Draft Reserve Bank of India (Local Area Banks – Credit Risk Management) Directions, 2025

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Reserve Bank of India (Local Area Banks – Credit Risk Management) Directions, 2025

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Introduction

Local Area Banks (LABs), in the course of financial intermediation, are exposed to various financial and non-financial risks, of which credit risk is the one of the most significant risks. If not managed effectively, credit risk may have ramifications for a range of other risk categories too. As credit exposures of LABs encompass varied sectors, borrower types and products with their own idiosyncratic complexities as well as systemic implications due to interconnectedness among themselves, credit risk management of LABs involve a range of prudential tools, including statutory and regulatory restrictions / prohibitions on certain activities. Recognising this, the Reserve Bank has, from time to time, issued guidelines to strengthen credit risk management practices.

Accordingly, in exercise of powers conferred by section 35A of the Banking Regulation Act, 1949, the Reserve Bank being satisfied that it is necessary and expedient in the public interest to do so, hereby issues these Directions hereinafter specified.

Chapter-I - Preliminary

A. Short title and Commencement

1. These directions shall be called the Reserve Bank of India (Local Area Banks – Credit Risk Management) Directions, 2025

2. These directions shall come into force with immediate effect.

B. Applicability

3. These Directions shall be applicable to Local Area Banks (hereinafter collectively referred to as ‘banks’ and individually as a ‘bank’).

C. Definitions

4. In these Directions, unless the context otherwise requires,

i) “Entity” means a counterparty to which bank has exposure in any currency (for the purpose of Chapter IV on Unhedged Foreign Currency Exposure).

Explanation*: Exposure shall mean all fund-based and non-fund-based exposures.*

ii) ‘Financial hedge' shall mean hedging through a derivative contract with a financial institution. Financial hedge shall be considered only where the entity has documented the purpose and the strategy for hedging at inception of the derivative contract and assessed its effectiveness as a hedging instrument at periodic intervals.

Note*: For the purpose of assessing the effectiveness of hedge, guidance may be taken from the applicable accounting standards and the relevant guidance notes of the Institute of Chartered Accountants of India on the matter.*

iii) 'Foreign Currency Exposure (FCE)' of an entity shall mean the gross sum of all items on the entity’s balance sheet that have impact on its profit and loss account due to movement in foreign exchange rates.

iv) 'Listed entities' shall mean entities listed on the recognised stock exchanges.

v) ‘Natural hedge’ shall mean a hedge arising out of the operations of the company when cash flows offset the risk arising out of the Foreign Currency exposure (FCE).

Explanation*: An exposure shall be considered as naturally hedged only if the offsetting exposure has the maturity / cash flow within the same accounting year. For instance, export revenues (booked as receivable) may offset the exchange risk arising out of repayment obligations of an external commercial borrowing if both the exposures have cash flows / maturity within the same accounting year.*

vi) 'Unhedged Foreign Currency Exposure (UFCE)' shall mean Foreign Currency Exposure (FCE) excluding items which are effective hedge of each other. While estimating UFCE of an entity, banks shall consider only two types of hedges - financial hedge and natural hedge.

(2) All other expressions unless defined herein shall have the same meaning as have been assigned to them under the Banking Regulation Act, 1949 or the Reserve Bank of India Act, 1934, and rules / regulations made thereunder, or any statutory modification or re-enactment thereto or in other relevant regulations issued by the Reserve Bank or as used in commercial parlance, as the case may be.

Chapter-II - Board Approved Policies

5. The bank shall put in place a comprehensive Board approved policy on Credit Risk Management. The policy shall, *inter alia*, cover aspects related to unhedged foreign currency exposures and valuation of properties including empanelment of valuers. The specific aspects to be addressed in these policies are also detailed in the relevant paragraphs of this Directions.

Chapter-III - Statutory Restrictions

A. Advances against Bank's own Shares

6. In terms of Section 20(1)(a) of the Banking Regulation Act, 1949, a bank cannot grant any loans and advances on the security of its own shares.

