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RESERVE BANK OF INDIA

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

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

Chapter I
Preliminary

A Short title and commencement

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

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

B Applicability

3. These Directions shall be applicable to Payments Banks (PBs) (hereinafter collectively referred to as 'banks' or 'PBs' and individually as a 'bank' or 'PB').

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

C Definitions

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

(1) 'Banking book' shall mean all items which are not included under trading book as per these Directions;

(2) 'Capital Market Exposures' shall include a bank's direct investment in equity shares, convertible bonds, convertible debentures and units of equity-oriented mutual funds the corpus of which is not exclusively invested in corporate debt;

(3) 'Counterparty Credit Risk (CCR)' is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. An economic loss would occur if the transactions or portfolio of transactions with the counterparty has a positive economic value at the time of default. Unlike a bank's exposure to credit risk through a loan, where the exposure to credit risk is

unilateral and only the lending bank faces the risk of loss, CCR creates a bilateral risk of loss, i.e., the market value of the transaction can be positive or negative to either counterparty to the transaction. The market value is uncertain and can vary over time with the movement of underlying market factor;

(4) 'Clearing member' is a member of, or a direct participant in, a CCP that is entitled to enter into a transaction with the CCP, regardless of whether it enters into trades with a CCP for its own hedging, investment, or speculative purposes or whether it also enters into trades as a financial intermediary between the CCP and other market participants. For this Master Direction, where a CCP has a link to a second CCP, that second CCP is to be treated as a clearing member of the first CCP. Whether the second CCP's collateral contribution to the first CCP is treated as initial margin or a default fund contribution shall depend upon the legal arrangement between the CCPs. In such cases, if any, the Reserve Bank shall be consulted for determining the treatment of this initial margin and default fund contributions;

(5) 'Client' in the context of transactions with a CCP is a party to a transaction with a CCP through either a clearing member acting as a financial intermediary, or a clearing member guaranteeing the performance of the client to the CCP;

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

(7) 'Cross product netting' refers to the inclusion of transactions of different product categories within the same netting set;

(8) '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;

(9) 'Default funds', also known as clearing deposits or guarantee fund contributions (or any other names), are clearing members' funded or unfunded contributions towards, or underwriting of, a CCP's mutualised loss sharing arrangements. The description given by a CCP to its mutualised loss sharing arrangements is not

determinative of their status as a default fund; rather, the substance of such arrangements shall govern their status;

(10) 'Deferred Tax Assets' and 'Deferred Tax Liabilities' shall have the same meaning as assigned under the applicable Accounting Standards;

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

(12) 'Going-concern Capital', from a regulatory perspective, is the capital which shall absorb losses without triggering bankruptcy of the bank;

(13) 'Gone-concern Capital', from a regulatory perspective, is the capital which shall absorb losses only in case of liquidation of the bank;

(14) 'Initial margin' means a clearing member's or client's funded collateral posted to the CCP to mitigate the potential future exposure of the CCP to the clearing member arising from the possible future change in the value of their transactions. For the purposes of these guidelines, initial margin does not include contributions to a CCP for mutualised loss sharing arrangements (i.e., in case a CCP uses initial margin to mutualise losses among the clearing members, it shall be treated as a default fund exposure);

(15) 'Legal risk' includes, but is not limited exposure to fines, penalties, or punitive damages resulting from supervisory actions, as well as private settlements;

(16) 'Leverage Ratio' is the net worth (the numerator) divided by the outside liabilities (the denominator), with this ratio expressed as a percentage;

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

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

(18) 'Member Lending Institutions (MLIs)' are as defined in respective schemes of the National Credit Guarantee Trustee Company Ltd (NCGTC);

(19) 'Netting Set' is a group of transactions with a single counterparty that are subject to a legally enforceable bilateral netting arrangement and for which netting is recognised for regulatory capital purposes. Each transaction that is not subject to a legally enforceable bilateral netting arrangement that is recognised for

regulatory capital purposes shall be interpreted as its own netting set for the purpose of these rules;

(20) 'Offsetting transaction' means the transaction leg between the clearing member and the CCP when the clearing member acts on behalf of a client (e.g., when a clearing member clears or novates a client's trade);

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

(22) 'Other approved securities' shall have the same meaning as defined under Reserve Bank of India (Small Finance Banks – Cash Reserve Ratio and Statutory Liquidity Ratio) Directions, 2025 as amended from time to time;

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

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

(25) 'Subsidiary' shall mean an enterprise that is controlled by another enterprise (known as the parent). The definition of 'control' shall be as given in the applicable Accounting Standards;

(26) 'Trade exposures' include the current exposure and potential future exposure of a clearing member or a client to a CCP arising from Over-the-counter (OTC) derivatives, exchange traded derivatives transactions or SFTs, as well as initial

margin. The current exposure of a clearing member includes the variation margin due to the clearing member but not yet received;

(27) 'Trading Book' shall include all instruments that are classified as 'Held for Trading' as per Reserve Bank of India (Payment Banks – Classification, Valuation and Operation of Investment Portfolio) Directions, 2025;

(28) 'Variation margin' means a clearing member's or client's funded collateral posted on a daily or intraday basis to a CCP based upon price movements of their transactions.

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

Chapter II

Regulatory Capital

A General

6. A bank shall compute its capital ratios in the following manner:

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

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

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

B Components of Regulatory Capital

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

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

  (i) Common Equity Tier 1 (CET 1) Capital;

  (ii) Additional Tier 1 (AT 1) Capital.

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

C Limits and minima

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

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

(2) CET 1 Capital shall be at least 6 per cent of the RWAs on an ongoing basis;

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

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

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

D Common Equity Tier 1 (CET 1) Capital

9. CET 1 capital of a bank shall comprise the following:

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

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

(iii) Statutory reserves;

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

(v) AFS Reserve

Note-

(1) AFS – Reserve shall be as per the Reserve Bank of India (Payment Banks – Classification, Valuation and Operation of Investment Portfolio) Directions, 2025.

(2) Any negative balance in the AFS - Reserve shall be deducted from CET 1 capital;

(vi) Revaluation reserves arising out of change in the carrying amount of a bank's property consequent upon its revaluation may be reckoned as CET

1 capital at a discount of 55 per cent, subject to meeting the following conditions:

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

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

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

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

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

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

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

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

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

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

(viii) Other disclosed free reserves, if any;

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

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

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

where

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

NP_t = Net profit up to the quarter 't'

D = average annual dividend paid during last three years

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

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

Criteria for classification as Common Shares (paid-up equity capital) for Regulatory Capital purposes

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

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

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

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

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

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

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

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

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

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

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

(xi) The paid-up amount is classified as equity under the relevant Accounting Standards;

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

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

Explanation - A related entity can include a parent company, a sister company, a subsidiary, or any other affiliate. A holding company is a related entity irrespective of whether it forms part of the consolidated banking group;

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

(xv) Paid-up capital is clearly and separately disclosed in the bank's Balance Sheet.

E Additional Tier 1 (AT 1) Capital

11. AT 1 capital shall comprise the following:

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

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

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

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

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

E.1 Criteria for inclusion of Basel III Perpetual Non-Cumulative Preference Shares (PNCPS) in AT 1 Capital

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

(1) Paid up status

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

(2) Amount

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

(3) Limits

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

(4) Maturity Period

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

(5) Rate of Dividend

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

(6) Optionality

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

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

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

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

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

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

(a) It replaces the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank. Replacement issues can be concurrent with but not after the instrument is called; OR

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

Explanation - Here, minimum refers to CET 1 capital of 6 per cent, Tier 1 capital of 7.5 per cent and total capital of 15 per cent;

(v) The use of tax event and regulatory event calls may be permitted. However, exercise of the calls on account of these events is subject to the requirements set out in paragraph 12(6)(ii) to 12(6)(iv). The Reserve Bank

may permit the bank to exercise the call only if it is convinced that the bank was not in a position to anticipate these events at the time of issuance of PNCPS.

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

(7) Repurchase / Buy-back / Redemption

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

(8) A bank may Repurchase / Buy-back / Redeem the instruments only if:

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

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

(9) Dividend Discretion

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

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

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

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

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

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

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

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

future years, even if adequate profit is available and the level of CRAR conforms to the regulatory minimum;

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

(viii) A bank may have dividend stopper arrangement that stops dividend payments on common shares in the event the holders of AT 1 instruments are not paid dividend / coupon. However, dividend stoppers shall neither impede the full discretion that bank shall have at all times to cancel distributions / payments on the AT 1 instrument, nor shall they act in a way that could hinder the re-capitalisation of the bank. For example, it shall not be permitted for a stopper on an AT 1 instrument to:

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

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

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

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

(10) Treatment in Insolvency

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

(11) Loss Absorption Features

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

(12) Prohibition on purchase / funding of PNCPS

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

(13) Re-Capitalisation

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

(14) Reporting of non-payment of dividends and non-exercise of call option

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

(15) Seniority of Claim

The claims of the investors in instruments shall be:

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

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

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

(16) Investment in instruments raised in Indian rupees by Foreign Entities / Non-Resident Indians (NRIs)

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

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

(17) Compliance with Reserve Requirements

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

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

(18) Reporting of Issuances

(i) A bank issuing PNCPS shall submit a report to the Chief General Manager-in-Charge, Department of Regulation, Central Office, Reserve Bank of India, Mumbai, giving details of the instrument as per the format prescribed in Annex II duly certified by the Chief Compliance Officer of the bank, soon after the issue is completed; and

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

(19) Investment in AT 1 capital instruments (PNCPS) Issued by other banks / Financial Institutions (FIs)

(i) A bank's investment in PNCPS issued by other banks and FIs shall be reckoned along with the investment in other instruments eligible for capital status while computing compliance with the overall ceiling of 10 per cent of investing banks' total regulatory capital as prescribed vide paragraph 18(7)(i) and also subject to cross holding limits;

(ii) A bank's investments in PNCPS issued by other banks / FIs shall attract risk weight as provided in paragraph 31 of these Directions, whichever applicable for capital adequacy purposes.

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

(20) Classification in the Balance Sheet

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

(21) PNCPS to Retail Investors

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

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

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

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

E.2 Criteria for inclusion of Basel III Perpetual Debt Instrument (PDI) in AT 1 capital

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

Terms of issue of instruments denominated in Indian rupees

(1) Paid-in Status

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

(2) Amount

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

(3) Limits

While complying with minimum Tier 1 of 7.5 per cent of RWAs, a bank cannot admit, PDI together with PNCPS in AT 1 capital, more than 1.5 per cent of RWAs. However, once this minimum total Tier 1 capital has been complied with, any

additional PNCPS and PDI issued by the bank can be included in total Tier 1 capital reported. While complying with minimum total capital of 15 per cent of RWAs, any excess PNCPS and PDI can be reckoned to comply with Tier 2 capital if the latter is less than 7.5 per cent of RWAs..

(4) Maturity Period

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

(5) Rate of Interest

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

(6) Optionality

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

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

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

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

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

(a) It replaces the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank. Replacement issue can be concurrent with but not after the instrument is called; or

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

Explanation - Minimum capital requirement refers to CET 1 of 6 per cent of RWAs, Tier capital of 7.50 per cent of RWAs, and total capital of 15 per cent of RWAs.

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

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

(7) Repurchase / Buy-back / Redemption

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

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

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

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

(8) Coupon Discretion

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

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

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

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

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

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

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

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

Note: As provided in Reserve Bank of India (Payment Banks – Classification, Valuation and Operation of Investment Portfolio) Directions, 2025, the unrealised gains transferred to AFS – Reserve shall not be available for any distribution such as coupon on AT 1 capital instruments;

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

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

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

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

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

(vii) The interest shall not be cumulative;

(viii) The instrument shall not have a credit sensitive coupon feature, i.e., a dividend that is reset periodically based in whole or in part on the bank's credit standing. For this purpose, any reference rate including a broad index which is sensitive to changes to the bank's own creditworthiness and / or to

changes in the credit worthiness of the wider banking sector shall be treated as a credit sensitive reference rate. A bank desirous of offering floating reference rate may take prior approval of the Reserve Bank (Department of Regulation) as regard permissibility of such reference rates;

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

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

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

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

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

(9) Treatment in Insolvency

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

(10) Loss Absorption Features

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

on Capital Adequacy) Directions, 2025. The pre-specified trigger for loss absorption for PDIs shall be at least CET 1 capital of 7 per cent of RWAs.

