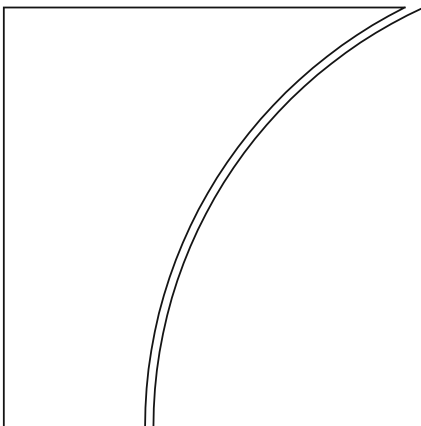
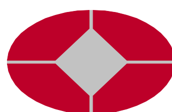
Basel Committee
on Banking Supervision



Regulatory Consistency Assessment Programme (RCAP)

Assessment of Basel III risk-based capital regulations – India

June 2015



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Glossary

ADC	Acquisition, development and construction
AFI	Annual financial inspection
AMA	Advanced Measurement Approach
ASA	Alternative Standardised Approach
AVC	Asset value correlation
BCBS	Basel Committee on Banking Supervision
BIA	Basic Indicator Approach
CCCB	Countercyclical capital buffer
CCF	Credit conversion factor
CCP	Central counterparty
CEM	Current exposure method
CEO	Chief executive officer
CET1	Common Equity Tier 1
CRE	Commercial real estate
CRE-RH	Commercial real estate-residential housing
CVA	Credit valuation adjustment
DTAs	Deferred tax assets
ECAI	External credit assessment institution
EEPE	Effective expected positive exposure
EL	Expected loss
FAQ	Frequently asked question
FIRB	Foundation IRB
FSAP	Financial Sector Assessment Program
FX	Foreign exchange
GAAP	Generally Accepted Accounting Principles
GDP	Gross domestic product
G-SIB	Global systemically important bank
HKMA	Hong Kong Monetary Authority
HVCRE	High volatility commercial real estate
ICAAP	Internal capital adequacy assessment process
IFRS	International Financial Reporting Standards

IMA	Internal Models Approach
IMM	Internal Models Method
INR	Indian rupee
IOSCO	International Organization of Securities Commissions
IRISc	Integrated risk and impact scoring
IRB	Internal Ratings-Based Approach
ISE	Inspection for supervisory evaluation
LGD	Loss-given-default
LTV	Loan-to-value
MD	Managing director
MDB	Multilateral development bank
MR	Market risk
NPA	Non-performing asset
OTC	Over-the-counter
PD	Probability of default
PDG	Policy Development Group
PDI	Perpetual debt instrument
PNCPS	Perpetual non-cumulative preference shares
PON	Point of non-viability
PSE	Public sector entity
RBI	Reserve Bank of India
RCAP	Regulatory Consistency Assessment Programme
RW	Risk weight
RWA	Risk-weighted assets
SEBI	Securities and Exchange Board of India
SIG	Supervision and Implementation Group
SL	Specialised lending
SME	Small and medium-sized enterprises
SPARC	Supervisory programme for assessment of risk and capital
SRE	Standard on Review Engagements
SREP	Supervisory review and evaluation process
TSA	The Standardised Approach
VaR	Value-at-risk

Preface

The Basel Committee on Banking Supervision (Basel Committee) sets a high priority on the implementation of regulatory standards underpinning the Basel III framework. The prudential benefits from adopting Basel standards can only fully accrue if these are implemented appropriately and consistently by all member jurisdictions. The Committee established the Regulatory Consistency Assessment Programme (RCAP) to monitor, assess, and evaluate its members' implementation of the Basel framework.

This report presents the findings of the RCAP Assessment Team on the domestic adoption of the Basel risk-based capital standards in India and its consistency with the minimum requirements of the Basel III framework. The assessment focuses on the adoption of Basel standards applied to the Indian banks that are internationally or regionally active and of significance to its domestic financial stability.

The RCAP Assessment Team was led by Mr Arthur Yuen, Deputy Chief Executive of the Hong Kong Monetary Authority (HKMA). The Assessment Team comprised seven technical experts drawn from Australia, France, Germany, Malaysia, Mexico, South Africa and the United Kingdom (Annex 1). The main counterpart for the assessment was the Reserve Bank of India (RBI).

The assessment relied upon the data, information and materiality computations provided by the Indian authorities by 31 March 2015. The assessment findings are based primarily on an understanding of the current processes in India as explained by the counterpart staff and the expert view of the Assessment Team on the documents and data reviewed. The overall work was coordinated by the Basel Committee Secretariat with support from HKMA staff.

The assessment began in October 2014 and consisted of three phases: (i) completion of an RCAP questionnaire (a self-assessment) by the Indian authorities; (ii) an off- and on-site assessment phase (October 2014 to March 2015); and (iii) a post-assessment review phase (April to June 2015). The second phase included an on-site visit for discussions with Indian counterparts and representatives of Indian banks. These exchanges provided the Assessment Team with a deeper understanding of the implementation of the Basel risk-based capital standards in India. The third phase consisted of a two-stage technical review of the assessment findings: first by a separate RCAP Review Team and feedback from the Basel Committee's Supervision and Implementation Group; and secondly, by the RCAP Peer Review Board and the Basel Committee. This two-step review process is a key instrument of the RCAP process to provide quality control and ensure integrity of the assessment findings. The focus of the assessment was on the consistency and completeness of the domestic regulations in India with the Basel minimum requirements. Issues relating to prudential outcomes, capital levels of individual banks, the adequacy of loan classification practices, or the Indian authorities' supervisory effectiveness were not in the scope of this RCAP assessment exercise.

Where domestic regulations and provisions were identified to be non-conforming with the Basel framework, those deviations were evaluated for their current and potential impact (or, non-impact) on the reported capital ratios for a sample of internationally active Indian banks. Some findings were evaluated on a qualitative basis. The assessment outcome was based on the materiality of findings and use of expert judgment. The Assessment Team also identified areas for follow-up action (Annex 12).

The report has three sections and a set of annexes: (i) an executive summary with a statement from the Indian authorities on the material findings; (ii) the context, scope and methodology, and the main set of assessment findings; and (iii) details of the deviations and their materiality along with other assessment-related observations.

The RCAP Assessment Team acknowledges the professional cooperation received from Indian counterparts throughout the assessment process. In particular, the team sincerely thanks the staff of the

RBI for playing an instrumental role in coordinating the assessment exercise. The Assessment Team would also like to thank the representatives of Indian banks that provided data and information to the Assessment Team. The series of comprehensive briefings and clarifications provided by the Indian counterparts helped the RCAP assessors to arrive at their expert assessment. The Assessment Team is hopeful that the RCAP assessment exercise will contribute to the sound initiatives that have been taken by the Indian authorities and to further strengthening the prudential effectiveness and full implementation of the recent reform measures in India.

Executive summary

The Indian Basel III framework for bank risk-based capital requirements came into force in April 2013 through the Circular on Implementation of Basel III Capital Regulations in India issued on 2 May 2012, which is included in the *Master Circular on Basel III Capital Regulations* (Annex 2). It applies to all scheduled commercial banking institutions, including the public sector banks. The framework has since been periodically updated to include amendments and the latest version was published in July 2014.

In October 2014, the RBI completed an extensive self-assessment of their capital regime as part of their preparation for the RCAP exercise. Based on the self-assessment and the Indian regulations the RCAP Assessment Team identified certain material variations from the Basel framework, which the Indian authorities resolved to rectify. The RBI took advantage of the RCAP exercise to undertake reform and upgrade its prudential capital framework – to the extent feasible and consistent with Indian national interests. This has resulted in a strengthening of the Indian capital regime.

The risk-based capital requirements issued in July 2014 are assessed as compliant with the minimum Basel capital standards. All 14 components of the Basel framework included in the assessment have been assessed as compliant. In all, the Indian capital framework benefited during the course of the RCAP assessment work from approximately 44 improvements, which became effective on 1 April 2015. The additional regulatory initiatives undertaken by the RBI improved the level of compliance with the Basel minimum standards. In the absence of these changes, the RCAP assessment would have generated a relatively less positive result.

The team identified an overarching issue regarding the use of the word "may" in India's regulatory documents for implementing binding minimum requirements. The team considers linguistic clarity of overarching importance, and would recommend the Indian authorities to use the word "must" in line with international practice. More generally, authorities should seek to ensure that local regulatory documents can be unambiguously understood even in an international context, in particular where these apply to internationally active banks. The issue has been listed for further reflection by the Basel Committee. As implementation of Basel standards progresses, increased attention to linguistic clarity seems imperative for a consistent and harmonised transposition of Basel standards across the member jurisdiction.

Several elements of the Basel capital framework, notably the Internal Ratings-Based Approach for credit risk, the Internal Models Approach for market risk, and the Advanced Measurement Approach for operational risk, at this point have minimal or no current participation by Indian banks (a number of banks are in parallel run, but the RBI has not yet granted any of them approval to exit the parallel run). The RCAP team notes that these regulations have yet to be applied in substantial practice to Indian banks and thus the deviations observed should be kept under follow-up review for materiality assessment.

Several aspects of the Indian framework are more conservative than the Basel framework. This includes higher minimum capital requirements and risk weightings for certain types of exposures, as well as higher minimum capital ratios. The RBI also applies certain restrictions to banking activities through its prudential framework. These aspects are listed in the report but have not been taken into account for the final assessment of compliance as per the agreed assessment methodology.

The Assessment Team compliments the Indian authorities for their substantial reforms and alignment with the Basel capital framework. Looking ahead, the Assessment Team also noted a few items for post-RCAP follow-up or for when another RCAP assessment is undertaken, to ensure that they do not become material (Annex 12). This will help ensure that India deploys its reformed capital framework effectively in supervising the Indian banking system and maintaining financial stability. The team also identified a few items that would benefit from further clarification by the Basel Committee (Annex 13).

Response from the Indian authorities

The Reserve Bank of India (RBI) appreciates the insights provided and the level of professionalism shown by the Assessment Team throughout the Indian regulatory assessment process under the leadership of Mr Arthur Yuen. The RBI welcomes the opportunity given to respond to findings on the implementation of Basel framework in India.

The RBI is pleased that the Assessment Team has considered the implementation of prudential regulation on capital in India compliant with the Basel framework.

RBI generally agrees with the findings of this assessment report. One of the issues which the report describes in detail is the use of the term "may" instead of "must" or equivalent in implementing minimum capital requirements. RBI strongly believes that communication, including regulatory communications, in order to be effective, must necessarily follow the linguistics and social characteristics of the language used in the region (Indian English in this case), which is rooted in the traditions and customs of the jurisdiction concerned. What therefore matters is how the regulatory communications have been understood and interpreted by the regulated entities. Specific to India, the use of word "may" in regulations is understood contextually and construed as binding where there is no qualifying text to convey optionality. We are happy that the Assessment Team has appreciated this point.

On the other specific issue of the use of an RWA multiplier of 11.1 for market and operational risk, it may be appreciated that the minimum capital requirement in India is higher at 9% of RWAs as against minimum of 8% of RWAs under the Basel framework. The absolute capital requirement for market risk and operational risk was effectively on a par with the Basel requirements. It may also be appreciated that the Indian banks are predominantly in the business of extending credit and, therefore, the credit risk RWAs constitute approximately 88% of total RWAs. As such, the use of an 11.1 multiplier for market and operational risks did not alter the fact that the capital requirements for banks in India are, overall, higher than the Basel requirement. However, in order to ensure that the capital requirements for Indian banks, in respect of market and operational risks, are higher than that prescribed under the Basel rules (as is the case in respect of credit risk), the multiplier for computation of RWAs has been changed from 11.11 to 12.5 in the case of market and operational risks.

Based on its self-assessment and, as identified by the RCAP Team, the RBI has carried out a number of modifications in the existing guidelines concerning domestic implementation of Basel capital framework. The RBI would like to thank BCBS and the Assessment Team for the proficiency with which the entire RCAP exercise for India was completed. The RBI concurs that the RCAP process promotes a level playing field amongst Basel member jurisdictions, reduces regulatory arbitrage and promotes global financial stability.

1. Assessment context and main findings

1.1 Context

Status of implementation

The Reserve Bank of India (RBI) is the monetary and banking authority as established by the Reserve Bank of India Act (RBI Act). As the banking authority, the RBI is responsible for supervision and control of the banking sector under the provisions of the Indian Banking Regulation Act. That is, the RBI has the statutory power to issue banking licenses and to carry out supervisory inspections of any banking entity in India. The supervisory department of the RBI is responsible for supervision of banks, while the regulatory department issues regulatory guidelines and is also responsible for model validation for advanced approaches. All the regulations assessed for this RCAP report are final regulations and are publicly available on the RBI website. Indian banking regulations are published in English.

At present no Indian bank has received approval to use the advanced Basel approaches for reporting regulatory capital (Table 1). However, a number of banks are currently in parallel run or are in the process of developing models for the advanced Basel approaches.

Status of approval of Basel advanced approaches

Number of banks, end-September 2014 — Table 1

	Advanced approach approved by Indian authorities	Application submitted and under review by Indian authorities	Pre-application phase (bank is in process of developing models for approval)
Credit risk (IRB)	Nil	Application submitted: 14 Being reviewed by the RBI and under parallel run for FIRB: 7	Nil
Market risk (IMA)	Nil	5	6
Operational risk (AMA)	Nil	12	2

Source: RBI. Notes: the RBI has not permitted banks to model the Specific Risk Charge for market risk and hence has not allowed banks to implement the IRC capital charge. Further, banks in India are not engaged in correlation trading and CRM has not been implemented. Regarding counterparty credit risk the guidelines on the Internal Models Method (IMM) and Standardised Method for CCR has not been issued. Banks need to follow Current Exposure Method (CEM) for capturing counterparty credit risk.

Regulatory system, model of supervision, and binding nature of prudential regulations

In India, all the scheduled commercial banks (also referred to as "commercial banks" in this report), comprising public sector banks, private sector banks and foreign banks but excluding regional rural banks, fall under the purview of Basel III regulations.

The Banking Regulation Act empowers the RBI to issue and amend banking regulations. All directions/guidelines/circulars issued by the RBI are legal inasmuch they have been issued by the RBI under the statutory powers vested by the Banking Regulation Act. There exists no hierarchy in the regulatory instruments, and the nomenclature given to a particular regulation has no material impact on its enforceability.

Overview of Indian laws and regulatory instruments Table 2

Level of rules (in legal terms)	Type
Reserve Bank of India Act, 1934 and Banking Regulation Act, 1949	Statutes which empower the RBI to issue directions/guidelines to banks.
Master Circular on Basel III capital regulations and Circulars on various subjects	All guidelines issued by the RBI to banks are mandatory.

The provisions containing the Basel standards are established by the Indian banking regulations and are binding for all commercial banks (Annex 7).

1.2 Structure of the banking sector

The Indian banking system is dominated by commercial banks which account for approximately 87% of total banking system assets. Of the commercial banks, public sector banks dominate with a market share of 73% of banking assets and 82% of bank branches (in total, there are nearly 90,000 bank branches in India). The banking system plays a major role in the mobilisation of savings and promotion of economic development in India.

Indian banking system – share by asset size Table 3

Institution	Market share of total banking assets (September 2014) (in percentage)
Scheduled commercial banks, of which	87%
Public sector banks	63%
Private sector banks	18%
Foreign banks	6%
Regional rural banks (RRBs)	3%
Urban cooperative banks	3%
Rural cooperative banks	7%
Total	100%

Source: RBI.

In recent decades, competition in the banking system has increased with the entry of new banks. Among other effects, this has led to the progressive adoption of technology and expansion of the branch network. Public sector banks have largely maintained their dominance in the banking system, although their market share has been declining. More broadly, the Indian banking sector is opening up and the RBI has allowed different banks to enter the market, including specialised banks such as payment banks and small savings banks. It is expected that the competition in the banking system will increase further in the near future.

Foreign banks account for about 6% of the Indian banking sector. At present, foreign banks are present in India in the form of branches only. They are subject to essentially the same capital requirements as Indian banks.

1.3 Scope of the assessment

Scope

The RCAP Assessment Team has considered all documents that effectively implement the risk-based Basel capital framework in India as of end-March 2015, the cut-off date for the assessment (Annex 4).

The assessment focused on two dimensions:

- A comparison of domestic regulations with the capital standards under the Basel framework to ascertain that all the required provisions have been adopted (*completeness* of the Indian domestic regulation); and
- Whether there are any differences in substance between the domestic regulations and the capital standards under the Basel framework and their significance (*consistency* of the Indian regulation).

In carrying out the above, the RCAP Assessment Team considered all binding documents that effectively implement the Basel framework in India as discussed above. Importantly, the assessment did not evaluate the adequacy of capital or resilience of the banking system in India or the supervisory effectiveness of the Indian regulatory authorities.

Any identified deviation was assessed for its materiality (current and potential, or having an insignificant impact) by using both quantitative and qualitative information. For potential materiality, in addition to the available data, the assessment used expert judgment on whether the domestic regulations met the Basel framework in letter and spirit (see further Section 1.4).

Bank coverage

The sample covers the top 15 Indian commercial banks by asset size, four of which are internationally active (with more than 10% of their assets in their overseas books). Given the structure of the Indian banking system and its low concentration rate, for individual data requests the RBI selected eight to 10 banks from the 15 banks in the sample to provide data for materiality testing purposes. The selection was made by the RBI, based on the nature of the issue, and includes those banks where the issue is most relevant given their exposures or business model. The RBI substantiated the selection of banks to the team. The entire sample of 15 banks covers approximately 60% of total assets of Indian commercial banks.

Assessment grading and methodology

As per the RCAP methodology approved by the Basel Committee, the outcome of the assessment was summarised using a four-grade scale, both at the level of each of the 14 key components of the Basel framework and overall assessment of compliance: compliant, largely compliant, materially non-compliant and non-compliant.[1]

[1] This four-grade scale is consistent with the approach used for assessing countries' compliance with the Basel Committee's *Core principles for effective banking supervision*. The actual definition of the four grades has been adjusted to take into account the different nature of the two exercises. In addition, components of the Basel framework that are not relevant to an individual jurisdiction may be assessed as not applicable (N/A). See www.bis.org/publ/bcbs264.htm for further details.

The materiality of the deviations was assessed in terms of their current or, where applicable, potential future impact (or non-impact) on the banks' capital ratios. The quantification was, however, limited to the agreed population of internationally active banks. Wherever relevant and feasible, the Assessment Team, together with the Indian authorities, attempted to quantify the impact based on data collected from Indian banks in the agreed sample of banks (see Annex 9). The non-quantifiable aspects of identified deviations were discussed and reviewed in the context of the prevailing regulatory practices and processes with the Indian authorities.

Ultimately, the assignment of the assessment grades was guided by the collective expert judgment of the Assessment Team. In doing so, the Assessment Team relied on the general principle that the burden of proof rests with the assessed jurisdiction to show that a finding is not material or not potentially material. A summary of the materiality analysis is given in Section 2 and Annex 9.

