). A copy of the review report shall be forwarded to the concerned office of Department of Supervision.

### 25.2 Breach

**25.2.1** Breach of exposure limits, if any, shall be under exceptional conditions beyond the control of AIFI, and needs to be rectified immediately. The breaches shall be reported to RBI (Department of Supervision, Central Office) immediately.

**25.2.2** AIFI, if under breach of exposure limits, cannot undertake any further exposure (at the entity or group level, as the case may be) until it is brought down within the limit.

**25.2.3** Failure to comply with the exposure limit may lead to imposition of penalties on the AIFIs by the supervisor.

### 25.3 Regulatory reporting

**25.3.1** AIFIs shall report their Large Exposures to the Reserve Bank (Department of Supervision, Central Office) as per the reporting template given in **Annex 21** on a monthly basis. The reporting shall cover the following:

(a) All exposures, meeting the definition of large exposure;

(b) All other exposures, measured without offsetting exposure value with credit risk mitigation instruments, meeting the definition of large exposure;

(c) All the exempted exposures meeting the definition of large exposure;

(d) 20 largest exposures included in the scope of application, irrespective of the values of these exposures relative to the AIFI's eligible capital base.

## Part B – Permitted exposures and other prudential exposure limits

### 26. Permitted exposures and limits

For sector and industry exposures the AIFIs shall fix internal limits for aggregate commitments to specific sectors e.g., textiles, chemicals, engineering, etc., so that the exposures are evenly spread over various sectors.

**Provided that** these limits shall be fixed having regard to the perceived risks and performance of different sectors and the limits so fixed shall be reviewed periodically.

### 27. Other permissible exposures

### 27.1 Bridge Loans / Interim Finance

**27.1.1** AIFIs shall be permitted to grant bridge loan / interim finance to companies other than NBFCs for the following purposes:

(i) against expected equity flows/issues subject to a Board-approved policy in this regard

**Provided that** AIFIs shall not grant any advance against rights issues irrespective of the source of repayment of such advance.

(ii) for commencing work on projects pending completion of formalities only against their own commitment and not against loan commitment of any other financial institution/bank.

**Provided that** this shall not be applicable in cases where the other lending institution faces temporary liquidity constraints on account of restrictions prescribed by the Reserve Bank.

**27.1.2** These restrictions shall also be applicable to the subsidiaries of AIFIs.

### 27.2 Issue of guarantees by AIFIs

**27.2.1** The AIFIs shall be permitted to extend guarantees in respect of infrastructure projects in favour of other lending institutions

**Provided that** the AIFI issuing the guarantee shall take a funded share in the infrastructure project at least to the extent of five per cent of the project cost

**Provided further that** the AIFI shall undertake normal credit appraisal, monitoring and follow up of the project.

### 27.3 Lending to Infrastructure Investment Trusts (InvITs)

**27.3.1** AIFIs shall be permitted to lend to InvITs subject to putting in place a Board approved policy on exposures to InvITs which shall inter alia cover the appraisal mechanism, sanctioning conditions, internal limits, monitoring mechanism, etc.
**Provided that** AIFIs shall undertake assessment of all critical parameters including sufficiency of cash flows at InvIT level to ensure timely debt servicing.
**Provided further that** the overall leverage of the InvITs and the underlying SPVs put together shall be within the permissible leverage as per the Board approved policy of the AIFIs.
**Provided further that** as InvITs are trusts, AIFIs shall keep in mind the legal provisions in respect of these entities especially those regarding enforcement of security.

**27.3.2** AIFIs shall lend to only those InvITs where none of the underlying SPVs, which have existing loans, is facing 'financial difficulty' as defined in para 2 of Annex-I to the circular DBR.No.BP.BC.45/21.04.048/2018-19 dated June 07, 2019 as amended from time to time.

**27.3.3** AIFIs shall monitor performance of the underlying SPVs on an ongoing basis as ability of the InvITs to meet their debt obligation will largely depend on the performance of these SPVs.

**27.3.4** The Audit Committee of the Board of AIFIs shall review the compliance to the above conditions on a half yearly basis.

### 27.4 Cross Holding of Capital among Banks / Financial Institutions

**27.4.1** AIFIs' investment in the following instruments, which are issued by banks / other AIFIs and are eligible for capital status for the investee bank / AIFIs, shall not exceed 10 percent of the investing AIFI's eligible capital base:

(i) Equity shares;
(ii) Preference shares eligible for capital status;
(iii) Subordinated debt instruments;
(iv) Hybrid debt capital instruments; and
(v) Any other instrument approved as in the nature of capital

**27.4.2** AIFIs shall be permitted to acquire fresh stake in a bank's / AIFI's equity shares.
**Provided that** the investing AIFI's holding shall not exceed 5 per cent of the investee bank's / AIFI's equity capital.

### 27.5 Exposure to capital markets

#### 27.5.1 Components of Capital Market Exposure (CME)

AIFIs' aggregate capital market exposures shall include both their direct and indirect exposures and shall constitute of the following:

(i) direct investment in equity shares, convertible bonds, convertible debentures and units of equity-oriented mutual funds the corpus of which is not exclusively invested in corporate debt;

(ii) advances against shares/bonds/debentures or other securities or on clean basis to individuals for investment in shares (including IPOs/ESOPs), convertible bonds, convertible debentures, and units of equity-oriented mutual funds;

(iii) advances for any other purposes where shares or convertible bonds or convertible debentures or units of equity oriented mutual funds are taken as primary security;

(iv) advances for any other purposes to the extent secured by the collateral security of shares or convertible bonds or convertible debentures or units of equity oriented mutual funds i.e. where the primary security other than shares/convertible bonds/convertible debentures/units of equity oriented mutual funds does not fully cover the advances;

(v) secured and unsecured advances to stockbrokers and guarantees issued on behalf of stockbrokers and market makers;

(vi) loans sanctioned to corporates against the security of shares / bonds/ debentures or other securities or on clean basis for meeting promoter's contribution to the equity of new companies in anticipation of raising resources;

(vii) bridge loans to companies against expected equity flows/issues;

(viii) all exposures to Alternative Investment Funds

**27.5.2 Limit on aggregate exposure to capital markets and investments in non-financial /commercial enterprises**

**27.5.2.1 Limit on aggregate exposure to capital markets**

The aggregate exposure of an AIFI to the capital markets in all forms (both fund based and non-fund based, direct and indirect), on solo as well as consolidated basis shall not exceed 40 per cent of its net worth, as on March 31 of the previous year.

**Provided that** the AIFI's direct exposure within this overall ceiling shall not exceed 20 per cent of its net worth.

**27.5.2.2 Limits on significant equity investments in non-financial/commercial enterprises**

(i) An AIFI's equity investment in a single company that is made in conformity with its statutory mandate shall not exceed 49% of the equity of the investee company.

**Provided that** in all other cases, an AIFI shall not hold more than 10% of the equity of the investee company as direct investment.

(ii) An AIFI shall be permitted to hold up to 49% of equity of a company as a pledgee.

**Provided that** if the AIFI ends up acquiring this in satisfaction of its claims, it shall be brought down below 10% limit within 3 years.

**27.5.2.3 Limits on aggregate exposure to capital markets**

(i) An AIFI's aggregate investment in equity of non-financial/commercial enterprises, other than that covered under section 27.5.2.2 (i) above, shall not exceed 10 per cent of the AIFI's net worth as on March 31 of the previous year.

**Provided that** the Board of AIFIs shall have the freedom to adopt a lower ceiling for the AIFI, keeping in view its overall risk profile and corporate strategy.

**27.5.3 Exemptions**

**27.5.3.1** The following items shall be exempted from the capital market exposure limits:

(i) AIFIs' investments in own subsidiaries, joint ventures, State Finance Corporations (SFCs) and investments in shares and convertible debentures, convertible bonds issued by institutions forming crucial financial infrastructure such as Acuité Ratings & Research Limited (Acuité), India SME Technology Services Ltd (ISTSL), India SME Asset Reconstruction Company Ltd (ISARC), North Eastern Development Finance Corporation Ltd (NeDFi), National Securities Depository Ltd. (NSDL), Central Depository Services (India) Ltd. (CDSL), National Stock Exchange (NSE), NSE Clearing Ltd., Clearing Corporation of India Ltd., (CCIL), a credit information company which has obtained Certificate of Registration from the Reserve Bank and of which the AIFI is a member, Multi Commodity Exchange Ltd. (MCX), National Commodity and Derivatives Exchange Ltd. (NCDEX), Indian Commodity Exchange Ltd., National Commodities Management Services Ltd. (NCML), National Payments Corporation of India (NPCI) and other Public Finance Institutions (PFIs) as defined under

Section 2 (72) of Companies Act, 2013. After listing, the exposures in excess of the original investment (i.e. prior to listing) would form part of the Capital Market Exposure.

(ii) Tier I and Tier II debt instruments issued by banks/ other AIFIs;

(iii) Investment in Certificate of Deposits (CDs) of banks/ other AIFIs;

(iv) Preference Shares;

(v) Non-convertible debentures and non-convertible bonds;

(vi) Units of Mutual Funds under schemes where the corpus is invested exclusively in debt instruments;

(vii) Shares acquired by AIFIs as a result of conversion of debt/overdue interest into equity as per the exemption provided under the Directions on "Prudential Framework for Resolution of Stressed Assets dated June 7, 2019 applicable to AIFIs as amended from time to time.;

(viii) Promoters' shares in the SPV of an infrastructure project pledged to the lending AIFI for infrastructure project lending; and

(ix) Exposure to brokers under the currency derivatives segment.

### 27.5.4 Computation of exposure

(i) For computing the exposure to the capital markets, loans/advances sanctioned shall be reckoned with reference to sanctioned limits or outstanding, whichever is higher.
**Provided that** in the case of fully drawn term loans, where there is no scope for re-drawal of any portion of the sanctioned limit, AIFIs' shall reckon the outstanding as the exposure.

(ii) AIFIs' direct investment in shares, convertible bonds, convertible debentures and units of equity-oriented mutual funds shall be calculated at their cost price.

## 28. Exposures permissible with prior approval of RBI

### 28.1 Working Capital Finance

AIFIs shall not be permitted to extend working capital finance, unless specifically permitted by the Reserve Bank.
**Provided that** AIFIs shall be permitted to extend working capital when banks are not in a position to meet the credit requirements of the counterparty concerned on account of temporary liquidity constraints.
**Provided further that** in case of a counterparty whose working capital is financed under a multiple banking arrangement, the AIFI shall obtain an auditor's certificate indicating the extent of funds already borrowed, before considering the request for further working capital finance.

## 29. Exposures not permissible

### 29.1 Revolving Underwriting Facility

AIFIs shall not be permitted to extend Revolving Underwriting Facility to Short Term Floating Rate Notes / Bonds or Debentures issued by companies.

**Annex 18**
**(section 21.7)**

**Illustrative examples of Economic Interdependence Criteria**

Requirement: Both A and B are customers of the AIFI and the exposure of the AIFI to each of them is more than 5% of its eligible capital base.

(i) Where 50% or more of one counterparty's gross receipts or gross expenditures (on an annual basis) is derived from transactions with the other counterparty

*Illustrative Example:*
Company A is a commercial space provider and company B utilises a major portion of this space and accounts for more than 50% of gross receipts for Counterparty A.

(ii) Where one counterparty has fully or partly guaranteed the exposure of the other counterparty, or is liable by other means, and the exposure is so significant that the guarantor is likely to default if a claim occurs;

*Illustrative Example:*
Company A fully or partly guarantees the loans undertaken by company B and the guarantee is so large that it could result in default in payments for A if it is invoked. AIFIs may consider parameters like networth, EBITDA, liquid assets, etc to assess whether the guarantor will be in a position to honour the claim on an on-going basis.

(iii) Where a significant part of one counterparty’s production/output is sold to another counterparty, which cannot easily be replaced by other customers;

*Illustrative Example:*
When a significant part of product/output/services of Company A is sold to Company B and there are no alternate buyers who can be approached if B fails to buy, in such a case goods may remain unsold and could lead to default in loan repayment by A. An auto part supplier and auto manufacturing firm could be part of the same economically dependent group based on this criteria. For deciding if the criteria would be applicable to the counterparties under consideration, AIFIs may use financial criteria like unsold inventory leading to operating loss/default in repayment as well as subjective criteria like ability of the seller to find alternate buyer/ market, R&D capability of the seller, etc.

(iv) When the expected source of funds to repay the loans of both counterparties is the same and neither counterparty has another independent source of income from which the loan may be serviced and fully repaid;

*Illustrative Example:*
Two auto component manufacturers i.e., company A and company B are suppliers to a commercial vehicle manufacturer i.e., company C. Source of funds for repayment of loans taken by A and B is dependent on sales to C. In this case, A and B are connected to each other based on the criteria of economic interdependence. Important factors to consider would be extent of dependence of A and B on C, ability of A and B to find another buyer, etc.

(v) Where it is likely that the financial problems of one counterparty would cause difficulties for the other counterparties in terms of full and timely repayment of liabilities;

*Illustrative Example:*
Company A supplies intermediate goods to Company C. Company C processes these goods and then sells it to company B. In such cases, difficulties at A could lead to difficulties for B. In such cases A and B are economically dependent. AIFIs may consider factors like financial strength of counterparty B to withstand the shock, its

ability to find alternate supplier in place of C, etc. to decide on applicability of the criteria.