(11) Prohibition on purchase / funding of instruments

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

(12) Re-Capitalisation

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

(13) Reporting of non-payment of coupons and non-exercise of call option

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

(14) Seniority of claim

The claims of the investors in instruments shall be:

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

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

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

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

(i) Investment by FIIs in instruments raised in Indian Rupees shall be outside the ECB limit for rupee denominated corporate debt, as fixed by the Government of India from time to time, for investment by FIIs in corporate debt instruments. Investment in these instruments by FIIs and NRIs shall

be within an overall limit of 49 per cent and 24 per cent of the issue, respectively, subject to the investment by each FII not exceeding 10 per cent of the issue and investment by each NRI not exceeding 5 per cent of the issue.

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

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

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

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

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

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

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

(17) Compliance with Reserve Requirements

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

(18) Reporting of Issuances

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

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

(i) A bank's investment in debt instruments issued by other banks and financial institutions shall be reckoned along with the investment in other instruments eligible for capital status while computing compliance with the overall ceiling of 10 per cent of investing banks' total regulatory capital as prescribed under paragraph 18(7)(i) of these Directions and also subject to cross holding limits; and

(ii) Bank's investments in debt instruments issued by other banks shall attract risk weight for capital adequacy purposes, as prescribed in paragraph 31 of these Directions.

(20) Classification in the Balance Sheet

The amount raised by way of issue of debt capital instrument shall be classified under 'Schedule 4 - Borrowings' in the Balance Sheet.

(21) PDIs to Retail Investors

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

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

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

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

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

F Tier 2 capital

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

(i) General Provisions and Loss Reserves

(a) Provisions or loan-loss reserves held against future, presently unidentified losses, which are freely available to meet losses which subsequently materialise, shall qualify for inclusion within Tier 2 capital. Accordingly, general provisions on standard assets, floating provisions, excess provisions which arise on account of sale of NPAs, and 'countercyclical provisioning buffer' shall qualify for inclusion in Tier 2 capital. However, these items together shall be admitted as Tier 2 capital up to a maximum of 1.25 per cent of the total credit RWAs under the standardised approach.

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

(b) Investment Fluctuation Reserve

(c) Provisions ascribed to identified deterioration of particular assets or loan liabilities, whether individual or grouped shall be excluded. Accordingly, for instance, specific provisions on NPAs, both at individual account or at portfolio level, provisions in lieu of diminution in the fair value of assets in the case of restructured advances,

provisions against depreciation in the value of investments shall be excluded.

(ii) Basel III debt capital instruments issued by the bank, which comply with the regulatory requirements as specified in paragraph 15;

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

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

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

F.1 Criteria for inclusion of Basel III Debt Capital Instruments as Tier 2 capital

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

Terms of Issue of Instruments Denominated in Indian Rupees

(1) Paid-in status

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

(2) Amount

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

(3) Maturity period

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

(4) Discount

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

Table 1: Progressive discount on debt instruments to be included in Tier 2

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

(5) Rate of interest

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

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

(6) Optionality

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

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

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

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

(a) It replaces the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank. Replacement issues can be concurrent with but not after the instrument is called; or

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

Explanation - Minimum refers to CET 1 capital of 6 per cent of RWAs, Tier 1 capital of 7.5 per cent of RWAs and Total Capital of 15 per cent of RWAs;

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

(7) Loss Absorption Features

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

(8) Treatment in Bankruptcy / Liquidation

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

(9) Prohibition on Purchase / Funding of Instruments

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

(10) Reporting of non-payment of coupons and non-exercise of call option

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

(11) Seniority of Claim

The claims of the investors in instruments shall be

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

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

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

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

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

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

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

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

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

(14) Terms of issue of Basel III Tier 2 Debt capital instruments in foreign currency

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

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

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

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

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

(15) Compliance with reserve requirements

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

(ii) The total amount raised by a bank through Tier 2 instruments shall be reckoned as liability for the calculation of net demand and time liabilities for

the purpose of reserve requirements and, as such, will attract CRR / SLR requirements.

(16) Reporting of Issuances

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

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

(i) A bank's investment in Tier 2 debt instruments issued by other banks and FIs shall be reckoned along with the investment in other instruments eligible for capital status while computing compliance with the overall ceiling of 10 per cent of investing bank's total regulatory capital prescribed under paragraph 18(7)(i) and also subject to cross holding limits; and

(ii) Bank's investments in Tier 2 instruments issued by other banks / FIs will attract risk weight as per paragraph 31 of these Directions.

(18) Classification in the Balance Sheet

The amount raised by way of issue of Tier 2 debt capital instrument shall be classified under 'Schedule 4 – Borrowings' in the Balance Sheet.

(19) Debt capital instruments to retail investors

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

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

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

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

in the Draft Shelf Prospectus, Shelf Prospectus and Tranche Document "; and

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

F.2 Criteria for inclusion of Basel II Upper Tier 2 debt capital instruments as Tier 2 capital

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

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

(1) Amount

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

(2) Limits

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

(3) Maturity Period

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

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

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

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

(4) Rate of interest

The interest payable to the investors shall be either at a fixed rate or at a floating rate referenced to a market determined rupee interest benchmark rate. The instrument shall not have a credit sensitive coupon feature, i.e., a coupon that is reset periodically based in whole or in part on the banks' credit standing. A bank desirous of offering floating reference rate shall take prior approval of the Reserve Bank (Department of Regulation) as regard permissibility of such reference rates.

(5) Options

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

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

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

(6) Step-up option

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

(7) Lock-in-Clause

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

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

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

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

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

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

(8) Seniority of claim

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

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

(ii) superior to the claims of Basel III Tier 2 debt capital instruments;

(iii) subordinate to the claims of Basel II Lower Tier 2 debt capital instruments;

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

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

(9) Redemption

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

(10) Other conditions

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

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

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

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

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

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

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

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

(12) Compliance with Reserve Requirements

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

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

(13) Reporting requirements

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

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

(i) A bank's investment in Upper Tier 2 instruments issued by other banks and FIs shall be reckoned along with the investment in other instruments eligible for capital status while computing compliance with the overall ceiling of 10 percent of an investing bank’s total regulatory capital as prescribed vide paragraph 18(7)(i) and also subject to cross holding limits.

(ii) A bank's investments in Upper Tier 2 instruments issued by other banks / financial institutions shall attract risk weight as per paragraph 31 of these Directions.

(15) Prohibition on purchase / funding of instruments

Neither the bank nor a related party over which the bank exercises control or significant influence (as defined under relevant accounting standards) shall purchase the instrument, nor shall the bank directly or indirectly fund the purchase of the instrument. A bank shall also not grant advances against the security of the Upper Tier 2 instruments issued by it.

(16) Classification in the Balance Sheet

The amount raised through Upper Tier 2 capital instruments shall be classified under ‘Schedule 4- Borrowing’ in the Balance Sheet.

(17) Treatment in bankruptcy / liquidation

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

(18) Reporting of non-payment of coupons and non-exercise of call option

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

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

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

(20) Upper Tier 2 debt capital instruments to retail investors

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

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

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

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

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

having understood these features and other terms and conditions of the instrument should be obtained.

F.3 Criteria for inclusion of Basel II Lower Tier 2 Debt Instruments as Tier 2 Capital

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

Terms of issue of bond

(1) Amount

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

(2) Maturity period

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

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

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

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

(3) Rate of interest

The interest payable to the investors shall be either at a fixed rate or at a floating rate referenced to a market determined rupee interest benchmark rate. The instrument shall not have a credit sensitive coupon feature, i.e., a coupon that is

reset periodically based in whole or in part on the banks' credit standing. A bank desirous of offering floating reference rate shall take prior approval of the Reserve Bank (Department of Regulation) as regard permissibility of such reference rates.

(4) Call option

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

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

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

(5) Step-up option

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

(6) Seniority of claim

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

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

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

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

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

(7) Other conditions

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

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

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

(8) Limits

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

(9) Prohibition on purchase / funding of instruments

Neither the bank nor a related party over which the bank exercises control or significant influence (as defined under relevant Accounting Standards) shall purchase the instrument, nor shall the bank directly or indirectly fund the purchase of the instrument. A bank shall also not grant advances against the security of the Lower Tier 2 instruments issued by it.

(10) Compliance with reserve requirements

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

(11) Treatment of investment in subordinated debt

Investments by a bank in subordinated debt of other banks shall be assigned 100 per cent risk weight for capital adequacy purpose. Also, a bank's investment in Lower Tier 2 instruments issued by other banks and FIs shall be reckoned along with the investment in other instruments eligible for capital status while computing compliance with the overall ceiling of 10 percent of an investing bank’s total regulatory capital as prescribed vide paragraph 18(7)(i) and also subject to cross holding limits.

(12) Subordinated debt to retail investors

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

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

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

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

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

(13) Subordinated debt in foreign currency

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

(14) Reporting requirements

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

(15) Classification in the balance sheet

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

(16) Treatment in bankruptcy / liquidation

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

(17) Reporting of non-payment of coupons and non-exercise of call option

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

G Regulatory adjustments / deductions

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

(1) Goodwill and all other Intangible Assets

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

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

(2) Deferred Tax Assets (DTAs)

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

(ii) DTAs which relate to timing differences (other than those related to accumulated losses) may, instead of full deduction from CET 1 capital, be recognised in the CET 1 capital up to 10 per cent of a bank's CET 1 capital, at its discretion [after the application of all regulatory adjustments mentioned from paragraphs 18(1) to 18(7)(ii)(c)(ii)]

(iii) Further, the limited recognition of DTAs as at paragraph (ii) above along with limited recognition of significant investments in the common shares of financial (i.e., banking, financial and insurance) entities in terms of paragraph 18(7)(ii)(c)(iii) taken together shall not exceed 15 per cent of the CET 1 capital, calculated after all regulatory adjustments set out from paragraphs 18(1) to 20(8). Paragraph 18(2)(vi) below provides an illustration of this applicable limited recognition. However, a bank shall ensure that the CET 1 capital arrived at after application of 15 per cent limit, specified above, shall in no case result in recognising any item more than the 10 per cent limit applicable individually.

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

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

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

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

(v) The amount of DTAs which is not deducted from CET 1 capital (in terms of paragraph 18(2)(ii) above) shall be risk weighted at 250 per cent as in the case of significant investments in common shares not deducted from bank's CET 1 capital as indicated in paragraph 18(7)(ii)(c)(iii).

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

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

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

Note-

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

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

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

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

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

(3) Cash flow hedge reserve

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

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

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

(ii) If a bank values its derivatives and securities financing transactions (SFTs) liabilities taking into account its own creditworthiness in the form of debit valuation adjustments (DVAs), then the bank shall deduct all DVAs from its CET 1 capital, irrespective of whether the DVAs arises due to changes in its own credit risk or other market factors. Thus, such deduction shall also include the deduction of initial DVA at inception of a new trade.

(5) Defined Benefit Pension Fund (including other defined employees' funds) assets and liabilities

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

DTL which will be extinguished if the asset becomes impaired or derecognised under the relevant accounting standards.

(6) Investments in own shares (Treasury stock)

(i) Investment in a bank's own shares shall be tantamount to repayment of capital and therefore, it is necessary to knock-off such investment from the bank's capital with a view to improving the bank's quality of capital. This deduction shall remove the double counting of equity capital arising from direct holdings, indirect holdings via index funds and potential future holdings as a result of contractual obligations to purchase own shares.

(ii) A bank shall not repay its equity capital without specific approval of the Reserve Bank. Repayment of equity capital can take place by way of share buy-back, investments in own shares (treasury stock) or payment of dividends out of reserves, none of which is permissible. However, a bank may end up having indirect investments in its own stock if it invests in / takes exposures to mutual funds or index funds / securities which have long position in the bank's share. In such cases, the bank shall look through holdings of index securities to deduct exposures to own shares from its CET 1 capital. Following the same approach outlined above, a bank shall deduct investments in its own AT 1 capital from the calculation of its AT 1 capital and investments in its own Tier 2 capital from the calculation of its Tier 2 capital. In this regard, the following rules may be observed:

(a) If the amount of investments made by the mutual funds / index funds / venture capital funds / private equity funds / investment companies in the capital instruments of the investing bank is known, the indirect investment shall be equal to the bank's investments in such entities multiplied by the percent of investments of these entities in the investing bank's respective capital instruments.

(b) If the amount of investments made by the mutual funds / index funds / venture capital funds / private equity funds / investment companies in the capital instruments of the investing bank is not known but, as per the investment policies / mandate of these entities such investments are permissible, the indirect investment would be equal

to the bank's investments in these entities multiplied by 10 per cent of investments of such entities in the investing bank's capital instruments. A bank shall not follow corresponding deduction approach, i.e., all deductions shall be made from the CET 1 capital even though, the investments of such entities are in the AT 1 / Tier 2 capital of an investing bank.

