भारतीय रिज़र्व बैंक

**RESERVE BANK OF INDIA**

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DBOD.No.BP.BC.116/21.06.200/2013-14 June 3, 2014

The Chairman and Managing Director/
Chief Executive Officer
All Scheduled Commercial Banks
(Excluding RRBs and LABs)

Dear Sir,

**Capital and Provisioning Requirements for Exposures to entities with Unhedged Foreign Currency Exposure-Clarifications**

Please refer to our circular DBOD.No. BP.BC. 85/21.06.200/2013-14 dated January 15, 2014 detailing guidelines on capital and provisioning requirements for exposures to entities with Unhedged Foreign Currency Exposure (UFCE). In this connection, we have received a number of queries from banks on certain provisions of the guidelines, clarifications for which are given as under.

2. The implementation of guidelines is dependent on getting quality data from entities on a periodic basis. The banks have mentioned that the accuracy of the information on UFCE received from entities could be ensured if entities submit information to banks which is audited by statutory auditors. It is, therefore, advised that information on UFCE may be obtained from entities on a quarterly basis on self-certification basis, and preferably should be internally audited by the entity concerned. However, at least on an annual basis, UFCE information should be audited and certified by the statutory auditors of the entity for its authenticity. In case of exposures of overseas branches/subsidiaries, to begin with, the requirement of statutory audit may not be insisted upon.

3. The guidelines assess the riskiness of the unhedged foreign currency exposure of the corporate from the perspective of the volatility of USD-INR exchange rates. On requests from banks, it is clarified that Foreign Currency Exposure (FCE) in currencies other than USD may be converted into USD using the current market rates.

4. The guidelines have given a detailed step-by-step procedure for calculating USD-INR annualised volatility. Banks feel that annualised volatility computed by them may vary from bank to bank. Banks have requested that in order to ensure that a consistent annualised volatility is used across banking industry, RBI may mandate Foreign Exchange Dealers' Association of India (FEDAI) to publish the USD-INR annual volatility which has to be used for computation of likely loss. Accordingly, it is advised that RBI will request FEDAI to compute the volatility of USD-INR rate based on the RBI reference rate by following the provisions of the guidelines and the same may be used for computing the extent of likely loss on account of UFCE. However, till the time FEDAI starts placing this information on its website on a daily basis, banks may continue to compute the volatility figure by following the provisions of the guidelines.

5. UFCE guidelines require that the likely loss on account of exchange rate movements should be compared with the annual EBID as per the latest quarterly results certified by the statutory auditors. Banks have mentioned that in case of private/unlisted companies, the audited EBID may not be available on a quarterly basis. In this context, it is advised that in case of unavailability of the audited results of the last quarter, latest audited quarterly or yearly results available have to be used. The yearly EBID figure used should at least be of the last financial year. It is also clarified that the guidelines do not differentiate between limited audited results and full audited results.

6. The guidelines introduce incremental capital and provisioning requirements over and above present requirements. Banks have requested clarification on the amount of exposure on which incremental capital and provisioning amount has to be computed, as the exposure used for computing capital and provisions are computed differently. In this context, it is advised that incremental provisioning for UFCE should be based on the exposure amount which is used for computing standard asset provisioning and

incremental capital requirements for UFCE should be based on the exposure amount which is used for computing credit risk capital requirements.

7. The guidelines are applicable to all entities on which the bank has taken credit exposure. Banks have requested clarification if the guidelines are applicable to inter-bank exposures also. In this context, it is clarified that inter-bank exposures may be excluded from the ambit of the UFCE guidelines.

8. The guidelines are applicable to all entities irrespective of the size of the entity. Banks have mentioned that computation of incremental capital and provisioning requirements on a quarterly basis for smaller entities will be operationally cumbersome. In this context, for exposures to smaller entities which are having unhedged foreign currency exposure, banks may have the option of following a standardised method which would require an incremental provisioning of 10 bps over and above extant standard asset provisioning. Banks following standardised method for smaller entities will not be required to get UFCE data from these entities and therefore will not be required to compute incremental capital and provisioning based on likely loss as a percentage of EBID in respect of these smaller entities. It is further clarified that smaller entities are those entities on which total exposure of the banking system is at ₹ 25 crore or less.

9. Standard asset provisions are presently eligible for inclusion in the Tier 2 capital within certain limits. Banks have requested to clarify if the incremental provisioning kept by following the guidelines will also be eligible for including in the Tier 2 capital in line with the present requirements. In this context, it is clarified that the incremental provision required is in addition to the present standard asset provisioning requirement. It may, therefore be treated as general provision for disclosures and inclusion in Tier 2 capital, similar to the existing treatment applicable to general provisions. Presently, for banks following standardised approach for credit risk, general provisions are admitted as Tier 2 capital up to a maximum of 1.25% of credit risk weighted assets. Under Internal Ratings Based Approach, where the total expected loss amount is less than

total eligible provisions, banks may recognise the difference as Tier 2 capital up to maximum of 0.6% of credit-risk weighted assets calculated under IRB approach.

10. The computation of incremental capital and provisioning is dependent on the extensive data collected from entities. Banks have mentioned that it may not be possible to get the required data in a timely manner in respect of all entities on which a bank has the credit exposure. Banks have requested clarification on the course of action to be followed in respect of exposure to entities which are not able to provide required data. In this context, it is advised that in cases, where the bank is not able to get sufficient data to compute UFCE, the bank may take a conservative view and place the exposure at the last bucket which requires incremental provisioning of 80bps and a 25 per cent increase in risk weight. It would be appropriate for a bank to price the cost of compliance with the UFCE guidelines on its lending rate for the borrower as it would improve quality and timeliness of information/data.

11. UFCE guidelines have become effective from April 1, 2014. Some banks have mentioned that as the required provision will be computed for the first time for the April-June quarter, the entire provisioning burden will fall on the earnings of one quarter. In this context, it is advised that the additional provisioning requirement applicable for April-June 2014 quarter based on the UFCE guidelines may be distributed equally during the financial year 2014-15. However, such relaxation would not be there for capital requirements.

Yours faithfully,

**(Rajesh Verma)**
**Chief General Manager-in-Charge**