(vi) Where the insolvency or default of one counterparty is likely to be associated with the insolvency or default of the other(s);

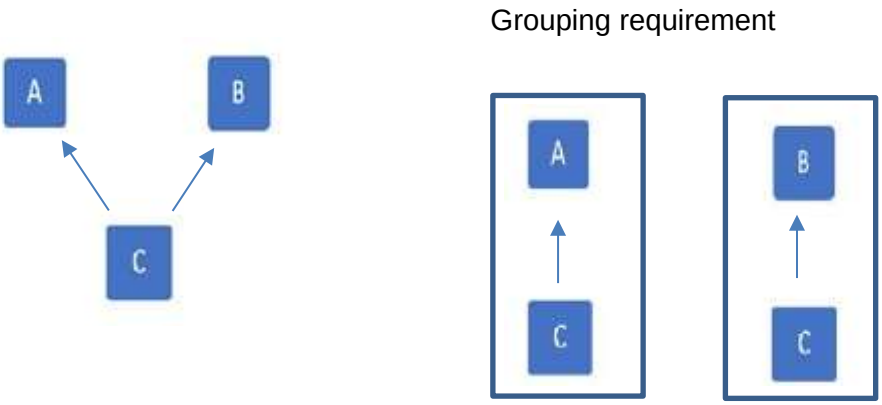
*Illustrative Example:*
Examples would include all such cases where insolvency or default of one company may lead to the insolvency or default of the other companies. AIFIs may use criteria such as intercorporate liabilities, significant trade receivables, etc. to decide on applicability of the criteria.

(vii) When two or more counterparties rely on the same source for the majority of their funding and, in the event of the common provider's default, an alternative provider cannot be found - in this case, the funding problems of one counterparty are likely to spread to another due to a one-way or two-way dependence on the same main funding source.

*Illustrative Example:*
Company A and Company B rely on the same non-AIFI source for their funding requirements and may not have access to alternative sources of funds. In such cases, difficulties at common source could lead to difficulties at both the companies and thus these companies are interconnected based on economic interdependence. Important factors to consider would be strength of A and B to decide alternate source of funds, likelihood of failure of the non-AIFI source, etc.

**Economic interdependence with two different entities**

If an entity (C) is economically dependent on two (or more) other entities (A and B) then payment difficulty of any one of the entities (A or B) may cause payment difficulties to dependent entity (C). Thus, C needs to be added in two different groups (A and C; B and C).



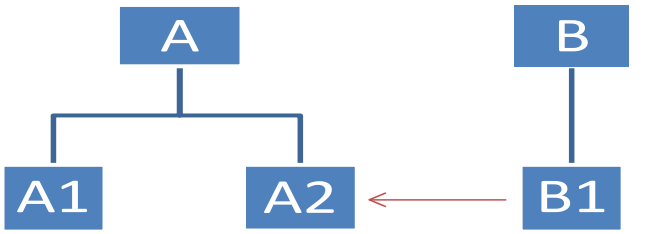

Since exposure to C is considered as single risk for two separate groups, it does not amount to double counting of exposure of C.

**Annex 19**
(**section 21.9**)

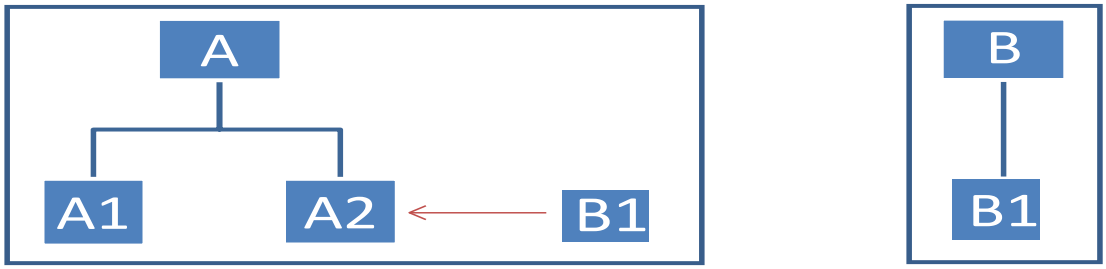
**Relation between interconnectedness through control and interconnectedness through economic dependency and illustration of grouping requirements**

Following examples provide illustrations for formulation of groups in case of one-way dependency and two-way dependencies.

(a) For example, consider A controls A1 and A2, and B controls B1, and B1 is economically dependent on A2 (one-way dependency only i.e., financial difficulties at A2 could impact B1 but not vice versa). In this case, B1 should be part of two separate groups of A and B.

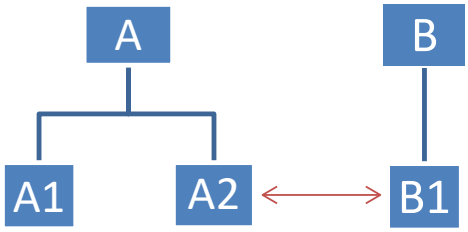



Grouping requirements:

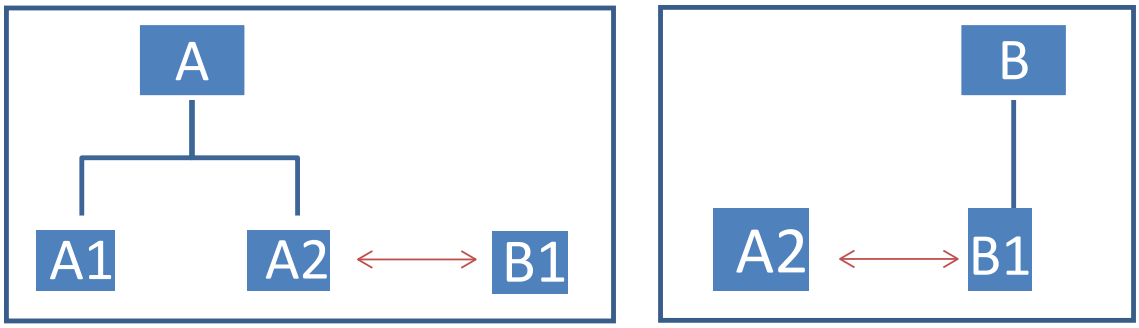



Three different groups of i) A, A1, A2, ii) B, B1, iii) A2, B1, may not be sufficient as financial difficulties of A2 is likely to cause difficulties for B1 also which is economically dependent on A2 (which in turn is dependent on A).

(b) In above example, consider that A2 and B1 have two-way economic dependency i.e., both are economically dependent on each other, which means that financial difficulty at either entity could impact the other entity.



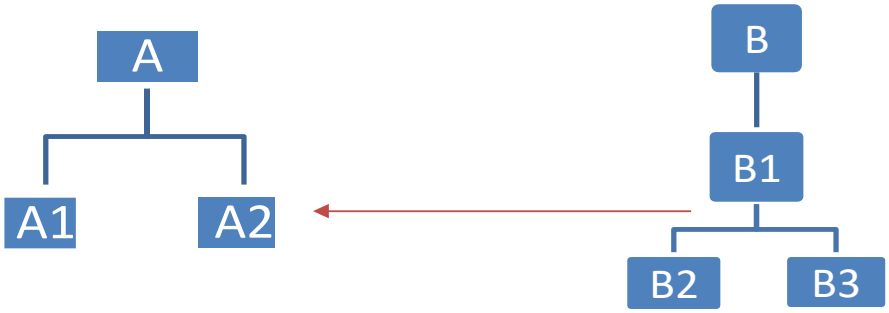

Grouping requirements:



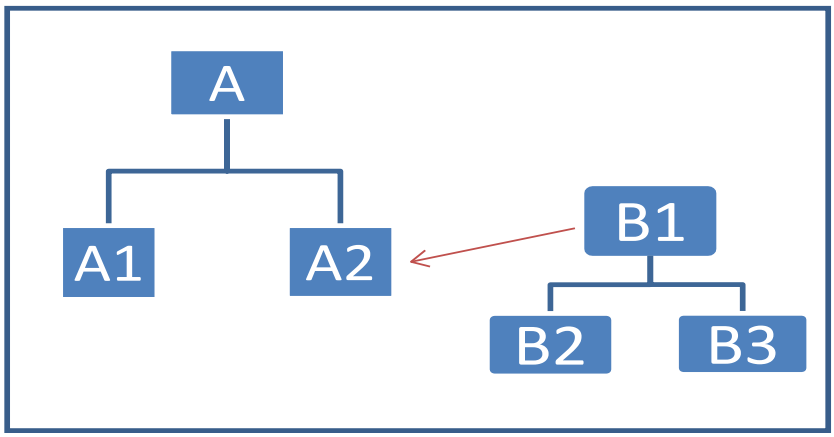
**Downstream Contagion**

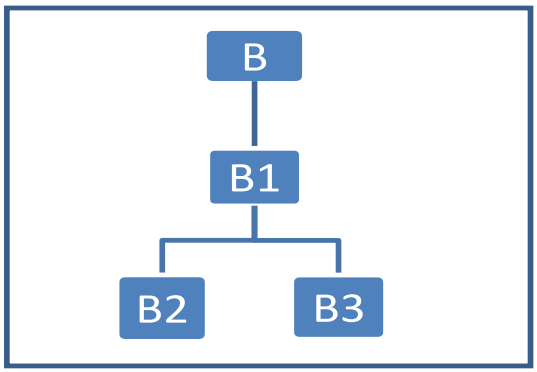
Downstream contagion should be assumed when an entity is economically dependent on another entity and is itself the head of a 'control group'. If the other entity is part of a group of connected clients, the control group of the economically dependent entity should then be included in the group of connected counterparties to which the economic dependency relationship exists. To overcome its own pending payment difficulties, the economically dependent entity is likely to withdraw resources from controlled entities, thus extending the risk of contagion downstream.

For example, consider A controls A1 and A2, and B controls B1, and B1 controls B2 and B3. Further, consider B1 has one-way economic dependency on A2. If A2 faces financial difficulty, it may impact B1 adversely, which then is likely to withdraw resources from its controlled entities B2 and B3.




Grouping requirements:

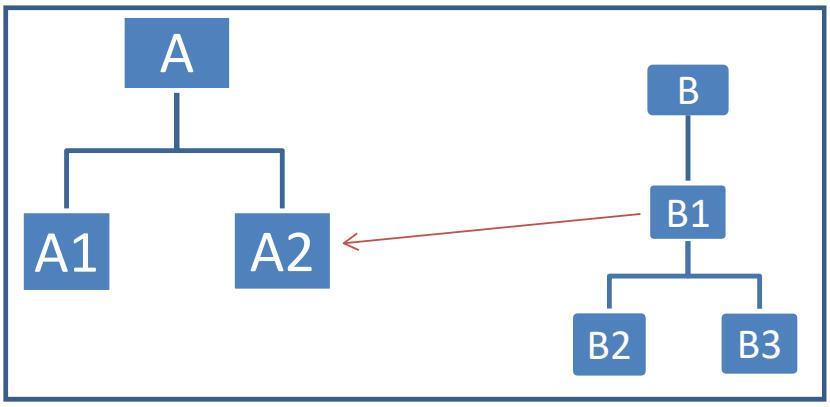


**Upstream Contagion**

On the other hand, upstream contagion of entities that control the economically dependent entity should be assumed only when the controlling entity is also economically dependent on the entity that constitutes the economic link between the two controlling groups.

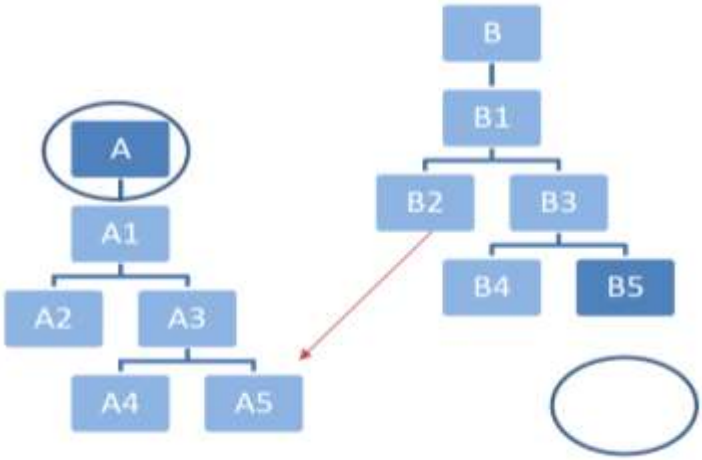
For instance, in the above example of downstream contagion, if B1 is so important to B that in a sense B is also dependent on B1, then contagion at A could also spread to B, through A→A2→B1→B and all these entities would form a single group.




