RBI / 2004-05/448
DBOD. No. BP. BC. 85 / 21.04.141 / 2004-05

April 30, 2005

All Commercial Banks (excluding RRBs)

Dear Sir,

Capital Adequacy - Investment Fluctuation Reserve

In terms of prevailing instructions, banks are required to build up Investment Fluctuation Reserve (IFR) of a minimum 5 per cent of investments in 'Held for Trading' (HFT) and 'Available for Sale' (AFS) categories within a period of 5 years, i.e., by March 31, 2006. The IFR is eligible for inclusion in Tier II capital for capital adequacy purpose. Further, with a view to ensuring smooth transition to Basel II norms banks were advised vide our circular DBOD.No.BP.BC.103/ 21.04.151/ 2003-04 dated June 24, 2004 to maintain capital charge for market risk in a phased manner over a two year period, as under:

(i) In respect of securities included in the HFT 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

(ii) In respect of securities included in the AFS category by March 31, 2006.

2. With a view to encourage banks for early compliance with the guidelines for maintenance of capital charge for market risks, it has been decided that banks which have maintained capital of at least 9 per cent of the risk weighted assets for both credit risk and market risks for <u>both</u> HFT (items as indicated at (i) above) and AFS category may treat the balance <u>in excess of</u> 5 per cent of securities included under HFT and AFS categories, in the IFR, as Tier I capital.

3. Banks satisfying the above criteria may transfer the amount in excess of the said 5 per cent in the IFR to Statutory Reserve. This transfer shall be made as a 'below the line' item in the Profit and Loss Appropriation Account.

4. Please acknowledge receipt.

Yours faithfully,

(Anand Sinha)
Chief General Manager-in-Charge