RBI/2007-2008/341

DBOD No.BP.BC 88/ 21.06.001./ 2007-08

May 30, 2008

The Chairman / CMD/ MD/ CEO
All Commercial Banks (excluding RRBs)

Dear Sir,

Capital Adequacy Norms – Treatment of banks' investments in subsidiaries/ associates and of the subsidiaries' /associates' investments in parent banks

Please refer to the paragraph 2.1.3 of the Master Circular DBOD No. BP.BC. 4/21.01.002 / 2007-08 dated July 2, 2007 on 'Prudential Norms on Capital Adequacy' and paragraph 4.4.6 of our circular DBOD. No. BP.BC. 90 / 20.06.001/ 2006-07 dated April 27, 2007 on 'Implementation of New Capital Adequacy Framework' regarding the treatment of banks' investments in subsidiaries / associates for the purpose of capital adequacy norms.

2. The norms governing the treatment of banks' investment in their subsidiaries and associates, and the investments by the banks' subsidiaries and associates in their parent banks, have been reviewed and it has been decided to revise the norms, both under the Basel - I and Basel - II Frameworks, as detailed below.

2.1. Bank's investment in a subsidiary / an associate

The investments of a bank in the equity as well as non-equity capital instruments issued by a subsidiary, which are reckoned towards its regulatory capital as per norms prescribed by the respective regulator, should be deducted at 50 per cent each, from Tier I and Tier II capital of the parent bank, while assessing the capital adequacy of the bank on 'solo' basis, under the Basel I Framework. (Under the extant instructions under Basel I environment, only the equity investments of a bank only in its subsidiaries are required to be deducted, only from Tier I capital of the bank; no such deduction is required for a bank's investment in associates.)

There is no change in the instructions in regard to the treatment of a bank's investment in its subsidiary / associate under the Basel II Framework.

2.2 Investments by a banking subsidiary / banking associate in its parent bank

The investments made by a banking subsidiary in the equity or non equity regulatory-capital instruments issued by its parent bank, should be deducted from such subsidiary's regulatory capital at 50 per cent each from Tier I and Tier II capital, in its capital adequacy assessment on a solo basis, under Basel I and Basel II Frameworks. In addition, under the Basel II Framework, the same treatment would be applied to the investment by a banking associate also, in its parent bank.

The treatment of investment by the non-banking financial subsidiaries / associates in the parent bank's regulatory capital would, however, be governed by the applicable regulatory capital norms of the respective regulators of such subsidiaries / associates.

3. It may please be noted that for the purpose of the foregoing norms, an "associate" would be defined as an entity in which the parent bank has an equity stake exceeding 30 per cent but less than 50 per cent of the paid up capital of the investee entity.

Yours faithfully,

(Prashant Saran)
Chief General Manager-in-Charge