Annex 4

Master Direction DOR.CAP.REC.No.61/21.01.002/2021-22 dated October 26, 2021 on Prudential Norms on Capital Adequacy for Local Area Banks (Directions), 2021:

<table>
<tr><th>Sr. No.</th><th>Reference Paragraph</th><th>Existing Extract</th><th>Amended text in RBI regulation (track change mode)</th></tr>
<tr><td>1</td><td>Annex 6</td><td>

…….

E. Risk Weights for Forward Rate Agreement (FRA) /Interest Rate Swap (IRS)

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

Step 1

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

<table>
<tr><th>Original maturity</th><th>Conversion factor</th></tr>
<tr><td>Less than one year</td><td>0.5 per cent</td></tr>
<tr><td>One year and less than two years</td><td>1.0 per cent</td></tr>
<tr><td>For each additional year</td><td>1.0 per cent</td></tr>
</table>

Step 2

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

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…….

E. Risk Weights for Forward Rate Agreement (FRA) /Interest Rate Swap (IRS) and Foreign Exchange Contracts

1. Foreign exchange contracts include- Cross currency swaps, Forward foreign exchange contracts, Currency futures and other contracts of a similar nature.

2. Foreign exchange contracts with an original maturity of 14 calendar days or less, irrespective of the counterparty, shall be assigned "zero" risk weight.

3. For reckoning the minimum capital ratio, the computation of risk weighted assets on account of FRAs / IRS and Foreign Exchange Contracts shall be done as per the two steps procedure set out below:

a) **Step 1**:

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

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<table>
<tr><th>Sr. No.</th><th>Reference Paragraph</th><th>Existing Extract</th><th>Amended text in RBI regulation (track change mode)</th></tr>
<tr><td></td><td></td><td>
specified below:
<table>
<tr><th>Counter party</th><th>Risk weight</th></tr>
<tr><td>Banks</td><td>20 per cent</td></tr>
<tr><td>Central & State Govt</td><td>0 per cent</td></tr>
<tr><td>All others</td><td>100 per cent</td></tr>
</table>
F. Computation of CRAR for Foreign Exchange Contracts
Foreign exchange contracts include- Cross currency interest rate swaps, Forward foreign exchange contracts, Currency futures and other contracts of a similar nature.
Foreign exchange contracts with an original maturity of 14 calendar days or less, irrespective of the counterparty, shall be assigned "zero" risk weight.
As in the case of other off-Balance Sheet items, a two stage calculation prescribed below shall be applied:
(a) Step 1 - The notional principal amount of each instrument is multiplied by the conversion factor given below:
<table>
<tr><th>Original Maturity</th><th>Conversion factor</th></tr>
<tr><td>Less than one year</td><td>2 per cent</td></tr>
</table>
</td><td>
<table>
<tr><th rowspan="2">Original maturity</th><th colspan="2">Conversion factor</th></tr>
<tr><td>Interest rate contracts</td><td>Foreign Exchange Contracts</td></tr>
<tr><td>Less than one year</td><td>0.5 per cent</td><td>2.0 per cent</td></tr>
<tr><td>One year and less than two years</td><td>1.0 per cent</td><td>5.0 per cent</td></tr>
<tr><td>For each additional year</td><td>1.0 per cent</td><td>3.0 per cent</td></tr>
</table>
When effective bilateral netting contracts as specified in paragraph E-4 of this Annex are in place, the conversion factors, as mentioned in the below table, shall be applicable[4]:
<table>
<tr><th rowspan="2">Original maturity</th><th colspan="2">Conversion factor</th></tr>
<tr><td>Interest rate contracts</td><td>Foreign Exchange Contracts</td></tr>
<tr><td>Less than one year</td><td>0.35 per cent</td><td>1.5 per cent</td></tr>
<tr><td>One year and less than two years</td><td>0.75 per cent</td><td>3.75 per cent</td></tr>
<tr><td>For each additional year</td><td>0.75 per cent</td><td>2.25 per cent</td></tr>
</table>
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</table>