Note - In terms of Securities and Exchange Board of India (SEBI) (Mutual Funds) Regulations 1996, no mutual fund under all its schemes should own more than ten per cent of any company's paid-up capital carrying voting rights.

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

The rules under this paragraph shall be applicable to a bank's equity investments in other banks and financial entities, even if such investments are exempted from 'capital market exposure' limit.

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

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

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

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

(ii) Non-Banking Finance Companies;

(iii) Housing Finance Companies;

(iv) Primary Dealers;

(v) Merchant Banking Companies;

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

(vii) Central Counterparties (CCPs);

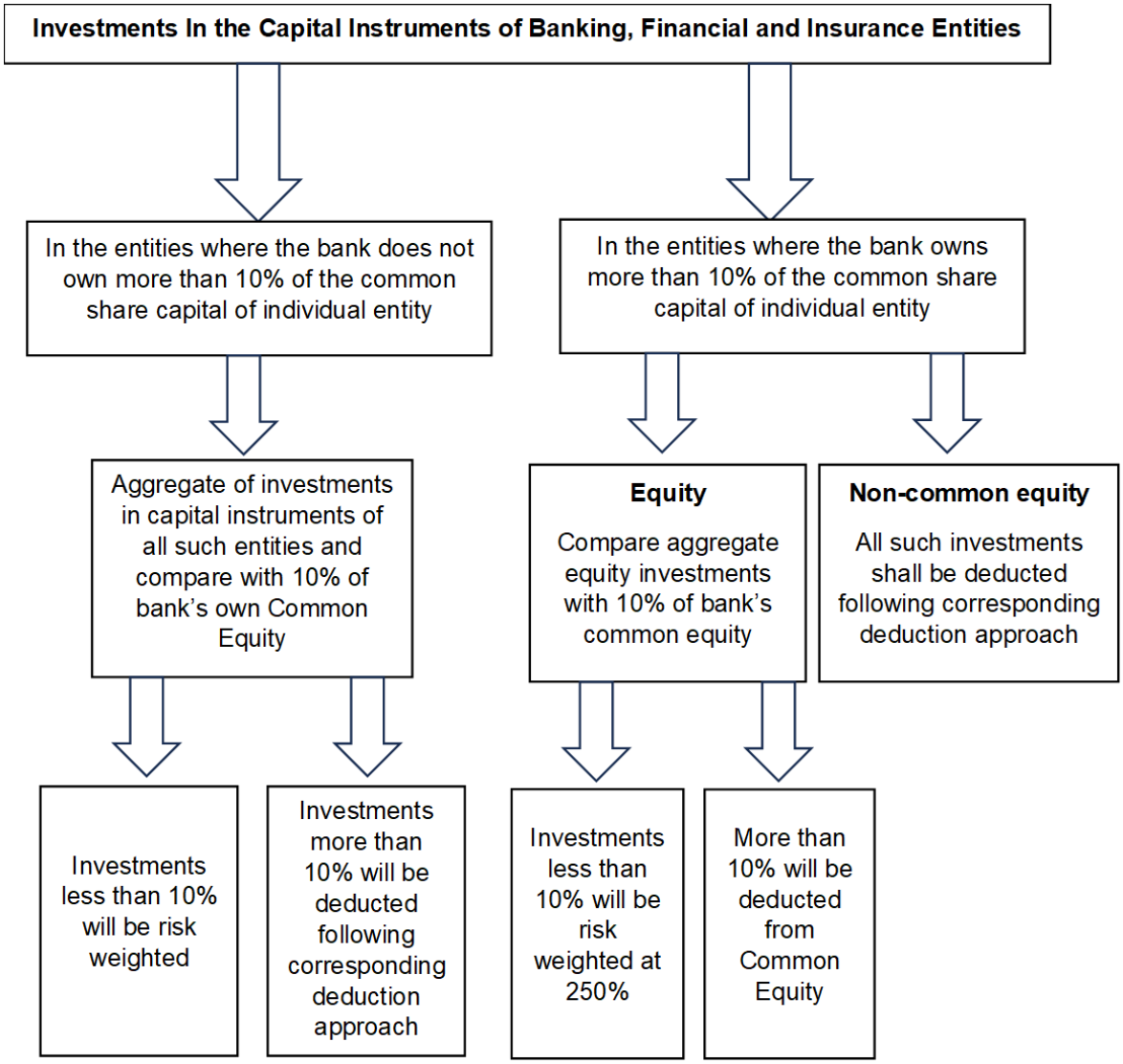
(c) Investments made by a banking subsidiary / associate in the equity or non- equity regulatory capital instruments issued by its parent bank shall be deducted from such subsidiaries' regulatory capital following corresponding deduction approach, in its capital adequacy assessment; and

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

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

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

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



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

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

(b) Investments in the capital of banking, financial and insurance entities where the bank does not own more than 10 per cent of the issued common share capital of the entity

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

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

Explanation - Indirect holdings are exposures or part of exposures that, if a direct holding loses its value, will result in a loss to the bank substantially equivalent to the loss in the value of direct holding.

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

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

(d) If the capital instrument of the entity in which a bank has invested does not meet the criteria for CET 1, AT 1, or Tier 2 capital of the bank, the capital is to be considered common shares for the purposes of this regulatory adjustment. If the investment is issued out of a regulated financial entity and not included in regulatory capital in the relevant sector of the financial entity, it is not required to be deducted.

(e) With the prior approval of the Reserve Bank, a bank can temporarily exclude certain investments where these have been made in the context of resolving or providing financial assistance to reorganise a distressed institution.

(ii) If the total of all holdings listed in paragraph 18(7)(ii)(b)(i) above, in aggregate exceed 10 per cent of the bank's CET 1 capital (after applying all other regulatory adjustments in full), then the amount above 10 per cent shall be deducted, applying a corresponding deduction approach. This means the deduction shall be applied to the same component of capital for which the capital would qualify if it was issued by the bank itself. Accordingly, the amount to be deducted from the CET 1 capital shall be calculated as the total of all holdings which in aggregate exceed 10 per cent of the bank's CET 1 capital (as per above) multiplied by the common equity holdings as a percentage of the total capital holdings. This shall result in a deduction from CET 1 capital which corresponds to the proportion of total capital holdings held in common equity. Similarly, the amount to be deducted from AT 1 capital shall be calculated as the total of all holdings which in aggregate exceed 10 per cent of the bank's CET 1 capital (as per above) multiplied by the AT 1 capital holdings as a percentage of the total capital holdings. The amount to be deducted from Tier 2 capital shall be calculated as the total of all holdings which in aggregate exceed 10 per cent of the bank's CET 1 capital (as per above) multiplied by the Tier 2 capital holdings as a percentage of the total capital holdings. (Please refer to illustration given under paragraph 18(7)(ii)(b)(vi)).

(iii) If, under the corresponding deduction approach, a bank is required to make a deduction from a particular Tier of capital and it does not have enough capital under that Tier to meet that deduction, the shortfall shall be deducted from the next higher Tier of capital (e.g., if a bank does not have enough AT 1 capital

to satisfy the deduction, the shortfall shall be deducted from CET 1 capital).

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

(v) For risk weighting as indicated in paragraph 18(7)(ii)(b)(iv) above, investments in securities having comparatively higher risk weights shall be considered for risk weighting to the extent required to be risk weighted. In other words, investments with comparatively poor ratings (i.e., with higher risk weights) shall be considered for application of risk weighting first and the residual investments shall be considered for deduction.

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

(a) Details of regulatory capital structure of a bank

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(d) If the capital instrument of the entity in which a bank has invested does not meet the criteria for CET 1, AT 1, or Tier 2 capital of the bank, the capital shall be considered common shares for the purposes of this regulatory adjustment. If the investment is issued out of a regulated financial entity and not included in regulatory capital in the relevant sector of the financial entity, it is not required to be deducted.

(e) With the prior approval of the Reserve Bank, a bank can temporarily exclude certain investments where these have been made in the context of resolving or providing financial assistance to reorganise a distressed institution.

Explanation -

(i) An affiliate of a bank is defined as a company that controls, or is controlled by, or is under common control with, the bank. Control of a company is defined as (i) ownership, control, or holding with power to vote 20 per cent or more of a class of voting securities of the company; or (ii) consolidation of the company for financial reporting purposes.

(ii) Indirect holdings are exposures or part of exposures that, if a direct holding loses its value, will result in a loss to the bank substantially equivalent to the loss in the value of direct holding.

(ii) Investments other than common shares

All investments included in paragraph 18(7)(ii)(c)(i) above which are not common shares shall be fully deducted following a corresponding deduction approach. This means the deduction shall be applied to the same Tier of capital for which the capital would qualify if it was issued by a bank itself. If a bank is required to make a deduction from a particular Tier of capital and it does not have enough capital under that Tier to meet that deduction, the shortfall shall be deducted from the next higher Tier of capital (e.g., if a bank does not have enough AT 1 capital to satisfy the deduction, the shortfall shall be deducted from CET 1 capital).

(iii) Investments which are common shares

All investments included in paragraph 18(7)(ii)(c)(i) above which are common shares, and which exceed 10 per cent of a bank's CET 1 capital (after the application of all regulatory adjustments) shall be deducted while calculating CET 1 capital. The amount that is not deducted (up to 10 per cent if bank's common equity invested in the equity capital of such entities) in the calculation of CET 1 shall be risk weighted at 250 per cent [refer to illustration given under paragraph 18(7)(ii)(b)(vi)]). However, in certain cases, such investments in both scheduled and non-scheduled commercial banks shall be fully deducted from CET 1 capital of an investing bank as required in Paragraph 31 of these Directions.

(iii) With regard to computation of indirect holdings through mutual funds or index funds, of capital of banking, financial and insurance entities as mentioned in paragraphs 18(7)(ii)(b) and paragraphs 18(7)(ii)(c) above, the following rules shall be observed:

(a) If the amount of investments made by the mutual funds / index funds / venture capital funds / private equity funds / investment companies in the capital instruments of the financial entities is known, the indirect investment of a bank in such entities shall be equal to bank's investments in these entities multiplied by the percent of investments of such entities in the financial entities' capital instruments;

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

(c) If neither the amount of investments made by the mutual funds / index funds / venture capital funds / private equity funds in the capital instruments of financial entities nor the maximum amount which these entities can invest in financial entities are known but, as per the investment policies / mandate of these entities such investments are permissible, the entire investment of the bank in these entities shall be treated as indirect investment in financial entities. A bank shall note that this method does not follow corresponding deduction approach i.e., all deductions shall be made from the CET 1 capital even though, the investments of such entities are in the AT 1 / Tier 2 capital of the investing bank.

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

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

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

The net unrealised gains arising on fair valuation of Level 3 financial instruments (including derivatives) shall be deducted from CET 1 capital.

Chapter III

Calculation of risk weighted assets (RWAs)

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

A Capital charge for Credit Risk

A.1 General

20. A bank shall follow the standardised approach for computing the capital charge for credit risk. Under this approach, a bank shall rely upon the ratings assigned by the external credit rating agencies or specific risk weights prescribed in these directions, as the case may be.

21. The guidelines for risk weight are without prejudice to other applicable guidelines for Payments Bank.

A.2 Claims on domestic sovereigns

22. The claims on the Central Government shall attract zero risk weight. Central Government guaranteed claims shall also attract zero risk weight.

23. The investment in State Government securities shall attract zero risk weight. State Government guaranteed claims shall attract 20 per cent risk weight.

24. The risk weight applicable to claims on Central Government exposures shall also apply to the claims on the Reserve Bank, and Deposit Insurance and Credit Guarantee Corporation (DICGC).

25. The above risk weights for both direct claims and guarantee claims shall be applicable as long as they are classified as ‘standard’ / performing assets. Where these sovereign exposures are classified as non-performing, they shall attract risk weights as applicable to non-performing investments, which are detailed in paragraphs 36 to 40.

26. The above risk weights shall be applied if such exposures are denominated in Indian rupees and also funded in Indian rupees.

