RBI/2007-2008/203
RPCD.CO.RF. BC. 40 / 07.38.03 / 2007-08

December 4, 2007
13 Agrahayana, Saka 1929

The Chairman / Managing Director
All State and Central Co-operative Banks

Dear Sir,

Mid-Term Review of Annual Policy Statement for
the year 2007-08 -Application of Capital Adequacy
Norms to State and Central Co-operative Banks

Please refer to Paragraph 149 of the Mid-Term Review of Annual Policy Statement for the year 2007-08 (copy of the extract enclosed). At present, State and Central Co-operative Banks are outside the Capital to Risk weighted Assets Ratio (CRAR) framework. In order to assess the capital structure of the State and Central Co-operative Banks, in the context of financial stability of the whole system, it is proposed that they should disclose the level of CRAR as on March 31, 2008 in their Balance Sheets.

2. Accordingly, all State and Central Co-operative Banks are advised to disclose their CRAR as on March 31, 2008 and thereafter every year as 'Notes on Accounts' to their Balance Sheets. The roadmap for achieving the desired level of CRAR norms would be communicated in due course.

3. Under the proposed CRAR framework, the Balance Sheet assets and non-funded / off-balance sheet items will be assigned weights and banks have to compute the ratio of their capital funds to the aggregate of risk weighted assets and other off-balance sheet exposures. The details of the framework and other procedural guidelines are indicated in the enclosed 'Memorandum of Instructions', which may please be studied carefully for the purpose of such computation.

4. Additionally, banks should furnish an annual return to our Regional Office / NABARD Regional office, indicating capital funds and risk assets ratio, in the format given in Annex 2. The return should be signed by two officials who are authorised to sign the statutory returns submitted to the Reserve Bank. The statement as per the format (Annex 2) indicating the position as on March 31, 2008 may please be furnished to the Regional Office of RPCD / NABARD under whose jurisdiction the bank is located, as soon as the annual accounts are finalised.

5. Please bring the contents of this letter to the notice of the Board of Directors of your bank.

6. Please acknowledge receipt to our Regional Office concerned.

Yours faithfully

(C.S.Murthy)
Chief General Manager in-Charge

Memorandum of Instructions

Capital Adequacy Standards

1. General

The fundamental objective behind introducing Capital to Risk Weighted Asset Ratio (CRAR) framework is to strengthen the soundness and stability of the rural co-operative banks.

2. Definition of Capital Funds etc.

The Capital Funds can be segregated into two broad groups/tiers - Tier I and Tier II. While Tier I Capital, otherwise known as core capital, provides the most permanent and readily available support to a bank against unexpected losses, the Tier ll capital consists elements that are less readily available.

2.1. Tier I Capital/Core Capital

Tier I Capital would include the following items:

(a) Paid up share capital collected from regular members of a bank having voting powers.

(b) Free Reserves

(c) Capital Reserve representing surplus arising out of sale proceeds of assets.

(d) Any surplus (net) in profit and loss account i.e. balance after appropriation towards dividend payable, education fund, other funds whose utilisation is defined and asset loss, if any, etc.

Note: Amount of intangible assets, losses in current year and those brought forward from previous periods, deficit in NPA provisions, income wrongly recognized on non performing assets, provision required for liability devolved on bank etc., will be deducted form Tier I Capital.

2.2. Tier II Capital

2.2.1 Undisclosed Reserves

These often have characteristics similar to equity and disclosed reserves. They have the capacity to absorb unexpected losses and can be included in capital, if they represent accumulation of profits and not encumbered by any known liability and should not be routinely used for absorbing normal loss or operating losses.

2.2.2. Revaluation Reserves

These reserves often serve as a cushion against unexpected losses, but they are less permanent in nature and cannot be considered as 'Core Capital'. Revaluation reserves arise from revaluation of assets that are undervalued on the bank's books. The typical examples in this regard are bank premises and marketable securities. The extent to which the revaluation reserves can be relied upon as a cushion for unexpected losses depends mainly upon the level of certainty that can be placed on estimates of the market values of the relevant assets, the subsequent deterioration in values under difficult market conditions or in a forced sale, potential for actual liquidation of those values, tax consequences of revaluation, etc. Therefore, it would be prudent to consider revaluation reserves at a discount of 55 percent when determining their value for inclusion in Tier II capital i.e. only 45% of revaluation reserve is available for inclusion in Tier II capital. Such reserves will have to be reflected on the face of the Balance Sheet as revaluation reserves.

