New Basel Capital Accord

DBOD.BP.1361 /21.04.118/ 2002-03

May 14, 2003

All Scheduled Commercial Banks
(excluding RRBs and LABs)

Dear Sir,

New Basel Capital Accord.

As you are aware, the Basel Committee on Banking Supervision (BCBS) is now engaged in revision to the Capital Accord of 1988. After conducting an impact assessment [Quantitative Impact Study (QIS 3)], the BCBS has recently issued Consultative Document (CP 3) on the New Basel Capital Accord for comments by July 31, 2003. The Consultative Document can be downloaded from BIS web-site, www.bis.org, and studied.

2. With a view to finalise our policy approach to the proposed New Basel Capital Accord so that external perception about India conforming to the best international standards is positive, a quantitative impact study covering all banks in India is being undertaken. An Excel Workbook, which has been basically designed on the basis of the DSB Returns being submitted by banks to the Department of Banking Supervision of the RBI, is enclosed for use by banks for completing the impact study. With a view to aiding banks in filling in the required data in the above workbook, a guidance note, relevant extracts from CP 3 (page Nos. 1 to 38) and the mapping of ratings given by Indian and International Rating Agencies are enclosed.

3. Banks are required to furnish the data with respect to the position as on March 31, 2003. In case, for any reason, it is not possible for any bank to do so, it may furnish the data as on March 31, 2002. The filled in workbook, both hard copy and soft copy, and also banks' comments on the Consultative Document as mentioned in paragraph 1 above, should positively reach us at the following address on or before June 30, 2003:

The Chief General Manager,
Department of Banking Operations and Development,
Banking Policy Section,
Reserve Bank of India, Central Office,
5th Floor, World Trade Centre, Centre 1,
Cuffee Parade, Colaba, Mumbai 400 005.
Fax : (022) 22183785

The details of the contact official for the purpose may please be reported by fax to the above address on or before May 20, 2003.

4. A copy of this letter, alongwith all enclosures, is also sent by email to banks' Chairman / Chief Executive's office and placed on RBI's web-site www.rbi.org.in ***/Notification.*** The Excel Workbook forwarded with the email or in RBI's web-site may be used by banks. In case of need, banks may contact any of the following officials for assistance in completing the study:

(i) Shri T.Murali Mohan
e-mail : tmuralimohan@rbi.org.in
Fax : (022) 22183785

(ii) Shri K. Damodaran
e-mail : kdamodaran@yahoo.com
Fax : (022) 22183785

Yours faithfully,

(***B. Mahapatra***)
Chief General Manager

Guidance Note

The Basel Committee had proposed to permit banks a choice between two broad methodologies for calculating their capital requirements for credit risk. One of the alternatives is to measure credit risk in a standardized manner with the support of the ratings of external credit rating agencies. The other alternative is to allow banks to use their internal ratings subject to the approval of the supervisor. To identify the rating agencies and map the ratings, a suggested mapping of the ratings is enclosed along with the consultative document. All banks in India will participate in the impact study under the Standardised Approach which will rely on the ratings awarded by the external credit rating agencies, where ratings are available. In case credit ratings are not available, these unrated have to be accord 100% risk weight. Further details on the New Capital Accord, for the benefit of banks, are available on the Bank for International Settlement web-site www.bis.org. The general rules to be followed for filling in the data for the impact study are set out in the following paragraphs.

2. ***Operational guidelines for filling the workbook***

The following may carefully be read to complete the excel workbook furnished along with the circular and the guidance note.

2.1 The Report on Capital Adequacy : This portion of the data is to track the increase or decrease in the total risk weighted assets. The data is to be provided as on March 31, 2003 (please see para 3 of the letter). The amount in Rupees is to be provided strictly in ***Crore*** (upto two decimals).

2.2 Risk Weighted Assets (Section A): This worksheet seeks information of the book value, margins and provisions, eligible financial collaterals, net book exposures, etc. The ***net book exposures is arrived at by deducting total book exposures, margins & provisions and eligible financial collateral.***

2.3 In the case of other debt securities and loans and advances, the data is to be furnished excluding NPAs, loans to Retail sector. Data on Retail sector and NPAs treatment may be furnished under Section D.

