Banking hours/working hours/Operation

- Banks are required to function for public transactions at least for 4 hours on week days and 2 hours on Saturdays in the larger interest of public and trading community. Extension counters, satellite offices, one man offices or other special class of branches may remain open for such shorter hours as may be considered necessary.
- Banks may fix, after due notice to customers, whatever business hours are convenient i.e. double shift, weekly holiday other than Sunday, or functioning Sundays also (7 days working) etc.
- The banks' branches in rural areas can fix the business hours (i.e., number of hours, as well as timings) and the weekly holidays to suit local requirements subject to the guidelines.
- Commencement of employees' working hours 15 minutes before commencement of business hours could be made operative by banks at branches in metropolitan and urban centres.
- Banks are required to extend business hours for banking transactions other than cash till one hour before close of working hours. Banks can have evening counters at the premises of existing branches in metropolitan/urban centres for providing facilities to the public beyond normal business hours to bring about improvement in customer service and the transactions should be merged with the main accounts of the branch where it is set up.
- All branches except very small branches should have "Enquiry" or "May I help You" counters either exclusively or combined with other duties located near the entry point of the banking hall. Time norms should also be displayed prominently in the banking hall.
- All Branch branches are required to display the various products and services they provide along with various key aspects such as service charges, interest rates, time norms for various banking transactions and grievance redressal mechanism, etc. grouped in 4 heads viz. "Customer Service Information", "Service Charges", "Grievance redressal" and "Others" as indicators in the Notice Boards as per the format provided by RBI. This would enhance the quality of customer service in banks and level of customer satisfaction.
- Further, in addition to the above Board, the banks should also display details such as 'Name of the bank / branch, Working Days, Working Hours and Weekly Off-days' outside the branch premises.
- Banks are further required to make available the detailed information in their Web-site in such a manner that customers are able to easily access the same from the Home Page of the site, besides in booklet form in the touch screen by placing them in the information kiosks or Scroll Bars, or Tag Boards. Website should contain the minimum information such as Policy/Guidelines, Complaints, Opening of accounts/ forms, Loans and Advances, Branches, etc.

Sick/old/incapacitated account holders — Operational Procedure

In case the old/sick/ incapacitated account holder can put his thumb or toe impression, the same may be accepted for withdrawal of money. It should be identified by two independent witnesses known to the bank, one of whom should be a responsible bank official.

- Where the customer cannot put even his/her thumb impression and also not able to present in the bank, a mark can be obtained on the cheque/withdrawal form which should be identified by two independent witnesses, one of whom should be a responsible bank official.
- Person to whom the payment is to be made may be indicated by the customer in both the above cases and he should be identified by two independent witnesses. The person should be asked to furnish his signature to the bank.
- As per the opinion obtained by IBA, a toe impression or any mark by a customer who lost both the hands can be taken for acceptance.

– Banks are required to take necessary steps to provide all **existing ATMs / future ATMs** with ramps so that wheel chair users / persons with disabilities can easily access them and also make arrangements in such a way that the height of the ATM does not create an impediment in its use by a wheelchair user.

– Banks are required to ensure that all the banking facilities such as cheque book facility including third party cheques, ATM facility, Net banking facility, locker facility, retail loans, credit cards etc., are invariably offered to the **visually challenged without any discrimination.**

– Banks are required to make at least one third of new ATMs installed as talking ATMs with Braille keypads and place them strategically in consultation with other banks to ensure that at least one talking ATM with Braille keypad is generally available in each locality for catering to needs of visually impaired persons.

– In respect of disabled persons with autism, cerebral palsy, mental retardation and multiple disabilities Banks can rely upon the **Guardianship Certificate** issued either by the District Court under Mental Health Act or by the Local Level Committees under the above Act for the purposes of opening / operating bank accounts.

Remittance

– Remittance (DD/MT/TT, etc.) of ₹ 50000/- and above should be by debit to customer's account or against cheques only. DDs of ₹ 20,000/- and above are to be issued **with "Account Payee" crossing** only.

– A DD is uniformly valid for a period of **three** months and procedure for revalidation after three months should be simplified.

– Duplicate Draft in lieu of lost for amount upto and including **₹ 5000/-** can be issued against suitable indemnity without waiting drawing advice within a fortnight from the date of receipt of the request. Delay beyond the period, penal provision to be invoked.

– Banks may ensure that both drop box facility and the facility for acknowledgement of cheques are made available at collection centres (branches) and no branch should refuse to give acknowledge of cheques if tendered at the counters. Banks should display on the drop box itself that "Customers can also tender the cheques at the counter and obtain acknowledgement on the pay-in-slips".

– Banks may place per transaction limits based on their risk perception in respect of Mobile transactions with the approval of their respective Boards.

– In order to assist migrant population who do not have access to formal banking channel for want of proof of identity/address, banks are permitted to put in place three schemes for **person to person (P2P) fund transfers** viz.

(a) **Cash Pay-out scheme** which facilitates transfer of funds from the accounts of their customers to beneficiaries not having bank accounts through the use of ATMs, BCs etc. upto '**₹ 10,000 per transaction** subject to a monthly cap of **'₹ 25,000** with full details of the beneficiary

(b) **Cash Pay-in scheme** where a walk-in / non-account holding customer can transfer funds to a bank account of a beneficiary etc. upto **'₹ 5000/-** per transaction with a monthly cap of ' **₹ 25,000** with minimum details of the remitter.

(c) **Card-to-Card transfers** up to '**₹ 5000** per transactions subject to a monthly cap of **₹ 25,000.**

– Banks need not make payment of cheques/drafts/pay orders/ banker's cheques bearing that date or any subsequent date, if they are presented beyond the period of three months from the date of such instrument (w.e.f. 01.04.12)

– For loss of cheque in transit or in clearing process or at the paying bank's branch, the banks are required to reimburse the accountholder related expenses for obtaining duplicate instruments and also interest for reasonable delays occurred in obtaining the same. The onus rests with the collecting banker and not the account holder.

General

Complaints

- Banks are required to provide Complaints/suggestion box at each office besides maintaining Complaint Book/Register with perforated copies in each set. A copy of the complaint is also to be forwarded to Controlling Office along with remark of the Branch Manager within a time frame.
- Complaint form along with name of the nodal officer for complaint redressal be provided in the Homepage of Website to facilitate submission by customers. Complaints received are to be reviewed by Board for taking corrective steps wherever required. The details are to be disclosed in the financial results giving the number of complaints received, redressed, Awards by Ombudsman, etc.
- Banks are also required to put in place a proper Grievance Redressal Mechanism and examine on an on-going basis whether it is found effective in achieving improvement in customer service in different areas.

Erroneous Debits arising on fraudulent or other transactions

- While opening and allowing operation in deposit accounts, banks should remain vigilant to avoid lapses to safeguard against unscrupulous persons opening accounts mainly to use them as conduit for fraudulently encashing payment instruments, etc.
- In such cases, banks should compensate the customer upon completion of departmental action or police interrogation as part of their approved Customer Relation Policy.

Safe Deposit Locker/Safe Custody Article Facility

- Banks have to refrain from restrictive practices such as linking the lockers facility with placement of fixed or any other deposit beyond what is specifically permitted. Banks may obtain Fixed Deposits to cover 3 years rent and charges of breaking open the locker to take care of an eventuality that the locker-hirer neither operates the locker nor pays rent.
- Bank branches are required to maintain a wait list for the purpose of allotment of lockers and ensure transparency in allotment of the lockers. A copy of the Agreement may be passed on to the locker-hirer at the time of allotment of the locker.
- Banks may carry out customer due diligence for both new and existing customers at least to the levels prescribed for customers classified as medium risk. If the customer is classified in a higher risk category, customer due diligence as per KYC norms applicable to such higher risk category should be carried out.
- Where the lockers have remained unoperated for more than three years for medium risk category or one year for a higher risk category, banks should immediately contact the locker-hirer and advise him to either operate the locker or surrender it. This exercise should be carried out even if the locker hirer is paying the rent regularly.
- Nomination facility is available to locker hirer which would provide for nomination and release of contents of safety lockers/safe custody article to the nominee and protection against notice of claim of other persons (Sec. 45ZC to 45 ZF of B.R. Act 1949)
- Nomination facility can be made available in respect of deposits held in the name of individuals (single/ Joint accounts) including sole proprietorship concerns and Safe Deposit Locker/Safe Custody. Nomination shall be made only in favour of individuals and a nominee cannot be an Association, Trust, Society or any other Organisation or any office-bearer thereof in his official capacity

– There cannot be more than one nominee in respect of a joint deposit account. In the case of a joint deposit account the nominee's right arises only after the death of all the depositors.

– Banks may allow variation/cancellation of a subsisting nomination by all the surviving depositor(s) acting together. This is also applicable to deposits having operating instructions "either or survivor".

– Banks are required to acknowledge in writing to the depositor(s)/ locker hirers (s) the filing of the relevant duly completed Form of nomination, cancellation and / or variation of the nomination.

– Banks may introduce the practice of recording on the face of the passbook the position regarding availment of nomination facility with the legend "Nomination Registered". This may be done in the case of term deposit receipts also.

Deceased Depositors – Settlement of claims – Procedure thereof

Accounts with survivor/nominee clause

In case there exists a valid nomination and the deposit account is opened with the survivorship clause ("either or survivor" or "anyone or survivor" or "former or survivor" or "latter or survivor"), bank can make payment of the balance in the deposit account to the survivor(s)/nominee of a deceased deposit account holder which is considered as a valid discharge of the bank's liability provided:-

(a) The bank has exercised due care and caution in establishing the identity of the survivor(s)/ nominee and fact of death of the account holder through appropriate documentary evidence; there is no order from the competent court restraining the bank from making the payment from the account of the deceased; and

(b) Survivor(s)/nominee has been advised in clear terms that he would be receiving the payment from the bank as a trustee of the legal heirs of the deceased depositor.

Banks may desist from insisting production of succession certificate, letter of administration or probate, etc., or obtain any bond of indemnity or surety from the survivor(s)/nominee, irrespective of the amount standing to the credit of the deceased account holder.

Accounts without the survivor/nominee clause

– In deceased deposit accounts without the survivor/nominee clause, banks may fix some minimum threshold limit for settlement of claim without insisting on production of any documents other than indemnity.

– Premature termination of Term deposit accounts would not attract any penalty and such clause may be incorporated in the opening form itself.

– Any claim on the balances lying in deceased depositors received from survivor(s) / nominee(s) should be settled within a period not exceeding 15 days from the date of receipt of the claim subject to the production of proof of death of the depositor and suitable identification of the claim(s), to the bank's satisfaction.

Access to Safe Deposit Locker/Safe Custody articles (with survivor/nominee clause)

– In the event of death of sole locker hirer, banks may give access to the locker with liberty to remove the contents of the locker to the nominee and in case of the locker hired jointly with operational instruction to operate under joint signatures and nomination exists, bank may give access to the locker with liberty to remove the articles jointly to the survivor(s)/nominee.

– In the case of the locker was hired jointly with survivorship clause and the hirers instructed that the access of the locker should be given over to "either or survivor", "anyone or survivor" or "former or survivor" or according to any other survivorship clause, banks may follow the mandate in the event of the death of one or more of the locker-hirers.

Access to Safe Deposit Locker/Safe Custody articles (without survivor/nominee clause)

- Banks are required to evolve a customer-friendly procedure drawn up in consultation with their legal advisers for giving access to legal heir(s) / legal representative of the deceased locker hirer. Similar procedure should be followed for the articles under safe custody of the bank.
- Banks are also required to prepare an inventory before returning articles left in safe custody/before permitting removal of the contents of the safe deposit locker. Banks are not required to open sealed/closed packets left with them in Safe Custody or found in locker while releasing them to the nominee and surviving locker heirs/depositor of safe custody article. Banks are required to put in their website the entire procedure for improvement in customer service.

Settlement of claims in respect of missing persons

Banks are required to formulate a policy which would enable them to settle the claims of a missing person after considering the legal opinion and taking into account the facts and circumstances of each case (claims are to be settled as per provisions u/s 107/108 of Indian Evidence Act 1872).

In order to avoid inconvenience and undue hardship to the common person, banks may, keeping in view their risk management systems, fix a threshold limit, up to which claims in respect of missing persons could be settled without insisting on production of any documentation other than (i) FIR and the non-traceable report issued by police authorities and (ii) letter of indemnity.

