To

All NBFCs (excluding RNBCs)

Dear Sir,

Revised Capital Adequacy Framework for Off-Balance Sheet Items for NBFCs- Clarification

Please refer to the Company Circular No.252 and Notifications No.237 and 238 all dated December 26, 2011 on the captioned subject.

2. In this connection, it is clarified that the Paragraph E in both the above Notifications (No.237 and 238) may be replaced with the following.

E. Credit conversion factors for Credit Default Swaps(CDS):

NBFCs are only permitted to buy credit protection to hedge their credit risk on corporate bonds they hold. The bonds may be held in current category or permanent category. The capital charge for these exposures will be as under:

(i) For corporate bonds held in current category and hedged by CDS where there is no mismatch between the CDS and the hedged bond, the credit protection will be permitted to be recognised to a maximum of 80% of the exposure hedged. Therefore, the NBFC will continue to maintain capital charge for the corporate bond to the extent of 20% of the applicable capital charge. This can be achieved by taking the exposure value at 20% of the market value of the bond and then multiplying that with the risk weight of the
issuing entity. In addition to this, the bought CDS position will attract a capital charge for counterparty risk which will be calculated by applying a credit conversion factor of 100 percent and a risk weight as applicable to the protection seller i.e. 20 per cent for banks and 100 per cent for others.

(ii) For corporate bonds held in permanent category and hedged by CDS where there is no mismatch between the CDS and the hedged bond, NBFCs can recognise full credit protection for the underlying asset and no capital will be required to be maintained thereon. The exposure will stand fully substituted by the exposure to the protection seller and attract risk weight as applicable to the protection seller i.e. 20 per cent for banks and 100 per cent for others.

3. The Notifications DNBS.PD.No.239/ CGM (US) 2011 and DNBS.PD.No. 240/CGM (US) 2011 both dated December 30, 2011 amending the Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 and the Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, (as amended vide Notifications.No.237 and No. 238 both dated December 26, 2011) are enclosed for meticulous compliance.

Yours sincerely,

(Uma Subramaniam)
Chief General Manager-in-Charge
Notification DNBS. PD.No.239 / CGM(US)-2011 dated December 30, 2011

The Reserve Bank of India, having considered it necessary in public interest and being satisfied that, for the purpose of enabling the Bank to regulate the credit system to the advantage of the country, it is necessary to amend the Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 (hereinafter referred to as the said Directions), contained in Notification No. DNBS. 192/DG(VL)-2007 dated February 22, 2007, in exercise of the powers conferred by section 45JA of the Reserve Bank of India Act, 1934 (2 of 1934) and of all the powers enabling it in this behalf, hereby directs that the said Directions shall be amended with immediate effect as follows, namely -

In paragraph 16(2), under Explanations (2), Para E viz;

“E Credit conversion factors for Credit Default Swaps (CDS)

A CDS creates a notional short position for specific risk in the reference asset/obligation for the protection buyer. This position will attract a Credit Conversion Factor of 100 and a risk weight of 100. The Add On factor may be fixed as 10 percent (of notional principal of CDS) in relation to potential future exposure”.

shall be replaced by the following

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(Uma Subramaniam)
Chief General Manager-in-Charge

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(ii) For corporate bonds held in permanent category and hedged by CDS where there is no mismatch between the CDS and the hedged bond, NBFCs can recognise full credit protection for the underlying asset and no capital will be required to be maintained thereon. The exposure will stand fully substituted by the exposure to the protection seller and attract risk weight as applicable to the protection seller i.e. 20 per cent for banks and 100 per cent for others.”

(Uma Subramaniam)
Chief General Manager-in-Charge