**Limitations in formulating groups of connected counterparties**

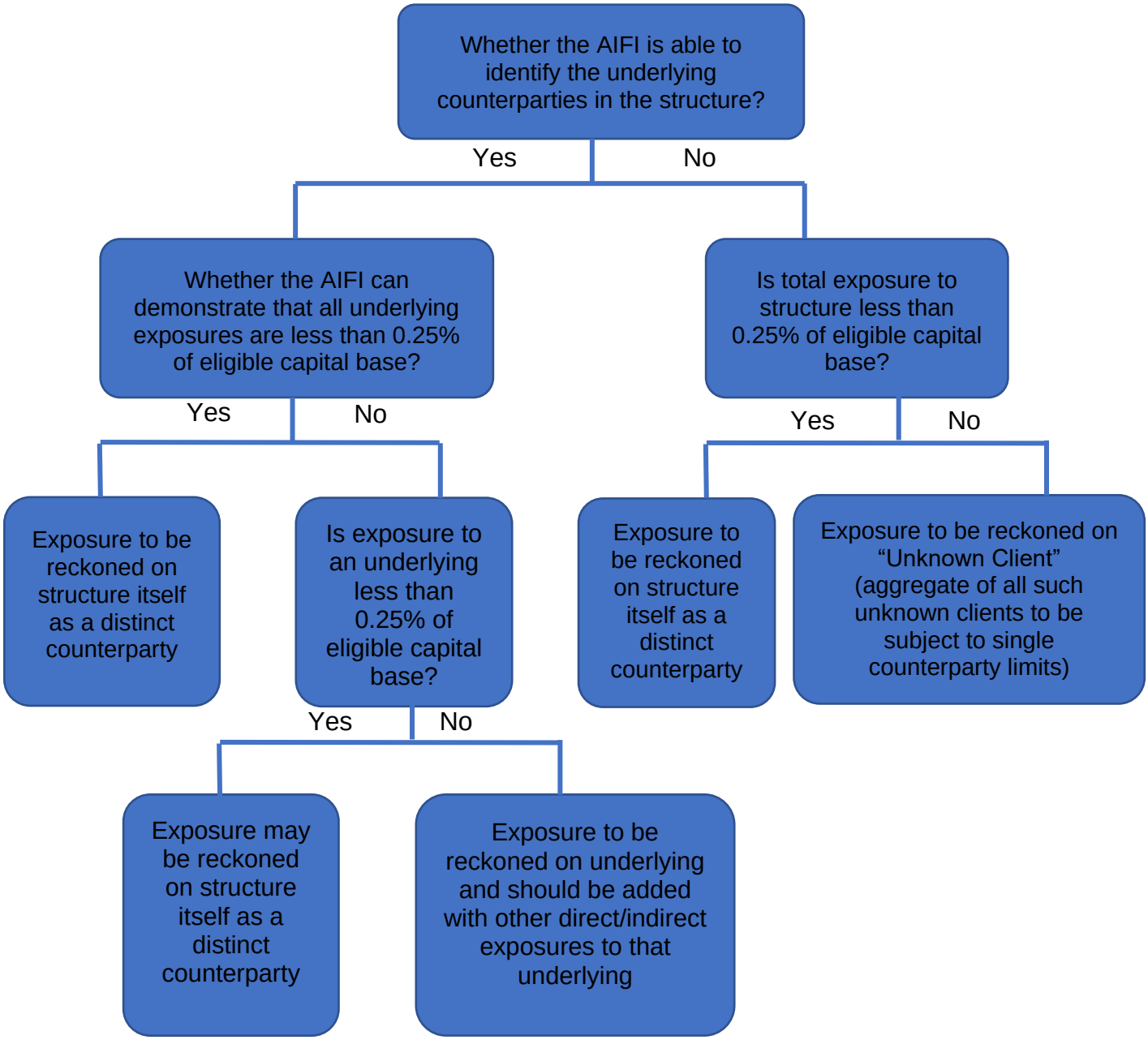
If an AIFI is not having exposure to all the entities, it may be difficult to accurately form group of connected counterparties. Such groups shall be formed on best efforts basis and AIFIs shall take reasonable steps to collect and use relevant information; this includes publicly available information (e.g., annual financial statements), information beyond institutions' clients and also soft information that typically exists at the level of individual loan officers and relationship managers. If there are interconnections among entities that are not clients of the AIFI, it may be difficult to formulate correct groupings. However, the AIFI shall incorporate any information that may be available to it publicly or through other clients or entities outside its clientele.

For instance, in illustration shown below, if AIFI has exposure to A and B5 only, then it may be difficult to formulate correct groupings.



**Annex 20**
(**section 22.4.1**)

**Look-Through Approach - a flow chart**



**Look-Through Approach - An Illustrative example (amounts in ₹. crore)**

AIFI's eligible capital base: 1000
Corpus of structure: 500
AIFI's investment in structure: 100 (which is 10% of eligible capital base i.e., more than 0.25% of eligible capital base)

Exposure values as per look-through approach:

| | **Investment of structure in that underlying** | | **AIFI's exposure to underlying through structure** | | **AIFI's other direct / indirect exposure to underlying** | | **Total exposure to underlying** | |
|---|---|---|---|---|---|---|---|---|
| | ***amount*** | ***as % of corpus*** | ***amount*** | ***as % of eligible capital base*** | ***amount*** | ***as % of eligible capital base*** | ***amount*** | ***as % of eligible capital base*** |
| Underlying 1 | 125 | 25.00% | 25 | 2.50% | 200 | 20.00% | 225 | 22.50% |
| Underlying 2 | 100 | 20.00% | 20 | 2.00% | 150 | 15.00% | 170 | 17.00% |
| Underlying 3 | 90 | 18.00% | 18 | 1.80% | 100 | 10.00% | 118 | 11.80% |
| Underlying 4 | 75 | 15.00% | 15 | 1.50% | 80 | 8.00% | 95 | 9.50% |
| Underlying 5 | 50 | 10.00% | 10 | 1.00% | 70 | 7.00% | 80 | 8.00% |
| Underlying 6 | 30 | 6.00% | 6 | 0.60% | 50 | 5.00% | 56 | 5.60% |
| Underlying 7 | 20 | 4.00% | 4 | 0.40% | 100 | 10.00% | 104 | 10.40% |
| Underlying 8 | 10 | 2.00% | 2 | 0.20% | 150 | 15.00% | 152 | 15.20% |

*Note:*
1. Exposure to underlying 8 (which is less than 0.25% of eligible capital base) may be counted as exposure on structure itself. Consequently, for underlying 8 total exposure to underlying will be 15.00% or 15.20% at the option of the AIFI.

2. Had the AIFI not been able to identify underlying exposures, entire exposure to the structure (i.e., 100, which is greater than 0.25% of eligible capital base) would be exposure on 'unknown client'. All such unknown clients would be treated as a single counterparty and single counterparty limit would apply on aggregate exposure to all such unknown clients.

**Annex 21**
(**section 25.3.1**)

**Return on Large Exposures**

| | |
|---|---|
| **Name of the AIFI** | |
| **Return for the Month** | |
| **Eligible Capital base (Tier I)** | **(₹ crore)** |

| **A. AIFI's 20 Largest Exposures to single counterparties (single as well as group of connected counterparties) irrespective of their values relative to AIFI's eligible capital base** | | | | |
|---|---|---|---|---|
| **Sl No.** | **Name of the Counterparty** | **Whether Single (S) or Group (G) of connected Counterparties** | **Exposure Amount** | **Exposure as % of Tier I Capital** |
| **1.** | | | | |
| **2.** | | | | |
| **3.** | | | | |
| **--** | | | | |
| **--** | | | | |
| **18.** | | | | |
| **19.** | | | | |
| **20.** | | | | |

| **B. AIFI's Large Exposures to with values equal to or above 10% of Tier I Capital** | | | | |
|---|---|---|---|---|
| **Sl No.** | **Name of the Counterparty** | **Whether Single (S) or Group (G) of connected Counterparties** | **Exposure Amount** | **Exposure as % of Tier I Capital** |
| 1. | | | | |
| 2. | | | | |
| -- | | | | |
| n | | | | |

| **C. AIFI's 20 other exposures (measured without effect of CRM) with values equal to or above 10% of Tier I capital (not including exposures reported in B already).** | | | | |
|---|---|---|---|---|
| **Sl No.** | **Name of the Counterparty** | **Whether Single (S) or Group (G) of connected Counterparties** | **Exposure Amount** | **Exposure as % of Tier I Capital** |
| 1. | | | | |
| 2. | | | | |
| -- | | | | |
| n. | | | | |

| **D. AIFI's exempted exposures with values equal to or above 10% of Tier I Capital** | | | | |
|---|---|---|---|---|
| **Sl No.** | **Name of the Counterparty** | **Whether Single (S) or Group (G) of connected Counterparties** | **Exposure Amount** | **Exposureas % of Tier I Capital** |
| 1. | | | | |
| 2. | | | | |
| -- | | | | |
| n. | | | | |

## Chapter IV- Significant Investments of AIFIs

The following instructions shall be read with the extant prudential norms on Exposures for the AIFIs.

### 30. Prudential limits for investments by AIFIs

AIFIs shall formulate policies, with the approval of their Board, covering the following aspects of investments in financial entities to the extent these are not covered under the cross holding limits prescribed under the Large Exposure Norms in Chapter III of these Directions.

### 30.1 Limits in terms of percentage of the paid up capital and reserves of the AIFI as per the last audited balance sheet or a subsequent balance sheet, whichever is lower

(i) Investment in equity of a single financial services entity which is not an affiliate of the AIFI

(ii) Aggregate investment in equity of all financial services entities which are not affiliates of the AIFI

(iii) Aggregate investment in equity of all financial services entities including the affiliates of the AIFI

(iv) The aggregate of equity investment in factoring subsidiaries and factoring companies

(v) Investment in equity of a single deposit taking NBFC

(vi) Equity/ Units of an Alternative Investment Fund (AIF) (other than Category III AIF) subject to the same being permitted under the statutory provisions contained in the respective AIFI's Act.

### 30.2 Requirement for approval of the Reserve Bank

**30.2.1** No AIFI shall, without the prior approval of the Reserve Bank, make:

(i) Investment in a subsidiary and a financial services company that is not a subsidiary.

Provided that such prior approval shall not be necessary in the following circumstances:

(a) The investment is in a company engaged in financial services; and

(b) The AIFI has minimum prescribed capital and has also made a net profit in the immediate preceding financial year; and

(c) The shareholding of the AIFI including the proposed investment is less than 10 per cent of the investee company's paid up capital; and

(d) The aggregate shareholding of the AIFI along with shareholdings, if any, by its subsidiaries or joint ventures or other entities directly or indirectly controlled is less than 20 per cent of the investee company's paid up capital.

Explanation: Prior approval of the Reserve Bank shall not be required if the investments in the financial services companies are held under the "Held for Trading" category and are not held beyond 90 days.

(ii) Investment in a non-financial services company in excess of 10 percent of such investee company's paid up share capital.

(iii) Investment of more than 10 per cent of the paid up capital/ unit capital in a Category I/Category II Alternative Investment Fund (AIF)

Provided that no AIFI shall make an investment in a Category III AIF. Investment by an AIFI's subsidiary in a Category III AIF shall be restricted to the regulatory minima prescribed by SEBI.

AIFIs shall ascertain the risks arising on account of equity investments in Alternative Investment Funds done directly or through their subsidiaries, within the Internal Capital Adequacy Assessment Process (ICAAP) framework and determine the additional capital

required which will be subject to review as part of Supervisory Review and Evaluation Process.

**30.2.2** AIFIs shall strictly adhere to the limits, both at an individual and aggregate level, on investments in subsidiaries, financial and non-financial entities prescribed Section 7.5.1 of Chapter II of these Directions read with Section 27.5 of Chapter III of these Directions.

**31. Procedure for seeking approval of the Reserve Bank:**

An AIFI desirous of making an investment that requires prior approval of the Reserve Bank shall make an application for its proposed investment along with the details of intended equity contribution in the subsidiary/ financial /non-financial services company, Board Note and Resolution approving the AIFI's proposal and the details of AIFI's existing equity contribution in its subsidiaries and other financial and non-financial services companies to the Department of Regulation, Central Office, the Reserve Bank, Mumbai.

**32. Relationship with subsidiaries**

A parent/ sponsor AIFI shall maintain an "arm's length" relationship with the subsidiary sponsored by it and evolve the following supervisory strategies:

(i) The Board of the parent/sponsor AIFI shall review the working of subsidiaries at periodical intervals.

(ii) The parent/sponsor AIFI shall undertake inspection/audit of the books of accounts of the subsidiaries at periodical intervals.

(iii) The subsidiary shall not set up another subsidiary, or promote a new company which is not a subsidiary thereof, or undertake any new business without prior approval of the Reserve Bank.
*Explanation:* 'New Business' shall not mean expansion into the same line of business that is already permitted/approved to be undertaken.

(iv) The subsidiary shall not make any portfolio investment in another existing company with an intention of acquiring controlling interest, without prior approval of the Reserve Bank. This shall not apply to the investments made by a Category I and II AIF set up by a subsidiary.

(v) A subsidiary shall not have any on-line access to customers' accounts maintained with the AIFI. The information between an AIFI and its subsidiary may be shared subject to maintaining arm's length relationship.

(vi) The AIFI shall not grant any unsecured advances to the subsidiary without prior approval of the Reserve Bank.

(vii) Transactions between an AIFI and its subsidiary shall be at arm's length. No preferential treatment shall be given to the subsidiary vis-à-vis a counterparty with similar risk characteristics.

## Chapter V - Prudential Norms for Classification, Valuation and Operation of Investment Portfolio by AIFIs

The Reserve Bank issues guidelines for the investment portfolio of the AIFIs, keeping in view the developments in the financial markets and taking into consideration the evolving international practices. This Chapter consolidates the guidelines/circulars issued by the Reserve Bank on prudential norms for classification, valuation and operation of investment portfolio by AIFIs.

### 33. Investment Policy Framework

**33.1** AIFIs shall adopt a comprehensive investment policy duly approved by the Board of Directors.

(i) The investment policy shall, at the minimum, include the broad investment objectives to be followed while undertaking investment transactions both on their own account and on behalf of clients, define securities in which investments can be made by the AIFI, derivatives in which the AIFI can deal, clearly define the authority to put through deals, procedure to be followed for obtaining the sanction of the appropriate authority, procedure to be followed while putting through deals, adherence to various prudential exposure limits, policy regarding dealing with brokers, systems for management of various risks, guidelines for valuation of the portfolio and the reporting system.

(ii) The investment policy shall be framed to ensure that transactions in securities and derivatives are conducted in accordance with sound and acceptable business practices.

(iii) The investment policy shall lay down prudential limits for investment in securities including those on private placement basis, sub-limits for PSU bonds, corporate bonds, guaranteed bonds, issuer ceiling, conservative limits for Zero-Coupon Bonds, etc. AIFIs shall ensure that their investments in issues through private placement, do not give rise to systemic concerns.