2.4 The credit mitigation technique: Paragraphs 90 to 179 of the Consultative Document may please be seen for credit risk mitigation techniques.

2.5 Operational risk : Section E of the workbook seeks to evaluate the capital charge for operational risk under the New Capital Accord. In the Standardised Approach, banks' activities are divided into eight business lines. The business lines and their descriptions are given in ***Annex 6*** to the Consultative Document enclosed. Within each line of business, gross income is a braod indicator to denote likely scale of operational risk exposure within each business line. The capital charge for each business line is calculated by multiplying gross income by a factor given in the Section E.

3. The New Accord sets out the revisions to the 1988 Accord for risk weighting banks' exposures. **Exposures that are not explicitly addressed in the guidance note will retain the current treatment**.

<u>3.1 Individual Claims</u>

3.2 Claims on Sovereigns :

3.2.1 Claims on Government of India, State Governments in India and RBI will receive a concessional risk weight of zero per cent as per our extant guidelines.

3.2.2 Claims to the extent guaranteed by the Central/ State governments will also receive a lower risk weight as per extant guidelines.

3.2.3 The above pertains to exposures funded in domestic currency. In the case of other currencies, claims on sovereigns as given ***para 27 to 29*** may be applied for banks exposure.

3.2.4 Claims on the Bank for International Settlements, IMF, World Bank, IFC, ADB and the Central Banks of various countries would also attract a concessional risk weight of zero per cent.

3.3 Claims on Banks : It has been decided to adopt the risk weights as per **option 1,** in respect of claims on banks**.** Under this option, all banks incorporated in a given country will be assigned a risk weight one category less favourable than that assigned to claims on the sovereign of incorporation. However, for claims on banks in sovereigns rated BB+ to B- and to banks in unrated countries the risk weight will be capped at 100%. While the rating as per this option is given below in the table, the risk weight in respect of banks registered in India will be 20%.

Credit assessment of Sovereign	**AAA to AA-**	**A+ to A-**	**BBB+ to BBB-**	**BB+ to B-**	**Below B-**	**Unrated**
Risk weight	20 %	50 %	100 %	100 %	150 %	100 %

3.4 Claims on securities: The extant guidelines on risk weighting would be followed for investment in SLR securities. Investment in non-SLR securities will be treated as claims on corporates as detailed below.

3.5 Claims on corporates: The table below illustrates the risk weighting of corporate claims.

Credit assessment	**AAA to AA-**	**A+ to A-**	**BBB+ to BB-**	**Below BB-**	**Unrated**
Risk weight	20 %	50 %	100 %	150 %	100 %

3.6 Claims included in retail portfolios: The claims that satisfy the following criteria will be considered as retail claims for capital adequacy purposes and will be included in retail portfolio. Exposures included in this portfolio will be risk weighted at 75%. The claims are required to meet the four criteria to qualify for being reckoned as retail portfolio:

- Orientation criterion – the exposure is to an individual person or persons or to a small business;

- Product criterion – the exposure takes the form of any of the following, revolving credits and lines of credit (including credit cards and overdrafts), personal term loans and leases (installment loans, auto loans and leases, student and educational loans, personal finance) and small business facilities and commitments. Securities such as bonds and equities, whether listed or not are to be excluded from this category. Mortgage loans are excluded to the extent that they qualify for treatment as claims secured under the residential property.

- Granualarity criterion – no aggregate exposure to one counterparty can exceed 0.2% of the overall regulatory retail portfolio.

- Low value of individual exposures – the maximum aggregate retail exposure to one counterpart cannot exceed an absolute threshold of Rs. 5 crore.

For details, please see para 44 of the extract of CP 3.

3.7 Treatment of NPAs: When provisions in respect of a NPA reach 20 % of the gross amount of NPA [total outstanding in the NPA account (including provisions etc.)], will attract a risk weight of 100 % instead of the 150 % risk weight bucket. In respect of a fully secured NPA where provisions held reach 15% of the gross amount, the risk weight will be 100%.