Unclaimed deposits/Inoperative Accounts in banks

- A savings as well as current account should be treated as inoperative / dormant if there are no transactions in the account for over a period of two years.
- If credits by way of interest on Fixed Deposit account is being received in the Savings Bank accounts as per the mandate of the customer, the same can be treated as a customer induced transaction and the account can be treated as an operative account. It will become inoperative only after 2 years from the date of the last credit entry of the interest on Fixed Deposit account.
- Banks need to ascertain the whereabouts of the account holder(s) by letters, telephone calls, or contacting legal heirs, or contacting the introducers or employers as available record or any other means suited to them in case of no operations (credits other than periodic interest or debiting service charges) for more than one year.
- Periodical interest should continue to be credited in the inoperative accounts and proceeds of FDR unpaid, the amount left unclaimed should attract Savings Bank rate of interest. Inoperative accounts should get audited periodically. There should not be any charge on activation of an inoperative account.

Customer Confidentiality Obligations

Banks are not supposed to divulge any information about the account to third parties except where:-

(a) disclosure is under compulsion of law

(b) there is duty to the public to disclose

(c) interest of bank requires disclosure and

(d) the disclosure is made with the express or implied consent of the customer.

The information collected from the customer for the purpose of opening of account is to be treated as confidential and not divulge any details thereof for cross selling or any other purposes.

Transfer of account from one branch to another

Instructions from customer for transfer of his account to another office should be carried out immediately by transferring the account opening form, specimen signature, standing instructions, etc. under advice to the customer.

Co-ordination with officers of Central Board of Direct Taxes

Banks should maintain greater co-ordination between the Income-Tax department and extend necessary help/ co-ordination to tax officials whenever required.

Declaration of Holiday under the Negotiable Instruments Act, 1881

- In terms of Section 25 of the Negotiable Instruments Act, 1881, the expression "public holiday" includes Sunday and any other day declared by the Central Government by notification in the Official Gazette to be a public holiday.
- This power has been delegated to State Govt. by Central Govt. subject to the condition that the Central Government may itself exercise the said function, should it deem fit to do so and this implies that when Central Government itself has notified a day as "public holiday" under Section 25 of the Negotiable Instruments Act, 1881, there is no need for banks to wait for the State Government notification.

Miscellaneous

- In predominantly residential areas banks may keep their branches open for business on Sundays by suitably adjusting the holidays and banks should keep rural branches open on weekly market day.
- Banks are required to accept standing instructions in Savings and Current accounts and the same can be enlarged to include payments on account of taxes, bills, rents, school/college fees, etc.
- Branch Manger may be permitted to allow clean overdraft for small amounts to customers whose dealings have been satisfactory.
- All transactions, including payment of interest on deposits/charging of interest on advances, should be rounded off to the nearest rupee
- In order to keep a watch on the progress achieved by the bank in the implementation of the recommendations of various working groups/Committees on customer service, banks may examine the recommendations which have relevance in the present day banking and continue to implement them.
- Banks should follow various provisions of the Code of Bank's Commitment to Customers, implementation of which is monitored by the Banking Codes and Standards Board of India (BCSBI), etc.

ANNEXURE II

CAPITAL ADEQUACY AND MARKET DISCIPLINE-NEW CAPITAL ADEQUACY FRAMEWORK (NCAF)

BASEL II

The Basel Capital Accord is an Agreement concluded among country representatives in 1988 to develop standardised risk-based capital requirements for banks across countries. The Accord was replaced with a new capital adequacy framework (Basel II), published in June 2004. The Revised Framework was updated in November 2005 followed by a comprehensive version of the framework was issued in June 2006.

Basel II is based on three mutually reinforcing Pillars that allow banks and supervisors to evaluate properly the various risks that banks face. The Pillars are:

(i) Minimum capital requirements, which seek to refine the present measurement framework

(ii) Supervisory review of an institution's capital adequacy and internal assessment process;

(iii) Market discipline through effective disclosure to encourage safe and sound banking practices

(i) Minimum Capital Requirement (Pillar I)

The New Capital Adequacy Framework (NCAF) provides three distinct options each for computing capital requirement for credit risk and operational risk as under:-

Credit Risk

(a) Standardised Approach

(b) Foundation Internal Rating Based Approach

(c) Advanced Internal Rating Based Approach

Operational Risk

(a) Basic Indicator Approach

(b) Standardised Approach

(c) Advanced Measurement Approach

All commercial banks (excluding Local Area Banks and Regional Rural Banks) are required to adopt Standardised Approach (SA) for Credit Risk and Basic Indicator Approach (BIA) for Operational Risk for computing capital to Risk Weighted Assets (CRAR) so as to fall in line with the International standards and reporting to their Boards on quarterly intervals.

With the up gradation of the risk management framework and likely accrual of capital efficiency thereto envisaged under Basel II as also the emerging international trend in this regard, it was considered desirable to lay down a timeframe for migration to the advanced approaches for credit risk and operational risk and accordingly a time frame has been drawn factoring the likely lead time for creating requisite technological and the risk management infrastructure etc. Banks were also advised to migrate to the approach, of course, with suitable approval from RBI.

Capital Funds

– Tier I CRAR is computed as under:-

$$\text{Tier I CRAR} = \frac{\text{Eligible Tier I capital funds}}{\text{Credit Risk RWA* + Market Risk RWA + Operational Risk RWA}}$$

* RWA = Risk weighted Assets

– Banks are required to maintain a minimum Total CRAR of 9% on an ongoing basis. The RBI will take into account the relevant risk factors and the internal capital adequacy assessments of each bank to ensure that the capital held by a bank is commensurate with the bank's overall risk profile. Total CRAR is worked out as under:-

$$\text{Total CRAR} = \frac{\text{Eligible total capital funds}}{\text{Credit Risk RWA + Market Risk RWA + Operational Risk RWA}}$$

– Capital funds are classified into Tier I and Tier II capital. Tier II capital will be reckoned to the extent of 100% of Tier I capital for the purpose of capital funds.

Tier I capital

It includes:-

(a) Paid-up equity capital, statutory reserves, and other disclosed free reserves, if any;

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

(c) Innovative perpetual debt instruments (IPDI) eligible for inclusion in Tier I capital,

(d) Perpetual Non-Cumulative Preference Shares (PNCPS),

(e) Any other type of instrument generally notified by RBI from time to time for inclusion in Tier I capital.

Limits on eligible Tier I Capital

(a) IPDIs upto 15% of Tier I capital as on March 31of previous financial year;

(b) The outstanding amount of Tier I preference shares i.e. Perpetual Non-Cumulative Preference Shares (PNCPS) along with Innovative Tier I instruments shall not exceed 40 per cent of total Tier I capital at any point of time.

(c) Innovative instruments/PNCPS, in excess of the limit shall be eligible for inclusion under Tier II, subject to limits prescribed for Tier II capital.

Tier II Capital

(a) Revaluation Reserve;

(b) General Provisions and Loss Reserves;

(c) Hybrid debt capital instruments;

(d) Subordinated debts;

(e) IPDI in excess of 15% of Tier I capital and PNCPS in excess of overall ceiling of 40% of Tier I capital;

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

Limits on eligible Tier II capital

(a) It shall not exceed 100% of Tier I capital net of goodwill, Deferred Tax Assets (DTA), and other intangible assets but before deduction of investments;

(b) Subordinated debt instruments are limited to 50% of Tier I capital after all deductions.

1. Capital charge for Credit Risk

Claims on Domestic Sovereigns (standard Assets)

(a) Both fund based and non fund based claims on the Central Government including Central Govt. guaranteed claims carry zero risk weight.

(b) Direct Loans/credit/overdraft exposure, if any, of banks to State Govt. and investment in State Govt. securities carry zero risk weight. State Government guaranteed claims will attract 20 per cent risk weight'.

(c) Risk weight applicable to Central Govt. exposure would also apply to claims on RBI, DI&CGC and Credit Guarantee Fund Trust for Small Industries (CGTSI) and claim on ECGC would attract 20% risk weight.

(d) 'Amount Receivable from GOI' under Agricultural Debt Waiver Scheme 2008 is to be treated as claim on GOI and attract zero risk weight whereas the amount outstanding in the accounts covered by the Debt Relief Scheme shall be treated as a claim on the borrower and risk weighted as per the extant norms.

Claims on Foreign Sovereigns

Claims on Foreign Sovereigns in foreign currency would be as per the rating assigned as detailed in the RBI circular. In case of claims dominated in domestic currency of Foreign Sovereign met out of the resources in the same currency, the zero risk weight would be applicable.

Claims on Public Sector Entities (PSE)

Claims on domestic PSEs and Primary Dealers (PD) would be risk weighted in the same manner that of corporate and foreign PSEs as per the rating assigned by foreign rating agencies as detailed in the Circular.

Other claims

- Claims on IMF, Bank for International Settlements (BIS), Multilateral Development Banks (MDBs) evaluated by the BCBS will be treated similar to claims on scheduled banks at a uniform 20% risk weight.
- Claims on Banks incorporated in India and Foreign Banks' branches in India, the applicable risk weight is detailed in the RBI Master Circular.
- Claims on corporate Asset Finance Companies (AFCs) and Non-Banking Finance Companies-Infrastructure Finance Companies (NBFC-IFC), shall be risk weighted as per the ratings assigned by the rating agencies registered with the SEBI and accredited by the RBI (Detailed in the Circular).
- The claims on non-resident corporate will be risk weighted as per the ratings assigned by international rating agencies.
- Regulatory Retail claims (both fund and non-fund based) which meet the Qualifying criteria, viz.

(a) **Orientation Criterion**: Exposure to individual person/s or to a small business (Average annual turnover less than ₹ 50 crore for last 3 years or projected turnover in case of new units);

(**b**) **Product Criterion**: Exposure (both fund-based and non fund-based) in form of revolving credits and lines of credit (incl. overdrafts), term loans & leases (e.g. instalment loans and leases, student and educational loans) and small business facilities and commitments

(**c**) **Granularity Criterion** – Sufficient diversification to reduce the risk portfolio; and

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

Would attract risk weight of 75% except NPAs.

(e) Home loans to individuals upto ₹ 30 Lakh backed by mortgage on residential property, the risk weight would be 50%; and above ₹ 30 Lakh but below ₹ 75 Lakh 75% provided the Loan to Value ratio (LTV) should not be more than 75% based on bank's approved valuation policy. LTV beyond 75% will attract a risk weight of 100%.

(f) The risk weight for residential housing loans of ₹ 75 Lakh and above irrespective of the LTV ratio will be

125% and restructured accounts at 25%.

(g) Commercial real estate exposure, the risk weight is to be taken at 100%.

Non-performing Assets (NPAs)

– The risk weight in respect of the unsecured portion of NPA (other than a qualifying residential mortgage loan), net of specific provisions (including partial write-offs), shall be:-

Specific Provisions	*Risk Weight %*
Less than 20% of outstanding	150
At least 20% of outstanding	100
At least 50% of outstanding	50

– The risk weight applicable for secured NPA is 100%, net of provisions when provisions reach 15% of the outstanding amount.

– NPA Home Loan claims secured by residential property, the risk weight shall be 100% net of specific provisions. In case the specific provisions are at least 20% but less than 50% of the outstanding, the risk weight shall be 75% (net of specific provisions) and specific provisions are 50% or more the applicable risk weight is 50%.

Other specified categories

	Category	*Risk Weight (%)*
01.	Venture capital	150 or higher
02.	Consumer credit including personal loans, credit card receivables, but excl. educational loan	125
03.	Capital market exposure	125
04.	Investment in paid up capital of Non-financial entities	125
05.	*Investment in paid up capital of financial entities (other than banks) where investment is upto 30% of equity of investee entity.*Investment exempted from 'capital market exposure'	125100
06.	Staff loans backed fully by superannuation benefits and/or mortgage of flat/house	20
07.	Other loans and advances to staff eligible for inclusion under retail portfolio	75
08.	All other assets	100
09.	Off balance sheet items (Market related and non-market related items)	As detailed in the RBI Circular.
10.	Securitization Exposure	As per Cir. Based on rating by external credit agency
11.	Commercial real estate (MBS backed)	-do-

External Credit Assessment

- RBI has identified various credit agencies whose ratings may be used by banks for the purposes of risk weighting their claims for capital adequacy purposes as under:-

  (a) Credit Analysis and Research Limited;

  (b) CRISIL Limited;

  (c) India Ratings & Research Pvt. Ltd. (India Rating)

  (d) ICRA Limited.

