भारतीय रिज़र्व बैंक

______________RESERVE BANK OF INDIA____________

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RBI/2013-14/

DBOD.No.BP.BC. /21.06.200/2013-14 July 2, 2013

The Chairman and Managing Director/
Chief Executive Officer
All Scheduled Commercial Banks
(Excluding RRBs and LABs)

Dear Sir,

Draft Guidelines on Capital and Provisioning Requirements for exposures to corporates having unhedged foreign currency exposure

Please refer to paragraph 99 of the Monetary Policy Statement for 2013-14 (Extract annexed). Unhedged foreign currency exposures of the corporate are an area of concern not only for individual corporates but also to the entire financial system. Corporates who do not hedge their foreign currency exposures can incur significant losses due to exchange rate movements. These losses may reduce their capacity to service the loans taken from the banking system and thereby affect the health of the banking system.

2. We have issued various guidelines advising banks to closely monitor the unhedged foreign currency exposures of their corporate clients and also factor this risk into the pricing. However, the extent of unhedged foreign currency exposures of the corporate continues to be significant and increases the probability of default in an environment of high currency volatility. It has, therefore, been decided to introduce incremental provisioning and capital requirements for bank exposures to corporates having unhedged foreign currency exposures. For calculating the incremental provisioning and capital requirements, the following methodology may be followed:

a. Ascertain the amount of Unhedged Foreign Currency Exposure (UFCE): UFCE pertains to total unhedged exposure of the corporate and is not limited to unhedged portion of bank's exposure to the corporate. Banks may obtain this information separately from the corporate under certification by statutory auditors on a quarterly basis. UFCE in currencies other than USD may be converted to USD at market rates and total amount of UFCE may be computed in USD. For the purpose of UFCE, banks may exclude natural hedge[1] available to the corporate. The amount UFCE will represent the portion of foreign currency exposure which is not hedged using derivatives.

b. Estimate the extent of likely loss: The loss to the corporate in case of movement in USD-INR exchange rate may be calculated using the annualised volatilities. For this purpose, largest annual volatility seen in the USD-INR rates during the period of last ten years may be taken as the movement of the USD-INR rate in the adverse direction[2].

c. Estimate the riskiness of unhedged position: Once the loss figure is calculated, it may be compared with the annual EBID[3] as per the latest quarterly results certified by statutory auditors. This loss may be computed as a percentage of EBID. Higher this percentage, higher will be the susceptibility of the corporate to adverse exchange rate movements. Therefore, as a prudential measure, all exposures to these corporates (whether in foreign currency or in INR) would attract incremental capital and provisioning requirements (i.e., over and above the present requirements) as under:

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[1] A foreign currency exposure may be treated as naturally hedged if the corporate is having uncovered receivables to cover its foreign currency exposure.

[2] Daily volatility may be computed as standard deviation of changes in the USD-INR rates over a period of one year and then the daily volatility may be annualised.

[3] EBID, as defined for computation of DSCR = Profit After Tax + Depreciation + Interest on term debt + Lease Rentals, if any.

Likely Loss/EBID (%)	Incremental Provisioning Requirement on the total credit exposures over and above extant standard asset provisioning	Incremental Capital Requirement
Upto 15 per cent	0	0
More than 15 per cent and upto 30 per cent	20bps	0
More than 30 per cent and upto 50 per cent	40bps	0
More than 50 per cent and upto 75 per cent	60bps	0
More than 75 per cent[4]	80 bps	25 per cent increase in the risk weight

3. In terms of circular DBOD.BP.BC.No.61/21.04.103/2012-13 dated November 21, 2012, banks have to monitor the UFCE on a monthly interval. Banks should calculate the incremental provisioning and capital requirements at least on a quarterly basis. However, during periods of high USD-INR volatility, the calculations may be done at monthly intervals. This framework may be implemented from October 1, 2013.

4. Banks may ensure that their policies and procedures for management of credit risk factor their exposure to currency-induced credit risks and are calibrated towards borrowers whose capacity to repay is sensitive to changes in the exchange rate and other market variables. These could include internal limits for these exposures and where these exposures are high, internal targets to reduce their risk from these exposures. While fixing internal limits, banks may also consider their overall risk appetite. Banks can reduce their risk either by reducing the exposure to these borrowers or by encouraging these borrowers to reduce their currency mismatches by hedging foreign currency exposures. Banks should also assess their loan pricing policies to ensure that they adequately reflect overall credit risks. Implementation of

[4] This category is most likely to default on account of high unhedged exposures due to volatility in the USD-INR rate. If the account becomes NPA, bank has to make provisions accordingly.

these requirements will be dependent on a robust MIS for getting sufficient information and data on a regular basis from the corporate customers. Further, banks should also ensure that the risk of unhedged foreign currency exposure may be effectively built in their internal credit rating system. In addition, the information collected on unhedged foreign currency exposure on monthly and quarterly basis may also be shared with the credit rating agency, carrying out the bank loan rating of the borrower. This will help in factoring the risk of unhedged foreign currency exposure in both external and internal rating process.

5. Banks may disclose their policies to manage currency induced credit risk as a part of financial statements certified by statutory auditors. In addition, banks should also disclose the incremental provisioning and capital held by them towards this risk.

6. Banks may offer their comments / feedback on the various proposals enumerated in these guidelines latest by **August 2, 2013** to the Principal Chief General Manager, Reserve Bank of India, Department of Banking Operations and Development, Central Office, 12th Floor, Central Office Building, Shahid Bhagat Singh Marg, Fort, Mumbai-400 001 or by e-mail .

Yours faithfully,

(Chandan Sinha)
Principal Chief General Manager

Annex

Extract from Monetary Policy Statement for 2013-14

Unhedged Foreign Currency Exposure

99. In terms of extant instructions, banks should put in place a proper mechanism to rigorously evaluate the risks arising out of unhedged foreign currency exposure of corporates and price them in the credit risk premium, while also considering stipulating a limit on the unhedged positions of corporates on the basis of banks' board-approved policy. These measures are of utmost importance since unhedged forex exposures of borrowers is a source of risk not only to them but also to the financing banks and the financial system, especially in times of currency volatility. The above measures need to be strengthened by requiring the corporates to put in place a risk management policy for their unhedged forex exposures. These measures have not yet been adequately put in place. In view of this and in order to address the risks on account of unhedged forex exposure of corporates, it is proposed to:

- increase the risk weight and provisioning requirement on banks' exposures to corporates on account of the corporates' unhedged forex exposure positions.

Detailed guidelines will be issued by end-June 2013.