(iv) The investment policy shall stipulate minimum ratings / quality standards and industry-wise, maturity-wise, duration-wise, issuer-wise, etc., limits, for acquiring exposure in corporate bonds & debentures, to mitigate concentration risk and the risk of illiquidity.

(v) The investment policy shall cover in detail the procedure for investment in equities and the policy for managing associated risks. AIFIs shall also build an adequate expertise in equity research by establishing a dedicated equity research department, as warranted by their scale of operations.

(vi) The decision to make investment in securities[212] shall be taken by the Investment Committee set up by the AIFI's Board. The Investment Committee shall be held accountable for the investments made by the AIFI.

(vii) All investment proposals shall be subject to the same standards of credit appraisal as any loan proposal

(viii) AIFIs shall refer to the list of defaulters obtained from Credit Information Companies and Central Repository of Information on Large Credits (CRILC) while taking investment decisions.

(ix) AIFIs shall make their own internal credit analysis and assign internal rating even in respect of externally rated issues and shall not rely solely on the ratings of external credit rating agencies.

(x) AIFIs shall ensure robust internal credit rating systems which shall also include building up of a system of regular (quarterly or half-yearly) tracking of the financial position of

[212] Securities, for the limited purpose of this sub-section, shall mean direct investment in equity shares, preference shares, convertible bonds / debentures and equity-like products.

the issuer with a view to ensure continuous monitoring of the rating migration of the issuers / issues.

(xi) AIFIs shall settle the transactions in securities and derivatives as per procedure prescribed in notifications/directions/guidelines issued by the concerned regulator.

(xii) AIFIs shall hold their investments in securities, privately placed or otherwise, only in dematerialized form.

**33.2** The aforesaid instructions shall be applicable mutatis mutandis, to the subsidiaries established by AIFIs except to the extent they are contrary to or inconsistent with specific regulations of the Reserve Bank, Securities and Exchange Board of India (SEBI), and International Financial Services Centres Authority (IFSCA), governing their operations.

## 34. Classification of Investments

**34.1** AIFIs shall classify their entire investment portfolio under three categories viz. 'Held to Maturity' (HTM), 'Available for Sale' (AFS) and 'Held for Trading' (HFT). AIFIs shall decide the category of the investment at the time of acquisition and the decision shall be recorded on the relevant investment document/proposal.

### 34.2 Held to Maturity (HTM)

**34.2.1** The investments included under HTM category shall not exceed 25 per cent of the AIFI's total investments.

**34.2.2** Investments in following securities shall be eligible for inclusion under the HTM category:

(i) Debt securities

(ii) Equity held in the subsidiaries and joint ventures

(iii) Re-capitalisation bonds received from the Government of India towards their own re-capitalisation requirement and held in investment portfolio

Provided that recapitalization bonds of other banks/AIFIs acquired for investment purpose shall not be included under HTM category.

(iv) Unquoted shares/bonds/units of Category I and II Alternative Investment Funds (AIFs) for initial period of three years

**Provided that** the period of three years shall be reckoned separately for each disbursement made by the AIFI to Category I and II AIF as and when the committed capital is called up.

**34.2.3** The following investments shall not be accounted for the purpose of ceiling of 25 percent specified under section 34.2.1 of these Directions:

(i) Investments as specified in sub-sections 34.2.2(ii) and 34.2.2(iii) above; and

(ii) Investments made by AIFIs, as per their statutory mandates, in long-term bonds and debentures (i.e., having minimum residual maturity of three years at the time of investment) issued by non-financial entities.

**34.2.4** Profit on sale of investments in this category shall be first taken to the Profit & Loss Account, and thereafter shall be appropriated to the Capital Reserve Account'. The amount so appropriated shall be net of taxes and the amount required to be transferred to Statutory Reserves. Loss on sale shall be recognised in the Profit & Loss Account.

### 34.3 Available for Sale (AFS) & Held for Trading (HFT)

**34.3.1** The securities acquired by the AIFIs with the intention to trade by taking advantage of the short-term price / interest rate movements shall be classified under 'Held for Trading (HFT)'. Investments classified under HFT shall be sold within 90 days.

**34.3.2** The securities which do not fall under HTM or HFT shall be classified under 'Available for Sale (AFS)'. However, quoted equity shares / bonds/ units of Category I and II AIFs; and equity, debentures and other financial instruments acquired by way of conversion of outstanding principal and / or interest amount shall always be classified in the AFS category.

**34.3.3** The AIFIs shall have the freedom to decide on the extent of holdings under AFS and HFT categories after considering various aspects such as basis of intent, trading strategies, risk management capabilities, tax planning, manpower skills and capital position.

**34.3.4** Profit or loss on sale of investments in both the categories shall be taken to the Profit & Loss Account.

**35. Shifting among Categories**

**35.1** AIFIs shall have the freedom to shift investments to / from HTM category with the approval of the Board of Directors once a year.

**Provided that** such shifting shall normally be allowed at the beginning of the accounting year.

**Provided further that** no additional shifting to / from HTM shall be done during the remaining part of that accounting year unless explicitly permitted by the Reserve Bank

**35.2** Investments in unquoted units/shares/bonds of Category I and II AIFs kept in HTM and which have completed three years under HTM category shall be shifted to AFS at the beginning of the next accounting year in one lot to coincide with the annual transfer of investments from HTM category.

**35.3** Transfer of securities from AFS / HFT category to HTM category shall be made at the lower of book value or market value.

**Provided that** where the market value is higher than the book value at the time of transfer, the appreciation shall be ignored, and the security shall be transferred at the book value.

**Provided further that** in cases where the market value is lower than the book value, the provision for depreciation held against the security (including the additional provision, if any, required based on valuation done on the date of transfer) shall be adjusted to reduce the book value to the market value and the security shall be transferred at the market value.

**35.4** Transfer of securities from HTM to AFS / HFT category shall be subject to the following conditions:

(i) Security originally placed under the HTM category at a discount, shall be transferred to AFS / HFT category at the acquisition price / book value.

(ii) Security originally placed under the HTM category at a premium shall be transferred to the AFS / HFT category at the amortised cost.

(iii) Securities shall be immediately re-valued consequent to transfer and resultant depreciation, if any, shall be provided.

Note: Regarding (i) above, AIFIs shall not accrue the discount on the securities held under HTM category and such securities shall be held at acquisition cost till maturity.

**35.5** AIFIs shall have the freedom to shift investments from AFS to HFT with the approval of their Board / ALCO (Asset Liability Committee) / Investment Committee.

**Provided that** in case of exigencies, such shifting may be done with the approval of the Chief Executive of the AIFI / Head of the ALCO and shall be ratified by the Board / ALCO.

**35.6** Shifting of investments from HFT to AFS shall not be permitted.

**Provided that** such shifting shall be permitted only under exceptional circumstances where the AIFI is not in a position to sell the security within 90 days due to tight liquidity conditions, or extreme volatility, or market becoming unidirectional.

**Provided further that** such shifting shall be done only with the approval of the Board / ALCO / Investment Committee.

**35.7** In the case of transfer of securities from AFS to HFT category or vice-versa, the securities need not be re-valued on the date of transfer and the provisions for the accumulated depreciation, if any, held shall be transferred to the provisions for depreciation against the HFT securities and vice-versa.

**35.8** If the value of sales/transfers of securities to / from HTM category exceeds 5 per cent of the book value of investments held in HTM category at the beginning of the year, AIFIs shall disclose in the 'Notes to Accounts' to the Financial Statements, the market value of the investments held in the HTM category and the excess of book value over market value for which provision is not made.

**35.9** The regulatory limit of 5 per cent prescribed in section 35.8 shall not apply to shifting/sale of securities in the following scenarios:

(i) The one-time transfer of securities to/from HTM category with the approval of Board of Directors undertaken by AIFIs at the beginning of the accounting year.

(ii) Sales to the Reserve Bank under liquidity management operations of the Reserve Bank such as the Open Market Operations (OMO) and the Government Securities Acquisition Programme (GSAP).

(iii) Repurchase of Government Securities by Government of India under buyback / switch operations.

(iv) Repurchase of State Development Loans by respective state governments under buyback / switch operations.

(v) Additional shifting of securities explicitly permitted by the Reserve Bank.

## 36. Valuation of Investments

### 36.1 Held to Maturity (HTM)

**36.1.1** Investments classified under HTM category need not be marked to market.

**36.1.2** The investments shall be carried at acquisition cost unless it is more than the face value, in which case the premium should be amortised over the period remaining to maturity.

(i) The amortised amount shall be reflected in 'Schedule – Interest Earned - Income on Investments', as a deduction and need not be disclosed separately.
(ii) The book value of the security shall continue to be reduced to the extent of the amount amortised during the relevant accounting period.

**36.1.3** AIFIs shall recognize and provide individually for any diminution (other than temporary) in the value of each of their investments in subsidiaries / joint ventures, which are included under HTM.

**36.1.4** The need to determine whether impairment has occured is a continuous process and shall arise in the following circumstances:

(i) On the happening of an event which suggests that impairment has occurred, which, at the minimum, shall include
(a) the company has defaulted in repayment of its debt obligations.
(b) the loan amount of the company with any financial institution has been

restructured.

(c) the credit rating of the company has been downgraded to below investment grade.

(ii) When the company has incurred losses for a continuous period of three years and the networth has consequently been reduced by 25 per cent or more.

(iii) In the case of new company or a new project when the originally projected date of achieving the break-even point has been extended, i.e., the company or the project has not achieved break-even within the gestation period as originally envisaged.

**36.1.5** When the need to determine whether impairment has occurred arises in respect of a subsidiary, joint venture or a material investment, the AIFI shall obtain a valuation of the investment by a reputed/ qualified valuer and make provisions for the impairment, if any.

**36.1.6** Notwithstanding the provisions in section 34.2.2 above, investments in special securities received from the Government of India towards AIFI's recapitalisation requirement from FY 2024-25 onwards shall be recognised at fair value / market value on initial recognition in HTM. The fair value / market value of these securities shall be arrived on the basis of the prices / YTM of similar tenor Central Government securities put out by Financial Benchmarks India Pvt. Ltd. (FBIL). Any difference between the acquisition cost and fair value arrived as above shall be immediately recognized in the Profit and Loss Account.

### 36.2 Available for Sale (AFS)

**36.2.1** The individual securities in the AFS category shall be marked to market at quarterly or more frequent intervals. The book value of the individual securities shall not undergo any change after the marking to market.

**36.2.2** Securities (both domestic and foreign investments) shall be valued security-wise and depreciation/appreciation shall be aggregated for arriving at net depreciation/appreciation of investments for each classification [viz. (i) Government securities, (ii) Shares, (iii) Debentures & Bonds, (iv) Subsidiaries / joint ventures and (v) Others (to be specified)]. Net depreciation, if any, shall be provided for. Net appreciation, if any, shall be ignored.

**36.2.3** Net depreciation required to be provided for in any one classification shall not be reduced on account of net appreciation in any other classification.

### 36.3 Held for Trading (HFT)

**36.3.1** The individual securities shall be marked to market at monthly or at more frequent intervals and provided for as in the case of those in the AFS category.

**36.3.2** The book value of the individual securities shall not undergo any change with the marking to market.

### 36.4 Market Value

The 'market value' for the purpose of periodical valuation of investments included in the AFS and the HFT categories would be as under:

#### 36.4.1 Quoted Securities

The 'market value' for the quoted securities shall be the prices declared by the Financial Benchmarks India Pvt. Ltd. (FBIL) in accordance with the Reserve Bank circular FMRD.DIRD.7/14.03.025/2017-18 dated March 31, 2018, as amended from time to time. For securities whose prices are not published by FBIL, market price of quoted security shall be as available from the trades/ quotes on the stock exchanges/ reporting platforms/trading platforms authorized by the Reserve Bank/SEBI and prices declared by the Fixed Income Money Market and Derivatives Association of India (FIMMDA).

### 36.4.2 Unquoted Securities

#### 36.4.2.1 Central Government Securities

(i) Central Government Securities shall be valued on the basis of the prices / YTM rates put out by the FBIL.

(ii) Treasury Bills shall be valued at carrying cost.

#### 36.4.2.2 Special Securities[213] issued by the Government of India

All special securities issued directly by the Central Government shall be valued at a spread of 25 bps above the YTM rates for Central Government Securities of equivalent maturities as published by FBIL.

#### 36.4.2.3 State Government Securities

State Government securities shall be valued on the basis of the prices / YTM rates put out by the FBIL.

#### 36.4.2.4 Debentures/Bonds

(i) All debentures/bonds shall be valued on the YTM basis.

(ii) Debentures/bonds shall be valued with appropriate mark-up over the YTM rates for Central Government securities as put out by FBIL/FIMMDA.

(iii) The mark-up shall be determined according to the ratings assigned to the debentures/bonds by the rating agencies subject to the following:

(a) For rated debentures/bonds, the mark up shall be at least 50 basis points above the rate applicable to a Government of India security of equivalent maturity.

(b) For unrated debentures/bonds, the rate used for the YTM shall not be less than the rate applicable to rated debentures/bonds of equivalent maturity.
**Provided that** the mark up for the unrated debentures/bonds shall appropriately reflect the credit risk borne by the AIFI.

(c) Where the debenture/bond is quoted and there have been transactions within 15 days prior to the valuation date, the value adopted shall not be higher than the rate at which the transaction has been recorded on the exchanges/trading platforms/reporting platforms authorized by SEBI/Reserve Bank.

#### 36.4.2.5 Uday Bonds and Bonds issued by State Distribution Companies (Discoms) under Financial Restructuring Plan

(i) UDAY bonds shall be valued on basis of prices/yields published by FBIL.