In a number of areas, the Indian rules go beyond the minimum Basel standards. Although these elements provide for a more rigorous implementation of the Basel framework in some aspects, they have not been taken into account for the assessment of compliance under the RCAP methodology as per the agreed assessment methodology (see Annex 10 for a listing of areas of super-equivalence).

1.4 Main findings

A summary of the main findings is given below.

Summary assessment grading — Table 4

Key components of the Basel capital framework	Grade
Overall grade:	C
Scope of application	C
Transitional arrangements	C
Pillar 1: Minimum capital requirements	
Definition of capital	C
Credit risk: Standardised Approach	C
Credit risk: Internal Ratings-Based Approach	C
Securitisation framework	C
Counterparty credit risk framework	C
Market risk: Standardised Measurement Method	C
Market risk: Internal Models Approach	C
Operational risk: Basic Indicator Approach and Standardised Approach	C
Operational risk: Advanced Measurement Approaches	C
Capital buffers (conservation and countercyclical)	C
Pillar 2: Supervisory review process	
Legal and regulatory framework for the Supervisory Review Process and for taking supervisory actions	C
Pillar 3: Market discipline	
Disclosure requirements	C

Compliance assessment scale (see Section 1.3 for more information on the definition of the grades): C (compliant), LC (largely compliant), MNC (materially non-compliant) and NC (non-compliant).

Overarching issues identified by the Assessment Team

Use of the word "may" in Indian regulation

The Basel framework generally uses the word "must" to express a binding minimum standard for banks.[2] Where the Basel framework provides optionality or discretion the terminology is typically based on words such as "may", "can" or "at the discretion of", to indicate the permissive nature of the provision.

A structural feature of Indian banking regulation is the prevalent use of the word "may" for implementing binding minimum requirements. As explained by the RBI, this reflects a long-standing cultural tradition of expressing itself through the use of non-confrontational language in certain circumstances and the avoidance of overly legalistic terminology. The RBI informed the team that the use of the word "may" where the intended meaning is "shall" or "must" does not restrict itself to banking regulation, but is widespread in Indian law and reflects a broader legislative and regulatory practice. In its review of the Indian regulations, the team came across a number of instances of the word "may" where the Basel standard uses the word "must". The team has also looked at other examples of the usage of the word "may" in banking regulations other than those reviewed under the RCAP exercise, and indeed there are occasions where the word "may" is used where a prescriptive requirement would be expected from the context, and the RBI confirmed that those are indeed mandatory in terms of application as against the permissive meaning that may be implied by the normal use of the word in English.

A central element of the RCAP assessment includes a review of the binding nature of the regulatory documents and the clarity of language used by the authorities to transpose the Basel minimum standards. The team has therefore held extensive discussions with the RBI and representatives of Indian banks to establish the binding character of Indian regulations, and in particular with regard to the clarity and meaning of its language and the prevalence of the word "may".

The RBI further explained to the Assessment Team that Indian regulations typically use contextual information to clarify whether a "may" is meant as a binding mandatory requirement or as a permissive discretion. That is, the context in the respective regulatory text clarifies whether the intended meaning is mandatory or permissive/enabling. More specifically, where "may" is accompanied with additional conditions or options, this would signify a permissive use, while a "may" without qualification is intended to mean "must". In addition, the RBI specified that the standard terminology to indicate permissiveness in banking regulation is the use of the expression "may, at the discretion of", which is distinct from the unqualified "may".

Senior representatives of several Indian banks unequivocally confirmed to the team during the on-site discussions that there is no doubt that the intended meaning of "may" in Indian banking regulations is "shall" or "must" (except where qualified by the phrase "may, at the discretion of" or similar terms). The team was also informed that the clarity of Indian regulatory language has not been raised as a matter of contention in previous international assessments, including the IMF FSAP assessments of the Basel Core Principles. The RBI has further provided the team with legal references and jurisprudence that shows that the use of the permissive word "may" in Indian regulations has been interpreted by the

[2] Alternative terminology in the Basel framework used to express binding standards includes words such as "will", "may not" or "may only".

Supreme Court of India as "must", albeit in a context different from that of banking regulations.[3] In addition, it was clarified that the RBI has wide-ranging powers and can instruct banks to observe its guidelines, irrespective of the language used.

The team considers that the evidence provided on jurisprudence supporting the interpretation of "may" as "must" in the circumstances explained by the RBI does not completely remove all potential ambiguity on the matter. The possibility of obtaining an independent legal opinion was discussed in the course of the assessment but considered by the RBI as inappropriate. The team also discussed with the RBI the alternative of clarifying the interpretation of "may" in a mandatory sense in all the relevant cases affecting the implementation of Basel standards, eg by issuing a circular to that purpose. However, the RBI explained that issuing such a circular could have serious negative repercussions in the Indian legal context, such as throwing into question the meaning of the word "may" in other legal texts of Indian laws and regulations. However, the team took note of the fact that RBI has used its broad regulatory powers to rectify 44 issues previously identified as deviations by the team in the context of capital regulations, but RBI has not deemed it feasible to rectify the 13 identified issues relating to the use of "may" in place of "must", and this might reflect the contentiousness with which the RBI regards its position in respect of this particular subject.

Given the context of this issue and the examples reviewed by the Assessment Team, and considering that to insist on obtaining a legally binding interpretation of the way the legal language is deployed in India is beyond the remit of the RCAP process, the team has adopted a pragmatic approach of reporting this issue as an observation rather than a finding and has viewed, for the purposes of this RCAP assessment, the use of "may" in Indian regulations as equivalent to the use of "must" in Basel standards, when used in line with the above considerations. For completeness, instances of the word "may" in Indian regulations, where Basel uses "must", have been listed as observations in Section 2.7 in this report. These observations have not been taken into consideration in the grading of the RCAP assessment. The team views the above as a way to deal with a very contextual issue, relevant only for the extraordinary and particular case of the use of language in India, and therefore as not setting any precedent for other future regulatory assessments.

At the same time, the team considers that, in the context of India's economic liberalisation and rapid international expansion of the Indian banking sector, the use of unambiguous language in regulatory documents becomes of overarching importance from an international perspective. The team's experience suggests that authorities should seek to ensure that local regulatory documents can be unambiguously understood even in an international context, in particular for Basel standards that are aimed at internationally active banks. The team has listed the issue for further consideration by the Basel Committee and recommends a review of linguistic guidance to harmonise regulatory language across member jurisdictions. As implementation of standards progresses, increased attention to linguistic issues seems imperative for a consistent and harmonised transposition of Basel standards across the member jurisdiction, using consistent and harmonised language and terminology.

Using a minimum capital ratio of 9% with a multiplier of 11.1 and risk weighting of 1111%

Calibration of the Basel framework is based on a minimum capital ratio of 8%. For example, for certain high-risk exposures, the Basel framework applies a 1250% risk-weight. For these exposures, the banks

[3] The legal reference provided by the RBI is State (Delhi administration) vs I.K. Nangia, AIR 1979 SC 1977 (1980).

are required to hold an amount of capital that is at least equal to the nominal size of the exposure (1250% is the inverse of 8%).

The RBI applies a minimum capital ratio of 9%, which is higher than the 8% minimum ratio of the Basel framework. Prior to the assessment the RBI applied a risk weight of 1111% for certain specific exposures (as the inverse of 9%) instead of the 1250% required by Basel. Similarly, the RBI applied a multiplier of 11.1 rather than 12.5 to calculate RWA from capital charges for market risk and operational risk. This approach resulted in minimum capital charges for the affected items that were equivalent to those under the Basel standard, while the overall minimum required capital was higher.

The team discussed the above differences in risk weights and multipliers with the RBI and expressed the concern that the RBI's approach could potentially result in a lower amount of total required capital than under the Basel standard. This is because the Basel III buffer requirements are applied to total RWA, which was lower for Indian banks (the materiality depending on the size of the exposures subject to the 1111% risk weight or to the 11.1 multiplier). Further, banks in India would report higher capital ratios, ceteris paribus, compared with banks under the Basel standard due to the resulting lower RWA. As a result, Indian banks' capital ratios would not be comparable to those of their international peers.

The RBI amended the regulation and changed the 1111% risk weight to 1250% and the 11.1 multiplier to 12.5, while keeping the 9% minimum requirement. Following the amendment the RBI's capital requirements are therefore effectively more conservative than the Basel standard. As per the agreed assessment methodology, this approach is considered fully compliant with the minimum Basel standards and has not been taken into account in the final assessment as a factor to offset any potential deficiencies.

Main findings by component

Scope of application

The RBI's implementation of the scope of application is compliant with the Basel Framework. The Basel framework applies to internationally active banks on a fully consolidated basis as well as at every tier within a banking group. Basel II paragraph 22 footnote 5 provides for the application of the Basel Framework on a solo basis (ie on a basis that does not consolidate assets and liabilities of subsidiaries) as an alternative to full subconsolidation, provided the full book value of any investments in subsidiaries and significant minority-owned stakes is deducted from the bank's capital.

The RBI applies the Basel framework to all scheduled commercial banks (including foreign banks' branch operations) on a solo and a consolidated basis. Under the RBI guidelines, investments in subsidiaries that are consolidated at the group level are deducted from the regulatory capital of the bank at the solo level.

Minimum capital requirements and transitional arrangements

The RBI's implementation of the calculation of minimum capital requirements and transitional arrangements is considered to be compliant with the Basel standards. The Assessment Team identified a few deviations from the Basel standards, which have subsequently been rectified by the RBI (refer to Annex 6).

Under the Basel Framework, banks using the Basel II advanced approaches are subject to a capital floor based on the application of the 1988 Accord (ie Basel I).The floor is applied at the entity level (ie it is an aggregate RWA-based floor). The RBI applies a separate floor to each risk category (a risk category-based capital floor) based on the Basel II standardised approaches to credit risk, operational risk and market risk.

Basel II paragraph 49 provides supervisors with the flexibility to develop appropriate bank-by-bank floors that are consistent with the Basel principles and subject to full disclosure of the nature of floors adopted. Such floors may be based on the approach the bank was using before adoption of the IRB approach and/or the AMA. The Basel Committee is also currently considering the design of a capital floor framework based on standardised approaches.[4] Hence, India's implementation of the capital floors based on the Basel II standardised approaches is considered to be in line with the Basel standards. Further, as a risk category-based capital floor would generally be more binding than an aggregate RWA-based floor (as offsetting across risk types would not be allowed), the Assessment Team judged India's implementation of risk-category based capital floors to be in line with the spirit of the Basel standards, pending the Basel Committee's finalisation of the capital floors framework.

Definition of capital

The RBI's implementation of the definition of capital is assessed as compliant with the Basel standards. The Assessment Team identified a number of issues relating to the capital rules in India, some of which have subsequently been rectified (refer to Annex 6). The remaining issues were deemed as not material.

- The RBI guidelines set the criteria for two types of instruments to qualify as Additional Tier 1 capital. In addition, the RBI guidelines include a reservation of authority provision, which provides the RBI with unconditional flexibility to approve any other type of instrument as Additional Tier 1, without setting any eligibility criteria for such instruments.

  The RBI explained that this is an enabling provision only to cater for future market developments, and that the RBI will provide suitable criteria if it were to allow other types of instruments to qualify as Additional Tier 1 capital. The Assessment Team deemed this deviation to be non-material given that the RBI has provided criteria, consistent with the Basel standards, for instruments which are currently recognised as Additional Tier 1 capital.

- The RBI applies minimum capital requirements of 5.5% CET1, 7% Tier 1 and 9% total capital, which are higher than the Basel minima. A side effect of the higher minimum capital requirements is that a correspondingly higher share of minority interest and other capital issued out of consolidated subsidiaries that is held by third parties is counted towards consolidated group capital. This is because surplus capital (with respect to the higher minimum) would be lower under the RBI guidelines, compared with the surplus capital calculated under the Basel standards.

  This particular side effect of more stringent capital requirements is not explicitly covered by Basel rules. The Assessment Team considers that the higher minimum requirements and the corresponding lower amounts of surplus capital would generally be more significant than the higher capital ratios reported by banks due to this side effect. The data provided by the RBI indicated that the capital impact of this deviation on Indian banks is non-material.

- The Basel III treatment for banks' investments in their own shares applies irrespective of the location of the exposure in the banking book or the trading book. The RBI guidelines do not explicitly state this requirement.

[4] In December 2014, the Basel Committee published a consultative document on capital floors: the design of a framework based on standardised approaches. See www.bis.org/bcbs/publ/d306.htm.

The RBI explained that no exemptions are provided under its guidelines from the treatment of own shares for exposures held in the banking book or the trading book. However, the Assessment Team is of the view that the inclusion of an explicit statement that the treatment applies irrespective of the location of the exposure in the banking book or the trading book would provide additional clarity.

The Assessment Team also identified an interpretative issue where the Basel standards themselves may benefit from clarification. This issue relates to the Basel III requirement that Additional Tier 1 capital instruments that are classified as liabilities for accounting purposes must have principal loss absorption (through either conversion into common shares or write-down) at a minimum trigger point of 5.125% CET1. The Basel Committee may wish to clarify whether there is any interlinkage between the minimum CET1 capital requirement and the prescribed minimum loss absorption trigger level for Additional Tier 1 capital instruments (eg whether the minimum loss absorption trigger level should be set higher than the minimum CET1 requirement). This issue may be relevant where jurisdictions apply minimum CET1 requirements that are higher than the Basel minimum. The details of this issue are set out in Annex 13.

Capital buffers (conservation and countercyclical)

Basel III established a capital conservation buffer above the minimum capital requirements. The consequence of a bank's CET1 ratio falling into the buffer range is that the bank becomes subject to a restriction on the distribution of future earnings. India's implementation of the capital conservation buffer is in line with the Basel standards and therefore assessed to be compliant.

The countercyclical capital buffer (CCCB) regime of Basel III works by extending the capital conservation buffer when excess aggregate credit growth is judged to be associated with a build-up of system-wide risk. The RBI's guidelines on CCCB came into effect on 5 February 2015 and were revised on 1 April 2015. The RBI's revised guidelines on CCCB are assessed as compliant with the Basel standards.

Credit Risk: Standardised approach

The Indian regulation of credit risk standardised approach is judged as compliant with the Basel standard. There are some identified deviations relating to: (i) the permitted options for assigning risk weights to claims on banks; (ii) the lower risk weight assigned to claims such as commercial real estate, residential housing and loans and advances to banks' own staff fully covered by superannuation benefits and/or mortgage of a flat/house; and (iii) the inclusion of life insurance policies as eligible collateral. In detail:

- For exposures to banks, the RBI requires a risk weight aligned with Basel option 1 for claims on banks in their jurisdiction (a risk weight with a floor of 20% and increasing depending on the capital adequacy level), while for claims on foreign banks the RBI generally follows Basel option 2. The Basel framework, however, does not envisage mixing such options.
- Regarding commercial real estate-residential housing (CRE-RH), the RBI assigns lower risk weights than the Basel standard. Lower risk weights are also applied to residential housing and loans and advances to a bank´s own staff fully covered by superannuation benefits and/or mortgage of a flat/house.
- Finally, a deviation is observed with regard to eligible financial collateral. Life insurance policies are included under eligible financial collateral with a 0% haircut, although they do not fall under any of the categories defined in the Basel standards.

Regarding the materiality assessment, the team used data to assess the quantitative impact of these deviations. Both the individual and cumulative overall impact of the deviations, however, turned out not to be material at present. The weighted average impact across the RCAP sample of banks of the

deviations amounted to 4 basis points on capital, while the impact for the most affected bank was 6 basis points.

The team notes that the implementation of the Basel Standardised Approach for credit risk by the RBI is more conservative in some areas than the Basel standard. For example, a higher risk weight is assigned to assets such as public sector entities (which are risk-weighted as corporates), consumer credit (with a 125% RW) and claims secured by residential property (varies from 50% to 75%, depending on the exposure amount and LTV ratio), venture capital fund (150% RW), capital market (125% RW) and corporates with certain ratings/rating bands.

Credit risk: Internal Ratings-Based Approach

The RBI's IRB framework is considered compliant with the Basel framework with some minor deviations that are not material.

The RBI has issued detailed guidelines covering IRB. No bank is currently using the approach for its regulatory capital requirements, although 14 have applied and seven banks have been approved by the RBI to commence parallel running for Foundation IRB. The RBI informed the team that it does not expect banks to be allowed to use Foundation IRB for regulatory capital in the near future, and approval based on parallel runs will be provided as per the preparedness of the banks in meeting detailed IRB requirements. The work towards approval of the use of the advanced approach will likely commence only after that. The general structure and most of the detailed requirements for the Internal Ratings-Based Approach (IRB) are in substance consistent with the Basel standards. However, there are certain deviations from the Basel standards which are outlined below. As no bank is currently using IRB in India the Assessment Team is unable to quantify the materiality of deviations accurately. Hence the use of IRB for credit risk needs to be considered for follow-up analysis:

- The absence of a High Volatility Commercial Real Estate (HVCRE) approach either in India or in other jurisdictions where the local supervisor has defined such an approach. The materiality of these items is limited by Indian banks' relatively low levels of exposures to commercial real estate.
- Differences from the Basel approach in the calculation of size adjustments and the exemption from the need to include an explicit maturity adjustment for exposures to SMEs, and the materiality threshold that allows equities to be exempted from the IRB approach. The first two reflect pre-existing definitions and practices in India. In these cases, it is quite possible that the RBI's approach will prove more conservative in practice when applied to exposures as a whole, although there may be instances where this is not the case.
- Permanent exemption from the IRB approach of some small exposures which are capable of categorisation under the IRB approach – claims on venture capital funds and loans to staff.
- The "days past due" element of the definition of default for certain loans being based on crop seasons as opposed to 90 days.
- The omission from the RBI's guidelines of part of the requirements included in the Basel text on two issues – action to be taken if a bank fails to implement a remedial plan, and part of the provisions for re-ageing of accounts in default. The RBI has implemented the other provisions in the relevant Basel paragraphs.

Also of note is the RBI's treatment of sovereign exposures. The RBI's guidelines allow application of IRB to sovereign exposures to be deferred if banks find it difficult to build rating systems due to lack of data points. However, the Assessment Team were satisfied that this alleviation could not be used in practice by Indian banks given the RBI's strict limits on partial use – exposures amounting to no more than 15% of the lower of total assets and operating profits can remain on the standardised

approach from first use of IRB. Accordingly this is recorded only as an observation and not a finding that feeds into the grade.

Credit risk: Securitisation framework

The RBI's securitisation framework is considered compliant with the Basel framework with some minor deviations that are not material.

The securitisation market is modest in size in India and expected to remain so. Only two of the top eight Indian banks have any securitisation exposures and none has securitisation RWAs in excess of 1.5% of its total RWAs. Securitisation products are relatively simple, with RBI regulation preventing Indian banks, including their overseas branches, from assuming exposures relating to synthetic securitisation, resecuritisations or revolving structures.