Claims on foreign sovereigns and foreign central banks

27. Subject to paragraph 28 below, claims on foreign sovereigns and their central banks shall attract risk weights as per the rating assigned to those sovereigns

and central banks / sovereign and central bank claims, by international rating agencies as follows:

Table 4: Claims on foreign sovereigns / central banks – risk weights

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

A.3 Claims on public sector entities (PSEs)

28. Claims on domestic PSEs shall be risk weighted as claims on corporates given in paragraphs 33 to 35.

29. Claims on foreign PSEs shall be risk weighted as per the rating assigned by the international rating agencies as under:

Table 5: Claims on foreign PSEs – risk weights

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

A.4 Claims on Multilateral Development Banks (MDBs), Bank for International Settlements (BIS) and International Monetary Fund (IMF)

30. Claims on the BIS, the IMF and the following eligible MDBs evaluated by the Basel Committee on Banking Supervision (BCBS) shall be treated as claims on scheduled banks meeting the minimum capital adequacy requirements and assigned a uniform twenty per cent risk weight:

(i) World Bank Group: IBRD and IFC,
(ii) Asian Development Bank,
(iii) African Development Bank,
(iv) European Bank for Reconstruction and Development,
(v) Inter-American Development Bank,
(vi) European Investment Bank,

(vii) European Investment Fund,

(viii) Nordic Investment Bank,

(ix) Caribbean Development Bank,

(x) Islamic Development Bank and

(xi) Council of Europe Development Bank

(xii) International Finance Facility for Immunization (IFFIM)

(xiii) Asian Infrastructure Investment Bank (AIIB)

A.5 Claims on banks

31. Investments of a bank in equity and capital instruments of other banks shall not be treated in terms of paragraph 18 (7) above, but shall be risk-weighted as per Table 6.1 and 6.2 below, when they satisfy the following conditions:

(i) Investments in **capital instruments** of banks where the investing bank holds not more than 10 per cent of the issued common shares of the investee banks subject to the condition that aggregate of these investments, together with investments in the capital instruments in insurance and other financial entities, do not exceed 10 per cent of Common Equity of the investing bank.

(ii) **Equity investments** in other banks where the investing bank holds more than 10 per cent of the issued common shares of the investee banks, subject to the condition that aggregate of these investments, together with such investments in insurance and other financial entities, do not exceed 10 per cent of Common Equity of the investing bank.

Table 6.1: Claims on banks incorporated in India and foreign bank branches in India

	Risk Weights (%)					
	All Scheduled Banks (Commercial Banks, Regional Rural Banks, Local Area Banks, and Co-operative Banks)			All Non-Scheduled Banks (Commercial Banks, Regional Rural Banks, Local Area Banks, and Co-operative Banks)		
Level of CET1 including applicable CCB (%) of the investee bank under Basel III / Total capital of other banks (where applicable)	**Investments referred to in paragraph 31(i)**	**Investments referred to in paragraph 31(ii)**	**All other claims**	**Investments referred to in paragraph 31(i)**	**Investments referred to in paragraph 31(ii)**	**All other claims**
1	2	3	4	5	6	7
For banks which are under Basel III Capital Regulations						
Applicable Minimum CET1 + (Applicable CCB and above)	125 % or the risk weight as per the rating of the instrument or counterparty, whichever is higher	250	20	125% or the risk weight as per the rating of the instrument or counterparty, whichever is higher	300	100
Applicable Minimum CET1 + (CCB = 75% and <100% of applicable CCB)	150	300	50	250	350	150
Applicable Minimum CET1 + (CCB = 50% and <75% of applicable CCB)	250	350	100	350	450	250
Applicable Minimum CET1 + (CCB = 0% and <50% of applicable CCB)	350	450	150	625	Full deduction*	350
Minimum CET1 less than applicable minimum	625	Full deduction*	625	Full deduction*	Full deduction*	625
For banks which are not under Basel III Capital Regulations						

	Risk Weights (%)					
	All Scheduled Banks (Commercial Banks, Regional Rural Banks, Local Area Banks, and Co-operative Banks)			**All Non-Scheduled Banks (Commercial Banks, Regional Rural Banks, Local Area Banks, and Co-operative Banks)**		
Level of CET1 including applicable CCB (%) of the investee bank under Basel III / Total capital of other banks (where applicable)	**Investments referred to in paragraph 31(i)**	**Investments referred to in paragraph 31(ii)**	**All other claims**	**Investments referred to in paragraph 31(i)**	**Investments referred to in paragraph 31(ii)**	**All other claims**
1	2	3	4	5	6	7
9 and above	100 % or the risk weight as per the rating of the instrument or counterparty, whichever is higher	250	20	Higher of 100 % or the risk weight as per the rating of the instrument or counterparty, whichever is higher	300	100
6 to < 9	150	300	50	250	350	150
3 to < 6	250	350	100	350	450	250
0 to < 3	350	450	150	625	Full deduction*	350
Negative	625	Full deduction*	625	Full deduction*	Full deduction*	625

*The deduction should be made from CET 1 capital

The claims on a foreign bank shall be risk weighted as under as per the ratings assigned by international rating agencies.

Table 6.2: Claims on foreign banks – risk weights

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

A.6 Claims on primary dealers

32. Claims on primary dealers shall be risk weighted in a manner similar to claims on corporates.

A.7 Claims on corporates and non-banking financial companies (NBFCs)

33. Claims on corporates, and exposures to all NBFCs excluding core investment companies (CICs), shall be risk weighted as per the ratings assigned by the rating agencies registered with the SEBI and accredited by the Reserve Bank. Exposures to CICs, rated as well as unrated, shall be risk-weighted at 100 per cent. Tables 7.1 and 7.2 indicate the risk weight applicable to claims on corporates and exposures to all NBFCs, excluding CICs.

Explanation - Claims on corporates shall include all exposures other than those which qualify for inclusion under 'sovereign', 'bank', 'non-performing assets', specified category addressed separately in these guidelines.

Table 7.1: Long term claims on corporates and NBFCs excluding CICs - risk weights

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

Table 7.2: Short term claims on Corporates and NBFCs excluding CICs -risk weights

CARE	**CRISIL Ratings Ltd.**	**India Ratings and Research Private Limited (India Ratings)**	**ICRA**	**Brickwork**	**Acuite Ratings & Research Limited (Acuite)**	**INFOMERICS Valuation and Rating Ltd.**	**(%)**
CARE A1+	CRISIL A1+	IND A1+	ICRA A1+	Brickwork A1+	Acuite A1+	IVR A1+	20
CARE A1	CRISIL A1	IND A1	ICRA A1	Brickwork A1	Acuite A1	IVR A1	30
CARE A2	CRISIL A2	IND A2	ICRA A2	Brickwork A2	Acuite A2	IVR A2	50
CARE A3	CRISIL A3	IND A3	ICRA A3	Brickwork A3	Acuite A3	IVR A3	100

CARE A4 & D	CRISIL A4 & D	IND A4 & D	ICRA A4 & D	Brickwork A4 & D	Acuite A4 & D	IVR A4 and D	150
Unrated	Unrated	Unrated	Unrated	Unrated	Unrated	Unrated	100

Explanations –

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

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

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

34. The Reserve Bank may increase the standard risk weight for unrated claims where a higher risk weight is warranted by the overall default experience. As part of the supervisory review process, the Reserve Bank may also consider whether the credit quality of unrated corporate claims held by an individual bank should warrant a standard risk weight higher than 100 per cent.

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

Table 8: Claims on non-resident corporates - risk weight mapping for the ratings assigned by S&P/Fitch/Moody's Ratings

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

Explanations –

(1) Unrated claims having aggregate exposure from banking system of more than ₹200 crore shall attract a risk weight of 150 per cent.

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

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

A.9 Non-Performing Assets (NPAs) (including Non-Performing Investments (NPIs))

36. The unsecured portion of NPA , net of specific provisions (including partial write-offs), shall be risk-weighted as follows:

(1) 150 per cent risk weight when specific provisions are less than 20 per cent of the outstanding amount of the NPA;

(2) 100 per cent risk weight when specific provisions are at least 20 per cent of the outstanding amount of the NPA;

(3) 50 per cent risk weight when specific provisions are at least 50 per cent of the outstanding amount of the NPA

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

38. For defining the secured portion of the NPA, eligible collateral shall be the same as recognised for credit risk mitigation purposes (paragraph 63). Hence, other forms of collateral like land, buildings, plant, machinery, current assets shall not be reckoned while computing the secured portion of NPAs for capital adequacy purposes.

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

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

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

40. The above collaterals (mentioned in paragraph 39) shall be recognised only where the bank is having clear title to realise the sale proceeds thereof and can appropriate the same towards the amounts due to the bank. The bank's title to the collateral shall be well documented. These forms of collaterals are not recognised anywhere else under the standardised approach.

A.10 Specified categories

41. 'Capital market exposures' shall attract a 125 per cent risk weight or risk weight warranted by external rating (or lack of it) of the counterparty, whichever is higher.

Explanation - The applicable risk weight for banking book exposure for a bank's equity investments in other banks / financial institutions etc. are covered under paragraphs 31.

42. The exposure to capital instruments issued by NBFCs which are not deducted and are required to be risk weighted in terms of paragraph 18 (7)(ii)(b) shall be risk weighted at 125 per cent or as per the external ratings, whichever is higher. The exposure to equity instruments issued by NBFCs which are not deducted and are required to be risk weighted in terms of paragraph 18 (7) (ii)(c) shall be risk weighted at 250 per cent. The claims (other than in the form of capital instruments of investee companies) on all NBFCs excluding CIC shall be risk weighted as per the ratings assigned by the rating agencies registered with the SEBI and accredited by the Reserve Bank, in a manner similar to that of corporates. The claims on CICs, rated and unrated, shall be risk-weighted at 100 per cent.

43. All investments in the paid-up equity of non-financial entities which exceed 10 per cent of the issued common share capital of the issuing entity or where the entity is an unconsolidated affiliate as defined in paragraph 18 (7)(ii)(c)(i) shall receive a risk weight of 1250 per cent. Equity investments equal to or below 10 per cent paid-up equity of such investee companies shall be assigned a 125 per

cent risk weight or the risk weight as warranted by rating or lack of it, whichever higher.

44. The exposure to capital instruments issued by financial entities (other than banks and NBFCs) which are not deducted and are required to be risk weighted in terms of paragraph 18 (7)(ii)(b) shall be risk weighted at 125 per cent or as per the external ratings whichever is higher. The exposure to equity instruments issued by financial entities (other than banks and NBFCs) which are not deducted and are required to be risk weighted in terms of paragraph 18 (7)(ii)(c) shall be risk weighted at 250 per cent.

45. Bank's investments in the non-equity capital eligible instruments of other banks should be risk weighted as prescribed in paragraph 31.

A.11 Other Assets

46. Loans and advances to a bank's own staff which are fully covered by superannuation benefits and / or mortgage of flat / house shall attract a 20 per cent risk weight. Since flat / house is not an eligible collateral and since a bank normally recovers the dues by adjusting the superannuation benefits only at the time of cessation from service, the concessional risk weight shall be applied without any adjustment of the outstanding amount. In case a bank is holding eligible collateral in respect of amounts due from a staff member, the outstanding amount in respect of that staff member shall be adjusted to the extent permissible, as indicated in paragraphs 56 to 81.

47. Other loans and advances of up to ₹7.5 crore to bank's own staff shall attract a 75 per cent risk weight.

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

A.12 Off-balance sheet items

49. The total risk weighted off-balance sheet credit exposure shall be calculated as the sum of the risk-weighted amount of the market related and non-market related off-balance sheet items. The risk-weighted amount of an off-balance sheet item that gives rise to credit exposure shall be calculated by the following process:

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

(2) the resulting credit equivalent amount shall be multiplied by the risk weight applicable to the counterparty or to the purpose for which the bank has exposure or the type of asset, whichever is higher.

50. Where the off-balance sheet item is secured by eligible collateral or guarantee, the credit risk mitigation directions detailed in paragraphs 56 to 81 shall be applied.

51. Non-market-related off-balance sheet items

(1) The credit equivalent amount in relation to a non-market related off-balance sheet item shall be determined by multiplying the contracted amount of that particular transaction by the relevant CCF as elaborated in Table 9.

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

(3) In the case of irrevocable commitments to provide off-balance sheet facilities, the original maturity shall be measured from the commencement of the commitment until the time the associated facility expires. Such commitments should be assigned the lower of the two applicable credit conversion factors.

