Tier II Capital :

The elements of Tier II capital include the following elements.

a) Elements of Tier II capital as applicable to Indian banks.

b) Head Office (HO) borrowings raised in foreign currency (for inclusion in Upper Tier II Capital) subject to certain terms and conditions.

3.6 Risk-adjusted Assets

Various assets of a bank are exposed to varying degrees of risks. For example, cash balances are not susceptible to any risks whereas advances are susceptible to credit risks. Even within advances, the risk of loss arising from failure of the customer to settle his obligation fully is less in the case of loans guaranteed by DICGC/ECGC as compared to unguaranteed loans.

Similarly, different off-balance sheet items also involve varying degree of risk. For example, the risk involved in guarantees given against counter-guarantees of other banks is much less compared to other guarantees. Similarly, guarantees related to particular transactions are less risky compared to general guarantees of indebtedness.

Recognising the above, the Reserve Bank has assigned different risk weights to different categories of assets. For example, cash, balances with Reserve Bank of India and other banks and several other assets have been assigned a risk weight zero, loan and advances have generally been assigned a risk weight of 100 per cent (except certain specified loans which have been assigned a risk weight of zero or lesser than 100 per cent considering the nature of security/guarantee against them). The risk adjusted value (with reference to which capital adequacy is to be assessed) of a category of assets is determined by multiplying the nominal value of the category as per the balance sheet with the risk weight assigned thereto. For example, if a bank has DICGC/ECGC guaranteed advances of ` 100 crores outstanding on the balance sheet date, the risk -adjusted value of these advances would be ` 50 crores (loans guaranteed by DICGC/ECGC have been assigned a risk weight of 50).

The following table shows the weights to be assigned to the value of different assets and off-balance sheet items:

Risk Weights for Calculation of Capital charge for Credit Risk I.

Domestic Operations

A. Funded Risk Assets

Sr. No.	Item of asset or liability	Risk Weight %
I	**Balances**	
1.	Cash, balances with RBI	0

2.	i. Balances in current account with other banks	20
	ii. Claims on Bank	20
II	**Investments (Applicable to securities held in HTM)**	
1.	Investments in Government Securities.	0
2.	Investments in other approved securities guaranteed by Central! State Government. Note: If the repayment of principal / interest in respect of State Government Guaranteed securities included in item 2, 4 and 6 has remained in default, for a period of more than 90 days banks should assign 100% risk weight. However the banks need to assign 100% risk weight only on those State Government guaranteed securities issued by the defaulting entities and not on all the securities issued or guaranteed by that State Government.	0
3.	Investments in other securities where payment of interest and repayment of principal are guaranteed by Central Govt. (This will include investments in Indira/Kisan Vikas Patra (IVP/KVP) and investments in Bonds and Debentures where payment of interest and principal is guaranteed by Central Govt.)	0
4.	Investments in other securities where payment of interest and repayment of principal are guaranteed by State Governments.	0
5.	Investments in other approved securities where payment of interest and repayment of principal are not guaranteed by Central/State Govt.	20
6.	Investments in Government guaranteed securities of Government Undertakings which **do not** form part of the approved market borrowing programme.	20
7.	Claims on commercial banks. Note: The exposure of Indian branches of foreign banks, guaranteed/ counter-guaranteed by overseas Head Offices or the bank's branch in other country, would amount to a claim on the parent foreign bank	20

	and the risk weight of such exposure would depend upon the rating (assigned by the international rating agencies) of the overseas parent of the Indian branch.	
8.	Investments in bonds issued by other banks	20
9.	Investments in securities which are guaranteed by banks as to payment of interest and repayment of principal.	20
10.	Investments in subordinated debt instruments and bonds issued by other banks or Public Financial Institutions for their Tier II capital.	100
11 .	Deposits placed with SIDBI/NABARD in lieu of shortfall in lending to priority sector.	100
12.	Investment in Mortgage Backed Securities (MBS) of residential assets of Housing Finance Companies (HFCs) which are recognised and supervised by National Housing Bank	50
13	Investment in Mortgage Backed Securities (MBS) which are backed by housing loan qualifying for 50% risk weight.	50
14.	Investment in securitised paper pertaining to an infrastructure facility.	50
15	Investments in debentures/ bonds/ security receipts/ Pass Through Certificates issued by Securitisation Company / SPVs/ Reconstruction Company and held by banks as investment	100
16.	All other investments including investments in securities issued by PFIs.	100
	Note: Equity investments in subsidiaries, intangible assets and losses deducted from Tier I capital should be assigned zero weight	
17	Direct investment in equity shares, convertible bonds, debentures and units of equity oriented mutual funds	125
18	Investment in Mortgaged Backed Securities and other securitised exposures to Commercial Real Estate	150
19	Investments in Venture Capital Funds	150
20	Investments in Securities issued by SPVs (in respect of securitisation of standard assets) underwritten and devolved on originator banks during the stipulated period of three months	100