The deviations concern the omission from the RBI's guidelines of certain provisions that are related to the boundary between exposures that should be covered by the securitisation and normal credit risk frameworks.

- Basel II, paragraph 538, says that banks must apply the securitisation framework for determining regulatory capital requirements on all exposures that have the economic substance of securitisation exposures. The IRB Guidelines do contain the necessary text on economic substance but this is not repeated in the Basel III Master Circular or the specific securitisation guidelines. The IRB text does not ensure by itself that the Basel criterion is adequately considered for the current capital treatment of securitisation exposures across all Indian banks.
- Basel II, paragraph 539, sets out the distinction between tranching in securitisation structures and ordinary senior/subordinated debt instruments, in that junior securitisation tranches can absorb losses without interrupting contractual payments to more senior tranches, whereas subordination in the latter is a matter of priority of rights to the proceeds of liquidation. The RBI's guidelines do not make this distinction.
- Basel II, paragraph 543, includes sponsorship of a conduit as an activity that results in a bank being considered as an originating bank, with the resulting capital requirements in respect of the relevant exposures. The RBI does not include conduits within its definition of securitisation activities.

The RBI has found no evidence suggesting that exposures are, or have been, in practice misreported across the boundary at this time. Accordingly the team considers the above deviations not to be material. The RBI's regulations otherwise closely follow the substance of the Basel framework. The RBI does not include the Basel requirements on products that Indian banks are not allowed to assume, as the existence of requirements in RBI guidelines might cause confusion about the prohibition. It would be appropriate to include securitisation in follow-up work if the restrictions on these products were removed.

Counterparty credit risk framework

Only one minor issue has been identified concerning the counterparty credit risk framework. This issue concerns the exemption from the capital requirements on counterparty risk of all foreign exchange (except gold) contracts which have an initial maturity of 14 calendar days or less; figures provided by the RBI show that the finding is, however, not material. The team has therefore assessed the counterparty credit risk framework as compliant with the Basel standard.

Market risk: Standardised Approach

The RBI's requirements implementing the Standardised Measurement Method for market risk are considered compliant with the Basel framework: no deviation have been identified.

The requirements are identical to the Basel text, except that the Indian authorities have chosen more conservative numbers for some risk weight coefficients, or for some products (commodities, equity derivatives, correlation trading portfolio), which are not authorised in the trading book of Indian banks. The standardised approach is the only approach available for capturing specific risk.

Market risk: Internal Models Approach

The RBI's current requirements implementing the Internal Model Approach for market risk are considered compliant with the Basel framework with one non-material deviation identified. The deviation is the omission by the RBI of the requirement concerning supervisory stress scenarios. The idea behind these scenarios is to compare the large losses observed on the trading book to the capital and to estimate the number of such losses would have been covered by the capital requirements deduced from the VaR. But as the backtesting reports requested by the RBI should very likely include the information necessary to compute these supervisory stress scenarios, the Assessment Team does not consider these deviations to be material.

Operational risk: Basic Indicator Approach, Standardised Approach, and Advanced Measurement Approaches

The Basel Framework allows three approaches in order to calculate the capital requirements for operational risk, namely: the Basic Indicator Approach (BIA), the Standardised Approach (TSA) or its variant the Alternative Standardised Approach (ASA) and the Advanced Measurement Approach (AMA). The RBI Regulations cater for all of the above-mentioned approaches that can be adopted by banks operating in India. However, currently all banks are making use of the BIA for regulatory purposes, although seven banks are on parallel run for TSA. Several more TSA and AMA applications are under consideration by the RBI for approval under parallel run.

The RBI's requirements for the BIA, TSA, ASA and AMA are assessed as compliant with the Basel Framework.

Supervisory review process

The Indian framework is judged as compliant with the Basel Supervisory review process. Generally, the domestic regulations have adequately addressed the requirements under the four Principles of Pillar 2 covered under the RCAP. The power to conduct supervisory review is provided under the RBI's Basel III Capital Regulations.

The ICAAP developed by the banks is an important component of the supervisory review process. The RBI conducts an exhaustive review of the ICAAP, from the assumptions under the exercise to the overall result, and maintains a close and active dialogue with the institutions. The ICAAP is also well integrated within the risk management of the banks.

In case the RBI is not satisfied with the level of capital or with the quality of the risk management process or internal controls, it has the powers and ability to require any bank to hold capital at a level higher than the minimum level.

Disclosure requirements

The RBI's implementation of the disclosure requirements of Pillar 3 market discipline, disclosure requirements for remuneration and capital disclosures are assessed as compliant with the Basel standards.

It is important to note that the RBI Guidelines on remuneration and compensation are only applicable to private sector banks and foreign banks operating in India and not to government-owned public sector banks as there is no risk-reward remuneration component in the compensation structure of the executives of these banks.

The RBI has identified the MDs, CEO and other "Whole Time Directors" of a bank as the material risk-takers. The remuneration of these material risk takers are in fact also approved by the RBI. Banks have been directed to implement relevant guidelines in respect of these executives and to put in place a compensation policy for other risk-takers in line with the guidelines.

2. Detailed assessment findings

The component-by-component details of the assessment of compliance with the risk-based capital standards of the Basel framework are detailed below. The focus of Sections 2.1 to 2.5 is on findings that were assessed to deviate from the Basel minimum standards and on their materiality. Section 2.6 lists some observations and other findings specific to implementation practices in India. Section 2.7 lists examples of where Indian regulations use the word "may" in the meaning of "must".

2.1 Scope of application

Section grade	Compliant
Summary	The RBI has generally implemented the scope of application in line with the Basel requirements.

2.2 Calculation of minimum capital requirements and transitional arrangements

Section grade	Compliant
Summary	The RBI's implementation of the calculation of minimum capital requirements and the transitional arrangements is assessed as compliant with the Basel standards. The Assessment Team identified a few deviations from the Basel standards, which have subsequently been rectified by the RBI (refer to Annex 6).

2.3 Pillar 1: Minimum capital requirements

2.3.1 Definition of capital

Section grade	Compliant
Summary	The RBI has generally implemented the definition of capital in line with the Basel standards. The Assessment Team identified a number of deviations, some of which have subsequently been rectified by the RBI. The remaining three deviations were deemed as not material. Hence, RBI's implementation of the definition of capital is assessed as compliant with the Basel standards.
Basel paragraph no	Basel III paragraph 54
Reference in domestic regulation	RBI Master Circular – Basel III Capital Regulations paragraph 4.2.4.1, Annex 3, Annex 4 and Annex 16
Findings	Basel III sets out the criteria for recognition of instruments in different categories of regulatory capital (ie CET1, Additional Tier 1 and Tier 2 capital). The RBI guidelines set the criteria for the inclusion of perpetual non-cumulative preference shares (PNCPS) and perpetual debt instruments (PDI) in Additional Tier 1 capital, which is in line with the Basel standards. In addition, paragraph 4.2.4.1(iv) of the RBI guidelines allows the inclusion of "any other type of instrument generally notified by the Reserve Bank from time to time for inclusion in Additional Tier 1 capital". The RBI regulations do not indicate which criteria such other types of instruments will have to meet to qualify as Additional Tier 1 capital. The RBI explained that, to date, only PNCPS and PDI are considered as eligible Additional Tier 1 instruments, and detailed criteria is provided for these instruments in the RBI guidelines. If the RBI were to allow any other type of instrument to be recognised as Additional Tier 1 capital, suitable eligibility criteria would be provided for such an instrument. In the view of the Assessment Team, the RBI provision gives unconditional flexibility to the RBI for approving any other type of instrument as Additional Tier 1 capital (ie it

	is not bound by any conditions such as the RBI would provide criteria for any such instruments in line with the criteria for other Additional Tier 1 instruments). Nevertheless, the Assessment Team takes note of the assurance provided by the RBI that suitable eligibility criteria will be provided for any new types of Additional Tier 1 capital instruments.
Materiality	Given that the RBI currently only allows PNCPS and PDI as eligible Additional Tier 1 instruments, and has assured the Assessment Team that suitable eligibility criteria would be provided for any new types of instruments, this issue is assessed as not material.
Basel paragraph no	Basel III paragraphs 62–64
Reference in domestic regulation	RBI Master Circular – Basel III Capital Regulations paragraph 4.3
Findings	Basel III limits the amount of minority interests and third-party investments in other capital instruments of consolidated subsidiaries that can be recognised in regulatory capital at group level (ie surplus capital of the subsidiary that is attributable to minority shareholders and third-party investors is not recognised at the group level). The RBI applies minimum capital requirements of 5.5% CET1, 7% Tier 1 and 9% Total capital, which are higher than the Basel minima. The effect is a lower surplus capital as a result of higher minimum capital requirements than the surplus capital calculated under the Basel standards. At the same time, as an effect of the higher minimum capital requirements, the capital ratios tend to be slightly higher, due to the higher amount of minority interests and third-party investments in other capital instruments of the subsidiary that is recognised as regulatory capital. This particular "side effect" of more stringent capital requirements is not explicitly covered by the Basel rules. The data provided by the RBI indicate that the impact of this side effect is not material in the case of Indian banks.
Materiality	Based on the data provided by the RBI, the effect of higher recognition of minority interests (as a result of higher minimum capital requirements) than under Basel standards on capital ratios reported by Indian banks is slight, compared with the direct effect of the higher minimum capital requirements. Hence, this issue is assessed as not material.
Basel paragraph no	Basel III paragraph 78
Reference in domestic regulation	RBI Master Circular – Basel III Capital Regulations paragraph 4.4.8
Findings	Basel III requires banks' investments in their own shares, whether held directly or indirectly, to be deducted in the calculation of CET1 (unless already derecognised under the relevant accounting standards). In addition, any own stock which banks could be contractually obliged to purchase should be deducted in the calculation of CET1. Under Basel III, this treatment applies irrespective of the location of the exposure in the banking book or the trading book. The RBI guidelines do not explicitly state that this treatment will apply irrespective of the location of the exposure in the banking book or the trading book. The RBI explained that the domestic rules do not provide any exemption from the treatment of own shares (whether held in the trading book or banking book). Further, banks are not permitted to invest in own shares (ie cannot have direct investments in own shares and also cannot have any contractual obligations to purchase own shares), but they may end up having indirect investments in own shares. The Assessment Team notes the RBI's rationale for the exclusion of this Basel requirement from its guidelines. However, the Assessment Team is of the view that the inclusion of an explicit statement (that the treatment of own shares will apply irrespective of the location of the exposure in the banking book or the trading book) would provide additional clarity.
Materiality	The Assessment Team assessed this issue as not material as the RBI guidelines do not provide any exemptions from the treatment of investments in own shares.

2.3.2 Capital buffers (conservation and countercyclical)

Section grade	Compliant
Summary	The RBI has generally implemented the capital conservation buffer requirements in line with the Basel Framework. The RBI's guidelines on the CCCB came into effect on 5 February 2015. The Assessment Team identified one potentially material deviation along with other minor deviations from the Basel standards. Following discussions with the Assessment Team, the RBI rectified all identified issues. The RBI's revised guidelines on the CCCB are assessed as compliant with the Basel standards.

2.3.3 Credit risk: Standardised Approach

Section grade	Compliant
Summary	In general, Indian authorities have implemented the Standardised Approach for credit risk in line with the Basel framework. In a number of areas, the RBI has done a more conservative implementation of the Basel Framework. For example, higher RWA for certain assets, such as public sector entities, consumer credit and claims secured by residential property, venture capital fund, capital market and corporate with certain ratings/rating bands. On the other hand, some deviations were identified in respect of claims on banks, Commercial Real Estate – Residential Housing (CRE-RH) and loans to bank´s own staff. Also, some non-eligible collateral under the Basel Framework is included in the RBI's Basel III Capital Regulations – Life insurance policies. The overall impact of these deviations has been assessed as not material since the weighted average impact across the RCAP sample of banks is 4 basis points on capital. The impact for the most affected bank is 6 basis points.
Basel paragraph no	Basel II paragraphs 60–64
Reference in domestic regulation	5.6 of DBOD.No.BP.BC.6/21.06.201/2014-15 on Basel III Capital Regulations
Findings	The Basel framework provides that claims on banks are to be risk-weighted based on either one of two options – the sovereign rating (risk weight one category less favourable) or the bank's own credit rating. The RBI's Basel III Capital Regulations, on the other hand, apply a RWA aligned with option 1 for claims on banks in their jurisdiction (a RWA with a floor of 20% and increasing depending on the capital adequacy ratio) and, as the general case, they apply option 2 for claims on foreign banks in foreign jurisdictions. The Indian authorities have explained that, for exposures on foreign banks in foreign jurisdictions, the capital adequacy prescription may be different for banks in the respective jurisdictions. In such cases, applying a risk weight based on their capital adequacy ratio would not be adequate and therefore option 2 would be applied to foreign bank exposures. The Assessment Team appreciates the rationale behind the treatment provided in the RBI's Basel III Capital Regulations. However, the Basel framework does not envisage such a mixing of options.
Materiality	Not material An assessment of the impact was made under the assumption of using option 1 to claims on foreign banks in foreign jurisdictions. In general, since non-AAA jurisdictions use the discretion given under paragraph 54 of the Basel II framework, a 20% risk weight would apply for exposures on banks in those jurisdictions (a risk weight one category less favourable than the sovereign). As compared with this, exposures on foreign banks in foreign jurisdictions under para 5.6.2 of the RBI guidelines require risk weights ranging from 20% to 150%. This treatment implies a more conservative approach when compared with the Basel standard.
Basel paragraph no	Basel II paragraph 74

Reference in domestic regulation	5.11 of DBOD.No.BP.BC.6/21.06.201/2014-15 on Basel III Capital Regulations
Findings	Paragraph 74 of the Basel Framework applies a RWA of 100% to commercial real estate and makes no distinction for any subcategory of this type of project. Under the RBI's Basel III Capital Regulations, claims on Commercial Real Estate - Residential Housing receive a RWA of 75%. Indian authorities have explained that this treatment was contemplated based on the lower risk profile of the CRE-RH exposures as compared with other forms of CRE. However, the Basel framework does not give freedom to specify risk weights lower than stipulated in the Basel Framework.
Materiality	Not material Impact analysis on banks showed that the impact on RWA numbers and capital ratios is not material at present. The weighted average impact across the RCAP sample of banks is 2 basis points. The impact for the most affected bank is 6 basis points. The issue has been listed for a follow-up assessment (see Annex 12).
Basel paragraph no	Basel II paragraphs 69–73
Reference in domestic regulation	5.14 of DBOD.No.BP.BC.6/21.06.201/2014-15 on Basel III Capital Regulations
Findings	Under the Basel Framework, assets such loans and advances to a bank´s own staff fully covered by superannuation benefits and/or mortgage of flat/house would be classified under the regulatory retail portfolios (75% RW) or under claims secured by residential property (35% RW). However, under the Indian Basel IIII Capital Regulations, loans and advances to bank´s own staff fully covered by superannuation benefits and/or mortgage of flat/house will attract a 20% RW. Indian authorities have explained this type of asset represents a very low risk to the bank and hence the lower RW. The Assessment Team appreciates the rationale behind the treatment provided in the RBI's Basel III Capital Regulations. However, the Basel framework does not give freedom to specify risk weights lower than stipulated in the Basel Framework.
Materiality	Not material Impact analysis on banks showed that the impact on RWA numbers and capital ratios is not material at present. The weighted average impact across the RCAP sample of banks is 3 basis points. The impact for the most affected bank is 4 basis points. The issue has been listed for a follow-up assessment (see Annex 12).
Basel paragraph no	Basel II paragraph 136
Reference in domestic regulation	7.3.7(v) of DBOD.No.BP.BC.6/21.06.201/2014-15 on Basel III Capital Regulations
Findings	According to paragraph 136 of the Basel Framework, for certain types of repo-style transaction (broadly speaking, government bond repos as defined in paragraphs 170 and 171) supervisors may allow banks using standard supervisory haircuts or own-estimate haircuts not to apply these in calculating the exposure amount after risk mitigation. The RBI's Basel III Capital Regulations consider the surrender value of insurance policies as eligible for a 0% haircut. However, under the Basel framework those instruments are not eligible for a 0% haircut.
Materiality	Not material Impact analysis on banks showed that the impact on RWA numbers and capital ratios is not material at present. The weighted average impact across the RCAP sample of banks is zero basis points. The impact for the most affected bank is 1 basis point. The issue has been listed for a follow-up assessment (see Annex 12).
Basel paragraph no	Basel II paragraphs 145–146
Reference in domestic regulation	7.3.5 of DBOD.No.BP.BC.6/21.06.201/2014-15 on Basel III Capital Regulations

Findings	Paragraphs 145 and 146 of the Basel text provide a list of those instruments which are eligible collateral for credit risk mitigation techniques. Indian regulation considers life insurance policies as eligible collateral (paragraph 7.3.5 (v) of the Master Circular). However, this collateral is not considered eligible under the Basel framework (paragraph 145). Indian authorities explained that life insurance policies (if issued by an insurance provider regulated by insurance regulatory authority) are recognised in India as eligible collateral in view of their high liquidity and almost negligible uncertainty regarding payment as compared with equities (allowed in Basel II but not by the RBI). The Assessment Team appreciates the rationale behind the treatment provided in the RBI's Basel III Capital Regulations. However, life insurance policies are not eligible collateral under the Standardised Approach.
Materiality	Not material Impact analysis on banks showed that the impact on RWA numbers and capital ratios is not material at present. The weighted average impact across the RCAP sample of banks is zero basis points. The impact for the most affected bank is 1 basis point. The issue has been listed for a follow-up assessment (see Annex 12).

2.3.4 Credit risk: Internal Ratings-Based Approach

Section grade	Compliant
Summary	The findings regarding the RBI's guidelines on the IRB framework cover a range of issues, none of which are expected to be material, although proper quantification is not possible at this stage as no banks are using IRB at this time. Several reflect pre-existing practices in India. These include the structure of the discount for SME exposures and the exemption from the need to include an explicit maturity adjustment for exposures to SMEs. It is possible that these will prove to be more conservative, in many cases and at an aggregate level, than the Basel approach. For the definition of default, the RBI uses in some cases a higher, and therefore less conservative, number of days past due – based on crop seasons. The RBI has not implemented an approach to cover HVCRE within specialised lending because of the lack of experience of volatile real estate losses in India. This means that any exposures that should be classified as HVCRE would get lower capital requirements. Nor has it implemented an approach to cover any HVCRE that Indian banks might have in other jurisdictions where the local supervisor has defined HVCREs and which Basel requires should be applied by all lenders in that market. Another difference is a permanent exemption from the IRB approach of some small exposures which are capable of categorisation under the IRB approach – claims on venture capital funds and loans to staff. Finally, the RBI have omitted from their guidelines part of the requirements included in the Basel text on two issues – action to be taken when a bank fails to implement a remedial plan should it fail to comply with the standards, and part of the provisions for re-ageing of accounts in default.
Basel paragraph no	Basel II paragraphs 220, 227, 280–283, 379
Reference in domestic regulation	N/A
Findings	Basel II paragraphs 220, 227 etc include a separate HVCRE approach within specialised lending. The IRB guidelines do not include such an approach. The RBI have argued that paragraph 227 of Basel II defines HVCRE lending as financing of CRE that exhibits higher loss rate volatility than other types of SL, that none of the CRE portfolios have exhibited higher default rates or high loss rate volatility. As no CRE exposure meets the condition outlined in the Basel framework for classification as HVCRE, the RBI has not categorised any exposure as HVCRE. They report that in the Indian context, non-performing advances (NPAs) under the CRE asset subclass is always less than that of total NPAs and less volatility is witnessed. In addition, the CRE asset prices have shown very little volatility and have generally shown a one-sided (upward) trend.