B. Advances to Bank's Directors

7. The banks are prohibited from entering into any commitment for granting any loans or advances to or on behalf of any of its directors, or any firm in which any of its directors is interested as partner, manager, employee or guarantor, or any company [not being a subsidiary of the banking company or a company registered under Section 8 of the Companies Act, 2013, or a Government company] of which, or the subsidiary or the holding company of which any of the directors of the bank is a director, managing agent, manager, employee or guarantor or in which he holds substantial interest, or any individual in respect of whom any of its directors is a partner or guarantor.

8. Section 20(1)(b) of the Banking Regulation Act, 1949 also lays down the restrictions on loans and advances to the directors and the firms in which they hold substantial interest. Purchase of or discount of bills from directors and their concerns, which is in the nature of clean accommodation, is reckoned as 'loans and advances' for the purpose of Section 20 of the Banking Regulation Act, 1949. For the applicability of Section 20 of BR Act, 1949, the banks shall be guided by following instructions:

   i) Section 20 (1) (b) of the B. R. Act, 1949 shall not apply to

      a. subsidiary of the banking company, or

      b. a company registered under Section 8 of the Companies Act, 2013 or

      c. a Government company.

   ii) The sanction or grant of credit facilities to Companies in India by foreign banks having branches in India shall be in compliance with the spirit of Section 20 of the Banking Regulation Act, 1949. Accordingly, a foreign

bank branch in India shall not lend to a firm / company in India, if a director in the foreign bank's Board abroad has an interest in the firm / company or if the company is a subsidiary of any Indian / foreign parent in which the director is interested.

iii) A director shall be considered to have interest in a company if he is a director / managing agent / manager / employee or guarantor in the concerned company and shall be considered to have interest in a firm if he is a partner / manager / employee or guarantor in the concerned firm.

iv) In case a banking company is granting any loan or advance to a subsidiary of the holding company, the provisions of Section 20 shall be attracted if any of the directors of the banking company is a director of the holding company, irrespective of whether any of the directors of the banking company is a director of the subsidiary or not.

v) The provisions of Section 20(1)(b)(iii) of the B R Act, 1949 are not attracted in case of advances granted or commitment made by the bank to a company prior to appointment of the Director of the company on the Board of the bank.

vi) The bank is precluded from renewing the loan / limit after its expiry or enhancing the limit that would have been sanctioned prior to the date of company's Director becoming a Director of the bank as renewal / enhancement / change in terms would mean entering into fresh commitment by the bank. Alternatively, the director has to relinquish the directorship of either the bank or the company.

vii) Section 20 does not make any distinction between the directors on the basis of the interest they represent. Therefore, the prohibitions stipulated under Section 20 are applicable to nominee directors also.

viii) Purchase of cheques is specifically exempted from prohibitory provisions of Section 20. However, withdrawal against uncleared effects (cheques presented for clearing) amounts to grant of advance and therefore shall

attract provisions of Section 20.

ix) Derivative transactions are off balance sheet items and are treated on similar lines with non-fund based transactions and are out of purview of Section 20 provided it is ensured by banks that the transactions are genuine hedge transactions arising out of normal business requirements (not speculative ones) and no liability devolves on banks. The bank has to satisfy about the genuineness of the underlying exposure of the concerns. The banks shall adhere to the instructions contained in Reserve Bank of India (Local Area Banks – Credit Facilities) Directions, 2025 and Reserve Bank of India (Local Area Banks – Concentration Risk Management) Directions, 2025.

x) Provisions of Section 20 shall also apply to priority Sector lending.

xi) The provisions of Section 20 shall not apply to public trust.

9. (1) Section 20 of Banking Regulation Act, 1949 (B.R. Act, 1949) prohibits banks from granting any loan or advance to any of its Directors. However, in exercise of the powers conferred by clause (a) of the Explanation under sub-section (4) of Section 20 of Banking Regulation Act, 1949 and having regard to the considerations referred to therein, the Reserve Bank has specified that for the purposes of the said Section, the following loans / advances granted to the Chief Executive Officer / Whole Time Directors shall not be considered as 'loans and advances':

i) Loan for purchasing of car
ii) Loan for purchasing of personal computer
iii) Loan for purchasing of furniture
iv) Loan for constructing / acquiring a house for personal use
v) Festival advance
vi) Credit limit under credit card facility

The extant policy guidelines exempting the above mentioned loans and advances from applicability of Section 20 of Banking Regulation Act, 1949 required banks to approach Reserve Bank for prior approval, except in case of loans granted to

a Director who was an employee of the bank immediately prior to his / her appointment as a Director.

