RBI/2005-06/177

DBOD. No. BP.BC. 38/21.04.141/2005-06

October 10, 2005

All Commercial Banks (excluding RRBs)

Dear Sir**,**

Capital Adequacy - Investment Fluctuation Reserve

To ensure smooth transition to Basel II norms, banks were advised vide our circular DBOD.No.BP.BC.103/ 21.04.151/ 2003-04 dated June 24, 2004 to maintain capital charge for market risk in a phased manner over a two year period, as under:

(i) In respect of securities included in the HFT category, open gold position limit, open foreign exchange position limit, trading positions in derivatives and derivatives entered into for hedging trading book exposures by March 31, 2005, and

(ii) In respect of securities included in the AFS category by March 31, 2006.

2. With a view to encourage banks for early compliance with the guidelines for maintenance of capital charge for market risks, it was advised vide our Circular No. DBOD. No. BP.BC. 85 / 21.04.141 / 2004-05 dated April 30, 2005 that banks which have maintained capital of at least 9 per cent of the risk weighted assets for both credit risk and market risks for <u>both</u> HFT (items as indicated at (i) above) and AFS category may treat the balance <u>in excess of</u> 5 per cent of securities included under HFT and AFS categories, in the IFR, as Tier I capital. Banks satisfying the above were allowed to transfer the amount in excess of the said 5 per cent in the IFR to Statutory Reserve.

3. It has now been decided that banks which have maintained capital of at least 9 per cent of the risk weighted assets for both credit risk and market risks for <u>both</u> HFT (items as indicated at (i) above) and AFS category as on March 31, 2006, would be permitted to treat the entire balance in the IFR as Tier I capital. For this purpose, banks may transfer the balance in the Investment Fluctuation Reserve 'below the line' in the Profit and Loss

Appropriation Account to Statutory Reserve, General Reserve or balance of Profit & Loss Account.

4. In the event, provisions created on account of depreciation in the 'Available for Sale' or 'Held for Trading' categories are found to be in excess of the required amount in any year, the excess should be credited to the Profit & Loss account and an equivalent amount (net of taxes, if any and net of transfer to Statutory Reserves as applicable to such excess provision) should be appropriated to an Investment Reserve Account in Schedule 2 – "Reserves & Surplus" under the head "Revenue and other Reserves" and would be eligible for inclusion under Tier II within the overall ceiling of 1.25 per cent of total Risk Weighted Assets prescribed for General Provisions/ Loss Reserves.

5. Please acknowledge receipt.

Yours faithfully,

(Anand Sinha)
Chief General Manager-in-Charge