	HVCRE is defined in the Basel text as follows: "High-volatility commercial real estate (HVCRE) lending is the financing of commercial real estate that exhibits higher loss rate volatility (ie higher asset correlation) compared with other types of SL. HVCRE includes: Commercial real estate exposures secured by properties of types that are categorised by the national supervisor as sharing higher volatilities in portfolio default rates; Loans financing any of the land acquisition, development and construction (ADC) phases for properties of those types in such jurisdictions; and Loans financing ADC of any other properties where the source of repayment at origination of the exposure is either the future uncertain sale of the property or cash flows whose source of repayment is substantially uncertain (eg the property has not yet been leased to the occupancy rate prevailing in that geographic market for that type of commercial real estate), unless the borrower has substantial equity at risk." In the view of the Assessment Team, implementation of the Basel text requires, at the least, further definition of the volatility criteria for the first two subcategories and substantial equity at risk in the third subcategory. Further, the third subcategory – ADC loans – is not limited to cases where the market has shown high volatility. While the RBI does not allow Indian banks to lend for land acquisition, the RBI does allow development and construction loans, which are accordingly potential HVCRE exposures.
Materiality	The impact will depend upon the proportion of exposures that would merit a HVCRE treatment. Data provided by the RBI show the CRE RWAs of the top eight Indian banks to be less than 2% of their total RWAs. As HVCRE would only be a subset of these, the issue is not material at present and the Assessment Team believes that it is unlikely to become material in the near future.
Basel paragraph no	Basel II paragraphs 228, 280–283, 379 Table 5 – Credit risk: disclosures for portfolios subject to the standardised approach and supervisory risk weights in the IRB approaches: Quantitative Disclosures
Reference in domestic regulation	
Findings	Basel II paragraph 228 requires supervisors to apply the HVCRE approach to loans in other jurisdictions where the local supervisors have applied a HVCRE approach. There is no provision to implement this in the IRB guidelines. The RBI have said that, in terms of RBI guidelines, banks in India having an overseas presence have a general requirement across all prudential guidelines to follow the host country or home country norms, whichever is more stringent. The Assessment Team has some doubts as to whether this is sufficiently comprehensive. In particular, the team has not seen evidence whether this applies, as regards IRB capital requirements, only to exposures in subsidiaries incorporated in a host country, or also to exposures in branches of the Indian bank located in the that country and/or to cross border exposures from India to borrowers in that country. In addition, the absence from the Pillar 3 section of the RBI's IRB guidelines of references to HVCRE exposures, also suggests that reporting as HVCRE of exposures which meet the definition in an overseas supervisor's jurisdiction is not expected or accommodated by the RBI.
Materiality	Materiality will depend on the extent of HVCRE exposures held by Indian banks in jurisdictions which have applied this treatment. In the Assessment Team's view, informed also by input from Indian banks, this is likely to be not material.
Basel paragraph no	Basel II paragraphs 256–257
Reference in domestic regulation	Paragraphs 17 and 25 of DBOD.No.BP.BC.67/21.06.202/2014-15 on IRB capital requirements
Findings	The Basel text sets out a framework under which banks may diverge from the general principle that a bank that adopts the IRB approach must adopt it across all asset classes. However, in addition to the exemptions allowed by the Basel framework, the RBI's IRB guidelines, paragraph 17, specifically allow the exclusion of claims on venture capital funds and loans and advances to staff which appear capable of

	categorisation under the IRB asset classes. The RBI have pointed out that, in general, the standardised approach calibration is more conservative than that of IRB outcomes. Further, in the given example, risk weights on claims on venture capital funds under the standardised approach as per RBI guidelines are 150% which is much more stringent than under IRB. Similarly, in the case of loans and advances to bank's own staff which are fully covered by superannuation benefits and/or mortgage of flat/house will attract a risk weight of 20% in the RBI's standardised approach. This risk weight is applied without any adjustment for the security held which would result in a lower risk weight under IRB. Further, they say that exposures to such claims are immaterial in all the cases as compared with total RWAs but do not provide further quantification. The Assessment Team accepts that at least some exposures will have lower capital requirements under IRB than under standardised than IRB, but this is not the case across the board. For example exposures to venture capital funds would be 400% under the Simple Risk Weight IRB approach, which is higher than 150% under the Standardised Approach.
Materiality	In the view of the Assessment Team it is unlikely that the overall impact will be a materially lower requirement for these items under the Standardised Approach, especially given the expected relatively low level of these exposures and therefore it is judged to be not material.
Basel paragraph no	Basel II paragraphs 273–274
Reference in domestic regulation	Paragraphs 118–119 of DBOD.No.BP.BC.67/21.06.202/2014-15 on IRB capital requirements
Findings	Basel II paragraphs 273 and 274 have a size-related adjustment for capital requirements for SME exposures in the corporate asset class based on the turnover or the asset size of the borrower (between EUR 5 million and EUR 50 million). The RBI's IRB guidelines, paragraph 119, contain a size adjustment, but this is based on the total banking exposure to the entity (the thresholds are between approx. EUR 0.7 million and EUR 3.5 million). The RBI have explained that their framework for adjustments for SME exposures is based on the outcome of the 1992 Nayak committee report and subsequent, but no longer in place, restrictions on working capital that established a benchmark relationship between borrowings and sales. RBI explained that the eligible lending limit is generally found to be one fifth of the annual turnover for small and medium-sized Indian companies. They argue that their approach is the implementation of an alternative option in the Basel framework, as turnover data were not readily available in many cases. The Assessment Team does not agree that the RBI approach is in compliance with Basel framework as it will impact differently on different companies – with those with high turnover/borrowing or high assets/borrowing most likely to obtain lower requirements relative to Basel. The RBI emphasises that its coverage is restricted to SMEs which are unlikely to have these features. The Assessment Team agrees that it is likely that the overall impact of the RBI's treatment across its book is modest, and indeed quite possibly more conservative than the Basel text, but this affects the materiality of the finding, not whether or not the RBI's treatment represents a deviation.
Materiality	In the view of the Assessment Team, this issue is likely to be not material. RBI applies thresholds based on total banking book exposures of between approx. EUR 0.7 million and EUR 3.5 million. Assuming a lending limit – as explained by RBI – of one fifth of annual turnover, the Indian thresholds roughly translate into sales thresholds of about EUR 3.5 million to EUR 17.5 million. These thresholds are considerably below the Basel thresholds.
Basel paragraph no	Basel II paragraph 319
Reference in domestic regulation	Paragraph 108 of DBOD.No.BP.BC.67/21.06.202/2014-15 on IRB capital requirements
Findings	Basel II paragraph 319 allows national supervisors to exempt, from the explicit

	maturity approach under the Advanced IRB approach, facilities to smaller domestic corporate borrowers if the group to which they belong has reported sales and assets of less than EUR 500 million. The RBI's IRB Guidelines have a similar exemption but it is applicable in cases where the reported exposure to the consolidated group based in India is less than INR 1 billion subject to the condition that the banking system's total exposure to the borrower is not more than INR 50 million . Further, the RBI will not apply the treatment until requested by a bank, and it is not relevant until banks are able to adopt the Advanced IRB approach, which is not expected to be for several years. The RBI has explained that this framework is designed to be consistent with their application of the firm size adjustments for SMEs (see paragraphs 273–274 above). The relatively small size of the limits, (eg INR 1 billion is approximately equal to EUR 13 million) limits the impact.
Materiality	As with other IRB issues, no data are available to quantify the impact and, even on a judgmental basis, it is not straightforward to assess its materiality: (a) There is no clear directional consequence of adopting the exemption even in the Basel text (ie that the capital requirements might actually be higher if this exemption is adopted for banks with a relatively short maturity book; (b) The impact on an individual bank will vary with the maturity profile of its own book; (c) The low level of limits being applied by the RBI make its approach more conservative than the Basel mechanism for banks with relatively long books, but less conservative for banks with relatively short-maturity books. In the Assessment Team's view this deviation is likely to be not material.
Basel paragraph no	Basel II paragraph 358
Reference in domestic regulation	Paragraph 176 of DBOD.No.BP.BC.67/21.06.202/2014-15 on IRB capital requirements
Findings	Basel II paragraph 358 defines a materiality threshold, below which national supervisors may decide that a bank's equity exposures may be excluded from the IRB treatment, as 10% of a bank's Tier 1 and Tier 2 capital, or 5% if the equity portfolio contains less than 10 individual holdings. The RBI's IRB guidelines instead define the materiality threshold as 0.5% of total banking book exposures. Assessment of the impact for eight potentially affected banks shows that the RBI's methodology produces lower, and therefore more conservative, thresholds across the board than the Basel 10% approach – ranging from 0.28 to 0.74 times the Basel figure. This is driven by the high level of capital of the Indian banks. It is possible that the RBI's approach could produce a less conservative figure for at least some banks, for example, if the levels of capitalisation fell and/or if the 5% threshold was applicable to a bank. The latter would raise the RBI thresholds to 0.56 to 1.44 times the Basel figure. However, it is unlikely that an Indian IRB bank that had equities greater than 0.5% of its banking book exposures would have less than 10 individual holdings.
Materiality	The Assessment Team considers this item to be not material given the relatively low possibility of the RBI's floor proving less conservative than the Basel requirement.
Basel paragraph no	Basel II paragraph 393
Reference in domestic regulation	Paragraph 6 of Appendix 1 of DBOD.No.BP.BC.67/21.06.202/2014-15 on IRB capital requirements
Findings	Basel II paragraph 393 includes failure to satisfactorily implement a remedial plan within the events that will lead supervisors to reconsider a bank's eligibility for the IRB approach. The RBI's IRB guidelines largely repeat paragraph 393 but do not include this particular requirement. The RBI have pointed out that, in accordance with their guidelines, for the duration of any non-compliance, the RBI may consider the bank to compute capital as per the Standardised Approach. The Assessment Team note that this provision is also in the Basel text and is in addition to, not a replacement for, the requirement to reconsider eligibility if a remedial plan is not implemented.

Materiality	In the Assessment Team's view, this is likely to be not material as it is only applicable if a bank is in non-compliance and has failed to implement a remedial plan.
Basel paragraph no	Basel II paragraph 452
Reference in domestic regulation	Paragraph 74 of Appendix 1 of DBOD.No.BP.BC.67/21.06.202/2014-15 on IRB capital requirements Section 2 of part A of DBOD.No.BP.BC.9/21.04.048/2014-15 on Master Circular on Income Recognition, asset classification and provisioning pertaining to advances
Findings	Basel II paragraph 452 says that an account is in default when obligors are past due more than 90 days on any material credit obligations to the banking group. The IRB guidelines say that a default is considered to have occurred when an asset is classified as a non-performing asset (NPA) as per the extant RBI guideline. Although the Master Circular on Income Recognition etc generally use a "days past due" definition that is consistent with the Basel text, for exposures relating to crops, "days past due" is related to crop seasons, (two seasons for short-duration crops and one season for long-duration crops), as opposed to using 90 days. The rationale for this is that it is only after harvesting the crops that farmers are in a position to repay a loan. However, it does represent a deviation from the Basel definition. The RBI has pointed out that their definition of default is more conservative than that in the Basel text in several respects – there is no concept of a threshold for materiality; and for retail exposures, if more than 50% of amounts due from a borrower is NPA, then all the loans from that borrower are considered to be NPA, as compared with the facility-level default criteria for retail usually applied in the Basel framework.
Materiality	The team understands that the level of crop season-related lending is of limited materiality to Indian banks. Furthermore, changes to the NPA treatment of crop season lending are being considered and it is possible that this will take place before banks commence use of the IRB for capital requirements. In the judgment of the Assessment Team ,this deviation is likely to be not material.
Basel paragraph no	Basel II paragraph 458
Reference in domestic regulation	N/A
Findings	Basel II paragraph 458 sets out a number of requirements for re-ageing policies in respect of the counting of days past due. These include approval authorities and reporting requirements, and the setting of a minimum age of a facility before it is eligible for re-ageing, which do not appear to be present in the Master Circular on Income Recognition etc. The RBI maintains that this is included in Part B and Annex 5 of the Master Circular.
Materiality	In the Assessment Team's view, this issue is likely to be not material.

2.3.5 Securitisation framework

Section grade	Compliant
Summary	The few findings regarding India's implementation of the securitisation framework all relate to the omission from the RBI's guidelines of provisions regarding the boundary between exposures that should be covered by the securitisation and normal credit risk frameworks – the need for the securitisation framework to be applied to all exposures that have the economic substance of securitisation exposures, an articulation of the distinction between securitisation structures and ordinary senior/subordinated debt instruments where tranching exists, and the inclusion of sponsorship of a conduit as an activity which results in a bank being considered as an originating bank.
Basel paragraph no	Basel II paragraph 538
Reference in domestic regulation	Paras 5.16.1(i) and 5.16.9 of DBOD.No.BP.BC.6/21.06.201/2014-15 dated 1 July 2014 on Master Circular – Basel III Capital Regulations Paragraph 204 of DBOD.No.BP.BC.67/21.06.202/2011-12 on the IRB capital requirements

Findings	Basel II paragraph 538 says that banks must apply the securitisation framework for determining regulatory capital requirements on all exposures that have the economic substance of securitisation exposures. The RBI IRB Guidelines do contain the necessary text on economic substance but this is not repeated in the Basel III Master Circular or the specific securitisation guidelines. As no exposures are currently covered by the IRB approach, this wording does not provide reassurance for the current capital treatment of Indian banks.
Materiality	It is inherently difficult to quantify the amount, if any, of exposures that should be, but are not, covered under the securitisation framework, and the resulting impact on capital requirements. The RBI has not identified any misclassified exposures in their work. The Assessment Team believes this item is likely not material.
Basel paragraph no	Basel II paragraph 539
Reference in domestic regulation	N/A
Findings	Basel II paragraph 539 sets out the distinction between tranching in securitisation structures and ordinary senior/subordinated debt instruments in that junior securitisation tranches can absorb losses without interrupting contractual payments to more senior tranches, whereas subordination in the latter is a matter of priority of rights to the proceeds of liquidation. The RBI's guidelines do not make this distinction. The RBI says that the notion of tranching is embedded in their instructions, with some examples given, but acknowledges that the distinction between tranching in securitisation structures and the ordinary senior/subordinate debt instruments is not covered explicitly. Further, they say that the provisions under paragraphs 539–542 are more in the nature of explanation rather than of any expectations on specific requirements from the capital perspective, and that the divergence in explaining the difference between tranching and subordination has no impact on the capital computation/capital required for securitisation transactions which are aligned with the Basel guidelines. The Assessment Team believes that the provisions of 539–542 are important. In particular, paragraph 539 defines the notion of traditional securitisation, a notion which is used in other sections of Basel document. More specifically, the inclusion of an example of the operation of credit enhancement does not provide assurance that the distinction between securitisation and senior/subordinated debt instruments is achieved. Further, if the difference between tranching and subordination is not properly understood by the banks, then there will be an impact on capital requirements for any exposures which are reported incorrectly.
Materiality	It is inherently difficult to quantify the amount, if any, of exposures that are incorrectly assigned to either the securitisation or non-securitisation framework, and the resulting impact on capital requirements. The RBI has not identified any misclassified exposures. The Assessment Team believes this item is likely not material.
Basel paragraph no	Basel II paragraph 543
Reference in domestic regulation	N/A
Findings	Basel II paragraph 543 includes serving as a sponsor of an asset-backed commercial paper conduit or similar programme as an activity of an originating bank. The intention of the Basel treatment is to bring on-balance sheet the exposures of a conduit if a bank serves as a sponsor of a conduit; in accordance with 543(b), sponsorship of a conduit can be delivered by "in fact or in substance" managing or advising the programme, or placing securities into the market, in addition to the more mainstream credit-bearing activities of provision of liquidity or credit enhancement. The RBI does not include this activity within its definition of securitisation activities. The RBI has requirements that prohibit Indian banks from assuming exposures relating to, inter alia, securitisations with revolving structures but their requirements do not mention conduits, and these might also be associated with non-revolving structures.

Materiality	In the absence of evidence regarding the issue, the Assessment Team are inclined to conclude that Indian banks do not have any significant involvement in conduits or similar arrangements, and therefore the issue is not material.

2.3.6 Counterparty credit risk framework

Section grade	Compliant
Summary	Only one issue has been identified. This issue concerns the exemption by the RBI for the capital requirements on counterparty risk of all foreign exchange (except gold) contracts which have an initial maturity of 14 calendar days or less, an exemption which does not exist in the Basel text. Figures provided by the RBI showed that the impact is not material.
Basel paragraph no	Basel II paragraph 92(i) of Annex 4
Reference in domestic regulation	Paragraph 5.15.3.2 Master Circular on Basel III Capital Regulations (DBOD.No.BP.BC.6 /21.06.201/2014-15 dated 1 July 2014)
Findings	While Basel requires a PFE factor of 1% for counterparty risk for all foreign exchange (except gold) contracts which have a residual maturity of less than one year, the RBI provide an exemption for contracts which have an original maturity of 14 calendar days or less.
Materiality	Not material. Figures provided by the RBI showed that the impact of this exemption is not material.

2.3.7 Market risk: The Standardised Measurement Method

Section grade	Compliant
Summary	No issue has been identified.

2.3.8 Market risk: Internal Models Approach

Section grade	Compliant
Summary	One minor deviation identified regarding stress test requirements.
Basel paragraph no	Basel II paragraph 718(Lxxxi)
Reference in domestic regulation	Not available
Findings	In the stress-testing requirements, the Basel Committee introduced two types of scenarios: supervisory scenarios requiring no simulations by the bank and scenarios requiring a simulation by the bank. The first are based on the largest loss experiences by the banks. The idea is to compare these losses to the capital and to estimate the number of such losses that would have been covered by the capital requirements as deduced from the VaR. The RBI did not directly implement them in their regulations. The RBI requires quarterly reports on the results of the backtesting procedure including analysis of exceptions. When these reports include the size of the losses exceeding the VaR, the RBI will have all the necessary inputs to compute these supervisory scenarios. Even if this information is not included in these reports, the RBI considers that they will get it whenever they ask for it. But as the Indian rules do not specify explicitly that the size of the losses exceeding VaR should be disclosed to the RBI, the Assessment Team considers that the detailed backtesting reports requested by the RBI do not fully replace the supervisory scenarios requiring no simulations.
Materiality	Due to the information required in the backtesting reports, the Assessment Team does not consider these deviations to be material.