  (e) Brickwork Ratings India Pvt. Ltd.

  International Agencies (where specified)

  (a) Fitch

  (b) Moodys; and

  (c) Standard & Poor's

- Banks are required to use the chosen credit rating agencies and their ratings consistently for each type of claim, for both risk weighting and risk management purposes. The NCAF 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
- Under the Framework, ratings have been mapped for appropriate risk weights applicable as per Standardised approach. The risk weight mapping for Long Term and Short Term Ratings are given in the Circular.

Credit Risk Mitigation Techniques

(a) Collateralized transactions

- The credit exposure is hedged in whole or part by collaterals by a counterparty (party to whom a bank has an on-or off balance sheet credit exposure) or by a third party on behalf of the counterparty and banks have specific lien over the collaterals
- Under the Framework, banks are allowed to adopt either Simple Approach or Comprehensive Approach. The former approach substitutes the risk weighting of the collateral for the risk weighting of the counterparty for the collateraised portion of the exposure and under the latter approach which allows fuller offset of collaterals against exposures. Comprehensive approach is being adopted by banks in India.
- Cash, Gold, securities, KVP, NSC (no lock in period), LIC policies, Debt securities, Units of Mutual Funds, etc. are eligible financial instruments for recognition in the Comprehensive Approach.

(b) Balance Sheet Netting

Under this technique, banks have legally enforceable netting arrangements involving specific lien with proof of documentation. Capital requirement is reckoned on the basis of net credit exposure.

(c) Guarantees

Explicit, irrevocable, and unconditional guarantees may be taken as credit protection in calculating capital requirements. Guarantees issued by entities with lower risk weight as compared to the counterparty will lead to reduced capital charges.

2. Capital charge for Market Risk

Market Risk relates to risk of losses in on-balance sheet and off-balance sheet positions arising on account of movement in market prices. The market risk positions subject to capital charge requirement are risks pertaining to **interest rate** related instruments in trading books and equities 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:

(a) Securities included under the Held for Trading (HFT) category

(b) Securities included under the Available for Sale (AFS) category

(c) Open gold position limits

(d) Open foreign exchange position limits

(e) Trading positions in derivatives, and

(f) Derivatives entered into for hedging trading book exposures.

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

Measurement of capital charge for Interest Rate Risk

- The capital charge for interest rate related instruments would apply to current market value of the instruments in bank's trading book and banks are required to maintain capital for market risks on an ongoing basis by mark to market their trading positions on a daily basis.
- The minimum capital requirement is measured/ expressed in two ways viz. (i) Specific Risk charge and (ii) General Market Risk (dealt separately hereunder).
- In view of possible longer holding period and higher risk thereto in respect of debt securities held under AFS category, banks are required to hold capital charge for market risk equal to or greater of the Specific Risk Capital charge or Alternative Total Capital Charge.

(i) Specific Market Risk

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 both short (short position is not allowed in India except in derivatives) and long positions. The specific risk charges and Alternative Total Capital Charge for various kinds of exposures are detailed in Tabular Form in the RBI Circular.

(ii) General Market Risk

It relates to charge towards interest rate risk in the portfolio, where long and short position (which is not allowed in India except in derivatives) in different securities or instruments can be offset. The capital requirements for general market risk are designed to capture the risk of loss arising from changes in market interest rates.

General Market Risk is the sum of the following four components:-

(a) The net short (short position is not allowed in India except in derivatives) or long position in the whole trading book;

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

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

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

- Two broad methodologies for computation of capital charge for market risks are suggested by the Basle Committee viz. Standardised Method and Internal Risk Management models method of which banks have been advised to adopt Standardised Method as banks have not yet developed their Internal Risk Management system.
- Under the standardised method there are two principal methods of measuring market risk viz. a "maturity" method and a "duration" method. It has been decided to adopt standardised "duration" method as the same is more accurate method to arrive the capital charge.
- The mechanics under the method, Time band and assumed changes in yield are detailed in the Circular for reference.

Measurement for capital charge for Equity Risk

- The capital charge for equities would apply on their current market value in bank's trading book. The Minimum capital requirement, to cover the risk of holding or taking positions in equities in the trading book is detailed in the Circular. The instruments covered include equity shares, whether voting or non-voting, convertible securities that behave like equities, for example: units of mutual funds, and commitments to buy or sell equity.
- The capital charge for Specific Risk and General Market Risk, calculated on bank's gross equity position, would be 9% each and the Specific Risk capital charge on the banks investment in Security Receipts would be 13.5% (equivalent to 150% risk weight).

Measurement of capital charge for Foreign Exchange Risk

The bank's net open position in each currency shall be calculated by summing:

(a) The net spot position (i.e. all asset items less all liability items, including accrued interest, denominated in the currency in question);

(b) 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);

(c) Guarantees (and similar instruments) that are certain to be called and are likely to be irrecoverable;

(d) Net future income/expenses not yet accrued but already fully hedged (at the discretion of the reporting bank);

(e) Depending on particular accounting conventions in different countries, any other item representing a profit or loss in foreign currencies;

The open positions both Foreign exchange and gold are at present risk-weighted at 100% and the capital charge for market risks in foreign exchange and gold open position is 9%. These open positions, limits or actual whichever is higher, would continue to attract capital charge at 9%. 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.

For calculation of eligible capital for market risk, it will be necessary to ascertain the bank's minimum capital requirement for credit and operational risks so as to arrive the available Tier I and Tier II capital to support the market risk (Illustrated in the Circular).

3. Capital charge for Operational Risk

Operational risk is termed as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This includes legal risk, but excludes strategic and reputational risk. Legal risk includes, but is not limited to, exposure to fines, penalties, or punitive damages resulting from supervisory actions, as well as private settlements.

Measurement Methodologies

Three methods for calculating operational risk capital charges in continuum of increasing sophistication and risk sensitivity are provided under NCAF viz.

(i) The Basic Indicator Approach (BIA)

(ii) The Standardised Approach (TSA), and

(iii) Advanced Measurement Approach (AMA).

- Banks are advised, to begin with, to adopt the Basic Indicator Approach (BIA) and RBI would review the capital requirement under BIA for general credibility and in case it is found any laxity, appropriate Supervisory action under Pillar 2 will be considered.
- Under BIA, banks are required to hold capital for operational risk equal to the average positive annual gross income over the previous 3 years. In case the gross income for any year is negative or zero, the same should be excluded while calculating the average. RBI will initiate necessary supervisory action under Pillar 2 in case the negative gross income distorts banks Pillar I capital charge.

(ii) Supervisory Review and Evaluation Process (SREP) – (Pillar 2)

The objective of Supervisory Review Process (SRP) is to:-

(a) Ensure that banks have adequate capital to support all the risks in their business; and

(b) Encourage them to develop and use better risk management techniques for monitoring and managing their risks.

Key principles envisaged under the SRP are:-

(a) Banks are required to have a process for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital levels.

(b) Evaluation of banks' internal capital adequacy assessments and strategies as well as their ability to monitor and ensure their compliance with the regulatory capital ratios by Supervisors.

(c) Supervisors should expect banks to operate above the minimum regulatory capital ratios and should have the ability to require banks to hold capital in excess of the minimum.

(d) Supervisors should intervene at an early stage to prevent capital from falling below the minimum levels required to support the risk characteristics of a particular bank and should require rapid remedial action if capital is not maintained or restored.

- As regards SREP, banks should evolve an effective **Internal Capital Adequacy Assessment Process (ICAAP)** for assessing their capital adequacy based on the risk profiles as well as strategies for maintaining their capital levels.
- Pillar 2 also requires the Supervisory authorities to put in place an evaluation process known as **Supervisory Review and Evaluation Process (SREP)** and to initiate supervisory measures as may be necessary. This would also facilitate RBI to take suitable steps either to reduce exposure of the bank or augment/restore its capital. ICAAP is an important component of the SRP.
- Every bank (except LABs & RRBs) should have an ICAAP both at solo and consolidated levels and

the responsibility of designing and implementation of the ICAAP rests with the Board. Before embarking on new activities or introducing new products the senior management should identify and review the related 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.

– Banks are required to put in place a effective MIS which should provide the board and senior management a clear and concise manner with timely and relevant information concerning their institutions' risk profile including risk exposure. MIS should be capable of capturing limit breaches (concentrations) and same should be promptly reported to senior management, as well as to ensure that appropriate follow-up actions are taken. Risk management process should be frequently monitored and tested by independent control areas and internal and external auditors.

– The ICAAP should form an integral part of the management and decision-making culture of a bank. The implementation of ICAAP should be guided by the principle of proportionality and RBI expects degree of sophistication in the ICAAP in regard to risk measurement which should commensurate with the nature, scope, scale and the degree of complexity in the bank's business operations.

Sound Stress Testing Practices

– Stress testing that alerts bank management to adverse unexpected outcomes related to a broad variety of risks and provides an indication to banks of how much capital might be needed to absorb losses should large shocks occur. It is an important tool that is used by banks as part of their internal risk management. Moreover, stress testing supplements other risk management approaches and measures.

(iii) Market Discipline - (Pillar – 3)

– Market Discipline is termed as development of a set of disclosure requirements so that the market participants would be able to access key pieces of information on the scope of application, capital, risk exposures, risk assessment processes, and in turn the capital adequacy of the institution. It is considered as an effective means of informing the market about a bank's exposure to those risks and provides comparability. Non-compliance of the prescribed disclosure requirement attracts penalty including financial penalty.

– Banks are required provide as at the end of March each year all Pillar 3 disclosures both quantitative and qualitative along with annual financial statements. Banks with capital funds of ₹ 100 crore or more are further required to make interim disclosures on the quantitative aspects on a standalone basis on their websites as at end of September each year.

– All banks with capital funds of ₹ 500 crore or more are required to disclose their Tier I capital, total capital, total required capital and Tier I ratio and total capital adequacy ratio, on a quarterly basis on their respective websites.

– The disclosure on the websites should be made in a web page titled "Basel II Disclosures" and the link to this page should be prominently provided on the home page of the bank's website. Each of these disclosures pertaining to a financial year should be available on the websites until disclosure of the third subsequent annual (March end) disclosure is made.

– Banks operating in India are required to make additional disclosures in respect of:-

(a) Securitisation exposures in the trading book;

(b) Sponsorship of off-balance sheet vehicles;

(c) Valuation with regard to securitisation exposures; and

(d) Pipeline and warehousing risks with regard to securitisation exposures

- The disclosure requirements under Pillar 3 section wise along with narrations are outlined in Tabular Form in the RBI Master Circular on NCAF.

Detailed guidelines on issuance of various Debt Instruments viz. Innovative Perpetual Debt Instrument (IPDI), Perpetual Non-cumulative Preference Shares (PNCPS), Debt Capital Instruments, Perpetual Cumulative Preference Shares (PCPS), Redeemable Non-cumulative Preference Shares (RNPS), Redeemable Cumulative Preference Shares (RCPS), Subordinated Debts, Guidelines on Securitisation of Standard Assets, Credit Risk Mitigation – Illustrations, Illustrative Approach on Measurement of Capital Charge for Market Risks in respect of Interest Rate Risk and Derivatives, Illustrative Approach on Measurement Interest Rate Risk in Banking Books (IRRBB), etc. are given in the Master Circular RBI.

ANNEXURE III

BASEL III – CAPITAL REGLULATIONS

Introduction

The main objective of the **Basel III** framework issued by the Basel Committee on Banking Supervision (BCBS) in Dec. 2010 is to improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source, thus reducing the risk of spillover from financial sector to real economy. The reform package will amend certain provisions existing under Basel II framework (NCAF) and introduce some new concepts and requirements. These new global regulatory and supervisory standards mainly seek to raise the quality and level of capital to ensure banks are better able to absorb losses on both a going concern and a gone concern basis, increase the risk coverage of the capital framework, introduce leverage ratio to serve as a backstop to the risk-based capital measure, raise the standards for the supervisory review process and public disclosures etc. The macro prudential aspects of Basel III are largely enshrined in the capital buffers. Both the buffers i.e. the capital conservation buffer and the countercyclical buffer are intended to protect the banking sector from periods of excess credit growth.