21	Investments in Securities issued by SPVs in respect of securitisation of standard asset underwritten and devolved on bank as third party service provider during the stipulated period of three months	100
22	NPA Investment purchased from other banks	100
23	Investments in instruments issued by NBFC-ND-SI	100
III	**Loans & Advances** including bills purchased and discounted and other credit facilities	
1.	Loans guaranteed by Govt. of India	0
	Note: The amount outstanding in the account styled as "Amount receivable from Government of India under Agricultural debt Waiver Scheme 2008" shall be treated as a claim on the Government of India and would attract zero risk weight for the purpose of capital adequacy norms. However, the amount outstanding in the accounts covered by the Debt Relief Scheme shall be treated as a claim on the borrowers and risk weighted as per the extant norms.	
2.	Loans guaranteed by State Govts.	0
	Note: If the loans guaranteed by State Govts. have remained in default for a period of more than 90 days a risk weight of 100 percent should be assigned.	
3.	Loans granted to public sector undertakings of Govt. of India	100
4.	Loans granted to public sector undertakings of State Govt.	100
5.	(i) For the purpose of credit exposure, bills purchased/discounted /negotiated under LC (where payment to the beneficiary is not under reserve) is treated as an exposure on the LC issuing bank and assigned risk weight as is normally applicable to inter-bank exposures.	20
	(ii) Bills negotiated under LCs 'under reserve', bills purchased/discounted/negotiated without LCs, will be reckoned as exposure on the borrower constituent. Accordingly, the exposure will attract a risk weight appropriate to the borrower.	
	(i) Govt.	
	(ii) Banks	20
	(iii) Others	100
6.	Others including PFIs	100

7.	Leased Assets	100
8.	Advances covered by DICGC/ECGC Note: The risk weight of 50% should be limited to the amount guaranteed and not the entire outstanding balance in the accounts. In other words, the outstandings in excess of the amount guaranteed, will carry 100% risk weight.	50
9.	SSI Advances Guaranteed by Credit Guarantee Fund Trust for Small Industries (CGTSI) up to the guaranteed portion. **Note:** Banks may assign zero risk weight for the guaranteed portion. The balance outstanding in excess of the guaranteed portion would attract a risk-weight as appropriate to the counter- party.	0
10.	Insurance cover under Business Credit Shield, the product of New India Assurance Company Ltd. ***Note:*** The risk weight of 50% should be limited to the amount guaranteed and not the entire outstanding balance in the accounts. In other words, the outstandings in excess of the amount guaranteed, will carry 100% risk weight.	50
11	Advances against term deposits, Life policies, NSCs, IVPs and KVPs where adequate margin is available.	0
12.	Loans and Advances granted to staff of banks which are fully covered by superannuation benefits and mortgage of flat/house.	20
13.	Housing loans above `30 lakh sanctioned to individuals against the mortgage of residential housing properties having LTV ratio equal to or less than 75%	75
14	Note: If restructured Housing loans upto `30 lakhs sanctioned to	100
	individuals against the mortgage of residential housing properties having L TV ratio equal to or less than 75%.	50
15	Note: If restructured Consumer credit including personal loans and credit	75
	cards	125
15A	Educational Loans	100

16	Loans up to RS.1 lakh against gold and silver ornaments	50
17.	Takeout Finance	
	(i) Unconditional takeover (in the books of lending institution) (a) Where full credit risk is assumed by the taking over institution (b) Where only partial credit risk is assumed by taking over institution i) the amount to be taken over ii) the amount not to be taken over	20 20 100
	(ii) Conditional take-over (in the books of lending and Taking over institution)	100
18	Advances against shares to individuals for investment in equity shares (including IPOs/ESOPs), bonds and debentures, units of equity oriented mutual funds, etc.	125
19	Secured and unsecured advances to stock brokers	125
20	Fund based exposures commercial real estate*	100
21	Funded liquidity facility for securitisation of standard asset transactions	100
22	NPA purchased from other banks	100
23	Loans & Advances NBFC-NO-SI (other than Asset Finance Companies (AFCs)) &	100
24	**All unrated claims on corporate, long term as well as short term, regardless of the amount of the claim**	100
IV	**Other Assets**	
1.	Premises, furniture and fixtures	100
2.	Income tax deducted at source (net of provision)	0
	Advance tax paid (net of provision)	0
	Interest due on Government securities	0
	Accrued interest on CRR balances and claims on RBI on account of Government transactions (net of claims of Government/RBI on banks on account of such transactions)	0
	All other assets #	100