(ii) Bonds issued and serviced by State distribution companies (i.e., when bonds' liabilities are with the state discoms) and which are guaranteed by state governments shall be valued by applying a mark-up of 75 basis points on YTM rates for Central Government Securities of equivalent maturities as published by FBIL.

(iii) Bonds issued and serviced by State distribution companies (i.e., when bonds' liabilities are with the state discoms) and which are not guaranteed by state governments shall be valued by applying a mark-up of 100 basis points on YTM rates for Central Government Securities of equivalent maturities as published by FBIL.

(iv) Bonds issued and serviced by the State Government (i.e., when bonds' liabilities are with the State Government) shall be valued by applying a mark-up of 50 basis points on YTM rates for Central Government Securities of equivalent maturities as published by FBIL.

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[213] At present, special securities comprise of Oil Bonds, Fertiliser Bonds, bonds issued to State Bank of India (during the 2008 rights issue), Industrial Finance Corporation of India and Food Corporation of India.

### 36.4.2.6 Zero Coupon Bonds (ZCBs)

(i) ZCBs shall be valued in the books at carrying cost which shall be computed by adding the acquisition cost and discount accrued at the rate prevailing at the time of acquisition, which shall be marked to market with reference to the market value.

(ii) In the absence of market value, the ZCBs shall be marked to market with reference to the present value of the ZCB.

***Explanation:*** *The present value of the ZCBs may be calculated by discounting the face value using the 'Zero Coupon Yield Curve', with appropriate mark up as per the zero-coupon spreads put out by FBIL/FIMMDA. In case the AIFI is still carrying the ZCBs at acquisition cost, the discount accrued on the instrument should be notionally added to the book value of the bond, before marking it to market.*

### 36.4.2.7 Preference Shares

(i) The valuation of preference shares shall be on YTM basis.

(ii) Preference shares shall be valued with appropriate mark-up over the YTM rates for Central Government Securities put out by the FBIL.

(iii) The mark-up shall be graded according to the ratings assigned to the preference shares by the rating agencies subject to the following:

(a) The YTM rate shall not be lower than the coupon rate/ YTM for a Central Government security of equivalent maturity.

(b) For unrated preference shares, the rate used for the YTM shall not be less than the rate applicable to rated preference shares of equivalent maturity and shall appropriately reflect the credit risk borne by the AIFI.

(c) Where investment in preference shares is as part of rehabilitation, the YTM rate shall not be lower than 1.5 per cent above the coupon rate/ YTM for Central Government security of equivalent maturity.

(d) Where preference dividends/coupons are in arrears, no credit shall be taken for accrued dividends/coupons and the value determined on YTM basis shall be discounted by at least 15 per cent if arrears are for one year, 25 per cent if arrears are for two years, so on and so forth (i.e., with 10 per cent increments with addition of each year of arrears). The overarching principle should be that valuation shall be based on conservative assessment of cash flows and appropriate discount rates to reflect the risk. Statutory Auditors should also specifically examine as to whether the valuations adequately reflect the risk associated with such instruments. The depreciation/provision requirement arrived at in the above manner in respect of non-performing shares where dividends are in arrears shall not be allowed to be set-off against appreciation on other performing preference shares.

(iv) Investments in preference shares as part of the project finance shall be valued at par for a period of two years after commencement of production or five years after subscription, whichever is earlier.

(v) The preference share shall not be valued above its redemption value.

(vi) When a preference share has been traded on stock exchange within 15 days prior to the valuation date, the value should not be higher than the price at which the share was traded.

### 36.4.2.8 Equity Shares

(i) The equity shares in the AIFI's portfolio shall be marked to market preferably on a daily basis, but at least on a weekly basis.

(ii) The unquoted equity shares or equity shares where current quotations are not

available, shall be valued at "break-up" value (without considering revaluation reserves, if any) to be derived from the company's latest balance sheet. The date as on which the latest balance sheet is drawn up shall not precede the date of valuation by more than 18 months.

(iii) In case, the latest balance sheet is not available, the shares shall be valued at ₹.1/- per company.

#### 36.4.2.9 Mutual Funds Units (MF Units)

(i) Investment in unquoted MF Units shall be valued on the basis of the latest re-purchase price declared by the MF in respect of each scheme.

(ii) In case of funds with a lock-in period, where repurchase price / market quote is not available, MF Units shall be valued at Net Asset Value (NAV). If NAV is not available, these shall be valued at cost, till the end of the lock-in period.

#### 36.4.2.10 Commercial Paper

Commercial paper shall be valued at the carrying cost.

#### 36.4.2.11 Investment in securities issued by Asset Reconstruction Companies (ARCs)

(i) Investments in the Security Receipts (SRs) / Pass-Through Certificates (PTCs) issued by ARCs, in respect of the financial assets sold by AIFIs to them, shall be recognised at the lower of:

(a) the redemption value of the SRs /PTCs, and

(b) the Net Book Value (NBV) (i.e., Book value less provisions held), of the financial asset.

(ii) The above investment shall be carried in the books of the AIFI at the price as determined above until its sale or realisation, and on such sale or realisation, the loss or gain shall be dealt with as under:

(a) The shortfall arising due to sale to ARC at a price lower than the net book value (NBV) (i.e., book value less provisions held) shall be debited to the profit and loss account of that year. AIFIs shall have the option to use countercyclical / floating provisions for meeting any shortfall on such sale.

(b) If the sale value is higher than the NBV, AIFIs shall have the option to reverse the excess provision on sale of NPAs to its profit and loss account in the year the amounts are received.

**Provided that** the reversal of excess provision arising out of sale of NPAs shall be limited only to the extent cash received (by way of initial consideration and / or redemption of SRs / PTCs) is higher than the net book value (NBV) of the asset.

(c) The valuation, classification and other norms applicable to investment in non-Government debt securities prescribed by the Reserve Bank from time to time shall be mutatis–mutandis applicable to AIFI's investment in debentures / bonds / security receipts / PTCs issued by ARC.

**Provided that** for valuation of instruments issued by ARC which are limited to the actual realisation of the financial assets assigned to the instruments in the concerned scheme, AIFIs shall reckon the Net Asset Value (NAV) obtained from ARC from time to time.

#### 36.4.2.12 Investment in Category I and II Alternative Investment Funds (AIFs)

(i) The quoted equity shares/ bonds/ units of Category I and II AIFs shall be marked to market preferably on a daily basis, but at least on a weekly basis.

(ii) Unquoted shares/ bonds/ units of Category I and II AIFs transferred from HTM to AFS category after completion of three years shall be valued as under:

**(a) Units:** Valuation shall be done at the NAV shown by the Category I and II AIF in its financial statements. Depreciation, if any, on the units based on NAV shall be provided at the time of shifting the investments to AFS category from HTM category as also on subsequent valuations which shall be done at quarterly or more frequent intervals based on the financial statements received from the AIF. At least once in a year, the units shall be valued based on the audited results. However, if the audited balance sheet / financial statements showing NAV figures are not available continuously for more than 18 months as on the date of valuation, the investments shall be valued at ₹.1/- per AIF.

**(b) Equity:** Valuation shall be done at the required frequency based on the break-up value (without considering 'revaluation reserves', if any) which shall be ascertained from the company's (AIF's) latest balance sheet (which should not be more than 18 months prior to the date of valuation). Depreciation, if any on the shares shall be provided at the time of shifting the investments to AFS category as also on subsequent valuations which shall be done at quarterly or more frequent intervals. If the latest balance sheet available is more than 18 months old, the shares shall be valued at ₹.1/- per AIF.

**(c) Bonds:** The investment in the bonds of Category I and II AIFs, if any, shall be valued as per guidelines prescribed for quoted/unquoted bonds in these Directions.

**36.4.2.13 Investment in equity/debt/other financial instruments acquired by way of conversion of outstanding advances**

(i) Equity, debentures and other financial instruments acquired by way of conversion of outstanding principal and / or interest shall be valued in accordance with the extant instructions on valuation of AIFIs' investment portfolio prescribed in these Directions.

(ii) Equity classified as standard asset shall be valued either at market value, if quoted, or at break-up value ascertained from the company's latest balance sheet, if not quoted (without considering the revaluation reserve, if any). The date as on which the latest balance sheet is drawn up should not precede the date of valuation by more than 18 months. In case the latest balance sheet is not available, the equity shares of the company held by the AIFI shall be valued at ₹.1/-.

(iii) Equity classified as NPA shall be valued at market value if quoted and in case it is not quoted it shall be valued at ₹.1/-.

(iv) Depreciation on the instruments acquired by way of conversion, whether classified as standard or NPA, shall not be offset against the appreciation in any other securities held under the AFS category.

## 37. Investments in Government Securities

In addition to the guidelines mentioned above, the following instructions shall be followed while transacting in Government securities:

### 37.1 Transactions through SGL Account

Transactions in Government Securities shall be undertaken through SGL/CSGL account, under the Delivery Versus Payment System, in accordance with the guidelines issued by the Reserve Bank from time to time.

### 37.2 Government Securities on When Issued Basis

Transaction undertaken on 'When Issued' basis in Government securities, shall be subject to the guidelines specified in the When Issued Transactions (Reserve Bank) Directions, 2018 issued vide FMRD.DIRD.03/14.03.007/2018-19 dated July 24, 2018, as amended from time to time.

### 37.3 Value Free Transfer (VFT) of Government Securities

Value free transfer in Government securities, shall be subject to the guidelines specified in IDMD.CDD.No.S930/11.22.003/2021-22 dated October 5, 2021, as amended from time to time.

### 37.4 Separate Trading of Registered Interest and Principal Securities (STRIPS)

Stripping / reconstitution of Government Securities shall be subject to the conditions laid down in guidelines IDMD.DOD.07/11.01.09/2009-10 dated March 25, 2010, as amended from time to time provided that accounting and valuation of such transactions shall be done as per instructions contained in **Annex 22**.

### 37.5 Repo in Government Securities

Repo transactions (including reverse repo transactions) entered by the AIFIs shall be subject to the guidelines specified in Directions FMRD.DIRD.01/14.03.038/2018-19 dated July 24, 2018, as amended from time to time.

### 37.6 Settlement of transactions in government securities

**37.6.1** The settlement of transactions in government securities shall be governed in accordance with the guidelines issued by the Reserve Bank from time to time.

**37.6.2** All the transactions put through by an AIFI, either repo transaction or on outright basis shall be reflected on the same day in its investment account.

**37.6.3** AIFIs shall follow 'Settlement Date' accounting for recording purchase and sale of transactions in Government Securities.

## 38. Investments in Non-Government Securities

In addition to the above-mentioned guidelines, AIFIs shall adhere to the following instructions while investing in non-government debt securities[214] in the primary as well as the secondary market:

**38.1** AIFIs shall invest only in listed non-government debt securities of companies which comply with the requirements of the SEBI, except to the extent permitted in section 38.2 as under.

### 38.2 Investment in unlisted Non-Government securities

**38.2.1** The total investment in the unlisted non-Government securities should not exceed 10 per cent of the AIFIs' total investment in non-government securities as on March 31 (June 30 in case of NHB) of the previous year.

**Provided that** such investments shall comply with the disclosure requirements as prescribed by SEBI for listed companies.

**Provided further that** investment in non-government securities (both primary and secondary market) where the security is proposed to be listed on the Exchange(s) shall be considered as investment in listed security at the time of making investment.

**Provided further that** in case such security is not listed within the period specified between

[214] Non-government securities for this chapter means securities issued by corporates, banks, financial institutions and State and Central Government sponsored institutions, Special Purpose Vehicles (SPVs) etc., units of debt-oriented mutual funds i.e., schemes where major of corpus is invested in debt securities, units of liquid/short term debt schemes (by whatever name called) and shall also include capital gains bonds.

issuance and listing, the same shall be reckoned for the 10 per cent limit specified for unlisted non-government securities.

**Provided further that** in case such investments included under unlisted non-government securities leads to a breach of 10 per cent limit, the AIFI shall not be allowed to make further investments in non-government securities (both primary and secondary market) as also in unrated bonds issued by companies engaged in infrastructure activities till such time AIFI's investment in unlisted non-government securities comes within the limit of 10 per cent.

**38.2.2** AIFIs, are permitted to make investment in unlisted non-Government securities of additional 10 per cent over and above the limit of 10 per cent specified in section 38.2.1 above

**Provided that** such investment is in Securitisation papers issued for infrastructure projects, and bonds/debentures issued by Securitisation Companies (SCs) and Reconstruction Companies (RCs) registered with Reserve Bank.

**38.2.3** Investment in units of mutual fund schemes having an exposure to unlisted securities of less than 10 per cent of the corpus of the fund, shall only be treated on par with listed securities for the purpose of compliance with the prudential limits prescribed above.

***Explanation:*** Exposure to the unlisted securities for compliance with the norm of less than 10 per cent of the corpus of the mutual fund scheme, shall not include Treasury Bills, Tri-Party Repo, Repo/ Reverse Repo and Bank Fixed Deposits in the numerator.

**38.2.4** Investment in the following securities shall not be reckoned as 'unlisted non-government securities' for computing compliance with the prudential limits prescribed in these Directions:

**(i)** Securities directly issued by the Central and State Governments, the units of Gilt Funds and securities directly issued by foreign sovereigns;

**(ii)** Equity Shares;

**(iii)** Units of the equity oriented mutual funds scheme, i.e. the schemes wherein a major part of their corpus is invested in equity;

**(iv)** Equity/Debt instruments/Units issued by Category I and II AIFs;

**(v)** Commercial Paper;

**(vi)** Certificates of Deposit;

**(vii)** Non-Convertible Debentures (NCDs) with original or initial maturity up to one year issued by corporates (including NBFCs)

**(viii)** Securities acquired by way of conversion of debt, subject to periodic reporting to the Reserve Bank;

**(ix)** Security Receipts issued by SCs / RCs registered with the Reserve Bank; and

**(x)** Asset Backed Securities (ABS) and Mortgage Backed Securities (MBS), rated at or above the minimum investment grade.