2) In order to streamline the existing processes and to obviate the need to approach Reserve Bank on case-to-case basis, it has been decided that in exercise of the powers vested with Reserve Bank under Section 35B of the B.R. Act, 1949, commercial banks can grant loans and advances to the Chief Executive Officer / Whole Time Directors, without seeking prior approval of Reserve Bank, subject to the following conditions:

i) The loans and advances shall form part of the compensation / remuneration policy approved by the Board of Directors or any committee of the Board to which powers have been delegated or the Appointments Committee, as the case may be.

ii) The guidelines on Base Rate shall not be applicable on the interest charged on such loans. However, the interest rate charged on such loans shall not be lower than the rate charged on loans to the bank's own employees.

3) The terms and conditions of the loans granted to the Chief Executive Officer / Whole Time Directors which are currently outstanding may, at the banks' discretion, be reviewed in the light of the above guidelines in order to address transition issues.

4) Banks shall note that in view of the prohibition under Section 20 of the BR Act, 1949, apart from the types of loans mentioned in paragraph 9, no other loan can be sanctioned to Directors.

10. For the above purpose, the term 'loans and advances' shall not include the following:

i) loans or advances against Government securities, life insurance policies or fixed deposit;

ii) loans or advances to the Agricultural Finance Corporation Ltd;

iii) such loans or advances as can be made by a banking company to any of its directors (who immediately prior to becoming a director, was an employee of the banking company) in his capacity as an employee of that banking

company and on the same terms and conditions as would have been applicable to him as an employee of that banking company, if he had not become a director of the banking company. The banking company includes every bank to which the provisions of Section 20 of the Banking Regulation Act, 1949 apply;

iv) call loans made by banking companies to one another;

v) facilities like bills purchased / discounted (whether documentary or clean and sight or usance and whether on D/A basis or D/P basis), purchase of cheques, other non-fund based facilities like acceptance / co- acceptance of bills, opening of L/Cs and issue of guarantees, purchase of debentures from third parties, etc.;

vi) line of credit / overdraft facility extended by settlement bankers to National Securities Clearing Corporation Ltd. (NSCCL) / Clearing Corporation of India Ltd. (CCIL) to facilitate smooth settlement; and

vii) a credit limit granted under credit card facility provided by a bank to its directors to the extent the credit limit so granted is determined by the bank by applying the same criteria as applied by it in the normal conduct of the credit card business.

11. As regards giving guarantees and opening of L/Cs on behalf of the bank's directors, it is pertinent to note that in the event of the principal debtor committing default in discharging his liability and the bank being called upon to honour its obligations under the guarantee or L/C, the relationship between the bank and the director could become one of the creditor and debtor. Further, it is possible for the directors to evade the provisions of Section 20 by borrowing from a third party against the guarantee given by the bank. Such transactions defeat the very purpose of restrictions imposed under Section 20, if the bank does not take appropriate steps to ensure that the liabilities thereunder do not devolve on them. In view of the above, while extending non-fund-based facilities such as guarantees, L/Cs, acceptance on behalf of directors and the companies / firms in which the directors are interested; it shall be ensured that:

(i) adequate and effective arrangements have been made to the satisfaction of the bank that the commitments would be met by the openers of L/Cs, or acceptors, or guarantors out of their own resources,

(ii) the bank will not be called upon to grant any loan or advance to meet the liability consequent upon the invocation of guarantee, and

(iii) no liability would devolve on the bank on account of L/Cs acceptances.

12. In case, such contingencies arise as at (ii) & (iii) above, the bank shall be deemed to be a party to the violation of the provisions of Section 20 of the Banking Regulation Act, 1949.

C. Restrictions on Holding Shares in Companies

13. While granting loans and advances against shares, statutory provisions contained in Sections 19(2) and 19(3) of the Banking Regulation Act, 1949 shall be strictly observed.