i) The exposures to CCPs on account of derivatives trading and securities financing transactions (e.g. CBlOs, Repos) outstanding against them, will be assigned zero exposure value for counterparty credit risk, as it is presumed that the CCPs' exposures to their counterparties are fully coliateralised on a daily basis, thereby providing protection for the CCP's credit risk exposures;

ii) The deposits / collaterals kept by banks with the CCPs will attract risk weights appropriate to the nature of the CCP. In the case of CCIl, the risk weight will be 20 per cent and for other CCPs, it will be according to the ratings assigned to these entities as per the New Capital Adequacy Framework.

& As regards claims on AFCs, there is no change in the risk weights, which would continue to be governed by the credit rating of the AFC, except the claims that attract a risk weight of 150 per cent under the New Capital Adequacy Framework, which shall be reduced to a level of 100 per cent.

* It is possible for an exposure to get classified simultaneously into more than one category, as different classifications are driven by different considerations. In such cases, the exposure would be reckoned for regulatory / prudential exposure limit, if any, fixed by RBI or by the bank itself, for all the categories to which the exposure is assigned. For the purpose of capital adequacy, the largest of the risk weights applicable among all the categories would be applicable for the exposure.

Off-Balance Sheet Items

The credit risk exposure attached to off-Balance Sheet items has to be first calculated by multiplying the face value of each of the off-Balance Sheet items by 'credit conversion factor' as indicated in the table below. This will then have to be again multiplied by the weights attributable to the relevant counter-party as specified above.

Sr N	Instrument	credit conversion factor
1.	Direct credit substitutes e.g. general guarantees of indebtedness (including standby LICs serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptance).	100
2.	Certain transaction-related contingent items (e.g. performance bonds, bid bonds, warranties and standby LICs related to particular	50
3.	Short-term self-liquidating trade-related contingencies (such as documentary credits collateralized by the underlying shipments).	20
4.	Sale and repurchase agreement and asset sales with recourse, where the credit risk remains with the bank.	100
5.	Forward asset purchases, forward deposits and partly paid shares	100

	and securities, which represent commitments with certain drawdown.	
6.	Note issuance facilities and revolving underwriting facilities.	50
7.	Other commitments (e.g., formal standby facilities and credit lines) with an original maturity of over one year.	50
8.	Similar commitments with an original maturity upto one year, or which can be unconditionally cancelled at any time.	0
9.	Aggregate outstanding foreign exchange contracts of original maturity	
	• less than one year	2
	• for each additional year or part thereof	3
10	Take-out Finance in the books of taking-over institution	
	(i) Unconditional take out finance	100
	(ii) Conditional take out finance	50
Sr N	**Instruments**	**credit conversion factor**
	Note: As the counter-party exposure will determine the risk weight, it will be 100 percent in respect of all borrowers or zero percent if covered by Government guarantee.	
11	Non-Funded exposures to commercial real estate	150
12	Guarantees issued on behalf of stock brokers and market makers	125
13	Commitment to provide liquidity facility for secuitisation of standard asset transactions	100
14	Second loss credit enhancement for securitisation of standard asset transactions provided by third party	100
15	Non-funded exposure to NBFC-ND-SI	125

NOTE: In regard to *off-balance* sheet items, the following transactions with non-bank counterparties will be treated as claims on banks and carry a risk-weight of 20%

- Guarantees issued by banks against the counter guarantees of other banks.
- Rediscounting of documentary bills accepted by banks. Bills discounted by banks which have been accepted by another bank will be treated as a funded claim on a bank.

In all the above cases banks should be fully satisfied that the risk exposure is in fact on the other bank.

