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RESERVE BANK OF INDIA

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June 24, 2004

The Chief Executives of
All Scheduled Commercial Banks
(excluding RRBs)

Dear Sir,

Guidelines on Capital Charge for Market risks

The Basel Committee on Banking Supervision (BCBS) had issued the 'Amendment to the Capital Accord to incorporate market risks' containing comprehensive guidelines to provide explicit capital charge for market risks. In India, as an initial step towards prescribing capital charge for market risks, banks were advised to:

- assign an additional risk weight of 2.5 per cent on the entire investment portfolio;
- assign a risk weight of 100 per cent on the open position limits on foreign exchange and gold; and
- build up Investment Fluctuation Reserve up to a minimum of five per cent of the investments held in Held for Trading and Available for Sale categories in the investment portfolio.

2. In the Statement on Monetary and Credit Policy for the year 2002-03 announced in April 2002, it was mentioned that it would be appropriate for banks to adopt the BCBS norm on capital charge for market risk. Banks were also advised to study the BCBS framework on capital for market risks and prepare themselves to follow the international practices in this regard. As a further step in this direction, Reserve Bank had issued draft guidelines on computing capital charge for market risks, on the lines of the Basel Committee framework, in May 2003, to select banks seeking their comments.

3. It has now been decided to assign explicit capital charge for market risks on the lines of the Basel Committee guidelines. The draft guidelines have been reviewed on the basis of the feedback received and the detailed guidelines in this regard are furnished in the Annex. As announced by the Governor on May 18, 2004 in paragraph 119 of the annual policy Statement for 2004-05 (copy of the paragraph enclosed), banks should maintain capital charge for market risks in a phased manner over a two year period, as detailed below:

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a) Capital for market risks on securities included in the Held for Trading category, open gold position limit, open foreign exchange position limit, trading positions in derivatives and derivatives entered into for hedging trading book exposures ***by March 31, 2005***, and

b) In addition to (a) above, capital for market risks on securities included in the Available for Sale category by ***March 31, 2006***.

4. With a view to ensure smooth implementation of the guidelines, banks may nominate suitable official(s) who would be the contact point in the bank. The following details of the nominated official(s) may be advised to us viz. name, designation, telephone number, fax number, e-mail-id, and postal address. These contact officials may also seek clarifications, if any, by e-mail from Reserve Bank (dbodmrg@rbi.org.in)

Yours faithfully,

(C.R.Muralidharan)
Chief General Manager-in-Charge

Encls: as above.

Extract of Annual Policy Statement for the year 2004-05

" Capital Charge for Market Risk

119. In the annual policy Statement of April 2002, banks were advised to adopt the Basel norm for capital charge for market risk. As a further step in this direction, RBI issued draft guidelines on computing capital charge for market risk to select banks seeking their comments. In this context, with a view to ensuring smooth transition to Basel II norms, it is proposed to phase the implementation of capital charge for market risk over a two year period as under:

- Banks would be required to maintain capital charge for market risk in respect of their trading book exposures (including derivatives) by March 31, 2005.

- Banks would be required to maintain capital charge for market risk in respect of the securities included under available for sale (AFS) category by March 31, 2006. "