<table>
<tr><th>Sr. No.</th><th>Reference Paragraph</th><th>Existing Extract</th><th>Amended text in RBI regulation (track change mode)</th></tr>
<tr><td></td><td></td><td>
<table>
<tr><td>One year and less than two years</td><td>5 per cent</td></tr>
<tr><td>For each additional year</td><td>3 per cent</td></tr>
</table>

(b) Step 2 - The adjusted value thus obtained shall be multiplied by the risk weight age allotted to the relevant counter-party as given in Step 2 in paragraph E.
</td><td>
<u>b)</u> Step 2<u>:</u>
The adjusted value thus obtained shall be multiplied by the risk weightage allotted to the relevant counter-party as specified below:
<table>
<tr><th>Counter party</th><th>Risk weight</th></tr>
<tr><td>Banks</td><td>20 per cent</td></tr>
<tr><td>Central & State Govt</td><td>0 per cent</td></tr>
<tr><td>All others</td><td>100 per cent</td></tr>
</table>

<u>Footnote 4: For purposes of calculating the credit exposure to a netting counterparty for forward foreign exchange contracts and other similar contracts in which notional principal is equivalent to cash flows, the original credit conversion factors (i.e. without considering the impact of bilateral netting) should be applied to the notional principal, which is defined as the net receipts falling due on each value date in each currency. In no case should the reduced factors above be applied to net notional amounts.</u>
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<table>
<tr><th>Sr. No.</th><th>Reference Paragraph</th><th>Existing Extract</th><th>Amended text in RBI regulation (track change mode)</th></tr>
<tr><td></td><td></td><td></td><td>
<s>F. Computation of CRAR for Foreign Exchange Contracts</s>
<s>Foreign exchange contracts include- Cross currency interest rate swaps, Forward foreign exchange contracts, Currency futures and other contracts of a similar nature.</s>
<s>Foreign exchange contracts with an original maturity of 14 calendar days or less, irrespective of the counterparty, shall be assigned "zero" risk weight</s>.
<s>As in the case of other off-Balance Sheet items, a two stage calculation prescribed below shall be applied:</s>
<s>(a) Step 1 - The notional principal amount of each instrument is multiplied by the conversion factor given below:</s>
<table>
<tr><th><s>Original Maturity</s></th><th><s>Conversion factor</s></th></tr>
<tr><td><s>Less than one year</s></td><td><s>2 per cent</s></td></tr>
<tr><td><s>One year and less than two years</s></td><td><s>5 per cent</s></td></tr>
<tr><td><s>For each additional year</s></td><td><s>3 per cent</s></td></tr>
</table>
<s>(b) Step 2 - The adjusted value thus obtained shall be multiplied by the risk weight age allotted to the relevant counter-party as given in Step 2 in paragraph E.</s>
</td></tr>
</table>

Sr. No.	Reference Paragraph	Existing Extract	Amended text in RBI regulation (track change mode)
			4. Requirement for recognition of Bilateral Netting Contract: (a) Banks 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. (b) Banks may also net transactions subject to any legally valid form of bilateral netting not covered in (a), including other forms of novation. (c) In both cases (a) and (b), a bank will need to satisfy that it has: (i) A netting contract or agreement with the counterparty which creates a single legal obligation, covering all included transactions, such that the bank would have either a claim to receive or obligation to pay only the net sum of the positive and negative mark-to-market values of included individual transactions in the event a counterparty fails to perform due to any of the following:

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			default, bankruptcy, liquidation or similar circumstances; (ii) Written and reasoned legal opinions that, in the event of a legal challenge, the relevant courts and administrative authorities would find the bank's exposure to be such a net amount under: • The law of the jurisdiction in which the counterparty is chartered and, if the foreign branch of a counterparty is involved, then also under the law of the jurisdiction in which the branch is located; • The law that governs the individual transactions; and • The law that governs any contract or agreement necessary to effect the netting. (iii) Procedures in place to ensure that the legal characteristics of netting arrangements are kept under review in the light of possible changes in relevant law. (d) Contracts containing walkaway clauses will not be eligible for netting for the purpose of calculating capital requirements under these guidelines. A walkaway clause is a provision

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			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.