2.3.9 Operational risk: Basic Indicator Approach and the Standardised Approach

Section grade	Compliant
Summary	The RBI's Regulations are in line with the Basel Framework for the Basic Indicator Approach and Standardised Approach for operational risk.

2.3.10 Operational risk: Advanced Measurement Approaches

Section grade	Compliant
Summary	The RBI's Regulations are in line with the Basel Framework for measuring operational risk under the advanced measurement approach.

2.4 Pillar 2: Supervisory review process

Section grade	Compliant
Summary	Generally, the domestic regulations have adequately addressed the requirements under the four Principles of Pillar 2 covered under the RCAP. The power to conduct supervisory review is provided under the RBI's Basel III Capital Regulations.

2.5 Pillar 3: Market discipline

Section grade	Compliant
Summary	The RBI has implemented the disclosure requirements of the Pillar 3 market discipline, disclosure requirements for remuneration and capital disclosures in line with the Basel Framework.

2.6 Observations specific to implementation practices in India

The following list includes observations made by the Assessment Team regarding India's implementation of the risk-based capital standards. These observations are assessed as consistent with the Basel standard and are provided here for background information only.

Credit risk IRB

Basel paragraph no	Basel II paragraphs 215, 256–260
Reference in domestic regulation	Paragraphs 12 and 24–29 of DBOD.No.BP.BC.67/21.06.202/2014-15 on IRB capital requirements
Findings	Basel II paragraph 215 requires the inclusion of a sovereign asset class by banks using IRB, subject to the partial use provisions of 256–260. However, the RBI's IRB guidelines (paragraph 12) allow banks not to apply the IRB approach to sovereigns if they find it difficult to do so due to lack of data points, allowing them to defer implementation for up to two years. The Assessment Team was initially concerned with the apparent ability of IRB banks to use this provision to cherry-pick by continuing to apply the Standardised Approach to sovereigns, an exposure type which is known to frequently have higher capital requirements under IRB than under the Standardised Approach. Moreover, the limited number of sovereigns and the scarcity of defaults at the higher-quality end of the spectrum mean that it is not feasible to build statistically robust PD models for such borrowers based on internal default data, and this is not a situation that will change other than in the very long term. Hence, if internal default data were to be used for sovereign exposures, it is difficult to see how allowing a two-year rollout period would cure this problem. Accordingly, there would likely be little real difference in practice between a temporary and permanent exemption. However, the RBI pointed out that their IRB guidelines (paragraph 28) also placed a quantitative materiality limit on the amount of exposures that could be excluded from the IRB approach from the time that they commenced use of IRB. This is 15% of the lower of total assets and operating profits before provisions. The latter is particularly strict. Given the large amount of sovereign exposures held by Indian banks, the Assessment Team is satisfied that in practice this limit will prevent Indian banks from using IRB at all unless they apply it to sovereign exposures. Accordingly, the paragraph 12 alleviation for sovereigns cannot be applied in practice and, in the view of the Assessment Team, does not therefore produce a deviation from Basel when paragraph 28 is taken into account.
Basel paragraph no	Basel II paragraph 307(b)
Reference in domestic regulation	Paragraph 126(ii) of DBOD.No.BP.BC.67/21.06.202/2014-15 on IRB capital requirements
Observation	Basel II, paragraph 307(b) sets out criteria for acceptable sellers of credit protection under the double default framework, including that they need to be banks, investment firms or insurance companies. The IRB guidelines say that eligible sellers must be a bank or a primary dealer, which is a more restrictive definition than in the Basel text and therefore does not represent a current deviation from Basel standards. However, they also state that eligibility will be extended to "any other entity as permitted by the RBI", which raises the possibility that they may no longer be in compliance as a result of a future extension. The RBI have assured the Assessment Team that any extension will be done only on a very selective basis after ensuring compliance with international standards, including the Basel framework, and best practice. This point has been included in Annex 12 as an issue for possible follow-up in a future RCAP assessment.
Basel paragraph no	Basel II paragraph 322
Reference in domestic regulation	Paragraphs 110–111 of DBOD.No.BP.BC.67/21.06.202/2014-15 on IRB capital requirements
Observation	Basel II paragraph 322, as amended by "Treatment of trade finance under the Basel

	capital framework", automatically exempts issued and confirmed letters of credit from the one-year maturity floor. For other types of exposure to achieve the same exemption, the Basel text requires supervisors to define the types of short-term exposure that might be considered eligible after a careful review of the particular circumstances in their jurisdiction. The RBI's implementation of this requirement provides for the exemption of all short-term self-liquidating trade finance instruments from the one-year maturity floor. The guidelines also say that other exposures may be exempted from the floor by the RBI on a case-by-case basis.
Basel paragraph no	Basel II paragraph 462
Reference in domestic regulation	Paragraph 39(ii) of DBOD.No.BP.BC.67/21.06.202/2014-15 on IRB capital requirements
Observation	Basel II, paragraph 462, describes various techniques for the estimation of PD for corporate, bank and sovereign exposures, including the mapping of internal grades to the scale used by an external credit assessment institution (ECAI) and the attribution of the default rate observed for the ECAI's grades to those of the banks. The IRB guidelines largely repeat the language in the Basel text but omit the specific requirement for basis of mapping to be documented. The RBI believes that it is superfluous to include this provision as it would not be possible for a bank to comply with the other requirements of this paragraph unless the basis of mapping had been documented.
Basel paragraph no	Basel II paragraph 518
Reference in domestic regulation	Paragraph 4(b) of Appendix 3 of DBOD.No.BP.BC.67/21.06.202/2014-15 on IRB capital requirements
Observation	Basel II paragraph 518 includes in the operational requirements for recognition of financial receivables under the Foundation IRB approach, a requirement for a continuous monitoring process which may include, as appropriate and relevant, a number of mechanisms including borrowing base certificates. The IRB guidelines largely repeat the language of paragraph 518 of the Basel text or include similar language but omit any reference to borrowing base certificates. The RBI have advised the Assessment Team that this is because the terminology of borrowing base certificates is not in use in India, and the issues which these certificates address are adequately covered by other provisions in the guidelines.

Credit Risk: Securitisation

Basel paragraph no	Basel II paragraph 565
Reference in domestic regulation	Paragraph 6.2.5 of circular DBOD.No.BP.BC.6/21.06.201/2014-15 dated 1 July 2014 on Master Circular – Basel III Capital Regulations
Observation	Basel II paragraph 565(c) says that ECAIs that are eligible for providing ratings under the RBA must have a demonstrated expertise in assessing securitisations, which may be evidenced by strong market acceptance. This is not contained in the RBI's requirement. However, it was noted that the Securities and Exchange Board of India (SEBI) is the primary regulator of ECAIs, and ECAIs must comply with various requirements including that of the IOSCO code of conduct. Further, for the purpose of the credit rating of bank loans and related securitisation transactions, the RBI provides accreditation to ECAIs after a due accreditation process and the position of those accredited credit rating agencies is also reviewed annually by the RBI. The relevant extract of such review office note was provided for perusal. As this report contains explicitly an assessment on the qualification and on the experience of the staff of the rating agencies, and a section dedicated to structured finance ratings, the Assessment Team considered this to be an observation and not a finding. In the same paragraph, Basel requires that concerning the credit rating agencies, "[…] procedures, methodologies, assumptions, and the key elements underlining the assessments must be publicly available […]". Neither the RBI rules, nor the SEBI rules explicitly incorporate such a requirement. But as the credit rating agencies are required to comply with the IOSCO code of conduct, which incorporates them, the

	Assessment Team considered that this issue should not be considered as a finding.

Operational risk: Advanced Measurement Approaches

Basel paragraph no	Basel II paragraph 656 – Allocation mechanism for banks adopting AMA
Reference in domestic regulation	Para 2.1 of the RBI AMA Guidelines dated April 27, 2011 – Applicability of AMA guidelines Para 2.2, 2.3 as well as Para 4.1.10 to Appendix 1 (Part C, Para 4) (revised in terms of RBI circular dated October 16, 2014) – Requirements pertaining to capital computation for AMA banking groups Para 8.4.2, 8.4.4 and Para 8.4.5 (revised in terms of RBI circular dated October 16, 2014) – Allocation mechanism Para 2.9 to Appendix 1 (Part B, Para 2) – Home-host considerations
Observation	The Basel text states that a bank adopting the AMA may, with the approval of its host supervisors and the support of its home supervisor, use an allocation mechanism for determining the regulatory capital requirement for internationally active banking subsidiaries that are not deemed to be significant relative to the overall banking group but are themselves subject to this framework. The RBI has essentially covered the above-mentioned paragraph, albeit in different sections of their regulations. The RBI noted that their AMA guidelines are applicable at both the solo (including overseas branches) and consolidated/group-wide level, excluding group companies engaged in insurance business and businesses not pertaining to financial services. The RBI guidelines cover all banking entities in the group and do not distinguish between significant and non-significant subsidiaries; as such, for the purpose of AMA approval, the banks are required to put in place a capital allocation mechanism in respect of both the significant and non-significant subsidiaries. The efficacy and adequacy of capital allocation at the solo as well as consolidated level would be verified and validated by the RBI depending on a bank's intention to migrate to AMA on a solo or consolidated basis, subject to partial use considerations, if any. For all prudential, statutory and technical purposes as well as capital requirements, the branches of foreign banks are treated as independent entities/banks in India and fall within the same regulatory ambit as for Indian banks, unless specified otherwise. In addition, home-host considerations affect the assessment process where banking groups' applications are concerned. Key factors influencing the assessment process would include whether the RBI is acting as home or host supervisor, the size and local impact of the subsidiaries, and the contribution of the branch/subsidiary towards the AMA's design, implementation and process. Again it is noted that RBI guidelines are applicable to the Indian operations of foreign banks, in the same way as it is applicable to Indian banks, for which necessary approval for migration to AMA has to be obtained from the RBI. In case the home country regulations are more stringent/conservative, the banks are free to adopt the same for their Indian operations but the capital modelling has to be based on the risk profile/loss data relevant for the Indian operations.

Market risk: the valuation framework

Basel paragraph no	Basel II paragraph 718(cix)
Reference in domestic regulation	Section 8.8.1.2 paragraph (vii) of the Master Circular on Basel III Capital Regulations.
Observation	Basel requires the banks to compute valuation adjustments to consider in particular the unearned credit spread. Considering that the Basel requirements on the valuation adjustment due to the unearned credit spread, the RBI master circular proposes a methodology. This valuation adjustment is defined as the variation of a one-year exposure multiplied by a one-year default probability and by a LGD between the trade date and the calculation date. The RCAP review team consider that this formula, looking only at a one-year risk, may underestimate the impact of the unearned credit

	spread, ie of a counterparty default. The RBI confirmed that this formula is used only to compute the valuation adjustment required in this circular, and not to compute the credit valuation adjustment as required by the accounting rules applicable to Indian banks. This potential underestimation of the valuation adjustment due to the uncertainty of unearned credit spread has, however, no impact on the capital of banks, as only the valuation adjustments related to liquidity are deducted from capital.

Pillar 3: Market discipline

Basel paragraph no	Pillar 3 disclosure requirements for remuneration
Reference in domestic regulation	RBI Guidelines on compensation (DBOD No.BC.72 /29.67.001/2011-12 dated 13 January 2012
Observation	The RBI Guidelines on compensation are only applicable to private sector and foreign banks operating in India and not to public sector banks. The RBI advised the RCAP Assessment Team that Pillar 3 disclosure regarding remuneration and compensation-related guidelines are not applicable to government-owned public sector banks as there is no risk-reward remuneration component in the compensation structure of the executives of these banks. The remuneration of the executives of public sector banks is uniform across banks/within ranks and this is decided by the government, which is the owner of these banks.
Basel paragraph no	BCBS197 Pillar 3 disclosure requirements for remuneration paragraph 11 – Key disclosures
Reference in domestic regulation	Appendix 2 of the RBI Guidelines on compensation (DBOD No.BC.72 /29.67.001/2011-12 dated 13 January 2012 on Compensation of Whole Time Directors/Chief Executive Officers/Risk takers and Control Function Staff etc. Table DF-15 of Annex 18 of the Master Circular on Basel III Capital Regulations
Observation	The Basel Framework under paragraph 11 of BCBS197 Pillar 3 disclosure requirements for remuneration requires certain main qualitative and quantitative disclosures on remuneration that banks should include in their Pillar 3 document. The requested quantitative disclosures should only cover senior management and other material risk-takers and be broken down between these two categories. The RBI authorities noted that in Appendix 2 (disclosure requirement for remuneration) – Quantitative Disclosure – it is mentioned that quantitative disclosure should only cover Whole Time Directors/Chief Executive Officers/other risk-takers. The RBI has identified the MD and CEO and other Whole Time Directors of a bank as the material risk-takers, although not defined, and the remuneration of these material risk-takers is in fact also approved by the RBI. They further advised banks to implement the guidelines contained in the above-quoted circular in respect of these executives and to put in place a compensation policy for other risk-takers in line with the above guidelines.
Basel paragraph no	Basel III capital disclosure requirements paragraphs 5 and 38
Reference in domestic regulation	RBI Master Circular – Basel III Capital Regulations paragraph 14.9
Observation	The Basel rules require banks to publish the required disclosures with the same frequency as, and concurrent with, the publication of their financial statements, whether or not the financial statements are audited. The RBI guidelines require banks to make disclosures at least on a half-yearly basis, with certain exceptions (disclosures relating to capital adequacy and credit risk are to be made on a quarterly basis), whether or not financial statements are audited. While the Basel III capital disclosures are required to be made concurrent with the publication of financial statements, they are not required to be published with the same frequency as the publication of financial statements. The RBI explained that Indian commercial banks publish financial statements on an annual basis in terms of the provisions of the Banking Regulation Act, 1949. Hence, requiring banks to publish the required disclosures with the same frequency as that of

	the publication of financial statements (in line with the Basel III requirements) would seem to go against the Basel expectation that disclosures will typically be quarterly or half-yearly. The Assessment Team, however, noted that Indian banks publish certain unaudited financial results on a quarterly basis. The RBI advised that these results do not constitute a complete set of financial statements or interim financial reports and that the limited review has been carried out under the Standard on Review Engagements (SRE) 2410 :"Review of Interim Financial Information Performed by the Independent Auditor of the Entity", and not under SRE 2400: "Engagements to Review Financial Statements". In addition, the RBI authorities noted that the quarterly results are declared by listed entities in compliance with clause 41 of the Listing Agreement with stock exchanges. The results are as per a format specified under the Listing Agreement and these formats do not meet the requirements of interim financial reports as explained above. Thus, these results are not intended to be interim financial reports as envisaged both under Indian GAAP as well as International Financial Reporting Standards (IFRS), and the RBI therefore does not view the quarterly results as being interim financial statements.

2.7 Use of the word "may" in Indian regulation

The following overview provides instances where Indian risk-based capital regulations use the word "may", whereas the Basel standard uses the word "must". As discussed in Section 1.4 of the report, for the purpose of the assessment the team has accepted the view that "may" means "must" in the context of the Indian regulations.

Capital buffers (conservation and countercyclical)

Basel paragraph no	Basel III paragraph 139
Reference in domestic regulation	RBI Guidelines on CCCB – Annex paragraph 2
Findings	The Basel rules state that the size of the CCCB "will" vary between zero and 2.5% of RWAs. The RBI guidelines state that the amount of the CCCB "may" vary between zero and 2.5% of total RWAs.
Basel paragraph no	**Basel III paragraph 142**
Reference in domestic regulation	RBI Guidelines on CCCB – Annex paragraph 2
Findings	The Basel rules state that banks "must" meet the CCCB buffer with Common Equity Tier 1 or other fully loss-absorbing capital (footnote 53 to Basel III paragraph 142 clarifies that the Basel Committee is still reviewing the question of permitting other fully loss-absorbing capital beyond CET1 and that until the Committee has issued further guidance the CCCB is to be met with CET1).The RBI guidelines state that the CCCB "may" be maintained in the form of CET1 or other fully loss-absorbing capital only (following discussions with the Assessment Team, the RBI decided to remove the provision on other fully loss-absorbing capital from its CCCB guidelines).
Basel paragraph no	**Basel III paragraph 149**
Reference in domestic regulation	RBI Guidelines on CCCB – Annex paragraph 2
Findings	Basel III paragraph 149 states that banks "must" ensure that their CCCB requirements are calculated and publically disclosed with at least the same frequency as their minimum capital requirements. The RBI guidelines state that CCCB requirements "may" be disclosed at table DF-11 of Annex 18 as indicated in the Basel III Master Circular.