2.2.3. General Provisions and Loss Reserves

These will include such provisions of general nature appearing in the books of the bank which are not attributed to any identified potential loss or a diminution in value of an asset or a known liability. Adequate care must be taken to ensure that sufficient provisions have been made to meet all known losses and foreseeable potential losses before considering any amount of general provision as part of Tier II capital as indicated above. To illustrate, excess provision in respect of Bad and Doubtful Debt, general provision for Standard Assets etc. could be considered for inclusion under this category. Such provisions which are considered for inclusion in Tier II capital will be admitted up to 1.25% of total weighted risk assets.

2.2.4 Investment Fluctuation Reserve

Balance, if any, in Investment Fluctuation Reserve of bank.

Note:

It may be noted that the total of Tier II elements will be limited to a maximum of 100 percent of total Tier I elements for the purpose of compliance with the norms.

3. Risk Adjusted Assets and Off-Balance Sheet Items

Risk adjusted assets would mean weighted aggregate of funded and non-funded items. Degrees of credit risk expressed as percentage weightings have been assigned to Balance Sheet assets and conversion factors to off-Balance Sheet items. The value of each asset/item shall be multiplied by the relevant weights to produce risk-adjusted values of assets and of off-Balance Sheet items. The aggregate will be taken into account for reckoning the minimum capital ratio. The weights allotted to each of the items of assets and off-Balance Sheet items are furnished in the Annex 1.

Annex 1

PRUDENTIAL NORMS

Risk Weights for Calculation of CRAR

I. Domestic Operations

A. Funded Risk Assets

Sr. No.	Particulars	Risk Weight (%)
I	**Balances**	
1.	Cash, balances with RBI	0
2.	Balances in current account with other banks	20
II	**Investments**	
1.	Investments in Government Securities.	2.5
2.	Investments in other approved securities guaranteed by Central/State Govt.	2.5
3.	Investments in other securities where payment of interest and repayment of principal are guaranteed by Central Govt. (This will include investments in Indira/Kisan Vikas Patra (IVP/KVP) and investments in Bonds where payment of interest and principal is guaranteed by Central/ State Govt.)	2.5
4.	Investments in other securities where payment of interest and repayment of principal are guaranteed by State Governments. **Note:** Investment in securities where payment of interest or repayment of principal is guaranteed by State Government and which has become a non-performing investment, will attract 102.5 percentage risk weight	2.5
5.	Investments in other approved securities where payment of interest and repayment of principal are **not** guaranteed by Central/State Govt.	22.5

6.	Investments in Government guaranteed securities of Government undertakings which **do not** form part of the approved market borrowing programme.	22.5
7.	Claims on commercial banks, District Central Co-operative Banks and State Co-operative Banks, such as fixed deposits, certificates of deposits, money at call and short notice, etc.	20
8.	Investments in bonds issued by All India Public Financial Institutions	22.5
9.	Investments in bonds issued by Public Financial Institutions for their Tier II capital	102.5
10.	All other investments	102.5
	Note: Intangible assets for which losses have been deducted from Tier I capital should be assigned zero weight.	
III	**Loans & Advances**	
I	Loans and advances including bills purchased and discounted and other credit facilities	
1.	i. Loans guaranteed by Government of India	0
	ii. Loans guaranteed by State Governments **Note:** A State Government guaranteed advance which has become a non performing advance will attract a risk weight of 100 per cent.	0
	iii. Loans granted to public sector undertakings of Govt. of India	100
	iv. Loans granted to public sector undertakings of State Govts.	100
	v. (a) Housing Finance (fully secured by Mortgage of Residential Properties)	75
	v (b) Housing finance -others	100
	vi. Consumer Loan including Personal Loan	125
	vii. Others	100
	viii. Leased assets	100