(4) The CCFs for non-market related off-balance sheet transactions are as under:

Table 9: CCF - non-market related off-balance sheet items

Sr. No.	Instruments	CCF (%)
1.	Sale and repurchase agreement and asset sales with recourse, where the credit risk remains with the bank.	100

Sr. No.	Instruments	CCF (%)
	(These items are to be risk weighted according to the type of asset and not according to the type of counterparty with whom the transaction has been entered into.)	
2.	Partly paid shares and securities, which represent commitments with certain drawdown. (These items are to be risk weighted according to the type of asset and not according to the type of counterparty with whom the transaction has been entered into.)	100
3.	Lending of banks' securities or posting of securities as collateral by banks, including instances where these arise out of repo style transactions (i.e., repurchase / reverse repurchase and securities lending / securities borrowing transactions)	100
4.	Commitments with certain drawdown	100
5.	Other commitments to staff (e.g., formal standby facilities and credit lines) with an original maturity of a) up to one year b) over one year Similar commitments to staff that are unconditionally cancellable at any time by the bank without prior notice or that effectively provide for automatic cancellation due to deterioration in a borrower's credit worthiness. *Explanation:* 0 percent CCF shall be subject to a bank demonstrating that it is actually able to cancel any undrawn commitments in case of deterioration in a borrower's credit worthiness failing which the credit conversion factor applicable to such facilities which are not cancellable shall apply. The bank's compliance to these guidelines shall be assessed under Supervisory Review and Evaluation Process under Pillar 2 of the Reserve Bank.	20 50 0

52. Treatment of total Counterparty Credit Risk

(1) The total capital charge for counterparty credit risk shall cover the default risk. Counterparty risk may arise in the context of OTC derivatives, exchange traded derivatives, and SFTs.

Explanation: Instruments that give rise to counterparty risk generally exhibit the following abstract characteristics.

(i) The transactions generate a current exposure or market value.

(ii) The transactions have an associated random future market value based on market variables.

(iii) The transactions generate an exchange of payments or an exchange of a financial instrument against payment.

(iv) Collateral may be used to mitigate risk exposure and is inherent in the nature of some transactions.

(v) Short-term financing may be a primary objective in that the transactions mostly consist of an exchange of one asset for another (cash or securities) for a relatively short period of time, usually for the business purpose of financing. The two sides of the transactions are not the result of separate decisions but form an indivisible whole to accomplish a defined objective.

(vi) Netting may be used to mitigate the risk.

(vii) Positions are frequently valued (most commonly on a daily basis), according to market variables.

(viii) Remargining may be employed.

The 'capital charge for default risk' shall be calculated using current exposure method as explained in paragraph 52(2). The Current Exposure method is applicable only to OTC derivatives. The counterparty risk on account of SFTs is covered in paragraph 66 of this Master Direction.

(2) Default risk capital charge for counterparty credit risk (CCR)

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

(i) The credit equivalent amount of a market related off-balance sheet transaction calculated using the current exposure method is the sum of current credit exposure and potential future credit exposure of these contracts. For this purpose, credit equivalent amount shall be adjusted for legally valid eligible financial collaterals in accordance with the provisions of paragraphs 56 to 81 – Credit Risk Mitigation Techniques – collateralised transactions.

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

Explanation - For 'sold options' (outside netting and margin agreements) where the premium / fee or any other form of income is not fully received / realised, the add-on shall be capped to the amount of unpaid premia.

(iii) Current credit exposure is the sum of the positive mark-to-market value of these contracts. The CEM requires periodical calculation of the current credit exposure by marking these contracts to market, thus capturing the current credit exposure.

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

Table 10: Add-on factors for market-related off-balance sheet items

	Add-on factor (%)
	Exchange Rate Contracts and Gold
One year or less	2.00
Over one year to five years	10.00
Over five years	15.00

Note -

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

(b) For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity shall be set equal to the time until the next reset date.

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

(v) When effective bilateral netting contracts as specified in paragraph 54 are in place, RC shall be the net replacement cost and the add-on shall be A_{Net} as calculated below:

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

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

where:

NGR = level of net replacement cost / level of gross replacement cost for transactions subject to legally enforceable netting agreements. A bank shall calculate NGR on a counterparty-by-counterparty basis for all transactions that are subject to legally enforceable netting agreements.

A_{Gross} = sum of individual add-on amounts (calculated by multiplying the notional principal amount by the appropriate add-on factors set out in Table 10) of all transactions subject to legally enforceable netting agreements with one counterparty.

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

(c) Explanations regarding Bilateral Netting under Current Exposure Method -

(i) To avail the benefit of bilateral netting for computation of regulatory capital requirement for derivative transactions, a bank shall have an effective bilateral netting contract or agreement with each counterparty, as specified in paragraph 54.

(ii) Bilateral Netting as per this paragraph, shall be applicable for all OTC derivative exposures to a counterparty, arising from the netting set covered by a qualifying bilateral netting agreement, subject to meeting the criterion prescribed for effective bilateral netting contracts as specified in paragraph 54.

(iii) For such exposures as at (ii) above, Replacement Cost shall be Net Replacement Cost and Potential Future Exposure will be A_{Net}. A_{Net} shall be calculated using gross add-on (A_{Gross}) and NGR. Gross add-on (A_{Gross}), in turn, shall be calculated as sum of individual add-on amounts (add-on factor multiplied by notional principal amount).

(iv) However, while calculating add-on amounts in case of forward foreign exchange contracts or other similar contracts where notional principal amount is equivalent to cash flows, the notional principal amount shall be taken as the net receipts falling due on each value date in each currency.

(v) The term ‘product categories’ in the definition of cross-product netting refers to (a) OTC derivative transactions, and (b) repo / reverse repo. Cross-Product Netting is not permitted for capital

adequacy as well as leverage ratio measure. Thus, all eligible OTC derivative transactions with a counterparty shall form part of one netting set and all eligible OTC repo / reverse repo transactions with that counterparty shall form part of a separate netting set.

(vi) Within a netting set, trades with a counterparty across maturities shall be netted and the risk weight corresponding to the worst applicable long-term rating of the counterparty shall be applied.

Collateral can be netted against both replacement cost and PFE for capital adequacy purposes. The exposure computation under the Large Exposure Framework shall be as per this Master Direction. Regarding presentation in the financial statements, a bank may refer to Guidance Note on Accounting for Derivative Contracts (Revised 2021) issued by the Institute of Chartered Accountants of India (ICAI). The Guidance Note (paragraph 64) mandates that all amounts presented in the financial statements should be gross amounts.

(vii) The provisioning requirement for standard assets shall be applicable on the credit exposures arising from derivative contracts. For this purpose, credit exposure of derivative contracts shall be computed as per this Master Direction. Accordingly, for a netting set, standard asset provisions on derivative exposures shall be computed based on net replacement cost instead of current marked to market value of the contract (i.e., replacement cost), subject to compliance with the conditions prescribed for ‘effective bilateral netting contracts’ in paragraph 54. The CEM, as provided in this Master Direction, shall be applicable for measurement of credit exposure of derivatives products for the purpose of Reserve Bank of India (Payments Banks – Concentration Risk Management) Directions, 2025.

(3) Calculation of the aggregate CCR

The total CCR capital charge for the bank shall be determined as the sum of all counterparties of the CEM based capital charge determined as per paragraph 52(2).

(4) Capital requirement for exposures to CCPs

Scope of application

(i) Exposures to CCPs arising from OTC derivatives transactions, exchange traded derivatives transactions, and SFTs shall be subject to the counterparty credit risk treatment as indicated in the paragraphs below.

(ii) Exposures arising from the settlement of cash transactions (equities, fixed income, spot FX, commodity, etc.) shall not be subject to this treatment. The settlement of cash transactions shall be as per the treatment described in paragraph 53.

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

(iv) For the purpose of capital adequacy framework, CCPs shall be considered a financial institution. Accordingly, a bank's investments in the capital of CCPs shall be treated in terms of paragraph 18.

(v) Capital requirements shall be dependent on the nature of a CCP, i.e., whether it is a QCCP or a non-Qualifying CCP.

(a) Regardless of whether a CCP is classified as a QCCP or not, a bank shall maintain adequate capital for its exposures. Under Pillar 2, a bank shall consider whether it might need to hold capital in excess of the minimum capital requirements if, for example, (i) its dealings with a CCP give rise to more risky exposures, or (ii) where, given the

context of that bank's dealings, it is unclear that the CCP meets the definition of a QCCP.

(b) A bank may be required to hold additional capital against its exposures to QCCPs via Pillar 2, if in the opinion of the Reserve Bank, it is necessary to do so.

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

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

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

(5) Exposures to QCCPs

(i) Trade exposures

Clearing member exposures to QCCPs

(a) Where a bank acts as a clearing member of a QCCP for its own purposes, a risk weight of 2 per cent shall be applied to the bank's

trade exposure to the QCCP in respect of OTC derivatives transactions, exchange traded derivatives transactions, and SFTs.

(b) The exposure amount for such trade exposure shall be calculated in accordance with the CEM for derivatives and rules as applicable for capital adequacy for repo / reverse repo-style transactions (please refer to paragraph 66).

(c) Where settlement is legally enforceable on a net basis in an event of default and regardless of whether the counterparty is insolvent or bankrupt, the total replacement cost of all contracts relevant to the trade exposure determination shall be calculated as a net replacement cost if the applicable close-out netting sets meet the requirements set out in paragraph 54 of these guidelines.

Note - The trade exposure (i.e., both replacement cost and potential future exposure) shall be computed on net basis, provided other conditions stated in this paragraph 52(5) are met.

(d) A bank shall demonstrate that the conditions mentioned in paragraph 54 are fulfilled on a regular basis by obtaining independent and reasoned legal opinion as regards legal certainty of netting of exposures to QCCPs. A bank shall also obtain from the QCCPs, the legal opinion taken by the respective QCCPs on the legal certainty of their major activities such as settlement finality, netting, collateral arrangements (including margin arrangements); default procedures etc.

Clearing member exposures to clients

(e) The clearing member shall always capitalise its exposure to clients as bilateral trades, irrespective of whether the clearing member guarantees the trade or acts as an intermediary between the client and the QCCP. However, to recognise the shorter close-out period for cleared transactions, a clearing member may capitalise the exposure

to its clients by multiplying the EAD by a scalar which is not less than 0.71.

Client bank exposures to clearing member

(f) Where a bank is a client of the clearing member, and enters into a transaction with the clearing member acting as a financial intermediary (i.e., the clearing member completes an offsetting transaction with a QCCP), the client's exposures to the clearing member shall receive the treatment applicable to a clearing member's exposure to QCCPs (as described in sub-para (a) to (d) above) if following conditions are met:

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

(a) the default or insolvency of the clearing member;

(b) the default or insolvency of the clearing member's other clients; and

(c) the joint default or insolvency of the clearing member and any of its other clients.

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

(a) the law(s) applicable to client bank, clearing member and QCCP;

(b) the law of the jurisdiction(s) of the foreign countries in which the client bank, clearing member or QCCP are located;

(c) the law that governs the individual transactions and collateral; and

(d) the law that governs any contract or agreement necessary to meet this condition at (f)(i) above.

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

(g) Where a client is not protected from losses in the case that the clearing member and another client of the clearing member jointly default or become jointly insolvent, but all other conditions mentioned above are

met and the concerned CCP is a QCCP, a risk weight of 4 per cent shall apply to the client's exposure to the clearing member.

(h) Where the client bank does not meet the requirements in the above paragraphs, the bank shall be required to capitalise its exposure to the clearing member as a bilateral trade.

(i) Under situations in which a client enters into a transaction with the QCCP with a clearing member guaranteeing its performance, the capital requirements shall be based on the provisions herein.

Treatment of posted collateral

(j) In all cases, any assets or collateral posted shall, from the perspective of the bank posting such collateral, receive the risk weights that otherwise applies to such assets or collateral under the capital adequacy framework, regardless of the fact that such assets have been posted as collateral. Where assets or collateral of a clearing member or client are posted with a QCCP or a clearing member and are not held in a bankruptcy remote manner, the bank posting such assets or collateral shall also recognise credit risk based upon the assets or collateral being exposed to risk of loss based upon the creditworthiness of the entity holding such assets or collateral.

Provided that, where the entity holding such assets or collateral is the QCCP, a risk weight of 2 per cent applies to collateral included in the definition of trade exposures. The relevant risk weight of the QCCP shall apply to assets or collateral posted for other purposes.

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

Explanation - The word 'custodian' may include a trustee, agent, pledgee, secured creditor, or any other person that holds property in

a way that does not give such person a beneficial interest in such property and shall not result in such property being subject to legally-enforceable claims by such persons, creditors, or to a court-ordered stay of the return of such property, should such person become insolvent or bankrupt.

(l) Collateral posted by a client, that is held by a custodian, and is bankruptcy remote from the QCCP, the clearing member, and other clients, is not subject to a capital requirement for counterparty credit risk. If the collateral is held at the QCCP on a client's behalf and is not held on a bankruptcy remote basis, a 2 per cent risk weight shall apply to the collateral if the conditions laid down in the preceding provisions on 'client bank exposures to clearing members' are met. A risk weight of 4 per cent shall apply if a client is not protected from losses in the case that the clearing member and another client of the clearing member jointly default or become jointly insolvent, but all other conditions laid down in the preceding provisions on 'client bank exposures to clearing members' are met.