A. Guidelines on Minimum Capital Requirement

The Basel III capital regulations continue to be based on three-mutually reinforcing

Pillars, viz. minimum capital requirements (Pillar 1), supervisory review of capital adequacy (Pillar 2), and market discipline (Pillar 3) of the Basel II capital adequacy framework. Under Pillar 1, the Basel III framework will continue to offer the three distinct options for computing capital requirement for credit risk and three other options for computing capital requirement for operational risk, albeit with certain modifications / enhancements. These options for credit and operational risks are based on increasing risk sensitivity and allow banks to select an approach that is most appropriate to the stage of development of bank's operations. The options available for computing capital for credit risk are:-

(a) Standardised Approach,

(b) Foundation Internal Rating Based Approach; and

(c) Advanced Internal Rating Based Approach.

The options available for computing capital for operational risk are:-

(a) Basic Indicator Approach (BIA),

(b) The Standardised Approach (TSA); and

(c) Advanced Measurement Approach (AMA).

Keeping in view the Reserve Bank's goal to have consistency and harmony with international standards, as also capital efficiency likely to accrue to the banks by adoption of the advanced approaches, a time schedule was laid down in 2009 that all commercial banks in India (excluding Local Area Banks and Regional Rural Banks) may switch over to Internal Rating Based Approach (Both Foundation as well as Advanced Internal Rating Based Approach) for credit risk and Advanced Measurement Approach for operational risk by 31.03.2014. Accordingly, banks were advised to undertake an internal assessment of their preparedness for migration to advanced approaches and take a decision with the approval of their Boards/RBI, whether they would like to migrate to any of the advanced approaches. Banks may choose a suitable date to apply for implementation of advanced approach.

The provisions of Basel III include:-

(a) The Basel III capital regulation has been implemented from April 1, 2013 in India in phases.

(b) To ensure smooth transition to Basel III, appropriate transitional arrangements have been provided for meeting the minimum Basel III capital ratios, full regulatory adjustments to the components of capital etc. Consequently, Basel III capital regulations would be fully implemented as on March 31, 2018.

(c) Banks are required to maintain a minimum Pillar 1 Capital to Risk-weighted Assets Ratio (CRAR) of 9% on an on-going basis (other than capital conservation buffer and Countercyclical capital buffer etc.).

(d) Capital requirements for the implementation of Basel III guidelines are lower in the initial periods and higher in later years.

(e) Banks are required to disclose the capital ratios computed under Basel III capital adequacy framework from the quarter ending 30.06.2013.

(f) The RBI may consider prescribing a higher level of minimum capital ratio for each bank under Pillar 2 framework on the basis of their respective risk profiles and their risk management systems.

(g) Banks are required to comply with the capital adequacy ratio at two levels viz. consolidated (Group) and standalone (Solo) level. At consolidated level, the capital adequacy ratio requirements of a bank measure the capital adequacy of a bank based on its capital strength and risk profile after consolidating the assets and liabilities of its subsidiaries/joint ventures/associates, etc. except those engaged in insurance and any non-financial activities. The standalone level capital adequacy ratio requirements measure the capital adequacy of a bank based on its standalone capital strength and risk profile. The overseas operations of a bank through its branches will be covered in both the above scenarios. For the purpose of these guidelines, the subsidiary is an enterprise that is controlled by another enterprise (known as the parent), etc.

Under the Basel II framework, the total regulatory capital comprises of Tier I (core capital) and Tier 2 capital (supplementary capital). In order to improve the quality and quality of regulatory capital, capital will predominantly consist of Common Equity under Basel III. Non-equity Tier 1 and Tier 2 capital would continue to form part of regulatory capital subject to eligibility criteria as laid down in Basel III. Banks have to comply with the regulatory limits and minima as prescribed under Basel III capital regulations, on an ongoing basis. To ensure smooth transition to Basel III, appropriate transitional arrangements have been provided for meeting the minimum Basel III capital ratios, full regulatory adjustments to the components of capital etc. Consequently, Basel III capital regulations would be fully implemented as on March 31, 2018. In view of the gradual phase-in of regulatory adjustments to the Common Equity component of Tier 1 capital under Basel III, certain specific prescriptions of Basel II capital adequacy framework (e.g. rules relating to deductions from regulatory capital, risk weighting of investments in other financial entities etc.) will also continue to apply till March 31, 2017.

Composition of Regulatory Capital

Under Basel III, Banks are required to maintain a minimum Pillar 1 Capital to Risk-weighted Assets Ratio (CRAR) of 9% on an on-going basis (other than capital conservation buffer and countercyclical capital buffer etc.). The RBI will take into account the relevant risk factors and the internal capital adequacy assessments of each bank to ensure that the capital held by a bank is commensurate with the bank's overall risk profile. This would include, among others, the effectiveness of the bank's risk management systems in identifying, assessing / measuring, monitoring and managing various risks including interest rate risk in the banking book, liquidity risk, concentration risk and residual risk. Accordingly, RBI will consider prescribing a higher level of minimum capital ratio for each bank under the Pillar 2 framework on the basis of their respective risk profiles and their risk management systems. Further, in terms of the Pillar 2 requirements, banks are expected to operate at a level well above the minimum requirement.

The total regulatory capital fund will consist of the sum of the following categories:-

(i) Tier 1 Capital (going-concern capital*): comprises of:-

  (a) Common Equity Tier 1 capital

(b) Additional Tier 1 capital

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

(*From regulatory capital perspective, going-concern capital is the capital which can absorb losses without triggering bankruptcy of the bank. Gone-concern capital is the capital which will absorb losses only in a situation of liquidation of the bank).

Banks are required to compute the Basel III capital ratios in the following manner:-

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

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

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

* RWA = Risk weighted Assets;

Capital to Risk Weighted Asset Ratio

Elements of Capital funds – Indian Banks

(i) Common Equity Tier 1 capital

(i) Common shares (All common shares should ideally be the voting shares as detailed in RBI M. Cir.)

(ii) Stock surplus (share premium)

(iii) Statutory reserves

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

(v) Other disclosed free reserves, if any

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

(vii) Profit for current year calculated on quarterly basis as per the formula given in RBI Cir. (Less: Regulatory adjustments/ deductions)

(ii) Additional Tier 1 capital

(i) Perpetual Non-cumulative Preference shares (PNCPS)

(ii) Stock surplus (share premium)

(iii) Debt capital instruments

(iv) Any other type of instruments as notified by RBI from time to time.

(*Less*: Regulatory adjustments/ deductions)

(iii) Tier 2 Capital

(i) General Provisions and Loss Reserves

(ii) Debt capital instruments issued by banks

(iii) Preference share capital instruments (PCPS/RNCPS/RCPS)

(iv) Stock surpluses

(v) Revaluation reserves at a discount of 55%

(vi) Any other type of instruments generally notified by RBI for inclusion under Tier 2 capital (Less: Regulatory adjustments/deductions)

Elements of Capital funds – Foreign Banks

Common Equity Tier I capital

(i) Interest free funds from H.O.

(ii) Statutory reserves

(iii) Remittance surplus retained in Indian Books (non-repatriable)

(iv) Interest free funds remitted from abroad for acquisition of property

(v) Capital reserves arising out of sale of assets (non-repatriable), etc.

(Less: Regulatory adjustments/ deductions)

Additional Tier 1 capital

(i) H.O. borrowings for foreign currency

(ii) Any other item as allowed by RBI

(*Less*: Regulatory adjustments/ deductions)

Tier 2 Capital

(i) General Provisions and Loss Reserves

(ii) H.O. borrowings in foreign currency

(iii) Revaluation reserves at a discount of 55%

(*Less*: Regulatory adjustments/deductions)

Capital requirement

(a) All scheduled commercial banks (excl. LABs & RRBs) operating in India shall maintain a Minimum Total Capital (MTC) of 9% of total Risk Weighted Assets (RWA) i.e. capital to risk weighted assets (CRAR) as against 8% prescribed under Basel III rules.

(b) Out of the MTC of 9%, Common Equity Tier I (CET1) capital shall be at least 5.5% of RWA (i.e. for credit risk + market risk + operational risk) on an ongoing basis (Basel III at least 4.5% of RWA).

(c) Tier 1 capital shall be at least 7% of RWA on an ongoing basis. In other words, within the Tier 1 capital, Additional Tier 1 capital shall be maximum 1.5% of RWAs (Basel III 6%).

(d) Total Capital (Tier 1 capital + Tier 2 capital) shall be at least 9% of RWAs on an ongoing basis i.e. within the minimum CRAR of 9%, Tier 2 capital can be admitted maximum up to 2% (Basel III Tier 1 + Tier 2 shall be 8%).

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

(f) In addition to the minimum Common Equity Tier 1 capital of 5.5% of RWAs, banks are also required to maintain a capital conservation buffer (CCB) of 2.5% of RWAs (dealt separately) in the form of Common Equity Tier 1 capital.

With the full implementation of capital ratios (For smooth migration to these capital ratios, transitional arrangements have been provided) and CCB the capital requirements would be as follows:-

	Regulatory Capital	As % to RWAs
1.	Minimum Common Equity Tier 1 Ratio	5.50
2.	Capital Conservation Buffer (comprised of Common Equity)	2.50
3.	MCE Tier 1 Ratio + CCB	8.00
4.	Additional Tier 1 Capital	1.50
5.	Minimum Tier 1 Capital Ratio (1 + 4)	7.00
6.	Tier 2 Capital	2.00
7.	Minimum Total Capital Ratio (MTC) {5 + 6 }	9.00
8.	MTC + CCB (7 + 2)	11.50

(a) For prudential exposure limits linked to capital funds, the 'capital funds' will **exclude** the applicable capital conservation buffer and countercyclical capital buffer as and when activated, but **include** Additional Tier 1 capital and Tier 2 capital which are supported by proportionate amount of Common Equity Tier 1 capital. Accordingly, capital funds will be defined as the sum total of Common Equity Tier 1 capital, Additional Tier 1 capital, and Tier 2 capital eligible for computing and reporting CRAR of the bank. It may be noted that the term 'Common Equity Tier 1 capital' **does not include** capital conservation buffer and countercyclical capital buffer.

(b) For the purpose of reporting Tier 1 capital and CRAR, any excess Additional Tier 1 (AT1) capital and Tier 2 (T2) capital will be recognised in the same proportion as that applicable towards minimum capital requirements. In other words, to admit any excess AT1 and T2 capital, the bank should have excess CET1 over and above 8% (5.5%+2.5%).

(c) In cases where the a bank does not have minimum Common Equity Tier 1 + capital conservation buffer of 2.5% of RWAs as required but, has excess Additional Tier 1 and / or Tier 2 capital, **no** such excess capital can be reckoned towards computation and reporting of Tier 1 capital and Total Capital.

(d) A countercyclical capital buffer of 0.205% of RWAs in the form of Common Equity or other fully loss absorbing capital is to be created to mitigate/protect the banking sector from periods of excess aggregate credit growth and resultant system-wide risk being an extension of CCB.

Regulatory adjustments/deductions

The regulatory adjustments / deductions which will be applied to regulatory capital both at solo and consolidated level are as under:-

(a) Goodwill and all other intangible assets are required to be deducted from the Common Equity component of Tier 1.

(b) Under Basel III, Deferred Tax Assets (DTA) which relies on future profitability of bank, only such DTAs are to be deducted from Common Equity. However, as per the RBI guidelines, banks in India will be required to deduct all DTAs irrespective of their origin from Common Equity Tier 1 capital as a prudent measure. Application of these rules at consolidated level would mean deduction of DTAs from the consolidated Common Equity which is attributed to the subsidiaries, in addition to deduction of DTAs which pertain to the solo bank.

(c) The amount of cash flow hedge reserve which relates to hedging of items that are not fair valued in the balance sheet (including projected cash flows) should be derecognized in the calculation of Common Equity Tier 1.

(d) Shortfall of stock of provisions to expected losses under the Internal Ratings Based (IRB) approach should be deducted in the calculation of Common Equity Tier 1 capital. The full shortfall amount is to be deducted and should not be reduced by any tax effects that could be expected to occur if provisions were to rise to the level of expected losses.

(e) Other areas such as Gain-on-Sale Related to Securitisation Transactions, defined benefit pension fund liabilities, Investment in a bank's own shares, etc. are to be deducted appropriately from Common Equity Tier 1 capital.