D. Restrictions on Credit to Companies for Buy-back of their Securities

14. In terms of provisions of the Companies Act, 2013, companies are permitted to purchase their own shares or other specified securities out of their

1) free reserves, or
2) securities premium account, or
3) the proceeds of any shares or other specified securities,

subject to compliance of various conditions specified therein. Therefore, banks shall not provide loans to companies for buy-back of shares / securities.

Chapter-IV - Unhedged Foreign Currency Exposure (UFCE)

15. An explanatory note providing the background is furnished in Annex I.

16. Computation of UFCE

(1) Banks shall ascertain the Foreign Currency Exposure (FCE) of all entities at least on an annual basis. Banks shall compute the FCE following the relevant accounting standard applicable for the entity.

The requirement in paragraph 16(1) would not be applicable for entities which are already submitting the information on UFCE as per paragraph 16(2).

***Explanation**:* Banks shall consider the items maturing or having cash flows over the period of next five years.

***Note**:* For arriving at the foreign currency exposure of entities, their exposure from all sources including foreign currency borrowings and External Commercial Borrowings shall be taken into account.

(2) Banks shall assess the Unhedged Foreign Currency Exposure (UFCE) of entities with FCE by obtaining information on UFCE from the concerned entity.

***Provided* that** the information on UFCE shall be obtained from entities on a quarterly basis based on statutory audit, internal audit or self-declaration by the concerned entity.

***Provided* further that** UFCE information shall be audited and certified by the statutory auditors of the entity, at least on an annual basis.

17. For 'Provisioning and Capital Requirements' banks shall refer to Reserve Bank of India (Local Area Banks – Income Recognition, Asset Classification and Provisioning) Directions, 2025 and Reserve Bank of India (Local Area Banks – Prudential Norms on Capital Adequacy) Directions, 2025, respectively.

18. Systems and Controls

(1) Banks shall incorporate the risk of UFCE of entities in their internal credit rating

system and credit risk management policies and procedures.

(2) Banks shall stipulate internal limits for UFCE within the overall Board approved risk policy of the bank.

19. Consortium Lending

(1) In the case of consortium / multiple banking arrangements, the consortium leader / bank having the largest exposure shall have the lead role in monitoring the unhedged foreign exchange exposure of entities.

***Note**:* Banks shall put in place a system for information sharing and dissemination in terms of Reserve Bank of India (Local Area Banks – Transfer and Distribution of Credit Risk) Directions, 2025

20. Exemption / Relaxation

(1) Banks shall have the option to exclude the following exposures from the calculation of UFCE:

(i) Exposures to entities classified as sovereign, banks and individuals.

For this purpose, sovereign shall include domestic and foreign sovereign as provided in Reserve Bank of India (Local Area Banks – Prudential Norms on Capital Adequacy) Directions, 2025

For this purpose, RBI regulated financial institutions (SIDBI, NABARD, NHB, EXIM Bank and NaBFID), Bank of International Settlement (BIS), International Monetary Fund (IMF) and eligible Multilateral Development Banks (MDBs) listed in Reserve Bank of India (Local Area Banks – Prudential Norms on Capital Adequacy) Directions, 2025 shall be considered as 'bank'.

(ii) Exposures classified as Non-Performing Assets.

(iii) Intra-group foreign currency exposures of Multinational Corporations (MNCs) incorporated outside India.

For example, an Indian subsidiary of an MNC incorporated outside India may have borrowed from its parent.

***Provided* that** the bank is satisfied that such foreign currency exposures are appropriately hedged or managed robustly by the parent.

(iv) Exposures arising from derivative transactions and / or factoring transactions with entities, provided such entities have no other exposures to banks in India.

21. Overseas Branches/Subsidiaries

(1) The provisions of this paragraph shall be applicable to overseas branches/subsidiaries of banks subject to the following:

(i) With respect to the exposure to entities incorporated outside India, information on UFCE shall be obtained from such entities on a quarterly basis based on internal audit or self-declaration and the requirement of certificate from statutory auditors on annual basis, as provided in paragraph 16(2), may not be insisted upon. In cases where bank is not able to obtain information on UFCE from concerned entities, the treatment provided in Reserve Bank of India (Local Area Banks – Prudential Norms on Capital Adequacy) Directions, 2025 shall apply.