Credit risk: Internal Ratings-Based Approach

Basel paragraph no	Basel II paragraph 215
Reference in domestic regulation	Paragraph 8 of DBOD.No.BP.BC.67/21.06.202/2014-15 on IRB capital requirements
Findings	Basel II paragraph 215 states that banks "must" categorise banking book exposures into prescribed broad asset classes. The RBI's IRB guidelines say that banks "may" do so. It does seem unlikely that banks will not categorise their exposures into broad asset classes
Basel paragraph no	**Basel II paragraphs 363–364**
Reference in domestic regulation	Paragraph 29 of Appendix 10 of DBOD.No.BP.BC.67/21.06.202/2014-15 on IRB capital requirements
Findings	Basel II paragraph 363 says that that the default risk requirement for purchased receivables is to be based on the risk-weight function applicable to that particular exposure type as long as the bank can meet the qualification standards. The RBI's IRB guidelines say that "the risk weight may be calculated as per the treatment applicable to that retail sub-asset class". Further the Basel text paragraph 364 says that the

	estimates of default risk for purchased retail receivables "must" be calculated on a standalone basis; that is, without regard to any assumption of recourse or guarantees from the seller or other parties. The RBI's IRB guidelines say that the estimates "may" be calculated on a standalone basis. The Assessment Team expect the proportion of exposures covered by the purchased receivables treatment to be relatively low.
Basel paragraph no	Basel II paragraph 373
Reference in domestic regulation	Para 23 of Appendix 10 of DBOD.No.BP.BC.67/21.06.202/2014-15 on IRB capital requirements
Findings	Basel II paragraph 373 says that a guarantee provided by the seller or a third-party, in respect of a purchased receivable, will be treated using the existing IRB rules for guarantees. The RBI guidelines say that IRB rules for guarantees "may" be applied to guarantees taken into account in credit mitigation. The Assessment Team note that this issue will be relevant only to any exposures covered by the purchased receivables treatment, which is expected to be low, and the percentage of those that are covered by a guarantee.
Basel paragraph no	Basel II paragraphs 213, 388 and 392
Reference in domestic regulation	Paragraph 24 of DBOD.No.BP.BC.67/21.06.202/2014-15 on IRB capital requirements
Findings	Basel II paragraphs 388 and 392 say that to be eligible for the IRB approach a bank must demonstrate to its supervisor that it meets the IRB requirements at the outset (and on an ongoing basis). (Paragraph 213 also describes the requirements set out in paragraphs 388 to 537 as minimum requirements that banks must satisfy to use the IRB approach). However, paragraph 24 of the RBI's IRB Guidelines says only that if the RBI examines and finds that the bank applying to adopt the IRB approach does not meet the required criteria, it may reject the application. This item is relatively important as non-compliance with the minimum requirements risks severe harm to the efficacy of the IRB approach
Basel paragraph no	Basel II paragraphs 452–453
Reference in domestic regulation	Paragraph 75 of Appendix 1 of DBOD.No.BP.BC.67/21.06.202/2014-15 on IRB capital requirements
Findings	Basel II paragraph 452 includes an "unlikely to pay" leg of the definition of default and paragraph 453 sets out six elements which are to be included within indicators of unlikeliness to pay. The RBI's IRB guidelines do not explicitly require banks to consider these criteria. Rather they list these elements as being included in a list that a bank may consider as indications of default. The "days past due" leg of the definition is also in place and it seems unlikely that banks' practices will diverge sufficiently from the Basel requirements to result in a major difference in capital requirements
Basel paragraph no	Basel II paragraph 460
Reference in domestic regulation	Paragraph 44 of DBOD.No.BP.BC.67/21.06.202/2014-15 on IRB capital requirements
Findings	As regards the use of banks' own estimates of loss-given-default, Basel II paragraph 460 of the IRB guidelines says that the bank's own workout and collection expertise significantly influences their recovery rates and must be reflected in their LGD estimates. The RBI's IRB guidelines say that a bank's own workout and collection expertise "may" be reflected in their LGD estimates. This item is relatively important as it may allow the unjustified use of other banks' superior experience and therefore result in an underestimate of a bank's own risk position.
Basel paragraph no	Basel II paragraph 462
Reference in domestic regulation	Paragraph 39 of DBOD.No.BP.BC.67/21.06.202/2014-15 on IRB capital requirements
Findings	Basel II paragraph 462 sets out a number of requirements for the use of agency data as the basis of a PD estimate. These include a requirement that mapping must be based on a comparison of internal rating criteria to the criteria used by the external rating agency and on a comparison of the internal and external ratings of any

	common borrowers. The RBI's IRB guidelines say that the mapping may be based on a comparison. This risks allowing the unjustified use of agency experience for banks' PDs for a large range of borrowers which is a potentially important shortcoming.

Securitisation framework

Basel paragraph no	Basel II paragraph 624
Reference in domestic regulation	Paragraph 231 of DBOD.No.BP.BC.67/21.06.202/2011-12 on IRB capital requirements
Findings	Basel II paragraph 624 sets out the calculation of the capital charge used in the Supervisory Formula approach for securitisation exposures under IRB. Paragraph 626 says that the supervisory-determined parameters in the formula are 1000 for Tau and 20 for Omega (=20). The IRB guidelines say that banks "may "consider these values. Its applicability depends first on the proportion of securitisation exposures under the supervisory formula approach – none at present as no banks are using IRB – and then what different measures are used for Tau and Omega

Pillar 2: Supervisory review process

Basel paragraph no	Basel II paragraph 794
Reference in domestic regulation	Paragraph 13.9.1(v) of DBOD.No.BP.BC.6/21.06.201/2014-15 on Basel III Capital Regulations
Findings	Basel II paragraph 794 says that supervisors will take appropriate action to mitigate the effects of implicit support. The Basel III Master Circular says that the Reserve Bank may take appropriate supervisory action to mitigate the effects. Its relevance will be limited by the extent of securitisation exposures, (which are presently low or non-existent for Indian banks), and the proportion of these that are subject to implicit support
Basel paragraph no	Basel II paragraph 795
Reference in domestic regulation	Paragraph 7.1.2 of DBOD.No.BP.BC.6/21.06.201/2014-15 on Basel III Capital Regulations
Findings	Basel II paragraph 795 says that, with regard to residual risks associated with securitisation, supervisors will expect banks' policies to take account of the appropriateness of the protection recognised against first-loss credit enhancements in determining their economic capital. Where supervisors do not consider the approach to protection recognised to be adequate, supervisors will take appropriate action. Paragraph 7.1.2(iv) says only that, where these risks are not adequately controlled, the Reserve Bank "may" impose additional capital charges or take other supervisory actions. Its relevance will be limited by the extent of securitisation exposures, (which are presently low or non-existent for Indian banks), and the proportion of these for which there is first-loss credit enhancement.

Annexes

Annex 1: RCAP Assessment Team and Review Team

Assessment Team Leader

Name	Affiliation
Mr Arthur Yuen	Hong Kong Monetary Authority

Assessment Team Members

Name	Affiliation
Mr Philippe Durand	French Prudential Supervision and Resolution Authority
Ms Verónica Flores	Comisión Nacional Bancaria y de Valores (CNBV)
Mr Jacques Henning	South African Reserve Bank
Mr Roy Lim	Bank Negara Malaysia
Ms Isabel Mailly	Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)
Mr Kevin Ryan	Bank of England / Prudential Regulation Authority
Ms Raman Sandhu	Australian Prudential Regulation Authority

Supporting members

Name	Affiliation
Mr Noel Sacasa	Hong Kong Monetary Authority
Ms Carita Wan	Hong Kong Monetary Authority
Mr Maarten Hendrikx	Basel Committee Secretariat

Review Team

Name	Affiliation
Mr Georg Bulsink (SIG)	The Netherlands Bank
Mr Karl Cordewener	Basel Committee Secretariat
Mr Piers Haben (SIG)	European Banking Authority
Mr Lim Tuang Lee (PDG)	Monetary Authority of Singapore

Annex 2: Implementation of the Basel framework as of cut-off date

Overview of adoption of capital standards

Table 5

Basel III regulation	Date of issuance by the Basel Committee	Transposed into Indian rules	Date of implementation in India	Status
Basel II				
Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework – Comprehensive Version	June 2006	Master Circular on Basel III Capital Regulations. For previous circulars, see Table 6 in Annex 4.	2006	Green
Basel 2.5				
Enhancements to the Basel Framework Guidelines for computing capital for incremental risk in the trading book Revisions to the Basel II market risk framework	July 2009	Master Circular on Basel III Capital Regulations IMA guidelines	2010	Green
Basel III				
Basel III: A global regulatory framework for more resilient banks and banking systems – revised version	June 2011 (Consolidated version)	Basel III amendments – 1 September 2014 Basel III : circular on LCR – 9 June 2014 Basel III: circular on Liquidity risk management	2014	Green
Pillar 3 disclosure requirements for remuneration	July 2011	RBI Guidelines on compensation	2012	Green
Treatment of trade finance under the Basel capital framework	October 2011	Master Circular on Basel III Capital Regulations	2014	Green
Composition of capital disclosure requirements	June 2012	Master Circular on Basel III Capital Regulations	2014	Green
Capital requirements for bank exposures to central counterparties	July 2012	Master Circular on Basel III Capital Regulations	2014	Green

Colour code: Green = implementation completed; Yellow = implementation in process; Red = no implementation.

Annex 3: List of capital standards under the Basel framework used for the assessment

(i) International Convergence of Capital Measurement and Capital Standards: A Revised Framework (Basel II), June 2006

(ii) Enhancements to the Basel II framework, July 2009

(iii) Guidelines for computing capital for incremental risk in the trading book, July 2009

(iv) "Basel Committee issues final elements of the reforms to raise the quality of regulatory capital" Basel Committee press release, 13 January 2011

(v) Revisions to the Basel II market risk framework: Updated as of 31 December 2010, February 2011

(vi) Basel III: A global regulatory framework for more resilient banks and banking systems, December 2010 (revised June 2011)

(vii) Pillar 3 disclosure requirements for remuneration, July 2011

(viii) Treatment of trade finance under the Basel capital framework, October 2011

(ix) Interpretive issues with respect to the revisions to the market risk framework, November 2011

(x) Basel III definition of capital – Frequently asked questions, December 2011

(xi) Composition of capital disclosure requirements: Rules text, June 2012

(xii) Capital requirements for bank exposures to central counterparties, July 2012

(xiii) Regulatory treatment of valuation adjustments to derivative liabilities: final rule issued by the Basel Committee, July 2012

(xiv) Basel III counterparty credit risk – Frequently asked questions, November 2011, July 2012, November 2012

Annex 4: Local regulations issued by Indian authorities for implementing Basel capital standards

Overview of issuance dates of important Indian capital rules — Table 6

Domestic regulations	Name of the document, version and date
Domestic regulations implementing Basel II	Master Circular on Basel III Capital Regulations, July 2014 Master Circular on disclosure in Notes to Accounts, July 2014 FSD: Section 19 BR Act circular of 12 December 2011 Master Circular on Investment portfolio, July 2014 Circular on bilateral netting – October 2010 IRB guidelines, Dec 2011 AMA guidelines, April 2011 IMA guidelines, April 2010 TSA guidelines, March 2010 Master Circular on Exposure Norms, July 2014 Master Circular on Income recognition and asset classification, July 2014 Guidelines on Banks' Asset Liability Management Framework – Interest Rate Risk, November 2010 Guidelines on stress testing, December 2013 Master circular on Para Banking, July 2014 Guideline on securitization of standard assets, February 2006 Guidelines on securitization transactions, 7 May 2012 Master circular on Risk Management and Inter-bank dealing, 1 July 2014 Revisions to Basel II – Advanced Approaches of Operational Risk – TSA and AMA dated 16 October 2014
Domestic regulations implementing Basel II.5	Master Circular on Basel III Capital Regulations, July 2014 IMA guidelines, April 2010
Domestic regulations implementing Basel III	Basel III amendments – 1 September 2014 Basel III : circular on LCR – 9 June 2014 Basel III: circular on liquidity risk management

Hierarchy of Indian laws and regulatory instruments — Table 7

Level of rules (in legal terms)	Type
Reserve Bank of India Act, 1934 and Banking Regulation Act, 1949	Statutes which empower the RBI to issue directions/guidelines to banks.
Master Circular on Basel III Capital Regulations and Circulars on various subjects	All guidelines issued by the RBI to banks are mandatory.

Annex 5: Details of the RCAP assessment process

A. Off-site evaluation

(i) Completion of a self-assessment questionnaire by Indian authorities

(ii) Evaluation of the self-assessment by the RCAP Assessment Team

(iii) Independent comparison and evaluation of the domestic regulations issued by Indian authorities with corresponding Basel III standards issued by the Basel Committee

(iv) Identification of observations

(v) Refinement of the list of observations based on clarifications provided by Indian authorities

(vi) Assessment of materiality of deviations for all quantifiable deviations based on data and non-quantifiable deviations based on expert judgment

(vii) Forwarding of the list of observations to Indian authorities

B. On-site assessment

(viii) Discussion of individual observations with Indian authorities

(ix) Meeting with selected Indian banks, accounting firms and a credit ratings agency

(x) Discussion with Indian authorities and revision of findings to reflect additional information received

(xi) Assignment of component grades and overall grade

(xii) Submission of the detailed findings to Indian authorities with grades

(xiii) Receipt of comments on the detailed findings from Indian authorities

C. Review and finalisation of the RCAP report

(xiv) Review of comments by the RCAP Assessment Team, finalisation of the draft report and forwarding to Indian authorities for comments

(xv) Review of Indian authorities' comments by the RCAP Assessment Team

(xvi) Review of the draft report by the RCAP Review Team

(xvii) Review of the draft report by the Peer Review Board

(xviii) Reporting of findings to SIG by the team leader

Annex 6: List of rectifications by Indian authorities

The following amendments were published on 31 March 2015 and available at RBI's website (www.rbi.org.in).

Basel Paragraph	Reference to Indian document and paragraph	Brief description of the correction
Calculation of minimum capital requirements and transitional arrangements		
Basel II paragraph 44	TSA/ASA Guidelines – paragraph 3; AMA Guidelines – paragraph 0.7; IMA Guidelines – paragraph 15.1; and Master Circular – Basel III Capital Regulations – paragraphs 8.7 and 9.3	The RBI guidelines required the application of an 11.1 multiplier in the calculation of RWAs for market risk and operational risk (corresponding to a higher minimum total capital requirement of 9%), instead of the 12.5 multiplier prescribed under the Basel standards. Following discussions with the Assessment Team, the RBI amended the relevant parts of its guidelines by changing the multiplier for market risk and operational risk from 11.1 to 12.5.
Basel II paragraph 45–49	IRB Guidelines – paragraph 32; and AMA Guidelines – paragraph 6	The RBI guidelines deviated from the Basel II transitional arrangements in two areas: (i) the RBI guidelines did not explicitly address the differences in the treatment of provisions under the standardised and IRB approaches to credit risk in the calculation of the IRB capital floor; and (ii) the capital floor for AMA was applied for two years and not on an ongoing basis as required under the Basel standards. The amended RBI guidelines address the differences in the treatment of provisions under the standardised and IRB approaches to credit risk; and clarify that pending revisions to the capital floor framework by the Basel Committee, the AMA floor will continue to apply on a permanent basis.
Basel III paragraph 95	Master Circular – Basel III Capital Regulations – paragraph 4.5.5	The RBI guidelines did not restrict the phase-out of ineligible CET1 instruments to those issued by non–joint stock companies (ie the Basel provision on phase-out of ineligible CET1 instruments was applied more broadly to instruments issued by all scheduled commercial banks). The RBI advised that they have not allowed any ineligible CET1 instruments to be phased out. The RBI amended its guidelines, which now provide that capital instruments which do not meet the criteria for inclusion in CET1 will be excluded from CET1 as on 1 April 2013.
Definition of Capital		
Basel III paragraph 67–68	Master Circular on Basel III Capital Regulations – paragraph 4.4.4(ii)	For clarity, the RBI amended the wording in paragraph 4.4.1(ii) of its guidelines from "operating losses in the current period and those brought forward from previous periods should also be deducted from CET1" to "losses in the current period and those brought forward from previous periods should also be deducted from CET1, if not already deducted".
Basel III paragraph 69	Master Circular on Basel III Capital Regulations – paragraph 4.4.2	The RBI guidelines did not include the Basel provision that the deferred tax liabilities (DTLs) permitted to be netted against deferred tax assets (DTAs) under paragraph 69 must exclude amounts that have been netted against the deduction of goodwill, intangibles and defined benefit pension assets. The RBI amended paragraph 4.4.2 of its guidelines to align it with the Basel requirement.

Basel III paragraphs 84–89	Master Circular on Basel III Capital Regulations – paragraphs 3.3.2 and 4.4	The RBI guidelines did not explicitly include the deductions relating to insurance subsidiaries as part of the regulatory adjustments/deductions set out in paragraph 4.4 (although these deductions were captured in the scope of application section of the guidelines (paragraph 3.3.2)). The RBI amended Figure 1 in paragraph 4.4.9 of its guidelines, which now explicitly states that equity investments in insurance subsidiaries will be fully deducted from banks' Common Equity.
Basel III paragraph 90	Master Circular on Basel III Capital Regulations – paragraphs 3.3.2, 4.4 and 5.13.6	The RBI guidelines did not explicitly include the deductions relating to non-financial subsidiaries as part of the regulatory adjustments/deductions set out in paragraph 4.4 (although these deductions were captured in the scope of application section of the guidelines (paragraph 3.3.2)). The RBI amended its guidelines by inserting a new subparagraph 4.4.10, which states that equity investments in non-financial subsidiaries should be fully deducted from the consolidated and solo CET1 capital of the bank respectively, after making all other regulatory adjustments. Under the RBI guidelines (paragraph 5.13.6), significant equity investments (investments more than 10% of investee entity's common shares but up to 50%) in non-financial entities were risk-weighted at 1111% (which corresponded to the minimum Total capital requirement of 9%). Similarly, the other items listed in Basel III paragraph 90 were risk-weighted at 1111% as opposed to 1250% under Basel III. Following discussions with the Assessment Team, the RBI amended the relevant parts of its guidelines by changing the risk weights from 1111% to 1250%.
Capital buffers (conservation and countercyclical)		
Basel III paragraph 129	Master Circular on Basel III Capital Regulations – paragraph 15.2.1	For clarity, the RBI replaced the following wording in paragraph 15.2.1, "Banks should not distribute capital (ie pay dividends or bonuses in any form) in case capital level falls within this range" with "Capital distribution constraints will be imposed when capital levels fall within this range".
Basel III paragraph 142	RBI Guidelines on Countercyclical Capital Buffer, Annex – paragraph 2	The RBI guidelines stated that the CCCB may be maintained in the form of CET1 or other fully loss-absorbing capital only (although Table 1 in the guidelines restricted the recognition to CET1 instruments).The Assessment Team considered this to be sub-equivalent to the Basel standard, which does not currently allow the use of other fully loss-absorbing capital to meet the CCCB requirement. The RBI amended its guidelines by removing the wording "or other fully loss-absorbing capital" from paragraph 2 of the Annex to the CCCB guidelines.
Basel III paragraphs 143–145	RBI Guidelines on Countercyclical Capital Buffer, Annex – paragraph 9	The RBI guidelines required banks to maintain adequate CCCB capital based on the geographic location of the bank's total RWAs instead of basing it on the geographic location of the bank's private sector credit exposures as required under the Basel Framework. That is, the weighting applied to the buffer in place in each jurisdiction was calculated with reference to total RWAs instead of the total credit risk charge relating to private sector credit exposures. The Assessment Team considered that this deviation would have a material impact in case a bank reports a substantial difference in RWAs for private sector credit exposures and total RWAs for some jurisdictions but not all. In such situation, the use of total RWAs would result in a different weighting scheme compared with using RWAs for private sector credit exposures. The larger the difference, the larger the effect on the weighting scheme and the resulting bank-specific countercyclical buffer requirement. Note that the effect can go both ways. That is, the weighting scheme based on total RWAs can be less or more conservative than the weighting scheme based on RWAs for private sector credit exposures depending also on the size of the foreign countercyclical capital buffer. Following discussions with the Assessment Team, the RBI amended its CCCB guidelines to align them with the Basel standards (ie the basis for calculating the bank-specific CCCB requirement was changed from total RWAs to RWAs for private sector credit exposures).