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

(ii) Default fund exposures to QCCPs

(a) Where a default fund is shared between products or types of business with settlement risk only (e.g., equities and bonds) and products or types of business which give rise to counterparty credit risk, i.e., OTC derivatives, exchange traded derivatives, or SFTs, all of the default fund contributions shall receive the risk weight determined according

to the formulae and methodology specified hereinafter, without apportioning to different classes or types of business or products.

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

(c) A clearing member bank shall capitalise its exposures arising from default fund contributions to a qualifying CCP by applying the following methodology:

(i) A clearing member bank shall apply a risk weight of 1250 per cent to its default fund exposures to the QCCP, subject to an overall cap on the RWA from all its exposures to the QCCP (i.e., including trade exposures) equal to 20 per cent of the trade exposures to the QCCP. More specifically, the RWA for both bank i's trade and default fund exposures to each QCCP are equal to:

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

Where;

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

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

Note - The 2 per cent risk weight on trade exposures does not apply additionally, as it is included in the equation.

(6) Exposures to non-qualifying CCPs

(i) A bank shall apply the Standardised Approach for credit risk according to the category of the counterparty, to its trade exposure to a non-qualifying CCP.

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

(ii) A bank shall apply a risk weight of 1250 per cent to its default fund contributions to a non-qualifying CCP.

(iii) For the purpose of this paragraph, the default fund contributions of such a bank shall include both the funded and the unfunded contributions which are liable to be paid should the CCP so require. Where there is a liability for unfunded contributions (i.e., unlimited binding commitments) the Reserve Bank shall determine in its Pillar 2 assessments the amount of unfunded commitments to which 1250 per cent risk weight shall apply.

53. Failed transactions

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

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

(3) Failure of transactions settled through a delivery-versus-payment (DvP) system, providing simultaneous exchanges of securities for cash, expose a bank to a risk of loss on the difference between the transaction valued at the agreed settlement

price and the transaction valued at current market price (i.e., positive current exposure). Failed transactions where cash is paid without receipt of the corresponding receivable (securities, foreign currencies, or gold) or, conversely, deliverables were delivered without receipt of the corresponding cash payment (non-DvP, or free delivery) expose a bank to a risk of loss on the full amount of cash paid or deliverables delivered. Therefore, a capital charge is required for failed transactions and shall be calculated as under for all failed transactions, including transactions through recognised clearing houses and central counterparties but excluding repurchase, reverse-repurchase agreements, and securities lending and borrowing that have failed to settle.

(4) For DvP Transactions - If the payments have not taken place five business days after the settlement date, a bank shall calculate a capital charge by multiplying the positive current exposure of the transaction by the appropriate factor as under.

Table 11: Capital charge for DvP transactions

Number of working days after the agreed settlement date	Corresponding factor (in per cent)
From 5 to 15	9
From 16 o 30	50
From 31 to 45	75
46 or more	100

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

replacement cost, if any. This treatment shall apply until the second payment / delivery leg is effectively made.

54. Requirements for recognition of net replacement cost in close-out netting sets

(1) For repo-style transactions

(i) The effects of bilateral netting agreements covering repo-style transactions shall be recognised on a counterparty-by-counterparty basis if the agreements are legally enforceable in each relevant jurisdiction upon the occurrence of an event of default and regardless of whether the counterparty is insolvent or bankrupt. In addition, netting agreements shall:

(a) provide the non-defaulting party the right to terminate and close-out in a timely manner all transactions under the agreement upon an event of default, including in the event of insolvency or bankruptcy of the counterparty;

(b) provide for the netting of gains and losses on transactions (including the value of any collateral) terminated and closed out under it so that a single net amount is owed by one party to the other;

(c) allow for the prompt liquidation or setoff of collateral upon the event of default; and

(d) be, together with the rights arising from the provisions required in (a) to (c) above, legally enforceable in each relevant jurisdiction upon the occurrence of an event of default and regardless of the counterparty's insolvency or bankruptcy.

(e) Netting across positions in the banking and trading book shall only be recognised when the netted transactions fulfil the following conditions:

(i) All transactions are marked to market daily; and

(ii) The collateral instruments used in the transactions are recognised as eligible financial collateral in the banking book.

Note - The holding period for the haircuts shall depend as in other repo-style transactions on the frequency of margining

(2) For derivatives transactions

(i) A bank may net transactions subject to novation under which any obligation between a bank and its counterparty to deliver a given currency on a given value date is automatically amalgamated with all other obligations for the same currency and value date, legally substituting one single amount for the previous gross obligations.

(ii) A bank may also net transactions subject to any legally valid form of bilateral netting not covered in sub-paragraph (2)(i) above, including other forms of novation.

(iii) In both cases (i) and (ii), a bank shall need to satisfy that it has:

(a) A netting contract or agreement with the counterparty which creates a single legal obligation, covering all included transactions, such that the bank shall have either a claim to receive or obligation to pay only the net sum of the positive and negative mark-to-market values of included individual transactions in the event a counterparty fails to perform due to any of the following: default, bankruptcy, liquidation, or similar circumstances.

Note - Membership agreement together with relevant netting provisions contained in QCCP's bye-laws, rules, and regulations are a type of netting agreement.

(b) Written and reasoned legal opinions that, in the event of a legal challenge, the relevant courts and administrative authorities shall find the bank's exposure to be such a net amount under:

(i) The law of the jurisdiction in which the counterparty is chartered and, if the foreign branch of a counterparty is involved, then also under the law of the jurisdiction in which the branch is located;

(ii) The law that governs the individual transactions; and

(iii) The law that governs any contract or agreement necessary to effect the netting.

(c) Procedures in place to ensure that the legal characteristics of netting arrangements are kept under review in the light of possible changes in relevant law.

(iv) Contracts containing walkaway clauses shall not be eligible for netting for the purpose of calculating capital requirements under these Directions. A walkaway clause is a provision which permits a non-defaulting counterparty to make only limited payments or no payment at all, to the estate of a defaulter, even if the defaulter is a net creditor.

B External credit assessments

55. The regulatory instructions for external credit assessments, as applicable to Small Finance Banks as per the 'Reserve Bank of India (Small Finance Banks – Prudential Norms on Capital Adequacy) Directions, 2025', shall mutatis mutandis apply to Payments Banks.

C Credit risk mitigation

C.1 General principles

56. Credit risk mitigation (CRM) approaches as detailed herein shall be applicable to the banking book exposures of a bank.

57. The general principles applicable to use of CRM techniques are as under:

(1) No transaction in which CRM techniques are used shall receive a higher capital requirement than an otherwise identical transaction where such techniques are not used.

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

(3) Principal-only ratings shall not be allowed within the CRM framework.

(4) While the use of CRM techniques reduces or transfers credit risk, it simultaneously may increase other risks (residual risks). Residual risks include legal, operational, liquidity and market risks. Therefore, it is imperative that a bank employ robust procedures and processes to control these risks,

including strategy, consideration of the underlying credit, valuation, policies and procedures, systems, control of roll-off risks, and management of concentration risk arising from the bank's use of CRM techniques and its interaction with the bank's overall credit risk profile. Where these risks are not adequately controlled, the Reserve Bank may impose additional capital charges or take other supervisory actions.

C.2 Legal certainty

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

C.3 Credit risk mitigation (CRM) techniques - collateralised transactions

59. A collateralised transaction is one in which:

    (1) a bank has an exposure, and that exposure is hedged in whole or in part by collateral posted by a counterparty or by a third party on behalf of the counterparty. Here, 'counterparty' is used to denote a party to whom a bank has an on- or off-balance sheet exposure.

    (2) a bank has a specific lien on the collateral and the requirements of legal certainty are met.

Overall framework and minimum conditions

60. There are two approaches under the Basel framework – the simple approach and the comprehensive approach. A bank in India shall adopt the comprehensive approach, which allows fuller offset of collateral against exposures, by effectively reducing the exposure amount by the value ascribed to the collateral. Under this approach, a bank, which take eligible financial collateral (e.g., cash or securities, more specifically defined below), is allowed to reduce its exposure to a

counterparty when calculating its capital requirements to take account of the risk mitigating effect of the collateral. CRM is allowed only on an account-by-account basis. However, the following standards shall be met before capital relief is granted:

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

(2) For collateral to provide protection, the credit quality of the counterparty and the value of the collateral shall not have a material positive correlation.

Explanation – securities issued by the counterparty or by any related group entity would provide little protection and so would be ineligible.

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

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

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

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

(ii) the concentration risk to particular types of collateral;

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

(iv) the surrender of rights on collateral posted to counterparties.

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

62. **The comprehensive approach**

(1) A bank shall calculate its adjusted exposure to a counterparty for capital adequacy purposes in order to take account of the effects of the collateral taken. The bank shall adjust both, the amount of the exposure to the counterparty and the value of any collateral received in support of that counterparty, to account for possible future fluctuations in the value of either, occasioned by market movements. These adjustments are referred to as 'haircuts'. The application of haircuts shall give volatility adjusted amounts for both – exposure and collateral. The volatility adjusted amount for the exposure shall be higher than the exposure and the volatility adjusted amount for the collateral shall be lower than the collateral, unless either side of the transaction is cash. Therefore, the 'haircut' for the exposure shall be a premium factor and the 'haircut' for the collateral shall be a discount factor. Since the value of credit exposures acquired by a bank in the course of its banking operations would not be subject to market volatility, (as the loan disbursal / investment shall be a 'cash' transaction) haircut on such exposures shall not be applicable, though the haircut stipulated in Table 12 shall apply only to the eligible collateral of the bank. On the other hand, exposures of a bank, arising out of repo-style transactions shall require upward adjustment for volatility, as the value of security sold / lent / pledged

in the repo transaction, shall be subjected to market volatility. Hence, such exposures shall attract haircut.

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

(3) Where the volatility-adjusted exposure amount is greater than the volatility-adjusted collateral amount (including additional adjustment for foreign exchange risk), a bank shall calculate its RWA as the difference between the two multiplied by the risk weight of the counterparty. The framework for performing calculations of capital requirement is indicated in paragraph 64.

63. Eligible financial collateral

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

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

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

(iii) Securities issued by Central and State Governments

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

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

(vi) Debt securities rated by a chosen credit rating agency in respect of which a bank should be sufficiently confident about the market liquidity where these are either:

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

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

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

(vii) Debt securities not rated by a chosen credit rating agency in respect of which a bank should be sufficiently confident about the market liquidity where these are:

(a) issued by a bank;

(b) listed on a recognised exchange;

(c) classified as senior debt;

(d) all rated issues of the same seniority by the issuing bank are rated at least BBB (-) or CARE A3 / CRISIL A3 / India Ratings and Research Private Limited (India Ratings) A3 / ICRA A3 / Brickwork A3 / Acuite A3 / IVR A3 (INFOMERICS) by a chosen credit rating agency;

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

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

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

(a) price for the units is publicly quoted daily i.e., where the daily NAV is available in public domain; and

(b) the mutual fund is limited to investing in the instruments listed in this paragraph.

64. Calculation of capital requirement

(1) For a collateralised transaction, the exposure amount after risk mitigation shall be 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

(2) The exposure amount after risk mitigation (i.e., E^*) shall be multiplied by the risk weight of the counterparty to obtain the RWA amount for the collateralised transaction.

(3) Illustrative examples for calculation of exposure amount for collateralised transactions are as under.

Sl. No.	**Particulars**	**Case I**	**Case 2**	**Case 3**	**Case 4**	**Case 5**
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1	Exposure	100	100	100	100	100
2	Maturity of the exposure	2	3	6	3	3

Sl. No.	Particulars	Case I	Case 2	Case 3	Case 4	Case 5
(1)	(2)	(3)	(4)	(5)	(6)	(7)
3	Nature of the exposure	Corporate Bond	Corporate Bond	Corporate Bond	Corporate Bond	Corporate Bond
4	Currency	INR	INR	USD	INR	INR
5	Exposure in rupees	100	100	4000 (Row 1 x exch. rate##)	100	100
6	Rating of exposure	BB	A	BBB-	AA	B-
	Applicable Risk weight	150	50	100@	30	150
7	Haircut for exposure*	0	0	0	0	0
8	Collateral	100	100	4000	2	100
9	Currency	INR	INR	INR	USD	INR
10	Collateral (in ₹)	100	100	4000	80 (Row 1 x Exch. Rate)	100
11	Residual maturity of collateral (years)	2	3	6	3	5
12	Nature of collateral	Sovereign (GoI) Security	Bank Bonds	Corporate Bonds	Foreign Corporate Bonds	Corporate Bonds
13	Rating of Collateral	NA	Unrated	BBB	AAA (S & P)	AA
14	Haircut for collateral (%)	0.02	0.06	0.12	0.04	0.08
15	Haircut for currency mismatches (%) [cf. paragraph 65(4) of these Directions]	0	0	0.08	0.08	0
16	Total Haircut on collateral	2	6	800	9.6	8.0

Sl. No.	Particulars	Case I	Case 2	Case 3	Case 4	Case 5
(1)	(2)	(3)	(4)	(5)	(6)	(7)
	[Row 10 x (row 14+15)]					
17	Collateral after haircut (Row 10 - Row 16)	98	94	3200	70.4	92
18	Net Exposure (Row 5 – Row 17)	2	6	800	29.6	8
19	Risk weight (%)	150	50	100[@]	30	150
20	RWA (Row 18 x 19)	3	3	800	8.88	12

[##]Exchange rate assumed to be 1 USD = ₹40

[#]Not applicable

[@]In case of long-term ratings, as per paragraph 128 of Reserve Bank of India (Small Finance Banks – Prudential Norms on Capital Adequacy) Directions, 2025, where '+' or '-' notation is attached to the rating, the corresponding main rating category risk weight is to be used. Hence risk weight is 100 per cent.