**Provided that**, there shall be close monitoring of exposures to ABS on an AIFI specific basis based on monthly reports submitted to the Department of Supervision, Reserve Bank under the Supervisory Reporting System.

**(xi)** Unlisted convertible debentures[215]

[215] Investments in these instruments shall be treated as "Capital Market Exposure".

**38.2.5** AIFIs shall compute the denominator i.e., 'total non-government investments', in the prudential cap stated above, by totaling investments classified under the following four categories in Schedule to the balance sheet, viz., 'shares', 'bonds & debentures', 'subsidiaries/joint ventures' and 'others'.

**38.3** AIFIs shall not invest in non-government securities of original maturity of less than one-year.
**Provided that** the above restriction shall not apply to investments in Commercial Papers, Certificates of Deposits and NCDs with original or initial maturity up to one year issued by corporates (including NBFCs), which are covered under the Reserve Bank guidelines.

**38.4** AIFIs shall not invest in ZCBs issued by corporates (including those issued by NBFCs).
**Provided that** the above prohibition shall not apply in cases where the issuer builds up a sinking fund for all accrued interest and keeps it invested in liquid investments / Government securities.

**38.5** AIFIs shall not invest in Low Coupon Bonds which carry very low coupons that are not market related and are redeemed at maturity with substantial premium.
**Provided that** the above prohibition shall not apply in cases where the issuer builds up a sinking fund to the extent of the difference in the accrued interest calculated on the basis of YTM applicable to the bond and the actual coupon payable on the bond and keeps it invested in liquid investments / securities such as Government bonds.

**38.6** AIFIs shall not invest in unrated debt securities.

**Provided that** the AIFIs shall have the option to invest in unrated bonds of companies engaged in infrastructure activities, within the ceiling of 10 per cent for unlisted non-Government securities as referred in section 38.2.1 of these Directions.

**Provided further that** this provision is not applicable on investments in securities referred in section 38.2.4 of these Directions.

**38.7 Repo in Corporate Bonds:**

AIFIs shall undertake repo in corporate bonds as per guidelines given in circular FMRD.DIRD.01/14.03.038/2018-19 dated July 24, 2018, as amended from time to time.

**38.8 OTC Transactions in Certificates of Deposit (CDs) and Commercial Papers (CPs) and Non-Convertible Debentures (original maturity up to one year):**

(i) Investment in CPs shall be as per guidelines given in FMRD.DIRD.2/14.01.002/2017-18 dated August 10, 2017 as amended from time to time.

(ii) Investment in NCDs (original maturity up to one year) shall be as per guidelines given in Section IV of FMRD.Master Direction No.2/2016-17 dated July 7, 2016 as amended from time to time.

(iii) Investment in CDs shall be as per guidelines given in FMRD.DIRD.03/14.01.003/2021-22 dated June 4, 2021 as amended from time to time.

**38.9 Trading and Settlement in Corporate Bonds and Securitised Debt Instruments**

**(i)** Trades in listed corporate bonds shall be executed as per guidelines issued by SEBI.

**(ii)** All the secondary market OTC trades in corporate bonds and securitized debt instruments shall be reported within fifteen minutes of the trade on any of the stock exchanges (NSE, BSE and MCX-SX) regulated by SEBI.
**(iii)** All OTC trades in corporate bonds and securitized debt instruments shall be cleared and settled through the National Securities Clearing Corporation Ltd. (NSCCL) or Indian Clearing Corporation Ltd. (ICCL) or MCX-SX Clearing Corporation Ltd. (MCX-SX CCL) as

per the norms specified by the NSCCL, ICCL and MCX-SX CCL from time to time.

**38.10 Other requirements**

(i) AIFIs shall undertake usual due diligence in respect of investments in non-Government securities.

(ii) AIFIs shall ensure that credit facilities for activities/purposes precluded by the Reserve Bank regulations are not financed by way of funds raised through the non-Government securities.

(iii) Except for unrated securities permitted in these Directions, AIFIs shall make investment in the debt securities with a credit rating of not less than investment grade from a Credit Rating Agency registered with the SEBI.

(iv) Disclosure requirements in offer documents

(a) The investing AIFIs shall file a copy of all offer documents with all Credit Information Companies (CICs) which have obtained certificate of registration from the Reserve Bank in terms of Section 5 of the Credit Information Companies (Regulation) Act, 2005. When the AIFIs themselves raise debt through private placement, they should also file a copy of the offer document with all the CICs. The investing AIFIs shall also report any default relating to payment of interest / repayment of instalment in respect of any privately placed debt all the CICs along with a copy of the offer document.

(b) AIFIs shall disclose the details of the issuer composition of non-Government investments and the non-performing non-Government investments in the 'Notes to Accounts' of the balance sheet, as indicated in **Annex 23**.

**39. Role of Boards**

**39.1** It shall be the responsibility of the Board to ensure proper risk management systems are in place for capturing and analyzing the risks in respect of investment in debt securities and for taking timely remedial measures.

**39.2** The Board shall review the following aspects of investment in debt securities at least at quarterly intervals:

(i) Total turnover (investment and divestment) during the reporting period.
(ii) Compliance with the prudential limits prescribed by the Board for such investments.
(iii) Compliance with the prudential guidelines issued by the Reserve Bank on such investments.
(iv) Rating migration of the issuers/ issues held in the AIFI's books and consequent diminution in the portfolio quality.
(v) Adequacy of the systems and procedures prescribed under AIFI's investment policy for investment in privately placed instruments.
(vi) Extent of non-performing investments in the category.

**40. Internal Control System**

The AIFIs shall, at a minimum, observe the guidelines prescribed in this section for establishing a robust internal control system in respect of investment transactions.

**40.1** There shall be a clear functional separation of (a) trading, (b) settlement, (c) monitoring and control, and (d) accounting.

**40.2** There shall be a functional separation of trading and back-office functions relating to AIFIs' own Investment Accounts, and other Constituents (including brokers') accounts.

**40.3** For every transaction entered into, the trading desk shall prepare a deal slip which shall contain data relating to nature of the deal, name of the counterparty, whether it is a

direct deal or through a broker, and if through a broker, name of the broker, details of security, amount, price, contract date and time. The deal slips shall be serially numbered and controlled separately to ensure that each deal slip has been properly accounted for. Once the deal is concluded, the dealer shall immediately pass on the deal slip to the back office for recording and processing. For each deal, there must be a system of issue of confirmation to the counterparty. Back-office shall monitor the timely receipt of requisite written confirmation from the counterparty, which shall include all essential details of the contract.

**40.4** Checks and balances such as periodic reconciliation of the investment book not later than once a quarter, procedure for recording, verification and passing vouchers, contract verification, valuation of portfolios, monitoring of prudential limits and risk limits, and monitoring of cancelled deals shall be put in place. Processes and controls for compliance with legal and regulatory requirements of reporting deals on various platforms shall be put in place.

**40.5** AIFIs shall adhere to the FIMMDA code of conduct while executing trades in Government Securities on NDS-OM and in the OTC market.

**40.6** Transactions in Government securities, money market instruments (call/notice/term money, CPs, CDs, repo in corporate bonds and Government securities, non-convertible debentures of original maturity less than one year etc.), derivatives and other instruments shall be undertaken as per instructions issued by the Reserve Bank from time to time.

**40.7** Balances of Government Securities as per AIFI's books shall be reconciled at quarterly intervals with the balances in the books of PDOs. If the number of transactions so warrant, the reconciliation should be undertaken more frequently, say monthly. The internal audit department shall periodically check this reconciliation.

**40.8** AIFIs shall ensure that the stockbrokers as directors on the Boards of AIFIs or in any other capacity, do not involve themselves in any manner with the Investment Committee or in the decisions about making investments in shares, etc., or advances against shares.

**40.9** AIFIs shall put in place a system to report to the top management, on a weekly basis, the details of transactions in securities, details of bouncing of SGL, and a review of investment transactions undertaken during the period.

**40.10** The AIFIs' management shall ensure that there are adequate internal control and audit procedures for ensuing proper compliance of instructions regarding the investment portfolio.

### 41. Engagement of Brokers

AIFIs shall, at the minimum, observe the guidelines prescribed in this section for engaging the service of brokers.

**41.1** AIFIs engaging services of brokers shall ensure that the role of the broker shall be restricted to that of bringing the two parties to the deal together.

**Provided that** transactions between one AIFI and a bank/other AIFI should not be put through the brokers' accounts.

**Provided further that** the above prohibition shall not apply to securities[216] transactions undertaken with banks or non-bank clients[217] through members of the National Stock

[216] Although the Securities Contracts (Regulation) Act, 1956 defines the term `securities' to mean corporate shares, debentures, Government Securities and rights or interest in securities, the term 'securities' here would exclude corporate shares.

[217] The Provident / Pension Funds and Trusts registered under the Indian Trusts Act, 1882, shall be outside the purview of the expression `non-bank clients'.

Exchange (NSE), BSE (formerly known as Bombay Stock Exchange) and MCX Stock Exchange (MCX-SX).

*Note: The broker is not obliged to disclose the identity of the counterparty before the conclusion of the deal.*

**41.2** The brokerage on the deal payable to the broker, if any (if the deal was put through with the help of a broker), shall be clearly indicated on the notes / memorandum put up to the top management seeking approval for putting through the transaction.

**41.3** On conclusion of the deal, AIFIs shall ensure that the broker note clearly indicates name of the counterparty and exact time of the deal. Their back-office shall ensure that the deal time on the broker note and the deal ticket is the same. The AIFI shall also ensure that their concurrent auditors review this aspect.

**41.4** The brokers shall not have any role in the process of settlement of deals. The settlement of the deal, viz., both fund settlement and delivery of security, shall take place directly between the counterparties.

**41.5** AIFIs shall not transact in Government Securities in physical form with any broker.

**41.6** AIFIs shall, with the approval of their top management, prepare a panel of approved brokers which shall be reviewed annually or more often if so warranted. The criteria for empanelment of brokers shall include, at the minimum, prior experience, creditworthiness, market reputation and details of regulatory action, if any. AIFIs shall maintain a record of broker-wise details of deals put through and brokerage paid.

### 41.7 Prudential *Limits*[218]

AIFIs shall ensure that a disproportionate part of the business is not transacted through only one or a few brokers. AIFIs shall fix aggregate contract limits for each of the approved brokers. The aggregate upper contract limit for each of the approved brokers shall be restricted to a limit of 5 per cent of total transactions (both purchase and sales) entered into by an AIFI through all brokers during a year.

**Provided that** the limit shall be observed with reference to the year under review and the AIFI shall keep in view the expected turnover of the current year which shall be based on turnover of the previous year and anticipated rise or fall in the volume of business in the current year.

**Provided further that** if for any reason it becomes necessary to exceed the aggregate limit for any broker, AIFIs shall record in writing the specific reasons for such breach and the Board shall be informed, post-facto.

**Provided further that** the business put through any individual broker or brokers in excess of the limit, with the reasons for the same, shall be covered in the half-yearly review to the Board of Directors/Local Advisory Board.

**Provided further that** the limit of 5 per cent shall not apply to dealings through PDs.

**41.8** These instructions shall mutatis-mutandis apply to subsidiaries of the AIFIs.

## 42. Audit, Review and Reporting

AIFIs shall, at the minimum, adhere to the following instructions in regard to audit, review and reporting of investment transactions:

**42.1** AIFIs shall undertake a half-yearly review (as of March 31 and September 30) of their investment portfolio and place the same before their Boards within two months, i.e., by end-

[218] This limit should cover both the business initiated by an AIFI and the business offered / brought to the AIFI by a broker.

May and end-November[219]. The review shall cover, at the minimum, operational aspects of investment portfolio, amendments made to the Investment Policy, major irregularities observed in all audit reports, compliance position thereto and certify adherence to laid down internal investment policy and procedures and Reserve Bank guidelines.

**42.2** A copy of the review report put up to the AIFI's Board, shall be forwarded to the concerned office of Department of Supervision by June 15 and December 15 (October 15 and March 15 for NHB), every year.

**42.3** Treasury transactions shall be separately subjected to concurrent audit by internal auditors and the results of their audit should be placed before the Chairman/ Managing Director (MD) of the AIFI once every month.

**42.4** The business done through brokers shall be audited by the same concurrent auditors who audit the treasury operations of the AIFI and the audit report shall be included in their monthly report to the Chairman/MD of the AIFI.

**42.5** The internal audit shall cover the transactions in securities on an ongoing basis, monitor compliance with the laid down management policies/prescribed procedures and report deficiencies directly to the management.

**42.6** The Audit Committee of the Board (ACB) shall review in every meeting the total fund based and non-fund based capital market exposure of the AIFI, ensure that the guidelines issued by the Reserve Bank are complied with and adequate risk management and internal control systems are in place. With respect to investment in shares, the surveillance and monitoring shall be done by the ACB.

**42.7** The ACB shall keep the Board informed about the overall exposure to capital market, the compliance with the Reserve Bank and Board guidelines, adequacy of risk management and internal control systems.

**42.8** AIFIs shall institute a regular system of monitoring compliance with the prudential and other guidelines issued by the Reserve Bank. The AIFIs shall get compliance in key areas certified by their statutory auditors and furnish such audit certificate to the Regional Office of Department of Supervision, Reserve Bank under whose jurisdiction the Head Office of the AIFI falls.