(f) The investment of banks in the regulatory capital instruments of other financial entities contributes to the inter-connectedness amongst the financial institutions and hence it should be deducted from the respective tiers of regulatory capital so as to avoid double counting of capital in the financial system.

(g) Reciprocal cross holdings of capital might result in artificially inflating the capital position of banks and hence such holdings of capital has to be fully deducted from component of capital (Common Equity, Additional Tier 1 and Tier 2 capital) for which the capital would qualify if it was issued by the bank itself,

(h) Capital instruments which no longer qualify as non-common equity Tier 1 capital or Tier 2 capital (e.g. IPDI and Tier 2 debt instruments with step-ups) are to be phased out beginning 01.01.2013, etc.

Transitional Arrangements

As per Basel III terms, in order to ensure smooth migration without any near stress, appropriate transitional arrangements for capital ratios have been made which commenced as on 01.04.2013. Capital ratios and deductions from Common Equity will be fully phased-in and implemented as on 31.03.2018 and accordingly the phase-in arrangements for SCBs operating in India are drawn as under:-

Transitional Arrangements (Excl. LABs and RRBs)

Minimum capital ratios	01.04.13	31.03.14	31.03.15	31.03.16	31.03.17	31.03.18
CET 1	4.50	5.00	5.50	5.50	5.50	5.50
CCB	-	-	0.625	1.25	1.875	2.50
Minimum CET1 + CCB	4.50	5.00	6.125	6.75	7.375	8.00
Minimum Tier 1 capital	6.00	6.50	7.00	7.00	7.00	7.00
Minimum Total capital *	9.00	9.00	9.00	9.00	9.00	9.00
Minimum Total Capital + CCB	9.00	9.00	9.625	10.25	10.875	11.50
Phase-in of all deductions from CET 1 (in %) #	20	40	60	80	100	100

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

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

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

4. Capital charge for Credit Risk

RBI has identified external credit rating agencies that meet the eligibility criteria specified under the revised Framework. Banks are required to choose the external rating agencies identified by RBI for assigning risk weights for capital adequacy purposes as per the mapping furnished in the Basel III guidelines.

Claims on Domestic Sovereigns (standard Assets)

(e) Both fund based and non fund based claims on the Central Government including Central Govt. guaranteed claims carry zero risk weight.

(f) Direct Loans/credit/overdraft exposure, if any, of banks to State Govt. and investment in State Govt. securities carry zero risk weight. State Government guaranteed claims will attract 20 per cent risk weight'.

(g) Risk weight applicable to Central Govt. exposure would also apply to claims on RBI, CGTMSE, and Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH). The claims on ECGC will attract a risk weight of 20%.

(h) 'Amount Receivable from GOI' under Agricultural Debt Waiver Scheme 2008 is to be treated as claim on GOI and attract zero risk weight whereas the amount outstanding in the accounts covered by the Debt Relief Scheme shall be treated as a claim on the borrower and risk weighted as per the extant norms.

Claims on Foreign Sovereigns

Claims on Foreign Sovereigns in foreign currency would be as per the rating assigned as detailed in the RBI circular. In case of claims dominated in domestic currency of Foreign Sovereign met out of the resources in the same currency, the zero risk weight would be applicable.

Claims on Public Sector Entities (PSE)

Claims on domestic PSEs and Primary Dealers (PD) would be risk weighted in the same manner that of corporate and foreign PSEs as per the rating assigned by foreign rating agencies as detailed in the Circular.

Other claims

– Claims on IMF, Bank for International Settlements (BIS), and eligible Multilateral Development Banks (MDBs) evaluated by the BCBS will be treated similar to claims on scheduled banks at a uniform 20% risk weight. Similarly, claims on the International Finance Facility for Immunization (IFFIm) will also attract a twenty per cent risk weight

– Claims on Banks incorporated in India and Foreign Banks' branches in India, the applicable risk weight is detailed in the RBI Master Circular.

– Banks' investment in capital instruments of other banks such investments would not be deducted, but would attract appropriate risk as detailed in the RBI M. Circular.

– Claims on corporate Asset Finance Companies (AFCs) and Non-Banking Finance Companies-Infrastructure Finance Companies (NBFC-IFC), shall be risk weighted as per the ratings assigned by the rating agencies registered with the SEBI and accredited by the RBI (Detailed in the Circular).

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

– Regulatory Retail claims (both fund and non-fund based) which meet the Qualifying criteria, viz.

(h) Orientation Criterion: Exposure to individual person/s or to a small business (Average annual turnover less than ₹ 50 crore for last 3 years in case of existing or projected turnover in case of new units);

(i) Product Criterion: Exposure (both fund-based and non fund-based) in form of revolving credits and lines of credit (incl. overdrafts), term loans & leases (e.g. instalment loans and leases, student and educational loans) and small business facilities and commitments

(j) Granularity Criterion – Sufficient diversification to reduce the risk portfolio; and

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

Would attract risk weight of 75% except NPAs. As part of the supervisory review process, the RBI would also consider whether the credit quality of regulatory retail claims held by individual banks should warrant a standard risk weight higher than 75%.

– The RWA on claims secured by mortgage of residential properties would be as under:-

Category of Loan	LTV Ratio (%)	Risk Weight (%)
(a) Individual Housing Loans		
(i) Up to ₹ 20 lakh	90	50
(ii) Above ₹ 20 lakh and up to ₹ 75 lakh	80	50
(iii) Above ₹75 lakh	75	75
(b) Commercial Real Estate - ResidentialHousing (CRE-RH)	N/A	75
(c) Commercial Real Estate (CRE)	N/A	100

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

2. Banks' exposures to **third** dwelling unit onwards to an individual will also be treated as CRE exposures.

– Restructured housing loans should be risk weighted with an additional risk weight of 25% to the risk weights prescribed above.

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

– Investments in mortgage backed securities (MBS) backed by exposures will be governed by the guidelines pertaining to securitisation exposures (as detailed in the RBI Cir.)

Non-performing Assets (NPAs)

The risk weight in respect of the unsecured portion of NPA (other than a qualifying residential mortgage loan), net of specific provisions (including partial write-offs), shall be:-

Specific Provisions	Risk Weight %
Less than 20% of outstanding	150
At least 20% of outstanding	100
At least 50% of outstanding	50

– The risk weight applicable for secured NPA is 100%, net of provisions when provisions reach 15% of the outstanding amount.

– NPA Home Loan claims secured by residential property, the risk weight shall be 100% net of specific provisions. In case the specific provisions are at least 20% but less than 50% of the outstanding, the risk weight shall be 75% (net of specific provisions) and specific provisions are 50% or more the applicable risk weight is 50%.

Other specified categories

	Category	*Risk Weight (%)*
01.	Venture capital	150 or higher
02.	Consumer credit including personal loans, credit card receivables, but excl. educational loan	125
03.	Capital market exposure	125
04.	Investment in capital instruments of NBFC	125
05.	The exposure to equity instruments issued by NBFCs	250
05.	Investment in paid up equity of non-financial entities (other than subsidiaries) where investment is below 10% of equity of investee entity.Above 10%	1251111
06.	Staff loans backed fully by superannuation benefits and/or mortgage of flat/house	20
07.	Other loans and advances to staff eligible for inclusion under retail portfolio	75
08.	All other assets	100
09.	Off balance sheet items (Market related and non-market related items)	As detailed in the RBI Circular.
10.	Securitization Exposure	As per Cir. Based on rating by external credit agency
11.	Commercial real estate (MBS backed)	-do-

Definitions and general terminology

Counterparty Credit Risk (CCR)

CCR is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.

Securities Financing Transactions (SFTs)

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

Hedging Set

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

Current Exposure

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

Credit Valuation Adjustment

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

One-Sided Credit Valuation Adjustment

It is a credit valuation adjustment that reflects the market value of the credit risk of the counterparty to the firm, but does not reflect the market value of the credit risk of the bank to the counterparty.

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) as detailed in the Circular.

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

In addition to the default risk capital requirement for counterparty credit risk, banks are also required to compute an additional capital charge to cover the risk of mark-to-market losses on the expected counterparty risk (such losses being known as credit value adjustments, CVA) to OTC derivatives. The CVA capital charge will be calculated in the manner as indicated in the RBI Circular.

Failed Transactions

(a) With regard to unsettled securities and foreign exchange transactions, banks are exposed to counterparty credit risk from trade date, irrespective of the booking or the accounting of the transaction. Banks may develop and implement suitable 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) Banks must closely monitor securities and foreign exchange transactions that have failed, starting from the day they fail for producing management information that facilitates action on a timely basis

(c) Failure of transactions settled through a delivery-versus-payment system (DvP), providing simultaneous exchanges of securities for cash, expose banks to a risk of loss on the difference between the transaction valued at the agreed settlement price and the transaction valued at current market price (i.e. positive current exposure).

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

(e) For non-DvP transactions (free deliveries) after the first contractual payment/ delivery leg, the bank that has made the payment will treat its exposure as a loan if the second leg has not been received by the end of the business day.

External Credit Assessment

RBI has identified various credit agencies whose ratings may be used by banks for the purposes of risk weighting their claims for capital adequacy purposes under the revised framework as under:-

(a) Brickwork Ratings India Pvt. Limited (Brickwork);

(b) Credit Analysis and Research Limited;

(c) CRISIL Limited;

(d) ICRA Limited;

(e) India Ratings and Research Private Limited (India Ratings); and

(f) SME Rating Agency of India Ltd. (SMERA)

International Agencies (where specified)

(d) Fitch

(e) Moodys; and

(f) Standard & Poor's

Banks are required to use the chosen credit rating agencies and their ratings consistently for each type of claim, for both risk weighting and risk management purposes. The revised framework recommends development of a mapping process to assign the ratings issued by eligible credit rating agencies to the risk weights available under the Standardised risk weighting framework. Under the Framework, ratings have been mapped for appropriate risk weights applicable as per Standardised approach. The risk weight mapping for Long Term and Short Term Ratings are given in the Circular.

Credit Risk Mitigation Techniques

Banks use a number of techniques to mitigate the credit risks to which they are exposed. For example, exposures may be collateralised in whole or in part by cash or securities, deposits from the same counterparty, guarantee of a third party, etc. In order for banks to obtain capital relief for any use of CRM techniques, certain minimum standards for legal documentation must be met. All documentation used in collateralised transactions and guarantees must be binding on all parties and legally enforceable in all relevant jurisdictions. Banks must have conducted sufficient legal review, which should be well documented, to verify this requirement. Such verification should have a well-founded legal basis for reaching the conclusion about the binding nature and enforceability of the documents

Few of such CRM techniques are given below:-

(**d) Collateralized transactions** –

– The credit exposure is hedged in whole or part by collaterals by a counterparty (party to whom a bank has an on-or off balance sheet credit exposure) or by a third party on behalf of the counterparty and banks have specific lien over the collaterals

– Under the Framework, banks are allowed to adopt either Simple Approach or Comprehensive Approach. The former approach substitutes the risk weighting of the collateral for the risk weighting of the counterparty for the collateraised portion of the exposure and under the latter approach which allows fuller offset of collaterals against exposures. Comprehensive approach is being adopted by banks in India.

– In the comprehensive approach, when taking collateral, banks will need to calculate their adjusted exposure to a counterparty for capital adequacy purposes in order to take account of the effects of that collateral.

Hair Cut

In the comprehensive approach, Banks are required to adjust both the amount of the exposure to the counterparty and the value of any collateral received in support of that counterparty to take account of possible future fluctuations in the value of either, occasioned by market movements. These adjustments are referred to as 'haircuts'. The application of haircuts will produce volatility adjusted amounts for both exposure and collateral. The volatility adjusted amount for the exposure will be higher than the exposure and the volatility adjusted amount for the collateral will be lower than the collateral, unless either side of the transaction is cash. In other words, the 'haircut' for the exposure will be a premium factor and the 'haircut' for the collateral will be a discount factor.

It may be noted that the purpose underlying the application of haircut is to capture the market-related volatility inherent in the value of exposures as well as of the eligible financial collaterals. Where the volatility-adjusted exposure amount is greater than the volatility-adjusted collateral amount (including any further adjustment for foreign exchange risk), banks shall calculate their risk-weighted assets as the difference between the two multiplied by the risk weight of the counterparty.