*Haircut for exposure is taken as zero because the loans are not marked to market and hence are not volatile

Case 4: Haircut applicable as per Table 12

(4) Illustration on computation of capital charge for Counterparty Credit Risk (CCR) – repo transactions is as under.

Let us assume the following parameters of a hypothetical repo transaction:

Type of the Security	GOI security
Residual Maturity	5 years
Coupon	6 %
Current Market Value	₹1050
Cash borrowed	₹1000
Modified Duration of the security	4.5 years
Assumed frequency of margining	Daily

Type of the Security	GOI security
Haircut for security	2%
Haircut on cash	Zero
Minimum holding period	5 business-days

Computation of total capital charge comprising the capital charge for CCR and Credit for the underlying security:

In the books of the borrower of funds (for the off-balance sheet exposure due to lending of the security under repo) -

(In this case, the security lent is the exposure of the security lender while cash borrowed is the collateral)

Sr. No.	Items	Particulars	Amount (in ₹)
A.	**Capital Charge for CCR**		
1.	Exposure	MV of the security	1050
2.	CCF for Exposure	100 %	
3.	On-Balance Sheet Credit Equivalent	1050 * 100 %	1050
4.	Haircut	1.4 % @	
5.	Exposure adjusted for haircut as per Table 12 of these directions	1050 * 1.014	1064.70
6.	Collateral for the security lent	Cash	1000
7.	Haircut for exposure	0 %	
8.	Collateral adjusted for haircut	1000 * 1.00	1000
9.	Net Exposure (5- 8)	1064.70 – 1000	64.70
10.	Risk weight (for a Scheduled CRAR-compliant bank)	20 %	
11.	Risk weighted assets for CCR (9 x 10)	64.70 * 20 %	12.94
12.	Capital Charge for CCR (11 x 15%)	12.94 * 0.15	1.94
B.	**Capital for Credit Risk of the security**		
1.	Capital for credit risk (if the security is held under banking book)	Credit risk	Zero

Sr. No.	Items	Particulars	Amount (in ₹)
			(Being Government security)
Total capital required (For CCR + credit risk)			1.94

@The supervisory haircut of 2 per cent has been scaled down using the formula indicated in paragraph 65 of these directions.

In the books of the lender of funds (for the on-balance sheet exposure due to lending of funds under repo) -

(In this case, the cash lent is the exposure and the security borrowed is collateral)

Sr. No	**Items**	**Particulars**	**Amount (in ₹)**
A.	Capital Charge for CCR		
1.	Exposure	Cash	1000
2.	Haircut for exposure	0 %	
3.	Exposure adjusted for haircut as per Table 12 of the Direction	1000 * 1.00	1000
4.	Collateral for the cash lent	Market value of the security	1050
5.	Haircut for collateral	1.4 % @	
6.	Collateral adjusted for haircut	1050 * 0.986	1035.30
7.	Net Exposure (3 - 6)	Max {1000 -1035.30}	0
8.	Risk weight (for a Scheduled CRAR-compliant bank)	20 %	
9.	Risk weighted assets for CCR (7 x 8)	0 * 20 %	0
10.	Capital Charge for CCR	0	0
B.	Capital for Credit Risk of the security		
1.	Capital for credit risk (if the security is held under banking book)	Credit Risk	Not applicable, as it is maintained by the borrower of funds

@The supervisory haircut of 2 per cent has been scaled down using the formula indicated in paragraph 65 of these directions.

65. Haircuts

(1) A bank in India shall use only the standard supervisory haircuts prescribed in these Master Directions for both the exposure as well as the collateral. The haircuts (assuming daily mark-to-market, daily re-margining and a 10 business-day holding period), expressed as percentages, shall be as furnished in Table 12.

Explanation - Holding period shall be the time normally required by the bank to realise the value of the collateral.

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

(3) Sovereign shall include the Reserve Bank and DICGC which are eligible for zero per cent risk weight.

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

Table 12: Standard supervisory haircuts for sovereign and other securities which constitute exposure and collateral

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

Sr. No.		Issue rating for debt securities	Residual maturity (in years)	Haircut (in percentage)
		A1	> 1 year and ≤ 5 years	4
			> 5 years	8
	III	A to BBB A2, A3 and unrated bank securities as specified in paragraph 63 (vii) of these Directions	≤ 1 year	2
			> 1 year and ≤ years	6
			> 5 years	12
	IV	Units of Mutual Funds		Highest haircut applicable to any of the above securities, in which the eligible mutual fund {cf. paragraph 63(viii)} can invest
C	Cash in the same currency			0
D	Gold			15

Table 13: Standard supervisory haircut for exposures and collaterals which are obligations of foreign central sovereigns / foreign corporates

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

(5) For transactions in which a bank's exposures are unrated, or the bank lends non-eligible instruments (i.e., non-investment grade corporate securities), the haircut to be applied on the exposure shall be 25 per cent.

(6) Where the collateral is a basket of assets, the haircut on the basket shall be,

$$H = \sum_i a_i H_i$$

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

(7) Adjustment for different holding periods:

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

Table 14: Minimum holding period for different transaction types

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

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

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

In case a transaction has margining frequency different from daily margining assumed, the applicable haircut for the transaction shall also need to be adjusted by using the formula given in sub-paragraph (i).

(9) Formula for adjustment for different holding periods and / or non-daily mark-to-market or remargining: Adjustment for the variation in holding period and margining / mark-to-market, as indicated in sub-paragraphs (g) and (h) above shall be done as per the following formula:

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

Where;

H = haircut

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

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

T_M = minimum holding period for the type of transaction

66. Capital adequacy framework for repo / reverse repo-style transactions

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

(2) Treatment in the books of the borrower of funds:

(i) Where a bank has borrowed funds by selling / lending or posting, as collateral, of securities, the 'exposure' shall be an off-balance sheet exposure equal to the market value of the securities sold / lent as scaled up after applying appropriate haircut. For the purpose, the haircut as per Table 12 shall be used as the basis which shall be applied by using the formula in paragraph 65(9), to reflect minimum (prescribed) holding period of five business-days for repo-style transactions and the variations, if any, in the frequency of re-margining, from the daily margining assumed for the

standard supervisory haircut. The 'off-balance sheet exposure' shall be converted into 'on-balance sheet' equivalent by applying a CCF of 100 per cent, as per Table 9.

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

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

(iv) As the securities shall come back to the books of the borrowing bank after the repo period, it shall continue to maintain the capital for the credit risk in the securities in the cases where the securities involved in repo are held under banking book. The capital charge for credit risk shall be determined according to the credit rating of the issuer of the security. In the case of Government securities, the capital charge for credit risk shall be 'zero'.

(3) Treatment in the books of the lender of funds

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

(ii) The exposure, being cash, shall receive a zero haircut.

(iii) The collateral shall be adjusted downwards / marked down as per applicable haircut.

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

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

(4) The formula in paragraph 65 shall be adapted as follows to calculate the capital requirements for transactions with bilateral netting agreements. The bilateral

netting agreements shall meet the requirements set out in paragraph 54 (part A) of these guidelines.

$E^* = \max \{0, [(\Sigma(E) - \Sigma(C)) + \Sigma (E_s \times H_s) + \Sigma(E_{fx} \times H_{fx})]\}$

where:

E^* = the exposure value after risk mitigation

E = current value of the exposure

C = the value of the collateral received

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

H_s = haircut appropriate to Es

E_{fx} = absolute value of the net position in a currency different from the settlement

currency

H_{fx} = haircut appropriate for currency mismatch

The net long or short position of each security included in the netting agreement shall be multiplied by the appropriate haircut. All other rules regarding the calculation of haircuts stated in paragraphs 64 and 65 equivalently apply for bank using bilateral netting agreements for repo-style transactions.

67. Collateralised OTC derivatives transactions

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

counterparty charge = $[(RC + \text{add-on}) - C_A] \times r \times 15\%$

where:

RC = the replacement cost,

add-on = the amount for potential future exposure calculated according to paragraph 52(2),

C_A = the volatility adjusted collateral amount under the comprehensive approach prescribed in paragraphs 64 and 65 or zero if no eligible collateral is applied to the transaction, and

r = the risk weight of the counterparty.

Note: The risk-weighted assets for counterparty credit risk shall be determined by multiplying the CCR capital charge by a factor of 6.67 (100 / 15).

When effective bilateral netting contracts are in place, RC shall be the net replacement cost and the add-on shall be A_{Net} as calculated according to paragraph 54 and paragraph 52(2). The haircut for currency risk (H_{fx}) shall be applied when there is a mismatch between the collateral currency and the settlement currency. Even in the case where there are more than two currencies involved in the exposure, collateral and settlement currency, a single haircut assuming a 10- business day holding period scaled up as necessary depending on the frequency of mark-to-market shall be applied.

C.4 Credit risk mitigation (CRM) techniques - guarantees

68. Where guarantees are direct, explicit, irrevocable and unconditional a bank shall take account of such credit protection in calculating capital requirements.

69. A range of guarantors are recognised and a substitution approach shall be applied. Thus, only guarantees issued by entities with a lower risk weight than the counterparty shall 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.

70. Detailed operational requirements for guarantees eligible for being treated as a CRM are as under.

(1) A guarantee (counter-guarantee) shall represent a direct claim on the protection provider and shall be explicitly referenced to specific exposures or a pool of exposures, so that the extent of the cover is clearly defined and incontrovertible. The guarantee shall be irrevocable; there shall be no clause in the contract that would allow the protection provider to unilaterally cancel the cover or that would increase the effective cost of cover as a result of deteriorating credit quality in the guaranteed exposure. The guarantee shall also be unconditional; there shall be no clause in the guarantee outside the direct control of the bank that shall prevent the protection provider from being

obliged to pay out in a timely manner in the event that the original counterparty fails to make the payment(s) due.

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

71. In addition to the legal certainty requirements in paragraph 58, for a guarantee to be recognised, the following conditions shall be satisfied:

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

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

(3) Except as noted in the following sentence, the guarantee covers all types of payments the underlying obligor is expected to make under the documentation governing the transaction, for example notional amount, margin payments etc. Where a guarantee covers payment of principal only, interests and other uncovered payments shall be treated as an unsecured amount in accordance with paragraph 74.

72. Range of eligible guarantors (counter-guarantors)

Credit protection given by the following entities shall be recognised:

(1) Sovereigns, sovereign entities (including BIS, IMF, European Central Bank and European Community as well as those MDBs referred to in paragraph 30, banks and primary dealers with a lower risk weight than the counterparty.

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

73. Risk Weights

The protected portion is assigned the risk weight of the protection provider. Exposures covered by State Government guarantees shall attract a risk weight of 20 per cent. The uncovered portion of the exposure is assigned the risk weight of the underlying counterparty.

74. Proportional cover

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

75. Currency mismatches

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

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

Where;

G = nominal amount of the credit protection

H_{FX} = haircut appropriate for currency mismatch between the credit protection and underlying obligation.

A bank using the supervisory haircuts shall apply a haircut of eight per cent for currency mismatch.