**42.9** ***Reconciliation of holdings of Government Securities – Audit Certificate***

(i) AIFIs shall furnish a 'Statement of the Reconciliation of AIFI's Investments, as at the end of every accounting year duly certified by their auditors. The statement shall be submitted to the Regional Office of the Department of Supervision, Reserve Bank under whose jurisdiction the AIFI's Head Office is located, within one month from the close of the financial year.

(ii) The aforementioned requirement of reconciliation shall suitably be included in the letters of appointment issued to the external auditors.

(iii) The format for the statement and the instructions for compiling the same are given in **Annex 24**.

## 43. Accounting and Provisioning

### 43.1 Income recognition

(i) AIFIs shall recognize income on accrual basis for the following:

[219] NHB shall undertake a half-yearly review (as of June 30 and December 31) of their investment portfolio and place the same before their Boards within two months, i.e., by end-September and end-February.

(a) securities of corporate bodies/public sector undertakings in respect of which the payment of interest and repayment of principal have been guaranteed by the Central Government or a State Government, provided interest is serviced regularly and as such is not in arrears.

(b) shares of corporate bodies provided dividend has been declared by the corporate body in its Annual General Meeting and the owner's right to receive payment is established.

(c) Government securities and bonds and debentures of corporate bodies, where interest rates on these instruments are predetermined and provided interest is serviced regularly and is not in arrears.

(ii) Income from units of mutual funds shall be recognized on cash basis.

### 43.2 Accounting for Broken Period Interest

AIFIs shall not capitalize the broken period interest paid to the seller as part of cost and treat it as an item of expenditure under Profit & Loss Account in respect of investments in government securities[220].

### 43.3 Investment Reserve Account (IRA)

(i) In the event, provisions created on account of depreciation in the 'AFS' or 'HFT' categories are found to be in excess of the required amount in any year, the excess shall be credited to the Profit & Loss Account and an equivalent amount (net of taxes, if any and net of transfer to Statutory Reserves as applicable to such excess provision) shall be appropriated to an IRA Account in Schedule – "Reserves & Surplus" under the head "Other Reserves".

(ii) IRA shall be eligible for inclusion under Tier 2 within the overall ceiling of 1.25 per cent of total Risk Weighted Assets prescribed for General Provisions/ Loss Reserves.

(iii) The amount drawn down from the IRA shall not be available to an AIFI for payment of divided.

(iv) The balance in the IRA transferred 'below the line' in the Profit and Loss Appropriation Account to Statutory Reserve, General Reserve or balance of Profit & Loss Account is eligible to be reckoned as Tier I capital.

(v) AIFIs shall have the freedom to utilise IRA as follows:

(a) The provisions required to be created on account of depreciation in the AFS and HFT categories shall be debited to the Profit & Loss Account and an equivalent amount (net of tax benefit, if any, and net of consequent reduction in the transfer to Statutory Reserve), shall be transferred from the IRA to the Profit & Loss Account[221].

(b) The amounts debited to the Profit & Loss Account for provision shall be debited under the head 'Other Income'.

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[220] This accounting treatment does not take into account the tax implications and AIFIs shall comply with the requirements of Income Tax Authorities as prescribed

[221] Illustratively, AIFIs shall have the option to draw down from the IRA to the extent of provision made during the year towards depreciation in investment in AFS and HFT categories (net of taxes, if any, and net of transfer to Statutory Reserves as applicable to such excess provision). In other words, an AIFI which pays a tax of 30 per cent and should appropriate 25 per cent of the net profits to Statutory Reserves, can draw down ₹.52.50 from the IRA, if the provision made for depreciation in investments included in the AFS and HFT categories is ₹.100.

(c) The amount transferred from the IRA to the Profit & Loss Account, shall be shown as 'below the line' item in the Profit and Loss Appropriation Account, after determining the profit for the year.

(d) Provision towards any erosion in the value of an asset is an item of charge on the profit and loss account, and hence shall appear in that account before arriving at the profit for the accounting period.

(e) Adoption of the following shall not only be adoption of a wrong accounting principle but would, also result in a wrong statement of the profit for the accounting period and AIFIs shall not make the following entries:

i. the provision is allowed to be adjusted directly against an item of Reserves without being shown in the profit and loss account, OR

ii. an AIFI is allowed to draw down from the IRA before arriving at the profit for the accounting period (i.e., above the line), OR

iii. an AIFI is allowed to make provision for depreciation on investment as a below the line item, after arriving at the profit for the period.

**43.4 Non-Performing Investments (NPI)**

(i) AIFIs shall not reckon income on the securities and shall also make appropriate provisions for the depreciation in the value of the investment in respect of securities included in any of the three categories of investments where interest/ principal is in arrears. AIFIs shall not set-off the depreciation requirement in respect of these non-performing securities against the appreciation in respect of other performing securities.

(ii) The criterion used to classify an asset as Non-Performing Asset (NPA) shall be used to classify an investment as Non-Performing Investment (NPI) i.e., an NPI is one where interest/ installment (including maturity proceeds) is due and remains unpaid for more than 90 days.

(iii) The above shall apply, *mutatis-mutandis*, to preference shares where the fixed dividend is not paid. If the dividend on preference shares (cumulative or non-cumulative) is not declared/paid in any year it shall be treated as due/unpaid in arrears and the date of balance sheet of the issuer for that particular year shall be reckoned as due date for the purpose of asset classification.

(iv) In the case of equity shares, in the event the investment in the shares of any company is valued at Re.1 per company on account of the non-availability of the latest balance sheet in accordance with section 36.4.2.8 of these Directions, those equity shares shall be reckoned as NPI.

(v) If any credit facility availed by the issuer is NPA in the books of the AIFI, investment in any of the securities, including preference shares issued by the same issuer shall also be treated as NPI and vice versa.
**Provided that** this stipulation shall not be applicable in cases where only the preference shares are classified as NPI, and in such cases, the investment in any of the other performing securities issued by the same issuer need not be classified as NPI and any performing credit facilities granted to that borrower need not be treated as NPA.

(vi) In case of conversion of principal and/or interest into equity, debentures, bonds, etc., such instruments shall be treated as NPA ab initio in the same asset classification category as the loan, if the loan's classification is substandard or doubtful on implementation of the restructuring package and provision shall be made as per the norms.

***(vii) Government guaranteed investments***

(a) Investment in State Government Guaranteed securities, shall attract prudential norms for identification of NPI and provisioning, when interest/ instalment of principal (including maturity proceeds) or any other amount due to the AIFI remains unpaid for more than 90 days.

(b) AIFI's investments in bonds guaranteed by Central Government shall not be classified as NPI until the Central Government has repudiated the guarantee when invoked. However, this exemption from classification as NPI shall not be available for the purpose of recognition of income.

**Annex 22**
**(section 37.4)**

## Separate Trading of Registered Interest and Principal Securities (STRIPS) - Accounting and Valuation

1. STRIPS shall be valued and accounted for as zero coupon bonds and in the manner prescribed in in these Directions.

2. The discount rates used for valuation of STRIPS at inception shall be market-based. However, in case traded zero-coupon rates are not available, the zero coupon yields published by FBIL shall be used instead.

3. Accounting entries in the SGL accounts as a consequence of stripping/reconstitution, shall be passed at the face value. SGL account of participant placing request for stripping shall be debited by the face value of the Government Security, and shall be simultaneously credited with the aggregate face value of Coupon STRIPS (equal to the aggregate coupon amounts) as well as the face value of Principal STRIPS (equal to the face value of the government security)[222].

4. On the day of stripping, the STRIPS shall be recognised in the books of account of the participant at their discounted value and at the same time, the Government Security in question shall be derecognised. The accounting treatment for reconstitution shall be exactly the opposite of stripping. The detailed procedure for accounting of STRIPS is given below.

4.1 The stripping/reconstitution shall not result in any profit or loss. The present value of the STRIPS (coupon as well as principal) discounted using the Zero Coupon Yield Curve (ZCYC) shall be normalized using a factor that will be the ratio of the book value or market value of the security (whichever is lower) to the sum total of the market value of all STRIPS created out of the security[223].

4.2 AIFIs can strip eligible Government Securities held under the AFS/HFT category of their investment portfolio.

4.3 In case STRIPS are created from securities held in the HTM portfolio, the securities shall be transferred from the HTM category to the AFS/HFT category as per these Directions. Thereafter, the lower of the book value/market value shall be used for normalizing the market value of individual STRIPS to the book value/market value. Post- stripping, the book value/market value of the existing securities shall be derecognized and replaced by the normalized value of STRIPS whose sum total shall exactly equal the book value/market value of the extinguished security (thereby ensuring that there is no profit or loss on account

[222] Reference is invited to illustration given in Annex 3 of circular no. IDMD.DOD.07/11.01.09/2009-10 dated March 25, 2010 on Guidelines on Stripping/Reconstitution of Government Securities.
[223] Reference is invited to illustration given in Annex 4 of circular no. IDMD.DOD.07/11.01.09/2009-10 dated March 25, 2010 on Guidelines on Stripping/Reconstitution of Government Securities.

of stripping). Any appreciation, arising due to the shifting of the security from HTM shall be ignored. The same methodology shall be followed for securities that are stripped from the AFS/HFT portfolio.

4.4 Before a security is stripped, it shall be marked to market. Appreciation, if any, shall be ignored and depreciation, if any, shall be recognised, if the market value is lower than the book value. Such depreciation shall not be aggregated for the purpose of arriving at net depreciation/appreciation of investment under the AFS/HFT category. The book value/ market value of the security, whichever is lower, shall be used to normalise the STRIPS.

4.5 The Normalisation principle, on stripping/reconstitution shall be applied on the clean price of the security (without considering the accrued interest) as the accrued interest is booked as income/expenditure.

4.6 Normalisation shall also be applied in the case of reconstitution (even when STRIPS are acquired from the market).

4.7 The book value of the STRIPS (ZCBs) shall be valued and marked to market as per these Directions. Accordingly, the book value of the STRIPS shall be marked up to the extent of accrued interest before MTM.

**Annex 23**
**(Section 38.10(iv)(b))**

**Format for Disclosure in the "Notes on Accounts" in the Published Financial Statements in respect of Non-Government investment portfolio**

## A. Issuer Composition of Non-Government Investments

| | | | | | | (Amounts in ₹. Crore) |
|---|---|---|---|---|---|---|
| **Sr. No.** | **Issuer** | **Total Amount** | **Amount of** | | | |
| | | | **Investment made through Pvt. Placement** | **"Below Investment" grade Securities Held** | **Unrated Securities Held** | **Unlisted Securities Held** |
| (1) | (2) | (3) | (4) | (5) | (6) | (7) |
| 1. | PSUs | | | | | |
| 2. | FIs | | | | | |
| 3. | Banks | | | | | |
| 4. | Private Corporates | | | | | |
| 5. | Subsidiaries / Joint Ventures | | | | | |
| 6. | Others | | | | | |
| 7. | Provision held towards depreciation | | | | | |
| | **Total*** | | | | | |
| # | Only aggregate amount of provision held to be disclosed in column 3. | | | | | |

***Notes**

1. Total under column 3 should tally with the total of investments included under the following categories in Schedule to the balance sheet:

   a. Shares
   b. Debentures & Bonds
   c. Subsidiaries / Joint Ventures
   d. Others

2. Amounts reported under columns 4, 5, 6 and 7 above might not be mutually exclusive

## B. Non Performing Investments

| **Particulars** | **Amount (₹. Crore)** |
|---|---|
| Opening Balance | |
| Additions during the year since 1st April | |
| Reductions during the above period | |
| Closing balance | |
| Total provisions held | |

**Annex 24**
**(Section 42.9(iii))**

**RETURN/STATEMENT**

Proforma Statement showing the position of Reconciliation of Investment Account as on 31st March (30th June in case of NHB)

**Name of the AIFI:**

**Face value ₹. in crore**

| **Particulars of Securities** | **General Ledger Balance** | **SGL Balance** | |
|---|---|---|---|
| | | **As per PDO Books** | **As per AIFI's books** |
| **1** | **2** | **3** | **4** |
| **Central Govt** | | | |
| **State Govt** | | | |
| **Public Sector Bonds** | | | |
| **Units of UTI (1964)** | | | |
| **Others (Shares & Debentures etc.)** | | | |
| **TOTAL** | | | |

**Signature of the Authorised Official with the Name and Designation**

**Note:**

*1. Similar statements shall be furnished in respect of PMS client's Accounts and other constituents' Accounts (including Brokers). In the case of PMS/other constituents' accounts, the face value and book value of securities appearing in the relevant registers of the AIFI shall be mentioned under Column 2.*

*2. Details of securities held on physical form (SGL Forms, scrips, letter of allotment, subscription receipt etc.), if any, may be provided in the footnote.*

**General instructions for compiling reconciliation statement**

**a) Column - 2 (GL balances)**

It is not necessary to give complete details of securities in the format. Only aggregate amount of face value against each category may be mentioned. The corresponding book value of securities may be indicated in bracket under the amount of face value of securities under each category.

**b) Column - 3 and 4 (SGL balances)**

In the normal course balances indicated against columns 3 and 4 shall agree with each other. In case of any difference on account of any transaction not being recorded either in PDO or in the books of the AIFI this shall be explained giving full details of each transaction.

## Chapter VI - Resource Raising Norms

AIFIs play an important role in the financial markets and facilitate raising of funds, allocation of resources, etc. Initially, the Reserve Bank had prescribed instrument-wise limits for mobilisation of resources by the select AIFIs through the specified instruments. The instrument-wise ceilings were replaced by an "umbrella limit" linked to the 'net owned funds' of the AIFI concerned, which constituted the overall ceiling for borrowing by the AIFI through the specified instruments. It has been decided to introduce Leverage Ratio for the AIFIs under Basel III Capital Regulations and dispense with the limits on the overall borrowings by AIFIs.