Banks have two ways of calculating the haircuts viz. (i) Standard supervisory haircuts; using parameters set by the Basel Committee, and (ii) Own estimate haircuts, using banks' own internal estimates of market price volatility. Banks in India shall **use only the standard supervisory haircuts** for both the exposure as well as the collateral. The Standard Supervisory Haircuts (assuming daily mark-to-market, daily re-margining and a 10 business-day holding period), expressed as percentages, are given in detail in the RBI Circular.

Eligible Financial Collateral in Comprehensive approach

Cash, Gold, Securities issued by Central & State Governments, KVP, NSC (no lock in period is operational), LIC policies, Debt securities (rated by a chosen rating agency), Debt Securities (not rated by a chosen Credit Rating Agency in respect of which banks should be sufficiently confident about the market liquidity), Units of Mutual Funds, etc. are eligible financial instruments for recognition in the Comprehensive Approach.

Calculation of capital requirement

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

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

Where:

E^* = the exposure value after risk mitigation

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

H_e = haircut appropriate to the exposure

C = the current value of the collateral received H_c = haircut appropriate to the collateral

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

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

(**e) On Balance Sheet Netting** –

On-balance sheet netting is confined to loans/advances and deposits. Under this technique, banks have legally enforceable netting arrangements involving specific lien with proof of documentation. Capital requirement is reckoned on the basis of net credit exposure. Banks may calculate capital requirements on the basis of net credit exposures subject to some conditions as listed in the Circular.

(**f) Guarantees** –

Explicit, irrevocable, and unconditional guarantees may be taken as credit protection in calculating capital requirements. Guarantees issued by entities with lower risk weight as compared to 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. Detailed operational requirements for guarantees eligible for being treated as a CRM are given in the RBI Circular.

5. Capital charge for Market Risk

Market Risk relates to risk of losses in on-balance sheet and off-balance sheet positions arising on account of movement in market prices. The market risk positions subject to capital charge requirement are risks pertaining to **interest rate** related instruments in trading books and equities 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:

(g) Securities included under the Held for Trading (HFT) category

(h) Securities included under the Available for Sale (AFS) category

(i) Open gold position limits

(j) Open foreign exchange position limits

(k) Trading positions in derivatives, and

(l) Derivatives entered into for hedging trading book exposures.

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

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.

Measurement of capital charge for Interest Rate Risk

The capital charge for interest rate related instruments would apply to current market value of the instruments in bank's trading book and banks are required to maintain capital for market risks on an ongoing basis by mark to market their trading positions on a daily basis.

The minimum capital requirement is measured/ expressed in two ways viz. (i) Specific Risk charge and (ii) General Market Risk (dealt separately).

In view of possible longer holding period and higher risk thereto in respect of debt securities held under AFS category, banks are required to hold capital charge for market risk equal to or greater of the Specific Risk Capital charge or Alternative Total Capital Charge.

(i) Specific Market Risk

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 both short (short position is not allowed in India except in derivatives) and long positions. The specific risk charges and Alternative Total Capital Charge for various kinds of exposures are detailed in Tabular Form in the RBI Circular.

(ii) General Market Risk

It relates to charge towards interest rate risk in the portfolio, where long and short position (which is not allowed in India except in derivatives & Central Govt. securities) in different securities or instruments can be offset. The capital requirements for general market risk are designed to capture the risk of loss arising from changes in market interest rates.

General Market Risk is the sum of the following four components:-

(a) The net short (short position is not allowed in India except in derivatives) or long position in the whole trading book;

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

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

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

The Basel Committee has suggested two broad methodologies for computation of capital charge for market risks viz. Standardised Method and Internal Risk Management models method of which banks have been advised to adopt Standardised Method as banks have not yet developed their Internal Risk Management system.

Under the standardised method there are two principal methods of measuring market risk viz. a "maturity" method and a "duration" method. It has been decided to adopt standardised "duration" method as the same is more accurate method to arrive the capital charge. Accordingly, banks are required to measure the general market risk charge by calculating the price sensitivity (modified duration) of each position separately. The mechanics under the method - Time band and assumed changes in yield are detailed in the Circular for reference.

Measurement for capital charge for Equity Risk

The capital charge for equities would apply on their current market value in bank's trading book. The Minimum capital requirement, to cover the risk of holding or taking positions in equities in the trading book is detailed in the Circular. The instruments covered include equity shares, whether voting or non-voting, convertible securities that behave like equities, for example: units of mutual funds, and commitments to buy or sell equity.

Capital charge for specific risk (akin to credit risk) will be 11.25% or capital charge in accordance with the risk warranted by external rating of the counterparty, whichever is higher and specific risk is computed on banks' gross equity positions (i.e. the sum of all long and all short equity positions - short equity position is, however, not allowed for banks in India). In addition, the general market risk charge will also be 9% 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.

Specific Risk Capital Charge for banks' investment in Security Receipts will be 13.5% (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.

Measurement of capital charge for Foreign Exchange Risk

The bank's net open position in each currency shall be calculated by summing:

(f) The net spot position (i.e. all asset items less all liability items, including accrued interest, denominated in the currency in question);

(g) 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);

(h) Guarantees (and similar instruments) that are certain to be called and are likely to be irrecoverable;

(i) Net future income/expenses not yet accrued but already fully hedged (at the discretion of the reporting bank);

(j) Depending on particular accounting conventions in different countries, any other item representing a profit or loss in foreign currencies;

(k) The net delta-based equivalent of the total book of foreign currency options.

The open positions both Foreign exchange and gold are at present risk-weighted at 100% and the capital charge for market risks in foreign exchange and gold open position is 9%. These open positions, limits or actual whichever is higher, would continue to attract capital charge at 9%. 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.

Measurement of capital charge for Credit Default Swap (CDS) in the trading book, Capital charge for Counterparty Credit Risk, Capital charge for Counterparty Risk for Collaterised Transactions in CDS, Aggregation of the capital charge for Market Risks, Treatment for Illiquid Positions, Valuation Methodologies, etc. are detailed in the RBI Circular for reference.

6. Capital charge for Operational Risk

Operational risk is termed as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This includes legal risk, but excludes strategic and reputational risk. Legal risk includes, but is not limited to, exposure to fines, penalties, or punitive damages resulting from supervisory actions, as well as private settlements.

Measurement Methodologies

Three methods for calculating operational risk capital charges in continuum of increasing sophistication and risk sensitivity are provided under NCAF viz.

(iv) The Basic Indicator Approach (BIA)

(v) The Standardised Approach (TSA), and

(vi) Advanced Measurement Approach (AMA).

Banks are advised, to begin with, to adopt the Basic Indicator Approach (BIA) and RBI would review the capital requirement under BIA for general credibility and in case it is found any laxity, appropriate Supervisory action under Pillar 2 will be considered.

Under BIA, banks are required to hold capital for operational risk equal to the average positive annual gross income over the previous 3 years. In case the gross income for any year is negative or zero, the same should be excluded while calculating the average. RBI will initiate necessary supervisory action under Pillar 2 in case the negative gross income distorts banks Pillar I capital charge (the working is illustrated in the RBI Circular)

B. Supervisory Review and Evaluation Process (SREP) – (Pillar 2)

The objective of Supervisory Review Process (SRP) is to:-

(c) Ensure that banks have adequate capital to support all the risks in their business; and

(d) Encourage them to develop and use better risk management techniques for monitoring and managing their risks.

This in turn would require a well-defined internal assessment process within banks through which they assure the RBI that adequate capital is indeed held towards the various risks to which they are exposed. The process of assurance could also involve an active dialogue between the bank and the RBI so that, when warranted, appropriate intervention could be made to reduce the risk exposure of the bank or augment / restore its capital. Thus, Internal Capital Adequacy Assessment Process (ICAAP) is an important component of the SRP.

The main aspects to be addressed under SRP/ICAAP would include:-

(a) The risks that are not fully captured by the minimum capital ratio prescribed under Pillar 1;

(b) The risks that are not at all taken into account by the Pillar 1; and

(c) The factors external to the bank.

The capital adequacy ratio prescribed under Pillar 1 is only the minimum and addresses only the three risks viz. credit, market and operation risks, holding of additional capital might be necessary for banks to take care of the possible under-estimation of risks under the Pillar 1 and the actual risk exposure of a bank vis-à-vis the quality of its risk management architecture. Some of the risks which are generally exposed to but not fully captured in the regulatory CRAR include:-

(a) Interest rate risk in the banking book;

(b) Credit concentration risk;

(c) Liquidity risk;

(d) Settlement risk;

(e) Reputational risk;

(f) Strategic risk;

(g) Risk of under-estimation of credit risk under the Standardised approach;

(h) Model risk i.e., the risk of under-estimation of credit risk under the IRB approaches;

(i) Risk of weakness in the credit-risk mitigants;

(j) Residual risk of securitisation, etc.

It is, therefore, only appropriate that the banks make their own assessment of their various risk exposures, through a well-defined internal process, and maintain an adequate capital cushion for such risks. Banks were advised to develop and put in place, with the approval of their Boards, an ICAA P, in addition to a bank's calculation of regulatory capital requirements under Pillar 1, commensurate with their size, level of complexity, risk profile and scope of operations. The ICAAP was operationalised w.e.f. March 2008 by foreign banks and March 2009 by Indian Banks.

Based on the three mutually reinforcing Pillars i.e. Pillar 1, Pillar 2, and Pillar 3, the Basel Committee lays down four key principles under the SRP as under:-

(e) Banks are required to have a process for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital levels.

(f) Evaluation of banks' internal capital adequacy assessments and strategies as well as their ability to monitor and ensure their compliance with the regulatory capital ratios by Supervisors.

(g) Supervisors should expect banks to operate above the minimum regulatory capital ratios and should have the ability to require banks to hold capital in excess of the minimum.

(h) Supervisors should intervene at an early stage to prevent capital from falling below the minimum levels required to support the risk characteristics of a particular bank and should require rapid remedial action if capital is not maintained or restored.

The Principles **a & c** relates to the supervisory expectations while others i.e. **b & d** deals with the role of the supervisors under Pillar 2. This necessitates evolvement of an effective ICAAP for assessing their capital adequacy based on the risk profiles as well as strategies for maintaining their capital levels. Pillar 2 also requires the Supervisory authorities to put in place an evaluation process known as **Supervisory Review and Evaluation Process (SREP)** and to initiate supervisory measures as may be necessary. This would also facilitate RBI to take suitable steps either to reduce exposure of the bank or augment/restore its capital.

Based on the principles, responsibilities have been casted on banks and Supervisors under SREP and based on which banks are expected to operate above the minimum regulatory capital ratios commensurate with their individual risk profiles, etc. Under SREP, the RBI will assess the overall capital adequacy through comprehensive evaluation along with Annual Financial Inspection (AFI) based relevant data and ICAAP document being received from banks and available information. ICAAP and SREP are 2 important components of Pillar 2.

Every bank (except LABs & RRBs) should have an ICAAP both at solo and consolidated levels and the responsibility of designing and implementation of the ICAAP rests with the Board. Before embarking on new activities or introducing new products the senior management should identify and review the related 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.

Banks are required to put in place an effective MIS which should provide the board and senior management a clear and concise manner with timely and relevant information concerning their institutions' risk profile including risk exposure. MIS should be capable of capturing limit breaches (concentrations) and same should be promptly reported to senior management, as well as to ensure that appropriate follow-up actions are taken. Risk management process should be frequently monitored and tested by independent control areas and internal and external auditors.

The ICAAP should form an integral part of the management and decision-making culture of a bank. The implementation of ICAAP should be guided by the principle of proportionality and RBI expects degree of sophistication in the ICAAP in regard to risk measurement which should commensurate with the nature, scope, scale and the degree of complexity in the bank's business operations.

Operational aspects of ICAAP

The ICAAP of banks is expected normally to capture the risk universe, viz .Credit Risk, Market Risk, Operational Risk, interest rate risk in the banking book, credit concentration risk and liquidity risk. Other risks include reputational risk and or business or strategic risk, Off-balance sheet Exposure and Securitisation Risk etc. (Various risks are briefly outlined in the RBI Circular).

Bank's risk management process including the ICAAP should be consistent with the existing RBI guidelines on these risks. If banks adopt risk mitigation techniques, they should understand the risk to be mitigated and reckoning its enforceability and effectiveness on the risk profile of the bank.

Sound Stress Testing Practices

Stress testing that alerts bank management to adverse unexpected outcomes related to a broad variety of risks and provides an indication to banks of how much capital might be needed to absorb losses should large shocks occur. It is an important tool that is used by banks as part of their internal risk management. Moreover, stress testing supplements other risk management approaches and measures.