Basel III paragraph 149	RBI Guidelines on Countercyclical Capital Buffer, Annex – paragraph 11	The RBI guidelines required disclosure of the geographic breakdown of banks' total RWAs, consistent with the RBI's adoption of total RWAs as the basis for calculating the bank-specific CCCB requirement. The amended RBI guidelines require banks to disclose the geographic breakdown of their private sector credit exposures used in the calculation of the buffer requirements, which is in line with the Basel standards.
Credit risk: Standardised Approach		
Basel II 88 and Annex 3 para 8	Master Circular on Basel III Capital Regulations, paragraph 5.15.4 and IRB Guidelines, Appendix 7, paragraph 5(v)	The RBI has increased the risk weight for non-DvP transactions that are five business days or more overdue from 1111% to 1250%.
Basel II paragraph 54	Master Circular on Basel III Capital Regulations, paragraph 5.2	Claims on domestic sovereign to attract 0% risk weight only if exposures are denominated in Indian rupees and also funded in Indian rupees.
Basel II paragraph 70	Master Circular on Basel III Capital Regulations, paragraph 5.9	The definition of small business explicitly provided to align it with Basel rules.
Basel II: requirements of 1250% risk weight for certain exposures	Master Circular on Basel III Capital Regulations, different paragraphs in different guidelines	Basel rules require 1250% (reciprocal of 8%) for certain high risk exposures. For all such exposures, risk weight revised to 1250% from existing 1111%.
Basel II paragraph 188(c)	Master Circular on Basel III Capital Regulations, paragraph 7.4(d)	A new requirement for monitoring and controlling roll off risks has been added in the conditions for using loans and deposits.
Credit risk: IRB		
Basel II Paragraph 234	IRB Guidelines, paragraphs 132 and 138	The RBI has implemented a separate maximum exposure level of INR 50 lakh for inclusion as Qualifying Revolving Retail Exposures (QRRE). Previously QRRE were subject to the same (higher) maximum limit (INR 5 crore) as other retail exposures.
Basel II paragraphs 256 and 262	IRB Guidelines, paragraph 25	The RBI has excluded exposures to CCPs arising from OTC derivatives, exchange traded derivatives transactions and SFTs from the scope of the IRB approach and the IRB coverage calculations.
Basel II paragraph 272 as amended by Basel III	IRB Guidelines, paragraph 115	The RBI has introduced a 1.25 AVC multiplier for exposures to large or unregulated financial institutions.
Basel II paragraph 307	IRB Guidelines, paragraph 126	The RBI has added two additional standards to its operational requirements for the use of the double default framework for guarantees and credit derivatives. These are: to the extent possible for a bank to take steps to satisfy itself that the protection provider is willing to pay promptly if a credit event should occur; and for the seller of purchased receivables not to be a member of the same group as the protection provider in the case of protection against dilution risk.
Basel II paragraph 338	IRB Guidelines, paragraph 147	The RBI now requires the use of the Standardised Approach instead of internal assessments of credit equivalent amounts for foreign exchange and interest rate commitments within a bank's retail portfolio.

Basel II paragraph 354	IRB Guidelines, paragraph 171	The RBI has increased the maximum risk weight for equity exposures using the PD/LGD approach from 1111% to 1250%.
Paragraph 386	IRB Guidelines, paragraph 203	The RBI has increased the risk weight for EL amounts for equity exposures using the PD/LGD approach from 1111% to 1250%.
Basel II paragraph 402	IRB Guidelines, Appendix 1, paragraph 14	The RBI has clarified how banks should use the risk drivers listed in their guidelines in determining segmentation of retail exposures; namely that banks should consider the risk drivers mentioned, along with other relevant risk drivers, and base the segmentation into pools, for each rating system, on those drivers that provide a high degree of risk differentiation for the exposures covered by that rating system.
Basel II paragraph 410	IRB Guidelines, Appendix 1, paragraph 21	The RBI has clarified that the detailed standards on rating criteria set out in its guidelines, and which cover the content of Basel paragraph 410, are an eligibility requirement which must be included in a bank's internal rating policy.
Basel II paragraph 415	IRB Guidelines, Appendix 1, paragraph 26	The RBI has added a requirement that PD estimates for borrowers that are highly leveraged or for borrowers whose assets are predominantly traded assets must reflect the performance of the underlying assets based on periods of stressed volatilities.
Basel II paragraph 423	IRB Guidelines, Appendix 1, paragraph 45	The RBI has added a requirement that a bank's policies must include a process for identification of specific wrong way risk; and for the EAD for counterparty credit risk to be calculated differently where this risk has been identified.
Basel II paragraph 470	IRB Guidelines, paragraph 70	The RBI has added a requirement that, where a bank is using own estimates of loss given default and these take into account the existence of collateral, the bank must establish internal requirements for collateral management, operational procedures, legal certainty and risk management process that are generally consistent with those required for the standardised approach's
Basel II paragraph 521	IRB Guidelines, Appendix 3, paragraph 9	As regards the recognition of other physical collateral under the Foundation IRB approach, the RBI has removed a provision which allowed recognition of collateral subject to a Board-approved policy of regular collateral valuation with qualified professionals as an alternative to the existence of well established, publicly available market prices.
Basel II paragraph 525	IRB Guidelines, Appendix 3, paragraph 1079	The RBI has removed a provision that allowed banks using the internal models approach for equity exposures to use the PD/LGD approach for equity exposures as an alternative if they ceased complying with the requirements for the internal models approach. Banks may now only use the simple risk weight approach in these circumstances.
Credit risk: Securitisation Framework		
Basel II paragraph 554	Guidelines on Securitisation of Standard Assets, paragraph 7.16	The RBI has added an additional standard to its operational requirements for traditional securitisations not to require capital: that the securitisation transaction should not contain clauses that increase the yield payable to parties other than the originating bank, such as investors and third-party providers of credit enhancements, in response to a deterioration in the credit quality of the underlying pool.
Basel II paragraph 567	Master Circular on Basel III Capital Regulations, paragraphs 5.16.2, 5.16.5 and 5.16.9	The RBI has increased the risk weight under the standardised approach for resecuritisation exposures rated between BBB+ and BBB– from 200% to 225%. The RBI has also increased the risk weight under the standardised approach for securitisation exposures with a long-term rating below BB–, or a short-term rating below A-3/P-3, or which are unrated, from 1111% to 1250%.
Basel II paragraph 570	Master Circular on Basel III Capital Regulations, paragraph 5.16.2	The RBI has increased the risk weight under the standardised approach for exposures held by an originator that has a long-term rating below BBB–, or which is unrated, from 1111% to 1250%.
Basel II paragraph 578	Guidelines on	The RBI has added an additional standard to its requirements for off-balance sheet securitisation exposures to be treated as

	Securitisation of Standard Assets, paragraph 14.10	eligible liquidity facilities: that if the exposures that the facility is required to fund are externally rated securities, it can only be used to fund securities that are externally rated investment grade at the time of funding.
Basel II paragraph 586	Master Circular on Basel III Capital Regulations, paragraph 7.5.6	The RBI has clarified that SPEs cannot be recognised as eligible guarantors in respect of credit mitigation for securitisation exposures.
Basel II paragraph 609	IRB Guidelines, paragraph 212	The RBI has increased the risk weight under IRB for securitisation exposures, to which none of the various prescribed IRB approaches can be applied, from 1111% to 1250%.
Basel II paragraphs 615–616	IRB Guidelines, paragraph 215	The RBI has increased the risk weight for securitisation exposures under the IRB Ratings Based Approach, which have a long-term rating below BB–, a short-term rating below A-3/P-3 or which are unrated, from 1111% to 1250%.
Basel II paragraph 639	IRB Guidelines, paragraph 235	The RBI has increased the risk weight under IRB for liquidity facilities that are securitisation exposures, but to which none of the various prescribed IRB approaches can be applied, from 1111% to 1250%.
Market risk		
Basel II paragraph 718(Lxxvi)	Prudential Guidelines on Capital Adequacy – Implementation of Internal Models Approach for Market Risk, paragraph 9.8.	The RBI has specified that banks must update their data sets no less frequently than once every month and should also reassess them whenever market prices are subject to material changes.
Pillar 3		
Table 4 – Credit risk: general disclosure for all banks: Quantitative Disclosures	Circular DBR.No.BP.BC 80/21.06.201/2014–15 dated March 31 2015, Part A, Annex to the Master Circular on Basel III Capital Regulations – Table DF-3, paragraphs j, n and o	The RBI included quantitative disclosures in terms of credit risk which relates to disclosure by major industry or counterparty type, amount of impaired loans and past due loans broken down by significant geographic areas and reconciliation of changes in the allowances for loan impairment.
Table 9 – Securitisation: disclosure for standardised and IRB approaches: Qualitative and Quantitative Disclosures	Circular DBR.No.BP.BC 80/21.06.201/2014-15 dated March 31 2015, Part B Section 1, Annex to Implementation of the Internal Ratings-Based (IRB) Approaches for Calculation of Capital Charge for Credit Risk – Table 5 of Appendix 11 of IRB guidelines	A footnote was added in Table 5 of Appendix 11, indicating that for banks eligible to adopt IRB approach, Table 5 disclosures are in addition to the disclosures applicable to banks using the Standardised Approach.
Table 13 – Equities: disclosures for	Circular DBR.No.BP.BC	The RBI included a new table in Annex 18 to cover the qualitative and quantitative disclosures regarding equity disclosures for

banking book positions: Qualitative and Quantitative Disclosures	80/21.06.201/2014-15 dated March 31 2015, Part A, Annex to the Master Circular on Basel III Capital Regulations – Table DF-15	banking positions.
BCBS197 Pillar 3 disclosure requirements for remuneration paragraph 11 – Key disclosures	Circular DBR.No.BP.BC 80/21.06.201/2014-15 dated March 31 2015, Part C Section 3, Annex to Guidelines on Compensation of Whole Time Directors/Chief Executive Officers/Risk-takers and Control function staff etc – paragraph B(3) and paragraph B(3) – Appendix 2	The following wording was added by the RBI: "Banks are strongly encouraged not only to disclose the required information, but to articulate as far as possible how these factors complement and support their overall risk management framework." In addition, information as contained in the bullet points as part of the quantitative disclosures was similarly included.

Annex 7: Assessment of bindingness of regulatory documents

The following table summarises the assessment of the seven criteria used in the assessment to determine the eligibility of Indian regulatory documents.

Criterion	Assessment
(1) The instruments used are part of a well defined, clear and transparent hierarchy of legal and regulatory framework.	Yes. The Reserve Bank of India (RBI) is an autonomous body created under the Reserve Bank of India Act 1934. It is entrusted, inter alia, with the responsibility for the regulation and supervision of banks under the Banking Regulation Act 1949. The Banking Regulation Act (BR Act) provides the basic prudential framework including licensing, business activity, capital, liquidity management, governance, penal provisions, winding up and liquidation of non-viable banks. The RBI is also vested with broad powers under Sections 35A and 36 of the BR Act to issue guidelines to banking companies in general or to any banking company in particular on any issue relating to the functioning of banks if it is satisfied that these are required. The RBI has laid out mandatory prudential guidelines and norms for sound management of banks, liquidity management, capital adequacy, income recognition, asset classification and provisioning, connected lending, large exposures, securitisation, derivatives and risk management. The powers in the BR Act ensure the RBI can enforce compliance with the provisions of the Act. The guidelines issued by RBI to banks are thus based on clear legal authority provided to RBI by the Banking Regulation Act, 1949. All directions/guidelines/circulars issued by the RBI are legal inasmuch they have been issued by the RBI under the statutory powers vested in it by the BR Act, in the public interest, to safeguard depositors' interest and the stability of individual banks and the banking system of the country.
(2) They are public and easily accessible	Yes. Guidelines issued by RBI are available on the RBI website and can be accessed by anybody. Links to guidelines reviewed by RCAP team are provided in Annex 4.
(3) They are properly communicated and viewed as binding by banks as well as by the supervisors.	Yes. As stated earlier prudential guidelines issued to banks by RBI are based on power vested in it by the BR Act and thus are viewed as binding by all concerned.
(4) They would generally be expected to be legally upheld if challenged and are supported by precedent.	Yes. As stated earlier, prudential guidelines issued to banks by the RBI are based on the authority provided by the BR Act and thus have been upheld by the courts on numerous occasions.
(5) Consequences of failure to comply are properly understood and carry the same practical effect as for the primary law or regulation.	Yes. Section 27 of the BR Act authorises RBI to obtain information from banking companies, and Sections 35 and 22 empower the RBI to access the records/staff of banking companies, and provide for appropriate access on the part of the RBI to information in order to review compliance with internal rules and limits, as well as with external laws and regulations. More specifically, Section 35(2) of the BR Act gives the RBI access to every director, office or employee of a banking company and requires these persons to provide the RBI with any statements or information the RBI examiners may require. The RBI has also the power under Section 35A of the BR Act to issue directives to banking companies. The BR Act in Sections 46 and 47 authorises the RBI to take action against banking companies that fail to comply with the provisions of the BR Act, including the

		imposition of monetary penalties and the potential for criminal liability. Section 22(4) authorises the RBI to cancel the license of a banking company. RBI has, therefore, enough legal powers to ensure compliance with its guidelines. RBI thus has enough powers to ensure compliance with the prudential framework issued by RBI.
(6)	The regulatory provisions are expressed in clear language that complies with the Basel provisions in both substance and spirit.	Yes.
(7)	The substance of the instrument is expected to remain in force for the foreseeable future	Generally, yes. However, RBI's rules and regulations are modified/changed depending on changes made in international standards and also due to the needs of the situation.

Annex 8: Key financial indicators of Indian banking system

Overview of Indian banking sector as of September 2014 — Table 8

Size of banking sector (INR billions)	
Total assets all banks operating in the jurisdiction (including off-balance sheet assets)	117,621
Total assets of all locally incorporated internationally active banks	34,905
Total assets of locally incorporated banks to which capital standards under Basel framework are applied (ie excludes foreign bank branches)	106,307
	Number of banks
Number of banks operating in India	90
Number of internationally active banks	4
Number of banks required to implement Basel standards (according to domestic rules)	90
Number of Global Systemically Important Banks (G-SIBs)	No Indian-headquartered bank has been designated as a G-SIB; however, many of the G-SIBs have a presence in India in the form of branches.
Capital standards under the Basel framework	
Number of banks required to implement Basel equivalent standards	90
Use of advanced approaches by banks	0
Capital adequacy (internationally active banks) (INR billions; percent)	
Total capital	3,062
Total Tier 1 capital	2,309
Total CET1 capital	2,247
Total risk-weighted assets	23,470
RWAs for credit risk (percent of total RWAs)	86.2%
RWAs for market risk (percent of total RWAs)	6.0%
RWAs for operational risk (percent of total RWAs)	7.8%
Total off-balance sheet bank assets[5]	6,094
Capital Adequacy Ratio (weighted average)	13.0%
Tier 1 Ratio (weighted average)	9.7%
CET1 Ratio (weighted average)	9.3%

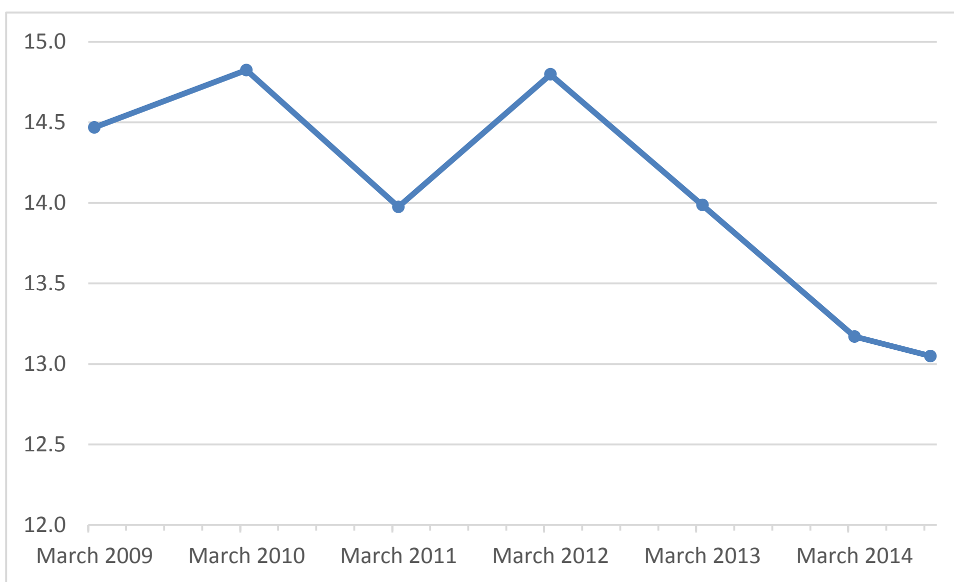
Source: RBI.

[5] Includes derivatives at fair value and the credit equivalent amount of non-market-related off-balance sheet exposures.

The average capital adequacy ratio of Indian banks has trended downwards in the past few years primarily due to an increase in non-performing assets held by banks. India implemented Basel III regulations with effect from 1 April 2013, which has further increased the capital requirements of banks and has led to the phase-out of non-Basel III compliant capital instruments issued before 2013. The increase in non-performing assets is related to a reduction in GDP growth. As GDP growth is projected to increase over the coming period, the problem of non-performing assets in the banking system is expected to ease, leading to higher profitability and higher capital ratios.

Evolution of capital ratios of Indian internationally active banks

Weighted average, in percent — Figure 1

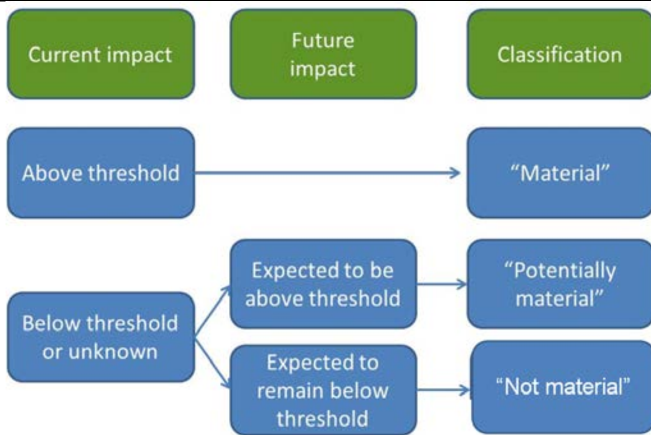


Source: RBI.

Annex 9: Materiality assessment

The assessment of materiality distinguished between quantifiable and non-quantifiable gaps. For the Indian RCAP, an attempt was made to quantify the impact of all quantifiable gaps for each bank in the sample affected by the gap. In total, seven gaps/differences were assessed based on bank data and data available to Indian authorities. In cases where the computation of the impact was not straightforward, the computation erred on the conservative side. Where no data were available to quantify gaps, the review team relied on expert judgment. Following this approach, an attempt was made to determine whether gaps are "not material", "material" or "potentially material".

Classification of quantifiable gaps — Figure 2



Number of gaps/differences by component — Table 9

Component	Non-material	Material	Potentially material
Scope of application	0	0	0
Transitional arrangements	0	0	0
Definition of capital	3	0	0
Capital buffers	0	0	0
Pillar 1			
Minimum capital requirements (general)	0	0	0
CR: Standardised Approach	5	0	0
CR: IRB	9	0	0
CR: Securitisation	3	0	0
Counterparty credit risk	1	0	0
MR: Standardised Approach	0	0	0
MR: Internal Models	1	0	0
OR: SA/BIA	0	0	0
OR: AMA	0	0	0
Pillar 2	0	0	0
Pillar 3	0	0	0

Note: materiality is defined based on quantitative benchmark thresholds (for the quantifiable gaps) and expert judgment (for the non-quantifiable gaps). See Section 2 with the detailed assessment findings for further information.