	ix. Advances covered by ECGC **Note:** The risk weight of 50% should be limited to the amount guaranteed and not the entire outstanding balance in the accounts. In other words, the outstandings in excess of the amount guaranteed, will carry 100% risk weight.	50
	x. Advances against term deposits, Life policies, NSCs, IVPs and KVPs where adequate margin is available.	0
	xi. Loans to staff of banks, which are fully covered by super-annuation benefits and mortgage of flat/house.	20
	Notes: i. While calculating the aggregate of funded and non-funded exposure of a borrower for the purpose of assignment of risk weight, banks may 'net-off' against the total outstanding exposure of the borrower - (a) advances collateralised by cash margins or deposits, (b) credit balances in current or other accounts of the borrower which are not earmarked for specific purposes and free from any lien, (c) in respect of any assets where provisions for depreciation or for bad debts have been made, (d) claims received from ECGC and kept in a separate account pending adjustment in case these are not adjusted against the dues outstanding in the respective accounts.	
IV	**Other Assets**	
1.	Premises, furniture and fixtures	100
2.	Other assets	
	i. Interest due on Government securities	0
	ii. Accrued interest on CRR balances and claims on RBI on account of Government transactions (net of claims of Government/RBI on banks on account of such transactions)	0
	iii. All other assets	100

V	**Market risk on Open Positions**	
1.	Market risk on foreign exchange open position (Applicable to Authorised Dealers Only).	100
2.	Market risk on open gold position.	100

B. Off-Balance Sheet Items

The credit risk exposure attached to off-Balance Sheet items has to be first calculated by multiplying the face amount of each of the off-Balance Sheet items by ‘credit conversion factor’ as indicated in the table below. This will then have to be again multiplied by the weights attributable to the relevant counter-party as specified above.

Sr. No.	Instruments	Credit Conversion Factor (%)
1.	Direct credit substitutes e.g. general guarantees of indebtedness (including standby L/Cs serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptance).	100
2.	Certain transaction-related contingent items (e.g. performance bonds, bid bonds, warranties and standby L/Cs related to particular transactions).	50
3.	Short-term self-liquidating trade-related contingencies (such as documentary credits collateralised by the underlying shipments).	20
4.	Sale and repurchase agreement and asset sales with recourse, where the credit risk remains with the bank.	100
5.	Forward asset purchases, forward deposit and partly paid shares and securities, which represent commitments with certain draw down.	100
6.	Note issuance facilities and revolving underwriting facilities.	50
7.	Other commitments (e.g., formal standby facilities and credit lines) with an original maturity of over one year.	50
8.	Similar commitments with an original maturity up to one year, or which can be unconditionally cancelled	0

	at any time.	
9.	i. Guarantees issued by banks against the counter guarantees of other banks.	20
	ii. Rediscounting of documentary bills accepted by banks. (Bills discounted by banks which have been accepted by another bank will be treated as a funded claim on a bank)	20
	Note: In these cases, banks should be fully satisfied that the risk exposure is, in fact, on the other bank.	
10.	Aggregate outstanding foreign exchange contracts of original maturity -	
	* less than 14 calendar days	0
	* more than 14 days but less than one year	2
	* for each additional year or part thereof	3
	Notes: * While calculating the aggregate of funded and non-funded exposure of a borrower for the purpose of assignment of risk weight, bank may 'net-off' against the total outstanding exposure of the borrower credit balances in current or other accounts which are not earmarked for specific purposes and free from any lien. *After applying the conversion factor as indicated above, the adjusted off-Balance Sheet value shall again be multiplied by the weight attributable to the relevant counter-party as specified.	

Note: At present, State and district Central Cooperative Banks may not be undertaking most of the off-balance sheet transactions. However, keeping in view their potential for expansion, risk-weights are indicated against various off-balance sheet items, which, perhaps banks may undertake in future.

II. Additional Risk Weights in respect of Overseas Operations of Indian Banks (Applicable to Authorised Dealers Only)

1. Foreign Exchange and Interest Rate related Contracts

i) Foreign exchange contracts include the following:

a. Cross currency interest rate swaps

b. Forward foreign exchange contracts

c. Currency futures

d. Currency options purchased

e. Other contracts of a similar nature

ii) 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:

Original Maturity	Conversion Factor
Less than one year	2%
One year and less than two years	5% (i.e. 2% + 3%)
For each additional year	3%

(b) Step 2 - The adjusted value thus obtained shall be multiplied by the risk weightage allotted to the relevant counter-party as given in **A** above.

2. Interest Rate Contracts

iii) Interest rate contracts include the following:

a. Single currency interest rate swaps

b. Basic swaps

c. Forward rate agreements

d. Interest rate futures

e. Interest rate options purchased

f. Other contracts of a similar nature

iv) 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 percentages given below:

Original Maturity	Conversion Factor
Less than one year	0.5%
One year and less than two years	1.0%
For each additional year	1.0%

(b) Step 2 - The adjusted value thus obtained shall be multiplied by the risk weightage allotted to the relevant counter-party as given in A above.