Sound Compensation Practices

Risk management must be embedded in the culture of a bank and should be under the critical focus of the Senior Management of the bank. For developing and maintaining a broad and deep risk management culture over time, compensation policies may be drawn which should be linked to longer-term capital preservation and the financial strength of the firm, and should consider risk-adjusted performance measures. In addition, a bank should provide adequate disclosure regarding its compensation policies to stakeholders.

C. Market Discipline - (**Pillar – 3**)

Market Discipline is termed as development of a set of disclosure requirements so that the market participants would be able to access key pieces of information on the scope of application, capital, risk exposures, risk assessment processes, and in turn the capital adequacy of the institution. It is considered as an effective means of informing the market about a bank's exposure to those risks and provides comparability. Non-compliance of the prescribed disclosure requirement attracts penalty including financial penalty.

Market discipline can contribute to a safe and sound banking environment. Hence, non-compliance with the prescribed disclosure requirements would attract a penalty, including financial penalty. It is recognized that the Pillar 3 disclosure framework does not conflict with the requirement under accounting standards which are broader in scope. RBI will consider future modifications to the Market Discipline disclosures as necessary in the light of its ongoing monitoring of this area and industry developments. Banks should have a formal disclosure policy approved by the Board of Directors that addresses the bank's approach for determining what disclosures it will make and the internal controls over the disclosure process.

The Pillar 3 disclosures as introduced under Basel III would become effective from **01.07.2013** and the first set of disclosures as required should be made by banks as on **30.09.2013** (with exception of Post March 31, 2017 template (dealt separately).

Pillar 3 applies at the top consolidated level of the banking group to which the Capital Adequacy Framework applies. Disclosures related to individual banks within the groups would not generally be required to be made by the parent bank. Banks are required to make Pillar 3 disclosures at least on a half yearly basis, irrespective of whether financial statements are audited, with the exception i.e. Capital Adequacy, Credit Risk: General Disclosure for all banks; and Credit Risk: Disclosures for Portfolios subject to the Standardised Approach. These are to be made at least on a quarterly basis by banks. All disclosures must either be included in a bank's published financial results/ statements or at a minimum, must be disclosed on bank's website.

Banks are required to make disclosures in the prescribed format by RBI. Banks are also required to maintain a 'Regulatory Disclosures Section' on their website where all information relating to disclosures will be made available to the market participants. The link should be prominently provided on the home page of the website so as to make it easily accessible. An archive for at least three years of all templates relating to prior reporting periods should be made available by banks on their websites.

Post March 31, 2017 Disclosure Template

A common template which will be used by banks to report the details of their regulatory capital after March 31, 2017 i.e. after the transition period for the phasing-in of deductions is over. It is designed to meet the Basel III requirement to disclose all regulatory adjustments. The template enhances consistency and comparability in the disclosure of the elements of capital between banks and across jurisdictions.

Template during the Transitional Period

During the transition period of phasing-in of regulatory adjustments under Basel III in India i.e. from April 1, 2013 to March 31, 2017, banks will use a modified version of the post March 31, 2017 template. This template is designed to meet the Basel III requirement for banks to disclose the components of capital which will benefit from the transitional arrangements.

Main Features Template

A common template has been designed to capture the main features of all regulatory capital instruments issued by a bank at one place. This disclosure requirement is intended to meet the Basel III requirement to provide a description of the main features of capital instruments.

Other Disclosure Requirements

This disclosure enables banks in meeting the Basel III requirement to provide the full terms and conditions of capital instruments on their websites.

Banks operating in India are required to make additional disclosures in respect of:-

(e) Securitisation exposures in the trading book;

(f) Sponsorship of off-balance sheet vehicles;

(g) Valuation with regard to securitisation exposures; and

(h) Pipeline and warehousing risks with regard to securitisation exposures

D. Capital Conservation Buffer Framework

Objective

The capital conservation buffer (CCB) is designed to ensure that banks build up capital buffers during normal times (i.e. outside periods of stress) which can be drawn down as losses incurred during a stressed period. The requirement is based on simple capital conservation rules designed to avoid breaches of minimum capital requirements. Outside the period of stress, banks should hold buffers of capital above the regulatory minimum. When buffers have been drawn down, one way banks should look to rebuild them is through reducing discretionary distributions of earnings. This could include reducing dividend payments, share buybacks and staff bonus payments. Banks may also choose to raise new capital from the market as an alternative to conserving internally generated capital. In the absence of raising capital from the market, the share of earnings retained by banks for the purpose of rebuilding their capital buffers should increase the nearer their actual capital levels are to the minimum capital requirement.

The capital conservation buffer can be drawn down only when a bank faces a systemic or idiosyncratic stress. A bank should not choose in normal times to operate in the buffer range simply to compete with other banks and win market share. This aspect would be specifically looked into by RBI during the SREP. The banks which draw down their capital conservation buffer during a stressed period should also have a definite plan to replenish the buffer as part of its ICAAP and strive to bring the buffer to the desired level within a time limit agreed to with RBI during the SREP.

The framework of capital conservation buffer will enable the banks to:-

(a) Strengthen the ability of banks to withstand adverse economic environment conditions,

(b) Help increase banking sector resilience both going into a downturn; and

(c) Provide the mechanism for rebuilding capital during the early stages of economic recovery.

By retaining a greater proportion of earnings during a downturn, banks will be able to help ensure that capital remains available to support the ongoing business operations / lending activities during the period of stress. Therefore, this framework is expected to help reduce pro-cyclicality.

Framework

Banks are required to maintain a capital conservation buffer of 2.5% of RWA in the form of Common Equity Tier 1 capital above the regulatory minimum capital requirement of 9%. CCB is to be phased-in over a period of 4 years in a uniform manner of 0.625% per year, commencing from 31.3.15. Banks should not distribute capital (i.e. pay dividends or bonuses in any form) in case capital level falls within this range. The constraints imposed are related to the distributions only and are not related to the operations of banks. The distribution constraints imposed on banks, when their capital levels fall into the range, increase as the banks' capital levels approach the minimum requirements. The minimum capital conservation ratios a bank must meet at various levels of the Common Equity Tier 1 capital ratios is shown as under:-

Minimum capital conservation standards for individual bank

CET 1 Ratio after including the current periods of retained earnings	Minimum Capital Conservation Ratios (in % of earnings)
5.5% - 6.125%	100%
>6.125% - 6.75%	80%
>6.75% - 7.375%	60%
>7.375% - 8.0%	40%
>8.0%	0%

It may be observed from the above that a bank with a Common Equity Tier 1 capital ratio in the range of 6.125% to 6.75% is required to conserve 80% of its earnings in the subsequent financial year (i.e. payout not more than 20% in terms of dividends, share buybacks and discretionary bonus payments is allowed). Basel III minimum capital conservation standards apply with reference to the applicable minimum CET1 capital and applicable CCB. During the transition period, banks may refer to the level of ratios provided by RBI in the Circular for meeting the minimum capital conservation ratios at various levels of the CET 1 capital ratios.

Capital conservation buffer is applicable both at the solo level (global position) as well as at the consolidated level, i.e. restrictions would be imposed on distributions at the level of both the solo bank and the consolidated group.

E. Leverage Ratio Framework

The leverage ratio provisions in the Basel III document are intended to serve as the basis for testing the leverage ratio during the parallel run period. The Basel Committee will test a minimum Tier 1 leverage ratio of 3% during the parallel run period from January 1, 2013 to January 1, 2017. The leverage ratio is calibrated to act as a credible supplementary measure to the risk based capital requirements. The main objective of the leverage ratio framework is:-

(a) constrain the build-up of leverage in the banking sector, helping avoid destabilising deleveraging processes which can damage the broader financial system and the economy; and

(b) reinforce the risk based requirements with a simple, non-risk based "backstop" measure

During the period of parallel run, banks should strive to maintain their existing level of leverage ratio but, in no case the leverage ratio should fall below 4.5%. A bank whose leverage ratio is below 4.5% may endeavor to bring it above 4.5% as early as possible. Final leverage ratio requirement would be prescribed by RBI after the parallel run taking into account the prescriptions given by the Basel Committee.

The leverage ratio shall be maintained on a quarterly basis. The basis of calculation at the end of each quarter is "the average of the month end leverage ratio over the quarter based on the definitions of capital (i.e. the capital measure) and the total exposure (i.e. the exposure measure) respectively as detailed in the RBI Circular.

(The criteria for Classification as Common Shares (Paid up Equity Capital) for Regulatory Purposes for Indian Banks as well as Foreign Banks, Detailed guidelines on issuance of various Debt Instruments viz. Innovative Perpetual Debt Instrument (IPDI), Perpetual Non-cumulative Preference Shares (PNCPS), Debt Capital Instruments, Perpetual Cumulative Preference Shares (PCPS), Credit Default Swaps (CDS), Illustrations on Credit Risk Mitigation (Loan Exposures) – Calculation of Exposure Amount for Collateralised transactions, Illustrations on computation of capital charge for Counterparty Credit Risk (CCR) – Repo Transactions, Measurement of capital charge for Market Risks in respect of Interest Rate Derivatives and Options, An Illustrative Approach for Measurement of Interest Rate Risk in the Banking Book (IRRBB) under Pillar 2, Redeemable Non-cumulative Preference Shares (RNPS), Redeemable Cumulative Preference Shares (RCPS), Subordinated Debts, Guidelines on Securitisation of Standard Assets, Illustrative Approach on Measurement of Capital Charge for Market Risks in respect of Interest Rate Risk and Derivatives, etc. are given in detail in the RBI Master Circular which also may be referred).

(*Source: RBI M. Circular dt. 01.07.13*)

PROFESSIONAL PROGRAMME

BANKING LAW AND PRACTICE

PP-BL&P

Open Book Examination in Elective Subjects (Paper - 9) in Module-III of Professional Programme (New Syllabus) Examination

Professional Programme (New Syllabus) offers five elective subjects in Module III, as mentioned herein below, out of which a student has to opt only one subject to study and qualify that suits his aptitude, interest, ability and career goal:

1. Banking Law and Practice
2. Capital, Commodity and Money Market
3. Insurance Law and Practice
4. Intellectual Property Rights-Law and Practice
5. International Business -Laws and Practices.

There is Open Book Examination (OBE) in all the above five elective subjects from June 2014 onwards. However, in all other subjects/modules of Professional Programme (New Syllabus), students would continue to be examined as per traditional pattern of examinations.

This is to inculcate and develop skills of creative thinking, problem solving and decision making amongst students of its Professional Programme and to assess their analytical ability, real understanding of facts and concepts and mastery to apply, rather than to simply recall replicate and reproduce concepts and principles in the examination.

In OBE, the candidates are allowed to consult their study material, class notes, textbooks, Bare Acts and other relevant papers, while attempting answers, as per the requirement of questions. The emphasis throughout is in assessing the students' understanding of the subject, applying their minds, rather than the ability to memorise large texts or rules or law.

Unlike a conventional/typical examination, which assesses how much information candiates have been able to store in their minds, the success in this type of examination depends on the candidate's ability to understand the question, identify inherent issues, application of various techniques, laws, principles, etc. while solving answers with the help of supporting reference material.

Broad pattern of Question Paper for OBE is as follows:

- Each question paper would contain **Six** questions carrying 100 marks
- Question No.1 will be of 50 marks based on case study ranging between 3000-4000 words.
- Question No.2 will be of 30 marks based on study of regulatory framework related to the subject.
- Question No.3-6 will be of 5 marks each covering important topics of the syllabus.

Candidates are not allowed to consult their fellow examinees or exchange their study material/notes, *etc.* with each other in the examination hall.

Candidates are prohibited to bring in any electronic devices, such as laptop, tab, I pad, palmtop, mobile phone, or any other electronic device/ gadget at the examination hall/room. However, they are permitted to use their own battery operated noiseless and cordless pocket calculator with not more than six functions, twelve digits and two memories.

PROFESSIONAL PROGRAMME EXAMINATION (NEW SYLLABUS)

ELECTIVE PAPER 9.1 – BANKING LAW AND PRACTICE

PRACTICE TEST PAPER

OPEN BOOK EXAMINATION

Time allowed: 3 hours *Max Marks: 100*

Attempt all questions. All questions are compulsory.