RCAP sample of banks

The following Indian commercial banks were selected for materiality testing of the quantifiable deviations. Together these banks represent approx. 60% of the total assets of the Indian banking system (March 2014). Given the structure of the Indian banking system and its low concentration rate, it was agreed that, for individual data requests, RBI would select eight to 10 banks from the 15 banks in the sample to provide data for materiality testing purposes. The selection was based on the nature of the issue and included those banks where the issue was most relevant given their exposures or business model.

1. State Bank of India
2. Punjab National Bank
3. ICICI Bank Ltd.
4. HDFC Bank Ltd.
5. Canara Bank
6. Bank of Baroda
7. Bank of India
8. Axis Bank Ltd.
9. Union Bank of India
10. IDBI Bank Limited
11. Central Bank of India
12. Indian Overseas Bank
13. Corporation Bank
14. Oriental Bank of Commerce
15. Syndicate Bank

Annex 10: Areas where Indian rules are stricter than the Basel standards

In several places, the Indian authorities have adopted a stricter approach than the minimum standards prescribed by Basel or has simplified or generalised an approach in a way that does not necessarily result in stricter requirements under all circumstances but never results in less rigorous requirements than the Basel standards. The following list provides an overview of these areas. It should be noted that these areas have not been taken into account as mitigants for the overall assessment of compliance.

Scope of application

1. Basel II paragraphs 20–23: While the Basel framework requires the application of capital standards to internationally active banks, India has made it applicable to all scheduled commercial banks. This ensures that all such banks are subject to the same standards and prevents any potential build-up of risk in these banks and the banking system.
2. Basel III paragraph 50: India has prescribed an additional 1% capital requirement on Indian banks on each of the component of the Basel minima capital. Indian banks are required to hold 5.5% Common Equity Tier 1, 7.0% Tier 1 capital and 9.0% total capital by March 2019. The higher minimum requirements will be phased in during the transitional period up to March 2019.

Definition of capital

1. Basel III paragraph 69: India has prescribed full deduction of Deferred Tax Assets (DTAs) from CET1 even where these DTAs relate to temporary differences (eg allowance for credit losses).
2. Basel III paragraphs 84–87: All equity and other regulatory capital investments in the insurance subsidiaries are fully deducted from consolidated regulatory capital following corresponding deduction approach, instead of threshold deduction in terms of Basel III.

Credit Risk – Standardised Approach

1. Basel II paragraph 58: PSEs in India are treated on a par with corporates in terms of the risk weights instead of treating the former on a par with bank or sovereigns according to the national discretion given in the Basel framework.
2. Basel II paragraph 59: MDBs are assigned a 20% risk weight in India in comparison with a possible 0% risk weight based on certain conditions.
3. Basel II paragraph 66: Claims on corporates rated AA and BB are treated more conservatively in India as risk weights applicable to these entities are greater than the risk weights prescribed for these entities under the Basel framework.
4. Basel II paragraphs 69 and 81: Consumer credit loans including personal loans and credit card receivables have been assigned a minimum of 125% risk weight as compared with 75% in the Basel II framework. Also, high-risk areas such as venture capital funds have been assigned a risk

weight of 150% as compared with the 100% risk weight prescribed in the Basel framework for "Other assets".

5. Basel II paragraph 72: In the case of individual housing loans secured by residential property, the risk weights in India vary from 50% to 75% depending upon the amount of loan and LTV ratio. This is more conservative in relation to the 35% risk weight prescribed in Basel framework for claims fully secured by mortgages on residential property.

Credit Risk – Internal Ratings-Based Approach

1. Basel II paragraph 266: As per the RBI prescription, the floor of LGD for retail exposures secured by residential properties has been set at 20% as against an applicable floor of 10% according to Basel norms.
2. Basel II paragraphs 287 and 295: The RBI prescription for FIRB LGD is more conservative than the prescription of Basel framework in case of both senior unsecured and different types of collateralised exposures.
3. Basel II paragraph 455: As per the RBI prescription, if 50% of the exposures to a retail borrower are in default, all exposures to that borrower are to be treated as defaulted. This is more conservative than the Basel prescription, which states that for retail definition of default may be applied at the facility level.

Securitisation framework

1. Basel II paragraph 552: As per Basel Guidelines (paragraph 552), the underlying assets can be sold to the SPV/SPE in exchange for cash or other assets funded by debt issued by the trust. However, in India, the assets can be sold only on cash basis, in order to fulfil the true sale criteria (in terms of paragraphs 5(vii) and 7.7 of the February 2006 Guidelines).
2. Basel II paragraph 567: The RBI has prescribed 30% risk weight for exposures rated AA whereas Basel requires only 20%.
3. Basel II paragraph 580: The RBI has not allowed the preferential treatment/0% CCF for the liquidity facilities that are available only in the event of a general market disruption. All liquidity facilities will attract a CCF of 100% in India.
4. Basel II paragraph 581: The RBI has prescribed 100% CCF for both credit enhancement and liquidity facility. As such, the RBI rule is more stringent. Further, the RBI has not allowed the benefit of excluding overlapping portion from capital requirement.
5. Basel II paragraph 582: The RBI has not allowed the concession/0% CCF for undrawn servicer cash advances or facilities that are unconditionally cancellable without prior notice, under the SA. The RBI has allowed it for IRB banks only.

Operational risk

1. Basel II paragraph 46: While Basel provides for prudential floors of 90% and 80% for the first and second year consecutively for AMA banks, the RBI has prescribed higher prudential floors

of 95% and 90% respectively for the first year and for the second year of implementation of the AMA approach and each year thereafter.

2. Basel II paragraph 673: Basel has prescribed that banks must have an appropriate de minimis gross loss threshold for internal loss data collection of, for example EUR 10,000. The RBI has stipulated that banks should establish one or more appropriate de minimis gross loss thresholds across business lines or loss event types, for the collection of the internal loss data such that no bank will fix a threshold above INR 50,000 for any of the business classes or loss event types.

Counterparty credit risk

1. Basel II paragraph 92(i) of Annex 4: Under the Current Exposure Method, Credit Conversion Factors (CCFs) prescribed are generally double those prescribed in the Basel rules.

Market risk – Standardised Measurement Method

1. Basel II paragraph 683(iii): There is no requirement to exclude structural foreign exchange positions from the trading book.
2. Basel II paragraph 689 (ii): There is no dealer exception for holdings in the trading book of the capital instruments of other banks, securities firms and other financial entities.
3. Basel II paragraph 710: Specific risk capital requirements – Specific risk capital charge for corporate bonds/securitisation positions are higher than prescribed in Basel II. For example, for an AAA-rated securitisation position, RBI prescribes a capital charge of 1.8% while the Basel II requirement is 1.6%.
4. Basel II paragraph 718 (xx): Equity Position Risk – Capital requirements are much more stringent than under the Basel framework:

	Basel	RBI guidelines
General market risk	8%	9%
Specific risk	8%	11.25%

5. Basel II paragraph 718 (xLi): Capital for foreign exchange risk positions – Capital requirements are much more stringent than under the Basel framework. Basel II requires a capital charge of 8% for forex risk positions while the RBI's requirement is 9%.

Annex 11: List of approaches not allowed by Indian regulatory framework

The following list provides an overview of approaches that Indian authorities have not made available to its banks through its regulatory framework. Where the Basel standards explicitly request certain approaches to be implemented under specific circumstances, the missing approaches have been taken into account in the assessment. However, where the Basel standards do not require jurisdictions to implement these approaches, they have been implicitly treated as "not applicable" for the assessment.

1. Credit risk: Internal Ratings-Based Approach
2. Securitisation framework: Internal Assessment Approach
3. Operational risk: Alternative Standardised Approach
4. Counterparty credit risk: Standardised Method and Internal Models Method for calculating EEPE and the advanced approach for the CVA capital charge
5. Market risk: Internal Models Approach: the Incremental Risk Charge

Annex 12: List of issues for follow-up RCAP assessments

The Assessment Team identified the following issues listed below for follow-up and for future RCAP assessments of India:

Credit risk: Standardised Approach

The materiality assessment indicated that the following identified deviations for Credit Risk Standardised Approach are not material at present. However, the team recommends a follow-up assessment to ascertain that the deviations do not assume materiality in the future. For more information on the identified deviations, see the detailed assessment findings in Chapter 2 of this report.

- Paragraph 74: lower risk weight for claims secured by commercial real estate;
- Paragraphs 69–73: lower risk weight for loans and advances to banks' own staff;
- Paragraph 136: treatment of insurance policies; and
- Paragraphs 145–146: the qualification of life insurance policies as eligible collateral.

IRB approach

- To re-assess whether there has been any change in the scope of acceptable sellers of credit protection under the double default framework to parties not included in the Basel framework, against the background of the RBI having explicitly reserved discretion to extend it beyond their present coverage of banks and primary dealers.
- More generally, given that no banks are currently using IRB in India, a follow-up analysis could usefully measure the impact of the various deviations identified to confirm the present assessment, based on expert judgment, that these are not material.

Annex 13: Areas for further guidance from the Basel Committee

The Assessment Team identified the following areas where further guidance is required from the Basel Committee. Additional detail is provided in Section 1.4 of the report.

Definition of capital

Under Basel III paragraph 55, Additional Tier 1 capital instruments classified as liabilities for accounting purposes must have principal loss absorption (through either conversion into common shares or write-down) at a pre-specified trigger point. The Basel III Definition of Capital FAQ 16 (paragraphs 54–56) sets a minimum trigger level of 5.125% CET1. While the Basel-prescribed minimum trigger level of 5.125% is higher than the Basel minimum CET1 requirement of 4.5%, it is not clear from FAQ 16 whether or not there is any interlinkage between the minimum CET1 requirement and the minimum loss absorption trigger level.

The question on interlinkage between the two minima noted above becomes relevant where a jurisdiction applies a higher minimum CET1 requirement than the Basel minimum. This issue was noted during the RCAP assessment of India. The RBI applies a minimum CET1 requirement of 5.5%. Under the RBI guidelines, Additional Tier 1 capital instruments classified as liabilities and issued before 31 March 2019 will be subject to two pre-specified loss absorption trigger levels – 5.5% CET1 before 31 March 2019 and 6.125% CET1 from 31 March 2019. During the period from 31 March 2015 to 30 March 2019, the RBI specified trigger level of 5.5% will be equal to the minimum CET1 capital requirement of 5.5%.

The Assessment Team is of the view that the Basel requirements on loss absorption trigger are intended to ensure that Additional Tier 1 capital instruments bear losses before the bank breaches its minimum capital requirement (as the minimum trigger level of 5.125% is set above the minimum CET1 requirement of 4.5%). India asserted that such an interlinkage between the two minima is not envisaged under the Basel standards as clarified by FAQs. Besides, there is no transitional arrangement provided for the pre-specified trigger. In the Assessment Team's view, the setting of a loss absorption trigger level equal to the minimum CET1 requirement goes against the spirit of the Basel standards. Nevertheless, the Assessment Team acknowledges that the Basel standards do not explicitly address this issue.

The Assessment Team assessed India's implementation of the loss absorption requirement as compliant with the Basel standards on the basis that it is a transitional matter only, and that from 31 March 2019 the trigger level of 6.125% will be set above the minimum CET1 requirement of 5.5%. However, the Assessment Team considers that the Basel standards would benefit from clarification of this issue as it would be more broadly relevant in all cases where jurisdictions apply higher CET1 requirements than the Basel minimum.

IRB approach

Basel II contains a distinct "top-down" treatment for purchased receivables in addition to the "bottom-up" approaches which represent the usual implementation of the IRB approach. The Assessment Team is satisfied that the RBI's guidelines are in line with the Basel II requirements as currently drafted. However, the team's review suggests that the Basel Committee may wish to consider whether the scope of this treatment and the qualifying conditions reflect the Committee's intentions. More specifically there are two issues on which the Committee may wish to reflect:

1. Whether the qualifying conditions in paragraphs 491–499 of the Basel text can be met by any types of exposure other than trade receivables; and
2. Whether and/or in what circumstances the purchased receivables approach can be used for loans purchased from other banks?

On the first issue, paragraph 241 of the Basel text says that, as regards corporate receivables, the top-down treatment is primarily intended for receivables that are purchased for inclusion in asset-backed securitisation structures, but banks may also use this approach for other exposures that "share the same features". However, the qualifying conditions, which apply to exposures in both the retail and corporate exposure classes, largely describe good practice procedures etc for dedicated businesses that provide finance for trade receivables with pools derived from this activity. It is hard to see how these conditions can be met by exposure types other than such trade receivables.

As regards the second issue, one of the concerns with the offering of a top-down approach was that banks might use it to avoid the detailed requirements of the bottom-up approach. If it can be used for loans purchased from other banks – which are, strictly speaking, both "receivables" and "purchased" – then the estimation for these exposures might have lower standards than those for loans originated directly by the bank. On the other hand, if the application of the purchased receivables approach is limited to exposures that meet the qualifying requirements of paragraphs 491–499, then it seems unlikely that loans purchased from other banks will be able to use the purchased receivables approach. This is because, as described in the previous paragraph, the qualifying requirements can likely be met only by trade receivables.

Annex 14: India's implementation of the Pillar 2 supervisory review process

The RBI has issued regulation and implemented Pillar 2 in India primarily as part of the overall supervisory framework governing commercial banks. The Pillar 2 process forms an integral part of capital adequacy framework.

The objective of the supervisory review process is to ensure that banks have adequate capital to support all the risks in their business and also to encourage them to develop better risk management techniques for monitoring and managing those risks. The RBI requires a well defined internal assessment process within banks by which the RBI can be assured that adequate capital is indeed held against the various risks to which they are exposed. The process of assurance could also involve an active dialogue between the bank and the RBI so that, when warranted, appropriate intervention could be made to reduce the risk exposure of the bank or augment/restore its capital. Thus, the Internal Capital Adequacy Assessment Process (ICAAP) is an important component of the supervisory review process.

Application of the four key principles of supervisory review

The RBI implements the four principles of the supervisory review in its supervisory framework as follows:

- Principle 1: Banks should have a process for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital levels.

The RBI requires that banks should have in place a process, ie an ICAAP, for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital levels in relation to their risk profile. Banks are required to submit an ICAAP document, a written record on the outcome of the ICAAP process, duly approved by the Board of respective banks annually. This record of the internal assessment of its capital adequacy should identify all the risks to which a bank is exposed, the manner in which those risks are monitored and managed, the impact of the bank's changing risk profile on the bank's capital position, details of stress tests/scenario analysis conducted and the resultant capital requirements. The reports shall be sufficiently detailed to allow the board of directors to evaluate the level and trend of material risk exposures, whether the bank maintains adequate capital against the risk exposures and, in the case of additional capital being needed, the plan for augmenting capital. The board of directors is expected to make timely adjustments to the strategic plan, as necessary.

- Principle 2: Supervisors should review and evaluate banks' internal capital adequacy assessments and strategies, as well as their ability to monitor and ensure their compliance with the regulatory capital ratios. Supervisors should take appropriate supervisory action if they are not satisfied with the result of this process.

The RBI subjects all commercial banks to a Supervisory Review and Evaluation Process (SREP). The SREP of banks supervised under the CAMELS approach is generally conducted along with the RBI's Annual Financial Inspection (AFI) of banks.[6] Banks currently supervised under CAMELS are set to be

[6] The abbreviation CAMELS stands for (C)apital adequacy; (A)ssets; (M)anagement capability; (E)arnings; (L)iquidity and (S)ystems and control.

moved to the RBS framework. For banks under Risk-Based Supervision, SREP is subsumed in the supervisory process of risk/capital assessment. The assessment process comprises continuous off-site engagements followed by a risk-focused on-site Inspection for Supervisory Evaluation (ISE). The supervisory review involves an independent evaluation of a bank's ICAAP, the quality and results of a bank's ICAAP, supervisory assessment of the bank's risk management processes, control systems and other relevant information relating to the bank's risk profile and capital position. The RBI takes appropriate action if it is not satisfied with the results of this process and, if necessary, it takes appropriate prudential measures and other supervisory actions including requiring banks to increase their capital levels and/or to reduce their exposures in conjunction with enhancements in the risk management framework.

As a part of the Risk-Based Supervision framework, the Supervisory Program for Assessment of Risk and Capital (SPARC) has been designed to take into account a bank's unexpected losses from all material risks it faces, ie Pillar I and Pillar II. Simultaneously, as a part of the SPARC, the bank's capital is assessed to determine its adequacy as of the date of risk assessment. The risk assessment and the capital available are quantified by way of a proprietary model (the integrated risk and impact scoring model or IRISc). The model processes the assessed level of risk in conjunction with the assessed level of capital available on the assessment date. In the case of banks where the assessed capital available is determined to be insufficient for the assessed level of risk, a capital add-on requirement is given as an output of the IRISc model. However, the supervisory capital prescription takes into account the model output (of the capital add-on requirement) and also the assessments of ICAAP, capital planning, the bank's ability to infuse capital, and other qualitative assessments of capital.

In the first year of SPARC implementation (2013–14), appropriate supervisory measures were assessed and initiated. As in the case of AFI under the CAMELS approach, an additional capital requirement has so far not been imposed on any bank.

- Principle 3: Supervisors should expect banks to operate above the minimum regulatory capital ratios and should have the ability to require banks to hold capital in excess of the minimum.

Since the capital adequacy ratio prescribed by the RBI under the Pillar 1 is only the regulatory minimum level, addressing only the three specified risks (namely, credit, market and operational risks), the RBI requires banks to hold additional capital as might be necessary, on account of both the possibility of some under-estimation of risks under Pillar 1 and the actual risk exposure of a bank vis-à-vis the quality of its risk management architecture. The RBI has the power to require any bank to hold capital at a level higher than the minimum.

- Principle 4: Supervisors should seek to intervene at an early stage to prevent capital from falling below the minimum levels required to support the risk characteristics of a particular bank and should require rapid remedial action if capital is not maintained or restored.

The RBI monitors the capital position of the individual banks on an ongoing basis, through off-site supervisory returns received from banks. The off-site supervisory surveillance mechanism, in combination with market intelligence system, is used for the continuous monitoring and analysis of banks' performance and financial condition, including the tracking of the risk profiles and capital level of individual banks. The RBI's ongoing supervisory process involves formal and informal communications as well as discussions with bank managements to share any supervisory concerns. Besides, the RBI's PCA framework can require an action plan from a subject bank, should its capital level become a matter of concern. The RBI may also enhance its supervisory scrutiny of any particular bank and it may conduct more frequent on-site inspections and commission an external audit should the situation warrant. Besides, the RBI may also impose business restrictions on a particular bank, if this is considered necessary to restore its performance. The process has been enhanced under RBS, where a structured and continuous assessment through a designated team of supervisors for a bank has been put in place. This has enabled timely and effective supervisory intervention.