(ii) Banks shall compute the potential loss due to UFCE by replacing INR with the domestic currency of that jurisdiction and USD with the foreign currency (i.e., currency other than domestic currency of that jurisdiction) in which the entity has maximum exposure in Reserve Bank of India (Local Area Banks – Prudential Norms on Capital Adequacy) Directions, 2025.

Note: Banks shall compute the largest annual volatility over a period of last ten years in the following manner: First, daily changes in the foreign exchange rates shall be computed as a log return of today's rate over the previous day's rate. Second, daily volatility shall be computed as standard deviation of these returns over a period of one year (250 observations). Third, this daily volatility shall be annualised by multiplying it by square root of 250. This computation shall be performed on a daily basis for the all the days in the last ten years. The largest annual volatility thus computed shall be used for the computation of the potential loss by multiplying it with the UFCE.

22. Exemption / Relaxation

(1) Banks shall have the option to exclude the following exposures from the calculation of UFCE:

(i) Exposures to entities classified as sovereign, banks, and individuals.

Explanation (1) sovereign include domestic and foreign sovereign as provided in Reserve Bank of India (Local Area Banks – Prudential Norms on Capital Adequacy) Directions, 2025.

Explanation (2) For this purpose, bank include Reserve Bank regulated financial institutions (SIDBI, NABARD, NHB, EXIM Bank, and NaBFID), Bank of International Settlement (BIS), International Monetary Fund (IMF), and eligible Multilateral Development Banks (MDBs) listed in Reserve Bank of India (Local Area Banks – Prudential Norms on Capital Adequacy) Directions, 2025.

(ii) Exposures classified as Non-Performing Assets.

(iii) Intra-group foreign currency exposures of Multinational Corporations (MNCs) incorporated outside India such as an Indian subsidiary of an MNC incorporated outside India may have borrowed from its parent.

***Provided* that** the bank is satisfied that such foreign currency exposures are appropriately hedged or managed robustly by the parent.

(iv) Exposures arising from derivative transactions and / or factoring transactions with entities, provided such entities have no other exposures to banks in India.

Chapter-V - Legal Entity Identifier (LEI) for Borrowers

23. The Legal Entity Identifier (LEI) code is conceived as a key measure to improve the quality and accuracy of financial data systems for better risk management post the Global Financial Crisis. LEI is a 20-digit unique code to identify parties to financial transactions worldwide.

24. The LEI for the participants of the OTC derivatives market has since been implemented vide circular RBI/2016-17/314 FMRD.FMID No.14/11.01.007/2-16-17 dated June 01, 2017 in a phased manner.

25. It is advised that regulated entities (REs) shall ensure that non-individual borrowers with aggregate exposure of ₹5 crore and above from banks (Scheduled Commercial Banks (excluding Regional Rural Banks), Local Area Banks, Small Finance Banks, and Primary (Urban) Co-operative Banks) and Financial Institutions (All India Financial Institutions and NBFCs (including HFCs)) obtain LEI codes

***Explanation**:* 'Exposure' for this purpose shall include all fund based and non-fund based (credit as well as investment) exposure of banks / FIs to the borrower. Aggregate sanctioned limit or outstanding balance, whichever is higher, shall be reckoned for the purpose. Lenders shall ascertain the position of aggregate exposure based on information available either with them, or CRILC database or declaration obtained from the borrower

26. Borrowers who fail to obtain LEI codes from an authorised Local Operating Unit (LOU) shall not be sanctioned any new exposure nor shall they be granted renewal / enhancement of any existing exposure. However, Departments / Agencies of Central and State Governments (not Public Sector Undertakings registered under Companies Act or established as Corporation under the relevant statute) shall be exempted from this provision.

***Explanation**:* A government agency is an administrative set up of the government, responsible for certain area/s of activity, e.g., ISRO, BIS, DGCA, etc..

Banks shall encourage large borrowers to obtain LEI for their parent entity as well as all subsidiaries and associates.

27. Entities can obtain LEI from any of the Local Operating Units (LOUs) accredited by the Global Legal Entity Identifier Foundation (GLEIF) – the entity tasked to support the implementation and use of LEI. In India, LEI code may be obtained from Legal Entity Identifier India Ltd (LEIIL), a subsidiary of the Clearing Corporation of India Limited (CCIL), which has been recognised by the Reserve Bank as issuer of LEI under the Payment and Settlement Systems Act, 2007 and is accredited by the GLEIF as the Local Operating Unit (LOU) in India for issuance and management of LEI.