Question No. 1

Read the case study and answer all questions given at the end of the case:

ABC ALUMINIUM COMPANY PVT. LTD.

This case relates to m/s ABC Aluminium Company Pvt. Ltd, a SSI unit located at Delhi Rohatak road, Haryana. The unit is in an area where cluster of industries have come up. It is located in an industrial area where all the infrastructure facilities are available.

The total capacity of the plant was 10 TPD which comes to 3000MT per annum. The company was provided medium term loan (MTL) of Rs 150.00 lacs and a cash credit (working capital) advance of Rs 160.00 lac. The loan was sanctioned by a nationalized bank at Patna and a sub limit was provided from one of the branches located at New Delhi for better control and supervision of account.

The promoters (directors) were from Patna (Bihar). They had a wooden ply industry at Patna, where they earned good money. Later on, during 1996 the pollution control board-department of government did not permit falling of the trees and transporting of local wooden logs and owner of the ply unit who promoted ABC Aluminium Company Pvt. Ltd deserted Patna and shifted to Rohtak for setting up this aluminium based plant.

Since the directors had contact with the bank at Patna during their plywood business at Patna they had a good and long relationship with the bank at Patna. The promoters approached the nationalized bank at Patna for creating the ABC Aluminium Company Pvt. Ltd for financial assistance. The bank asks for certain important information to satisfy them before appraisal of the loan proposal. The information asked was:

- Application form dully filled in.
- Memorandum and Article of Association of the Company.
- Allotment of land by Haryana Government- Industrial Area Development Authority.
- Project Report.
- Details of layout-land, building and detailed drawings of;
    - Administrative building
    - Factory shed
    - Godowns
    - Other civil constructions
- Quotations of machinery
- Estimate of civil construction duly signed by a civil engineer.
- Details of collateral securities of directors- land and building offered.

– Details of land and building of the plant allotted by Government at Rohtak.

– Means of financial strength of promoters and total source of capital to be raised.

The bank appraised and sanctioned the loan. The raw material is locally available and import of scrap material is permitted at lower excise duty and found to be competitive.

The project performance was critically examined by the bank before sanction of the loan. The parameters covered were:

– Capacity of the project to perform.

– Projected level of working.

– The Break Even Point

– Sales at projected level

– Elements of cost of production

Based on the true value of expenses the projected performance at the time of sanction of loan was as under:

Projected level of working 50%			
Sales quantity = 1500 MT(Metric Tones) at 50% capacity			
Sales Price (average)= Rs 105,000 per MT			
	100% Level	50% Level	**(Rs in lacs)**
Yearly Sales	3150	1575	**A**
Variable Cost			
Cost of Raw Material	2677	1340	
Fuel for Furnace	112	56	
Fuel for DG set	52	26	
Other Fuel	26	13	
Cost of Tools & Dies	8	4	
Wages	15	10	
Sub Total	**2896**	**1453**	**B**
Contribution (A-B)	**254**	**122**	**C**
Fixed Cost			
Salary	6	6	
Selling General and administrative expenses	24	24	
Interest on Working Capital	48	24	
Interest on Term Loan	18	18	
Depreciation	12	12	

Total Fixed Cost	**108**	**84**	**D**
PBT (C-D)	146	38	
Depreciation	12	12	
Cash Accrual	158	50	
Break Even Sales	1339.37	1084.42	
Break Even %	42.51	68.85% of Operation	

Based on the performance the term loan against fixed assets amounting to Rs 150 lacs was Sanctioned to be repaid in seven years and was termed as medium term loan (MTL). Also using the Tandon committee norms a working capital of Rs 160 lacs was sanctioned.

After the sanctioned was made following securities were obtained:

– Hypothecation of stocks

– Pledge of land, buildings, plant and machinery and other assets of the company.

– Equitable mortgage of director's property (land and building) offered as collateral security.

– Liens on the shares hold by directors.

– A lien on NSC and PPF.

– Creating charge of assets of the company with Registrar of the Company, being a private limited company.

Later on during the year 2002 the company's performance declined which was a threat and an early warning signal for the bank and for the company. The symptoms noticed by the bank were:

– Sales proceeds were not fully rooted through bank account.

– The drawing power declined and account became irregular.

– The term loan instalments became overdue due to non-payment in time.

– The account was feared to be NPA.

The matter was reported to the head office of the bank and a detailed study was conducted by a team of experts the details of diagnostic study and its recommendations follows.

Technical feasibility and problem faced by the company were conducted, the details of which are:

Process of manufacturing

It was found to be a successful process and was accepted by the bank.

Capacity of the plant

The machines were found in sound state of operation and the capacity was arrived at 3000 MT per annum while working on three shifts.

During the study to minimise losses and improve the quality of product following recommendations were made:

– The scrap should be shorted out based on their quality.

– Small and lighter scraps should be bundled on bundling machines to give it a compact look. For each charge an input output record needs to be maintained to measure operational losses.

– The quality of raw material should be chemically examined before charging in to the furnace. For this a simple material testing equipment is needed. The charge to the furnace needs to be standardized.

– At furnace point there should be a temperature measuring device to exactly note the temperature.

Land and building

It was observed that land and building is adequate to accommodate the present facilities needed for production and there is a room for 100% expansion.

Teething problems faced

At the time of financing the proposal there was no room for tools and dies which is a large component of investment. The company created a die-shop by diverting funds without informing the bank. It was a necessary component of the project cost which was not taken in to account while sanctioning the project. The cost of die-shop and dies was about Rs 20lacsand this resulted in to short fall in working capital fund due to diversion in this case short term source was used for long term uses causing a setback in the current asset value. The project was found technically feasible and was in a perfect working order.

Economic viability

Following data were analysed and based on these current data the economic feasibility was determined:

– Work force strength planning and its cost.

– Cost of raw material- a material-mix was arrived at. The weighted average material cost was arrived at Rs 89,250 per MT including 5% losses during the process.

Revised working capital was assessed and the components of working capital were as under:

Raw materials	23 days
Stock in process	7 days
Finished goods	9 days
Receivables	26 days
Total working capital cycle	60 days

It was seen that the present working capital limit was adequate but there was a gap between the current asset needed and current asset available. Which needs to be bridged by the company?

The company was found to be economically viable and capable to serve its interest and instalments for medium term loan already granted to it.

What went wrong?

– The company did not record its sales fully and due to unrecorded sales it resulted in to wrong performance than actual.

– The company also followed the practice of under billing.

– Sells to some small petty traders were not recorded at all and such traders were twenty two in numbers.

– Company diverted about Rs 25lacs in creating a tool room and dies which resulted in to diversion of fund within the industry (diversion from short term sources to long term uses).

– The company opened an account in different bank and routed the sales and deposit through current account which was not proper.

– There was exemption of sales tax (vat) which the company did not avail fully which was due to their inclination towards cash dealing without billing.

– The bank-customer relation was affected badly leading to strain relationship.

– Stock statements were not submitted in time and bank operation turned poorer day by day.

– The directors have created good asset in the form of self-owned building at Rohtak out of fund generated but diverted. Here this case was an example of healthy entrepreneur and sick industry.

The diversion of fund was traced and this amounted to about Rs 190 lacs during the past four years of operations which were as under:

Under billing	Rs. 150 lacs
Dies and tool room	Rs. 25 lacs
Construction of house	Rs. 50 lacs
Total	**Rs. 190 lacs**

This resulted into short fall in working capital and instalments payments to the bank resulting in to this bad shape.

Past four years of operation is an indicator of manipulation of facts which is detailed here under:

Year wise cash Accrual

				(*Rs. in lacs*)
Year	*Profit/Loss*	*Depreciation*	*Cash Accrual*	*Sales*
1998-99	(-1.51)	10.77	9.26	241.90
1999-2000	(-2.20)	10.64	8.44	175.45
2000-2001	0.36	11.00	11.36	324.86
2001-2002	(-13.8)	11.25	(-2.55)	240.01
Total Cash accrual			26.51	

The sales do not correlate with profit or cash accrual and the diversion of fund is feared.

The increase in depreciation shows that there is a creation of fixed asset by diversion of fund. The fixed assets added were as under:

Year	(Rs in lacs)
1998-99	23.17
1999-00	10.49
2000-01	11.15
2001-02	06.50
Total	51.31

Decision by the bank to take up the rehabilitation/ restructuring

The account in the books of the bank has turned sticky and irregular and is classified as NPA but it has strength for rehabilitation and restructuring since the major diversion were within the business. It may be considered for rehabilitation and restructuring. Following were the terms and conditions of the bank for taking up this case for rehabilitation:

– Closing the account of another bank- CBI Paharganj, New Delhi as banking with other bank is not allowed mainly which is not lender to the company.

– Providing additional working capital mainly coverage of Sundry Dr by clean bill limit.
– Restructuring the term loan and its repayment plan.
– Since it was a wilful default, no concession in interest should be permitted.
– The company should route the sales proceeds through bank account only and avail the bill limit by drawing bills through bank.
– The company must start working at least at 40% capacity utilisation which is higher than BEP and try to increase its level of operation subsequently.
– Additional security should be provided in the following manner.
  - Pledge or mortgage of additional fixed assets created by diversion of fund.
  - Equitable mortgage of land and building of directors created in personal or family name.
  - Hypothecation of current assets covered under working capital and its renewal from time to time.
  - Bringing fund in proportion to margin (own contribution) as required by the bank by raising the paid up capital.

Considering the facts and reasonable opportunity and probability to put the company on a proper track it is possible to rehabilitate the company by adopting honest practices and by creating a smooth bank-customer relationship. The care the bank should take is a stricter follow up, monitoring and control.

This decision will bring the company as a successful venture and will turn it in to a growing concern. This decision will add to the following advantages:

– The assets which may turn idle or scrap will be utilised.
– It will create better employment opportunity for the youth.
– The banks money will be realised and its NPA will be reduced. Also the bank will gain in long term in the form of interest earning which will keep on growing in relation to the growth of the company.
– The company directors and shareholders will be satisfied persons.
– By growth the company will expand providing more services to the nation.

Questions: (related to case study)

Answer all questions

a) What have you learnt from this case?
b) Why this industry faced this problem?
c) Is it the case of NPA or sickness?
d) How did the bank tackle this case?
e) What were wrong practices the company adopted?
f) What corrective measures do you suggest?
g) Conduct a SWOT analysis on this case?
h) What were the recommendations of the bank? Do you agree with the bank's decision?
i) For additional security of the loan what documents you should obtain as a branch manager?
j) It is very easy to call up the loan ending the bank-customer relationship but it is difficult to retain it for

a longer period. In your opinion what would be the advantages to the company, its shareholders, bank and the nation if it is brought back to good health as a discipline entrepreneur?

(***5 marks each***)

Question No. 2

Answer all the following questions.

a) What are the important documents banks generally obtain for each liability (loan) created? Mention period of each type of documents before it is time barred. As a consultant to the bank what guide lines you should provide to the bank to prevent the document to become time barred?

(***10 marks***)

b) You are working as a bank manager and have received a loan proposal for a large industrial sector related to setting up a thermal power plant. The total loan requirement is Rs 10,000 Crores which for a single bank is not feasible. What step you will take to see that the requirement of Rs 10,000 Crores is met?

(***10 marks***)

c) What are the problems faced by India in implementing BASEL committee report?

(***10 marks***)

Question No. 3

For a quick and honest grievance redressal 'Banking Ombudsman' was created. Discuss the objectives of Ombudsman and type of grievances generally covered under it. Is it advantageous to the society and will it acts as a tool to create a healthier and an ethical customer relationship? Support your answer with suitable examples where help from 'Banking Ombudsman' can be taken.

(***5 marks***)

Question No. 4

Mechanisation and e-banking has provided speed and comfort for both the banks and the customers but at the same time it has generated risks. Discuss the risks associated with e- banking and your suggestions to minimise it. Give suitable examples of risks possible in e- banking system and its control mechanism.

(***5 marks***)

Question No. 5

In the year 1935 Reserve Bank of India Act was framed and after independence the Banking Regulation Act 1949 was created. Describe the reasons of this change and important provisions built in it. Explain how this Act is going to strengthen the banking system in India.

(***5 marks***)

Question No. 6

a) What is Garnishee order and where is it applied? Narrate two situations where the Garnishee order will not be applicable.

b) What are the uses of Right of General Lien and Right of Set Off? Give an example of Right of Set Off.

(***5 marks***)