Risk weights for Open positions

Sr. No.	Item	Risk (%)	weight
1.	Foreign exchange open position.	100	
2.	Open position in gold *Note:* The risk weighted position both in respect of foreign exchange and gold open position limits should be added to the other risk weighted assets for calculation of CRAR	100	

I.D. Risk weights for Forward Rate Agreement (FRA) fInterest Rate Swap (IRS)

For reckoning the minimum capital ratio, the computation of risk weighted assets on account of FRAs fiRS should be done as per the two steps procedure set out below:

Step 1

The notional principal amount of each instrument is to be multiplied by the conversion factor given below:

Original Maturity	Conversion Factor
Less than one year	0.5 per cent
One year and less than two years	1.0 per cent
For each additional year	1.0 per cent

Step 2

The adjusted value thus obtained shall be multiplied by the risk weightage allotted to the relevant counter-party as specified below:

Counter party	Risk weight
Banks	20 percent
Central & State Govt.	0 percent
All others	100 percent

II. Overseas operations (applicable only to Indian banks having branches abroad)

A. Funded Risk Assets

Sr. No.	Item of asset or liability	Risk %
i)	Cash	0
ii)	Balances with Monetary Authority	0
iii)	Investments in Government securities	0
iv)	Balances in current account with other banks	20

v)	All other claims on banks including but not limited to funds loaned in money markets, deposit placements, investments in CDs/FRNs. Etc.	20
vi)	Investment in non-bank sectors	100
vii)	Loans and advances, bills purchased and discounted and other credit facilities	
	a) Claims guaranteed by Government of India.	0
	b) Claims guaranteed by State Governments	0
	c) Claims on public sector undertakings of Government of India.	100
	d) Claims on public sector undertakings of State Governments	100
	e) Others	100
viii)	All other banking and infrastructural assets	100

B. Non-funded risk assets

Sr. No.	Instruments	Credit Convers Factor
i)	Direct credit substitutes, e.g. general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptances)	100
ii)	Certain transaction-related contingent items (e.g. performance bonds, bid bonds, warranties and standby letters of credit related to transactions)	50
iii)	Short-term self-liquidating trade related contingencies- such as documentary credits collateralised by the underlying shipments	20
iv)	Sale and repurchase agreement and asset sales with recourse, the credit risk remains with the bank.	100
v)	Forward asset purchases, forward deposits and partly paid shares securities, which represent commitments with certain draw down	100
vi)	Note issuance facilities and revolving underwriting facilities	50
vii)	Other commitments (e.g. formal standby facilities and credit lines) with an original maturity of over one	50
viii)	Similar commitments with an original maturity up to one year, or which can be unconditionally cancelled at any time.	0

SSI Advances Guaranteed by Credit Guarantee Fund Trust for Small Industries <u>(CGTSI) - Risk weights and Provisioning norms</u>

Risk-weight Example I

CGTSI Cover: 75% of the amount outstanding or 75% of the unsecured amount or `18.75 lakh . whichever is less

Realisable value of Security

a)	Balance outstanding	: `1.50 lakh
b)	Realisable value of security	: ` 10.00 lakh
c)	Unsecured amount (a) - (b)	: ` 1.50 lakh
d)	Guaranteed portion (75% of (c)	: ` 6.381akh
e)	Uncovered portion (8.50 lakh - 6.38 lakh)	: ` 2.121akh
	Risk-weight on (b) and (e)	
	Risk-weight on (d)	

Example II

CGTSI cover : 75% of the amount outstanding or 75% of the unsecured amount or `18.75 lakh whichever is less

Realisable value of Security	*: ` 10.00 lakh.*
a) Balance outstanding	*: ` 40.00 lakh*
b) Realisable value of security	*: ` 10.00 lakh*
c) Unsecured amount (a) - (b)	*: ` 30.00 lakh*
d) Guaranteed portion (max.)	*: ` 18.75 lakh*
e) Uncovered portion (`30 lakh-18.75 lakh)	*: ` 11.25 lakh*
Risk-weight (b) and (e)	*- Linked to the counter party*
Risk-weight on (d)	*- Zero*

3.7 Reporting for Capital Adequacy Norms

Banks should furnish an annual return. The format for the returns is specified by the RBI under Capital Adequacy Norms. The returns should be signed by two officials who are authorised to sign the statutory returns now being submitted to the Reserve Bank.

Illustration 1

A commercial bank has the following capital funds and assets. Segregate the capital funds into Tier I and Tier II capitals. Find out the risk-adjusted asset and risk weighted assets ratio -

Capital Funds:	*(Figures in ` Lakhs)*
Equity Share Capital	*4,80,00*
Statutory Reserve	*2,80,00*