28. The rules, procedure and documentation requirements maybe ascertained from LEIIL.

29. After obtaining LEI code, banks shall also ensure that borrowers renew the codes as per GLEIF guidelines.

Chapter-VI - Valuation of Properties - Empanelment of Valuers

30. The banks shall be guided by the following aspects while formulating a policy on valuation of properties and appointment of valuers.

31. Policy for valuation of properties

1) The banks shall have a Board approved policy in place for valuation of properties including collaterals accepted for their exposures.
2) The valuation shall be done by professionally qualified independent valuers i.e. the valuer shall not have a direct or indirect interest.
3) The banks shall obtain minimum two Independent Valuation Reports for properties valued at ₹50 crore or above.

32. Revaluation of bank's own properties: In addition to the above, the banks may keep the following aspects in view while formulating policy for revaluation of their own properties:

1) The extant guidelines on Capital Adequacy permit banks to include revaluation reserves at a discount of 55 per cent as a part of Tier II Capital. In view of this, it is necessary that revaluation reserves represent true appreciation in the market value of the properties and banks have in place a comprehensive policy for revaluation of fixed assets owned by them. Such a policy shall inter alia cover procedure for identification of assets for revaluation, maintenance of separate set of records for such assets, the frequency of revaluation, depreciation policy for such assets, policy for sale of such revalued assets etc. The policy shall also cover the disclosure required to be made in the 'Notes on Account' regarding the details of revaluation such as the original cost of the fixed assets subject to revaluation and accounting treatment for appreciation / depreciation etc.
2) As the revaluation shall reflect the change in the fair value of the fixed asset, the frequency of revaluation shall be determined based on the observed volatility in the prices of the assets in the past. Further, any change in the method of depreciation shall reflect the change in the expected pattern of consumption of the future economic benefits of the assets. The banks shall adhere to these

principles meticulously while changing the frequency of revaluation / method of depreciation for a particular class of asset and shall make proper disclosures in this regard.

33. Policy for Empanelment of Independent valuers

1) The banks shall have a procedure for empanelment of professional valuers and maintain a register / record of 'approved list of valuers'.
2) The banks may prescribe a minimum qualification for empanelment of valuers. Different qualifications may be prescribed for different classes of assets (e.g. land and building, plant and machinery, agricultural land, etc.). While prescribing the qualification, banks shall take into consideration the qualifications prescribed under Section 34AB (Rule 8A) of the Wealth Tax Act, 1957.

34. The banks shall also be guided by the relevant Accounting Standard issued by the Institute of Chartered Accountants of India.

Chapter-VII - Filing of Security Interest relating to Immovable (other than equitable mortgage), Movable, and Intangible Assets in CERSAI

35. The Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI), a Government Company licensed under section 25 of the Companies Act 1956 has been incorporated for the purpose of operating and maintaining the Central Registry under the provisions of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act).

36. It is to be noted that initially transactions relating to securitization and reconstruction of financial assets and those relating to mortgage by deposit of title deeds to secure any loan or advances granted by banks and financial institutions, as defined under the SARFAESI Act, are to be registered in the Central Registry. The records maintained by the Central Registry shall be available for search by any lender or any other person desirous of dealing with the property. Availability of such records would prevent frauds involving multiple lending against the security of same property as well as fraudulent sale of property without disclosing the security interest over such property. It may be noted that under the provisions of Section 23 of the SARFAESI Act, particulars of any charge creating security interest over property is required to be filed with the Registry within 30 days from the date of creation.

37. The Government of India has issued a Gazette Notification dated January 22, 2016 for filing of the following types of security interest on the CERSAI portal:

1) Particulars of creation, modification or satisfaction of security interest in immovable property by mortgage other than mortgage by deposit of title deeds.
2) Particulars of creation, modification or satisfaction of security interest in hypothecation of plant and machinery, stocks, debts including book debts or receivables, whether existing or future.
3) Particulars of creation, modification or satisfaction of security interest in intangible assets, being know how, patent, copyright, trademark, licence, franchise or any other business or commercial right of similar nature.