### 44. Umbrella Limit

**44.1** The aggregate borrowings under the umbrella limit shall not at any time exceed 100% of the Net Owned Funds of the AIFI as per its latest audited balance sheet or as approved by the Reserve Bank from time to time for individual AIFIs.

**44.2** The 'umbrella limit' shall consist of borrowings through four instruments viz., term deposits, term money borrowings, certificates of deposits (CDs) and commercial papers (CPs). The terms and conditions relating to resource mobilization by the AIFIs through the various instruments shall be governed by the norms prescribed in this Chapter.

### 45. Term Deposits

**45.1** AIFIs shall be permitted to raise term deposits for a maturity period of not less than one year and not exceeding five years.

**Provided that** the term deposits shall be issued in a minimum denomination of ₹10,000.

**Provided further that** AIFIs shall not pay brokerage exceeding 1% of the deposits accepted.

**45.2** AIFIs shall not allow premature withdrawal of term deposits before completion of one year

**Provided that** premature withdrawal of term deposits before completion of one year shall be permitted in case of death of the depositor, medical exigencies, educational expenditure and other such reasons approved by the Board of the AIFI.

**45.3** AIFIs shall have the freedom to fix their own penal rate of interest on premature withdrawal of deposits

**Provided that** for deposits where premature withdrawal has been made before completion of six months, no interest shall be payable to the depositor

**Provided further that** for deposits where premature withdrawal has been made on the date of or after completion of six months and before completion of one year, interest shall be payable at the rate of average of the minimum and maximum saving deposit rates as published in the Weekly Statistical Supplement (WSS) to the monthly Reserve Bank Bulletin.

**45.4** AIFIs shall mandatorily have their term deposits rated from a SEBI approved Credit Rating Agency.

**45.5** AIFI shall not be permitted to provide loans against the term deposits accepted, unless specifically permitted by the Reserve Bank.

### 46. Term Money Borrowings

**46.1** AIFIs shall be permitted to borrow through term money for a maturity period of not less than three months and not exceeding six months.

**46.2** AIFIs shall be free to fix the interest rates payable on the term money borrowings.

**46.3** AIFIs shall be permitted to borrow term money only from scheduled commercial banks and co-operative banks.

## 47. Certificates of Deposit (CDs)

**47.1** CDs shall be issued only in dematerialised form and held with a depository registered with Securities and Exchange Board of India.

**47.2** AIFIs shall be permitted to issue CDs to all persons resident in India

**47.3** CDs shall be issued in a minimum denomination of ₹5 lakh and in multiples of ₹5 lakh thereafter.

**47.4** The tenor of a CD at issuance shall not be less than one year and shall not exceed three years.

**Provided that** AIFIs shall not be permitted to buyback their own CDs before maturity.

**Provided further that** there shall be no grace period for repayment of CDs.

**Provided further that** no loans shall be sanctioned by AIFIs against their CDs, unless specifically permitted by the Reserve Bank

**47.5** CDs shall be issued on a T+1 basis where T represents the date of closure of the offer period for issuance of the CDs.

**47.6** AIFIs shall be permitted to issue CDs at a discount to face value.

**Provided that** CDs shall be permitted to be issued on a fixed/floating rate basis

**Provided further that** the interest rate on the floating rate CD shall be reset at periodic rests agreed to at the time of issue and shall be linked to a benchmark published by a Financial Benchmark Administrator or approved by the FIMMDA for this purpose.

**Provided further that** FIMMDA shall ensure that any floating rate approved by them for this purpose is determined transparently, objectively and in arm's length transactions.

**47.7** In the secondary market, CDs shall be traded either in Over-the-Counter (OTC) markets, including on Electronic Trading Platforms, or on recognised stock exchanges with approval of the Reserve Bank.

**Provided that** the settlement cycle for OTC trades in CDs shall be T+0 or T+1.

**Provided further that** all secondary market transactions in CDs shall be settled on a DvP basis through the clearing corporation of any recognized stock exchange or any other mechanism approved by the Reserve Bank.

### 47.8 Reporting requirements

(i) Details of primary issuance of a CD shall be reported by the issuer to the Trade Repository (TR), i.e., Financial Market Trade Reporting and Confirmation Platform ("F-TRAC") of the Clearing Corporation of India Ltd. (CCIL) by 5.30 PM on the day of issuance or as decided by the Reserve Bank from time to time.

(ii) All secondary market transactions executed in the OTC market and/or on recognised stock exchanges in CDs shall be reported, with time stamp, within 15 minutes of execution (the time when price is agreed) on the F-TRAC platform by each counterparty to the transaction.

**48. Commercial Papers (CPs)**

AIFIs shall be governed by the instructions contained in Reserve Bank Commercial Paper Directions, 2017 issued vide circular reference FMRD.DIRD.2/14.01.002/2017-18 dated August 10, 2017 as amended from time to time.

**49. Bonds**

**49.1** AIFIs shall be permitted to raise resources by way of issue of bonds, either by public issue or through private placement, without the prior approval of the Reserve Bank

**Provided that** the minimum maturity of the bond at issuance shall be 3 years.

**Provided further that** the interest/coupon payable to the investors shall be permitted to be either at a fixed rate or at a floating rate referenced to a market determined benchmark rate.

**Provided further that** no call or put or exit options (by whatever name called) on the bonds shall be exercisable before the expiry of one year from the date of issue of the bonds

**50.** AIFIs shall ensure to comply with the provisions of any directions, regulations or guidelines issued by any regulator or any other authority that may be applicable, in respect of issue of all the above-mentioned instruments.

## Chapter VII – Exemptions, Interpretations and Repeal

### 51. Exemptions

The Reserve Bank may, if it considers necessary for avoiding any hardship or for any other just and sufficient reason, grant extension of time to comply with or exempt any AIFI, from all or any of the provisions of these Directions either generally or for any specified period, subject to such conditions as the Reserve Bank may impose.

### 52. Interpretations

For the purpose of giving effect to 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 on all the parties concerned.

### 53. Repeal

**53.1** With the issue of these Directions, the instructions / guidelines contained in the following circulars shall stand repealed with effect from the date of issue of these Directions or date of applicability of the Directions wherever mentioned specifically.

| Sl. No. | Circular Number | Date of Issue | Subject |
|---|---|---|---|
| 1. | DBR.No.FID.FIC 5/01.02.00/2015-16 | January 7, 2016 | Master Circular- Prudential Norms for Classification, Valuation and Operation of Investment Portfolio by FIs- Amendment |
| 2. | DBR.No.FID.FIC.1/01.02.00/2015-16 | July 1, 2015 | Master Circular - Resource Raising Norms for Financial Institutions |
| 3. | DBR.No.FID.FIC.3/01.02.00/2015-16 | July 1, 2015 | Master Circular - Prudential Norms for Classification, Valuation and Operation of Investment Portfolio by FIs |
| 4. | DBR.FID.FIC.No.4/01.02.00/2015-16 | July 1, 2015 | Master Circular - Exposure Norms for Financial Institutions |
| 5. | DBOD.FID.FIC.No.8/01.02.00/2010-11 | November 02, 2010 | Prudential Norms for Off Balance Sheet Exposure - Bilateral Netting of Counterparty Credit Exposures |
| 6. | DBS.FID.No.C-1/01.02.00/2004-05 | July 26, 2004 | Annual Policy Statement for the year 2004-05 - Prudential Credit Exposure Limits by FIs |
| 7. | DBS.FID.No.C-15/01.02.00/2003-04 | June 15, 2004 | Risk Weight for Exposure to Public Financial Institutions (PFIs) |
| 8. | DBS.FID.No.C-12/01.02.00/2002-2003 | January 20, 2003 | Credit Exposure Norms - Measurement of Credit Exposure of Derivative Products - Methodology for Measurement |
| 9. | DBS.FIDNo.C-6/01.02.00/2002- 03 | August 31, 2002 | Capital Adequacy Norms - Risk Weight for Housing Loans and Mortgage Backed Securities |
| 10. | DBS.FID No. C-5/01.02.00/2002-03 | August 8, 2002 | Capital adequacy and credit exposure norms - Treatment of loans granted by Financial |

| Sl. No. | Circular Number | Date of Issue | Subject |
|---|---|---|---|
| | | | Institutions (FIs) against the guarantee of banks |
| 11. | DBS.FID.No.C-12/02.01.00/2001-02 | January 31, 2002 | Ready Forward Contracts |
| 12. | DBS.FID No. C-9 /01.10.00/2001-02 | November 29, 2001 | Capital adequacy norms - Treatment of preference shares - Grant equivalent |
| 13. | DBS.FID.No.C.8/01.02.00/2001-02 | November 28, 2001 | Norms for Entry of the All-India Financial Institutions into Insurance Business |
| 14. | DBS.FID.No.C.3/01.02.00/2001-02 | August 27, 2001 | Credit Exposure Norms - Applicability to Refinancing Institutions |
| 15. | DBS.FID No. C-1/01.02.00/ 2000-01 | August 7, 2001 | Capital Adequacy Standards – risk Weight on Staff Loans and Advances |
| 16. | DBS.FID.No.C-3 /01.02.00/2001-02 | August 2, 2001 | Credit exposure norms – applicability to refinancing institutions |
| 17. | DBS.FID.No.C-26/01.02.00/2000-01 | June 20, 2001 | Monetary and Credit policy Measures, 2001-02 - Credit Exposure Norms |
| 18. | DBS.FID No.C.8/01.03.00/2000-001 | October 11, 2000 | Monetary and Credit Policy Measures – Prudential Norms on Income Recognition, Asset Classification, Provisioning, etc. – Provision on Standard Assets |
| 19. | DBS.FID.No.C-16/01.10.00/99-2000 | April 27, 2000 | Income Recognition, Asset Classification and Capital, Adequacy Standards - Take-out Finance |
| 20. | DBS.FID.No.C-14/01.10.00/99-2000 | April 04, 2000 | Valuation of Investments in Mutual Funds |
| 21. | DBS.FID.No.C-12/01.10.00/99-2000 | January 07, 2000 | Income Recognition, Asset Classification, Provisioning and other Related Matters and Capital Adequacy Standards - Take out Finance |
| 22. | DBS.FID.No.C-7/01.02.00/99-2000 | November 13, 1999 | Credit Exposure Norms for Individual Borrowers |
| 23. | DBS FID. No.C-6/01.02.00/99-2000 | November 13, 1999 | Risk Weight for Market Risk in Investment Portfolio of Non-Government Securities |
| 24. | DBS.FID.No.196/01.02.00/99-2000 | September 16, 1999 | Capital Adequacy Standards - Risk Weight on Assets |
| 25. | DBS.FID.No.40/01.02.00/98-99 | April 28, 1999 | Issue of Subordinated Debt for Raising Tier II Capital |
| 26. | DBS FID.No.41/01.10.00/98-99 | April 28, 1999 | Capital Adequacy Standards |
| 27. | DBS.FID.No.752/01.10.00/98-99 | April 21, 1999 | Capital Adequacy Standards |
| 28. | DBS.FID.No.37/02.01.01/98-99 | January 11, 1999 | Lending to Non-Banking Financial Companies-Bill |

| Sl. No. | Circular Number | Date of Issue | Subject |
|---|---|---|---|
| | | | Discounting |
| 29. | DBS.FID.No.507/01.02.00/98-99 | January 2, 1999 | Strengthening of Prudential Norms-Risk weight on Banks' Investments in Bonds/ Securities Issued by Financial Institutions |
| 30. | DBS.FID.No.36/01.02.00/98-99 | December 8, 1998 | Capital Adequacy Standards |
| 31. | DBS.FID.No.35/01.02.00/98-99 | December 3, 1998 | Strengthening of Prudential Norms |
| 32. | DBS.FID.No.25/01.10.00/97-98 | February 2, 1998 | Capital Adequacy Standards |
| 33. | DBS.No.FID.20/02.01.00/97-98 | December 12, 1997 | Limits on Credit Exposures of Term-Lending Institutions to Individual/Group Borrowers |
| 34. | DBS.No.FID.18/01.02.00/97-98 | September 09, 1997 | Limits on Credit Exposure of Term-Lending Institutions to Individual/Group Borrowers |
| 35. | FIC.No.12/01.10.00/96-97 | May 02, 1997 | Income Recognition, Asset Classification, Provisioning and other Related Matters - Depreciation on investments |
| 36. | FIC.No.10/01.10-00/96-97 | March 21, 1997 | Income Recognition, Asset Classification, Provisioning and other Related Matters |
| 37. | FIC.No.05/01.10.00/96-97 | January 11, 1997 | Capital Adequacy Standards - Subordinated Debts |
| 38. | FIC.No.04/01.10.00/96-97 | January 11, 1997 | Capital Adequacy Standards - Subordinated Debts |
| 39. | FIC.No.641/01.10.00/95-96 | March 7, 1996 | Capital Adequacy Standards |
| 40. | Paragraphs 7 and 8 FIC.No.520/01.10.01/95-96 | January 11, 1996 | Income Recognition, Asset Classification, Provisioning and other Related Matters and Capital Adequacy Standards |
| 41. | FIC.No.183/02.01.01/95-96 | August 18, 1995 | Lending to Non-Banking Financial Companies (NBFCs) |
| 42. | FIC.No.842/01.02.00/93-94 | March 29, 1994 | Capital Adequacy Standards |

**53.2** All approvals / acknowledgements given under the above circulars shall be deemed as given under these Directions.