76. Sovereign guarantees and counter guarantees

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

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

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

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

C.5 Maturity mismatch

77. For calculating risk-weighted assets, a maturity mismatch occurs when the residual maturity of collateral is less than that of the underlying exposure. Where there is a maturity mismatch and the CRM has an original maturity of less than one year, the CRM is not recognised for capital purposes. In other cases where there is a maturity mismatch, partial recognition is given to the CRM for regulatory capital purposes as detailed below in paragraphs 78 to 80. In case of loans collateralised by the bank's own deposits, even if the tenor of such deposits is less than three months or deposits have maturity mismatch vis-à-vis the tenor of the loan, the provisions of this paragraph regarding derecognition of collateral would not be attracted provided an explicit consent has been obtained from the depositor (i.e. counterparty) for adjusting the maturity proceeds of such deposits against the outstanding loan or for renewal of such deposits till the full repayment of the underlying loan.

78. Definition of Maturity

The maturity of the underlying exposure and the maturity of the collateral should both be defined conservatively. The effective maturity of the underlying should be gauged as the longest possible remaining time before the counterparty is

scheduled to fulfil its obligation, taking into account any applicable grace period. For the collateral, embedded options which may reduce the term of the collateral should be taken into account so that the shortest possible effective maturity is used. The maturity relevant here is the residual maturity.

79. Risk weights for maturity mismatches

As outlined in paragraph 77, collateral with maturity mismatches is only recognised when their original maturities are greater than or equal to one year. As a result, the maturity of collateral for exposures with original maturities of less than one year shall be matched to be recognised. In all cases, collateral with maturity mismatches shall no longer be recognised when they have a residual maturity of three months or less.

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

$$\mathbf{P_a = P \times (t - 0.25) \div (T - 0.25)}$$

where:

P_a = value of the credit protection adjusted for maturity mismatch

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

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

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

C.6 Treatment of pools of credit risk mitigation (CRM) techniques

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

provider has differing maturities, they shall be subdivided into separate protection as well.

D Treatment for illiquid positions

82. Requirements related to Prudent Valuation

A bank shall have a framework for prudent valuation practices (for positions that are accounted for at fair value) which, at the minimum, shall contain the following.

(1) Systems and Controls

A bank shall establish and maintain adequate systems and controls sufficient to give management and supervisors the confidence that its valuation estimates are prudent and reliable. These systems shall be integrated with other risk management systems within the bank (such as credit analysis). Such systems shall include:

(i) Documented policies and procedures for the process of valuation: This includes clearly defined responsibilities of the various areas involved in the determination of the valuation, sources of market information, and review of their appropriateness, guidelines for the use of unobservable inputs reflecting the bank's assumptions of what market participants would use in pricing the position, frequency of independent valuation, timing of closing prices, procedures for adjusting valuations, end of the month and ad-hoc verification procedures; and

(ii) Clear and independent (i.e., independent of front office) reporting lines for the department accountable for the valuation process.

(2) Valuation methodologies

(i) Marking to market

(a) A bank shall mark-to-market to the extent possible. The more prudent side of bid / offer shall be used unless the bank is a significant market maker in a particular position type and it can close out at mid-market.

(b) A bank shall maximise the use of relevant observable inputs and minimise the use of unobservable inputs when estimating fair value using a valuation technique. However, observable inputs or

transactions may not be relevant, such as in a forced liquidation or distressed sale, or transactions may not be observable, such as when markets are inactive. In such cases, the observable data shall be considered, but may not be determinative.

Explanation – Marking-to-market is the valuation of positions at least on a daily basis at readily available close out prices in orderly transactions that are sourced independently. Examples of readily available close out prices include exchange prices, screen prices, or quotes from several independent reputable brokers.

(ii) Marking to model

Where marking-to-market is not possible, a bank shall follow the instructions on valuation of investments in the Reserve Bank of India (Payment Banks – Classification, Valuation and Operation of Investment Portfolio) Directions, 2025. For investment and derivative positions other than those covered in the Master Direction *ibid*, the valuation model used by a bank shall be demonstrated to be prudent. When marking to valuation model other than that prescribed in the Reserve Bank / FIMMDA guidelines, an extra degree of conservatism is appropriate. The Reserve Bank will consider the following in assessing whether a mark-to-model valuation is prudent:

(a) Senior management shall be aware of the elements of the trading book or of other fair-valued positions which are subject to mark to model and shall understand the materiality of the uncertainty this creates in the reporting of the risk / performance of the business.

(b) Market inputs shall be sourced, to the extent possible, in line with market prices (as discussed above). The appropriateness of the

market inputs for the particular position being valued shall be reviewed regularly.

(c) Where available, generally accepted valuation methodologies for particular products shall be used as far as possible.

(d) Where the model is developed by the bank itself, it shall be based on appropriate assumptions, which have been assessed and challenged by suitably qualified parties independent of the development process. The model shall be developed or approved independently of the front office. It shall be independently tested. This includes validating the mathematics, the assumptions, and the software implementation.

(e) There shall be formal change control procedures in place and a secure copy of the model shall be held and periodically used to check valuations.

(f) Risk management shall be aware of the weaknesses of the models used and how best to reflect those in the valuation output.

(g) The model shall be subject to periodic review to determine the accuracy of its performance (e.g., assessing continued appropriateness of the assumptions, analysis of P&L versus risk factors, comparison of actual close out values to model outputs).

(h) Valuation adjustments shall be made as appropriate, for example, to cover the uncertainty of the model valuation.

Explanation – Marking-to model is defined as any valuation which has to be benchmarked, extrapolated, or otherwise calculated from a market input.

(iii) Independent Price Verification

(a) Independent price verification is distinct from daily mark-to-market. It is the process by which market prices or model inputs are regularly verified for accuracy. While daily marking-to-market may be performed by dealers, verification of market prices or model inputs shall be performed by a unit independent of the dealing room, at least monthly (or, depending on the nature of the market / trading activity,

more frequently). It need not be performed as frequently as daily mark-to-market, since the objective, i.e., independent, marking of positions shall reveal any error or bias in pricing, which shall result in the elimination of inaccurate daily marks.

(b) Independent price verification entails a higher standard of accuracy in that the market prices or model inputs are used to determine profit and loss figures, whereas daily marks are used primarily for management reporting in between reporting dates. For independent price verification, where pricing sources are more subjective, e.g., only one available broker quote, prudent measures such as valuation adjustments may be appropriate.

(iv) Valuation adjustments

(a) As part of its procedures for marking to market, a bank shall establish and maintain procedures for considering valuation adjustments. A bank using third-party valuations shall consider whether valuation adjustments are necessary. Such considerations are also necessary when marking to model.

(b) At a minimum, a bank shall consider the following valuation adjustments while valuing its derivatives portfolios:

(i) incurred CVA losses;

Explanation – Provisions against incurred CVA losses are akin to specific provisions required on impaired assets and depreciation in case of investments held in the trading book. These provisions shall be in addition to the general provisions at 0.4 per cent required on the positive MTM values. The provisions against incurred CVA losses may be netted off from the exposure value while calculating capital charge for default risk under the CEM as required in terms of paragraph 52(2).

(ii) close-out costs, which factor in the cost of eliminating the market risk of the portfolio;

(iii) operational risks;

(iv) early termination, investing, and funding costs (i.e., the cost of funding and investing cash flow mismatches at rates different from the rate which models typically assume);

(v) future administrative costs, which relate to the cost that will be incurred to administer the portfolio; and

(vi) where appropriate, model risk.

(c) A bank shall follow any recognised method / model to compute the above adjustments except provisions against incurred CVA losses. However, a bank shall use the following formula to calculate incurred CVA loss on derivatives transactions:

$$\mathbf{ICVAL_t = Max\ [0,\{(EE_t * RP_t) - (EE_0 * RP_0)\}]}$$

Where;

$ICVAL_t$ = Cumulative Incurred CVA loss at time 't'.

EE_t = Value of counterparty exposure projected after one year from 't' and discounted back to 't' using CEM and a risk free discount rate for one year

EE_0 = Counterparty exposure estimated at time '0' using CEM

RP_t = Credit spread of the counterparty as reflected in the CDS or bond

(d) In cases where market-based credit spreads are not available, risk premium applicable to the counterparty according to its credit grade as per the internal credit rating system of the bank used for pricing / loan approval purposes at time 't' shall be used.

RP_0 = Credit spread of the counterparty as reflected in the CDS or bond prices.

(e) In cases where market-based credit spreads are not available, risk premium applicable to the counterparty according to its credit grade as per the internal credit rating system of the bank used for pricing / loan approval purposes at time '0', i.e., the date of the transaction.

Explanation – The instructions in this paragraph are especially important for positions without actual market prices or observable inputs to valuation, as well as less liquid positions which raise supervisory

concerns about prudent valuation. The valuation guidance in this paragraph is not intended to require a bank to change valuation procedures for financial reporting purposes.

(3) Adjustment to the current valuation of less liquid positions for regulatory capital purposes

(i) A bank shall establish and maintain procedures for judging the necessity of and calculating an adjustment to the current valuation of less liquid positions for regulatory capital purposes. This adjustment shall be in addition to any changes to the value of the position required for financial reporting purposes and shall be designed to reflect the illiquidity of the position. An adjustment to a position's valuation to reflect current illiquidity shall be considered whether the position is marked to market using market prices or observable inputs, third-party valuations or marked to model.

(ii) A bank shall make an adjustment to the current valuation of these positions and review their continued appropriateness on an on-going basis. Reduced liquidity may have arisen from market events. Additionally, close-out prices for concentrated positions and / or stale positions shall be considered in establishing the adjustment. While the Reserve Bank has not prescribed any particular methodology for calculating the amount of valuation adjustment on account of illiquid positions, a bank shall consider all relevant factors when determining the appropriateness of the adjustment for less liquid positions. These factors shall include, but are not limited to, the amount of time it would take to hedge out the position / risks within the position, the average volatility of bid / offer spreads, the availability of independent market quotes (number and identity of market makers), the average and volatility of trading volumes (including trading volumes during periods of market stress), market concentrations, the ageing of positions, the extent to which valuation relies on marking-to-model, and the impact of other model risks not included in this paragraph. The valuation adjustment on account of illiquidity shall be considered irrespective of whether the

guidelines issued by FIMMDA have taken into account the illiquidity premium or not, while fixing YTM / spreads for the purpose of valuation.

(iii) For complex products including, but not limited to, securitisation exposures, a bank shall explicitly assess the need for valuation adjustments to reflect two forms of model risk:

(a) the model risk associated with using a possibly incorrect valuation methodology; and

(b) the risk associated with using unobservable (and possibly incorrect) calibration parameters in the valuation model.

The adjustment to the current valuation of less liquid positions made under paragraph 82(3)(ii) shall not be debited to Profit and Loss Account but shall be deducted from CET 1 capital while computing CRAR of the bank. The adjustment may exceed those valuation adjustments made under financial reporting / accounting standards and paragraph 82(2)(iv).

Chapter IV Market Discipline

83. Pillar 3: Market Discipline, as applicable to Small Finance Banks, shall mutatis mutandis apply to Payments Banks, subject to their licensing conditions and extant operating guidelines.

Chapter V

Leverage ratio framework

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

Chapter VI

General provisions

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

Chapter VII

Repeal and Other Provisions

Repeal and saving

86. With the issue of these Directions, the existing Directions, instructions, and guidelines relating to Prudential Norms on Capital Adequacy as applicable to Payment Banks stand repealed, as communicated vide circular DOR.RRC.REC.302/33-01-010/2025-26 dated November 28, 2025. The Directions, instructions and guidelines repealed prior to the issuance of these Directions shall continue to remain repealed.

87. Notwithstanding such repeal, any action taken or purported to have been taken, or initiated under the repealed Directions, instructions, or guidelines shall continue to be governed by the provisions thereof. All approvals or acknowledgments granted under these repealed lists shall be deemed as governed by these Directions. Further, the repeal of these directions, instructions, or guidelines shall not in any way prejudicially affect:

    (i) any right, obligation or liability acquired, accrued, or incurred thereunder;

    (ii) any, penalty, forfeiture, or punishment incurred in respect of any contravention committed thereunder;

    (iii) any investigation, legal proceeding, or remedy in respect of any such right, privilege, obligation, liability, penalty, forfeiture, or punishment as aforesaid; and any such investigation, legal proceedings or remedy may be instituted, continued, or enforced and any such penalty, forfeiture or punishment may be imposed as if those directions, instructions, or guidelines had not been repealed.

Application of other laws not barred

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

Interpretations

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

(Sunil T S Nair)
Chief General Manager

Annex I

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

(1) Name of the bank:

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

(3) Date of issue:

	FIIs			NRIs	
Number of FIIs	Amount raised		Number of NRIs	Amount raised	
	(in ₹)	As a percentage of the total issue size		(in ₹)	As a percentage of the total issue size

(4) It is certified that:

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

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

Authorised Signatory

Date

Seal of the bank

Annex II

Format for reporting of capital issuances

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

Note -

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

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

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