4) Particulars of creation, modification or satisfaction of security interest in any ‘under construction’ residential or commercial or a part thereof by an agreement or instrument other than mortgage.

Chapter-VIII - Repeal and other provisions

A. Repeal and saving

38. With the issue of these Directions, the existing Directions, instructions, and guidelines relating to Credit Risk Management as applicable to Local Area Banks, stands repealed, as communicated vide notification dated XX, 2025. The Directions, instructions and guidelines already repealed shall continue to remain repealed.

39. Notwithstanding such repeal, any action taken or purported to have been taken, or initiated under the repealed Directions, instructions, or guidelines shall continue to be governed by the provisions thereof. All approvals or acknowledgments granted under these repealed lists shall be deemed as governed by these Directions.

B. Application of other laws not barred

40. The provisions of these Directions shall be in addition to, and not in derogation of the provisions of any other laws, rules, regulations, or directions, for the time being in force.

C. Interpretations

41. For the purpose of giving effect to the provisions of these Directions or in order to remove any difficulties in the application or interpretation of the provisions of these Directions, the RBI may, if it considers necessary, issue necessary clarifications in respect of any matter covered herein and the interpretation of any provision of these Directions given by the RBI shall be final and binding.

Annex I

Explanatory Note to Chapter on Unhedged Foreign Currency Exposure

Introduction

1. Unhedged foreign currency exposures of any entity are an area of concern not only for the individual entity but also to the entire financial system. Entities which do not hedge their foreign currency exposures can incur significant losses during the period of heightened volatility in foreign exchange rates. These losses may reduce their capacity to service the loans taken from the banking system and increase their probability of default thereby affecting the health of the banking system.

Background and Rationale

2. The Reserve Bank first introduced the concept in October 1999 as part of risk management systems after it was observed during the economic crises in some countries that banks bear additional credit risk on entities which have unhedged foreign currency risk. Accordingly, banks were advised to evolve a suitable framework for regular monitoring of foreign currency risk exposure of entities which do not have natural hedge and to factor such unhedged exposures of entities into the risk rating system for taking credit decisions.

3. The aim of the framework was that the banks shall price the risk from Unhedged Foreign Currency Exposure (UFCE) as credit risk premium which may nudge entities to hedge their foreign currency exposures in the market. To this end, banks were further advised though a series of instructions to a) regularly monitor the unhedged portion of large foreign currency exposures of entities; b) have a Board approved policy on hedging of foreign currency loans; and c) have a mechanism for information sharing on UFCE in case of consortium lending. However, a sizeable portion of entities' foreign currency exposures remained unhedged resulting in significant but avoidable risks to entities' balance sheets, in turn, impacting the quality of bank's assets.

4. To address the risk on bank's books, banks were advised to maintain incremental provisioning and capital requirements for their exposures to entities with UFCE. The process of computing incremental provisioning and capital requirements can be summarised in following steps:

a) Step 1: Assess the foreign currency exposure (FCE) of the entity.
b) Step 2: Ascertain the amount of UFCE from entities' FCE taking into account two types of hedges – natural hedge and financial hedge.
c) Step 3: Estimate the potential loss to the entity from UFCE exposure of entity due to exchange rate movements.
d) Step 4: Maintain incremental provisioning and capital requirements against banks' exposure to the entity based on impact of likely / potential loss on entity's overall profitability.

5. Based on banks' feedback, a few amendments were made to the guidelines for operational clarity and accuracy of information obtained. These included, inter alia, allowing collection of information on UFCE directly from entities (through self-certified / audited UFCE certificates); clarification on capital treatment of incremental provisioning requirement for UFCE; and treatment in case bank is unable to obtain information on UFCE from entity. Banks were also given an option to follow an alternative method for their exposure to smaller entities. Under this alternative method, instead of obtaining information on UFCE from smaller entities, bank could maintain incremental provisioning of 10 bps for such exposures.

6. Further, some exposures were excluded from the ambit of these instructions, namely, inter-bank exposures, intra-group exposures of Multinational Corporations incorporated outside India and exposure to entities which have not borrowed from Indian banking system.