3.8 Other assets: The standard risk weight for all other assets will be 100%.

3.9 Off–balance sheet items: Off-balance sheet items under the standardized approach will be converted into credit exposure equivalents through the use of credit conversion factors. Commitments with an original maturity up to one year and commitments with an original maturity over one year will receive a credit conversion factor of 20 % and 50 % respectively. Any commitments that are unconditionally cancelable, or that effectively provide for automatic cancellation, due to deterioration in a borrower’s creditworthiness, at any time by the bank without prior notice will receive a 0 % credit conversion factor. A 20% credit conversion factor to trade finance letters of credit will have to be applied.

3.10 Claims secured by residential property: Lending fully secured by mortgages on residential property that is or will be occupied by the borrower, or that is rented will be riskweighted at 35%. However, when claims are past due for more than 90 days, the risk weight will be 100%.

3.11 Claims secured by commercial real estate: Mortgage on commercial real estate justify a risk weightage of 100 %.

3.12 Operational Risk: In the standardized approach, banks' activities are divided into eight business lines such as corporate finance, trading and sales, retail banking, commercial banking, payment and settlement, agency services, asset management and retail brokerage. Banks are required to split gross income into eight different business lines and the average gross income for three years should be multiplied with the beta given in the workbook. If banks cannot split gross income into the eight business lines, the gross income can be split into the amount for traditional banking (commercial and retail) and others will be multiplied with the beta given as an alternate approach.

Mapping of Ratings of Indian and International Rating Agencies

Crisil Average One-Year Transition Rates (1993 – 2000)

Rating	Data Points	AAA	AA	A	BBB	BB	B	C & Below
AAA	154	96.8%	3.2%					
AA	500	2.8%	85.2%	10.0%	1.0%	0.4%	0.4%	0.2%
A	759		3.3%	82.3%	8.8%	3.2%	0.3%	2.1%
BBB	317		0.3%	5.7%	73.2%	11.0%	1.9%	7.9%
BB	117				2.6%	58.1%	2.6%	36.7%
B	16						62.5%	37.5%
C & Below	32							100%

ICRA's Average One-Year Transition Rates (1992 – 2001)

Rating	Data Points	AAA	AA	A	BBB	NI
AAA	142	92.3%	7.0%	0.7%		
AA	287	1.7%	86.4%	10.1	0.3%	1.4%
A	279		1.4%	83.5%	7.5%	7.5%
BBB	133			0.8%	85.7%	13.5%
NI					2.6%	58.1%

NI – Non-Investment (BB+ to D)

Moody's Average one-year transition matrix

Initial Rating	Rating at year-end (%)							
	Aaa	Aa	A	Baa	Ba	B	Caa	Default
Aaa	93.40	5.94	0.64	0	0.02	0	0	0
Aa	1.61	90.55	7.46	0.26	0.09	0.01	0	0.02
A	0.07	2.28	92.44	4.63	0.45	0.12	0.01	0
Baa	0.05	0.26	5.51	88.48	4.76	0.71	0.08	0.15
Ba	0.02	0.05	0.42	5.16	86.91	5.91	0.24	1.29
B	0	0.04	0.13	0.54	6.35	84.22	1.91	6.81
Caa	0	0	0	0.62	2.05	4.08	69.20	24.06

Standard and Poor's Average one-year transition matrix

Initial Rating	Rating at year-end (%)							
	AAA	AA	A	BBB	BB	B	CCC	Default
AAA	90.81	8.33	0.68	0.06	0.12	0	0	0
AA	0.70	90.65	7.79	0.64	0.06	0.14	0.02	0
A	0.09	2.27	91.05	5.52	0.74	0.26	0.01	0.06
BBB	0.02	0.33	5.95	86.93	5.30	1.17	0.12	0.18
BB	0.03	0.14	0.67	7.73	80.53	8.84	1.00	1.06
B	0	0.11	0.24	0.43	6.48	83.46	4.07	5.20
CCC	0.22	0	0.22	1.30	2.38	11.24	64.86	19.79

Suggested Mapping (based on Default Probability) -

Agency				Risk Weight for Corporates Standardized Approach – Basel II	
Crisil	**ICRA**	**Moody's**	**S&P**		
AAA	AAA	Aaa to Aa	AAA to AA	AAA to AA-	20%
AA	AA	A	A	A+ to A-	50%
A	A	Baa to Ba	BBB to BB	BBB+ to BB-	100%
BBB & below	BBB & below	B	B	Below BB-	150%
-	-	-	-	Unrated	100%