Note: At present, most of the State and District Central Cooperative Banks are not carrying out forex transactions. However, those who have been given A.D's licence may undertake transactions mentioned above. In the event of any uncertainty in assigning risk weights against a specific transaction, RBI clarification may be sought for.

<u>Annex 2</u>

PRUDENTIAL NORMS

<u>Statement of Capital Funds, Risk Assets/Exposures and Risk Asset Ratio</u>

Part A - Capital Funds and Risk Assets Ratio

(Amount – Rupees in lakh)

I	**Capital Funds**	
A	**Tier I capital elements**	
	(a) Paid-up capital	
	Less: Intangible assets and losses	
	Total	
	(b) Reserves & surplus	
	1. Statutory reserves	
	2. Capital reserve (see note below)	
	3. Other reserves	
	4. Surplus in Profit & Los Account *	
	Total	
	Notes: Capital reserves representing surplus on sale of assets and held in a separate account will be included.	
	Revaluation reserves, general/floating provisions and specific provisions made for loan losses and other asset losses or diminution in the value of any assets will not be reckoned as capital funds. * Any surplus (net) in profit and loss account i.e. balance after appropriation towards dividend payable, education fund, other funds whose utilisation is defined and asset loss, if any etc.	

B	**Tier II capital elements**	
(i)	Undisclosed reserves	
(ii)	Revaluation reserves	
(iii)	General provisions and loss reserves #	
(iv)	Investment fluctuation reserves / funds	
II	**Risk Assets**	
(a)	Adjusted value of funded risk assets i.e. on Balance Sheet items (to tally with Part 'B')	
(b)	Adjusted value of non-funded and off-Balance Sheet items (to tally with Part 'C')	
(c)	Total risk-weighted assets (a + b)	
III	**Percentage of capital funds to risk-weighted assets [I : II (III)]**	
	# Includes General Provision on standard assets	

Part B - Weighted Assets i.e. on-Balance Sheet Items

(Amount - Rupees in lakh)

Sr. No.		**Book Value**	**Risk Weight**	**Adjusted Value**
I	**Cash & Bank Balance**			
(a)	Cash in hand (including foreign currency notes)			
(b)	Balances with banks in India -			
i)	Balances with RBI			
ii)	Balances with other banks			
	1. Current account (in India and outside India)			
	2. Other accounts (in India and outside India)			

II	Money at Call and Short Notice			
III	**Investments**			
(a)	Government and other approved securities *			
(b)	Others (net of depreciation provided)			
IV	**Advances **** Loans and advances, bills purchased and discounted and other credit facilities			
(a)	Claims guaranteed by Government of India			
(b)	Clams guaranteed by State Governments			
(c)	Claims on public sector undertakings of Government of India			
(d)	Claims on public sector undertakings of State Governments			
(e)	Others			
	Notes: 1. Netting may be done only for advances collateralised by cash margins or deposits and in respect of assets where provisions for depreciation for bad and doubtful debts have been made. 2. Intangible assets for which losses have been deducted from Tier I capital should be assigned zero weight.			
V	Premises (net of depreciation provided)			

VI	Furniture and fixtures (net of depreciation provided)			
VII	Other assets (including branch adjustments, non-banking assets, etc.)			
	Total			

* **Provision**, if any, made for depreciation in investments in Government and other approved securities may be included by way of a footnote.

** **Provisions** held, either general or specific, for bad and doubtful debts may be indicated by way of footnote.

Part C - Weighted Non-funded Exposures/Off-Balance Sheet Items

Each off-Balance Sheet item may be submitted in the format indicated below:

(Amount – Rupees in lakh)

Nature of Item	Book Value	Conversion Factor	Equivalent Value	Risk Weight	Adjusted Value

149. The Internal Working Group on RRBs (Chairman : Shri A.V.Sardesai) had recommended that RRBs may be advised to maintain a minimum level of capital to risk weighted assets ratio (CRAR) which would be progressively raised to the current level of CRAR as per the Basel I norms. At present, capital adequacy norms are not prescribed for RRBs and state / central co-operative banks. In order to further strengthen the capital structure of RRBs and state / central co-operative banks as also in the context of financial stability of the whole system, it is proposed that :

- RRBs and state / central co-operative banks should disclose the level of CRAR as on March 31, 2008 in their balance sheets.
- a road-map may be evolved for achieveing the desired level of CRAR by these banks.