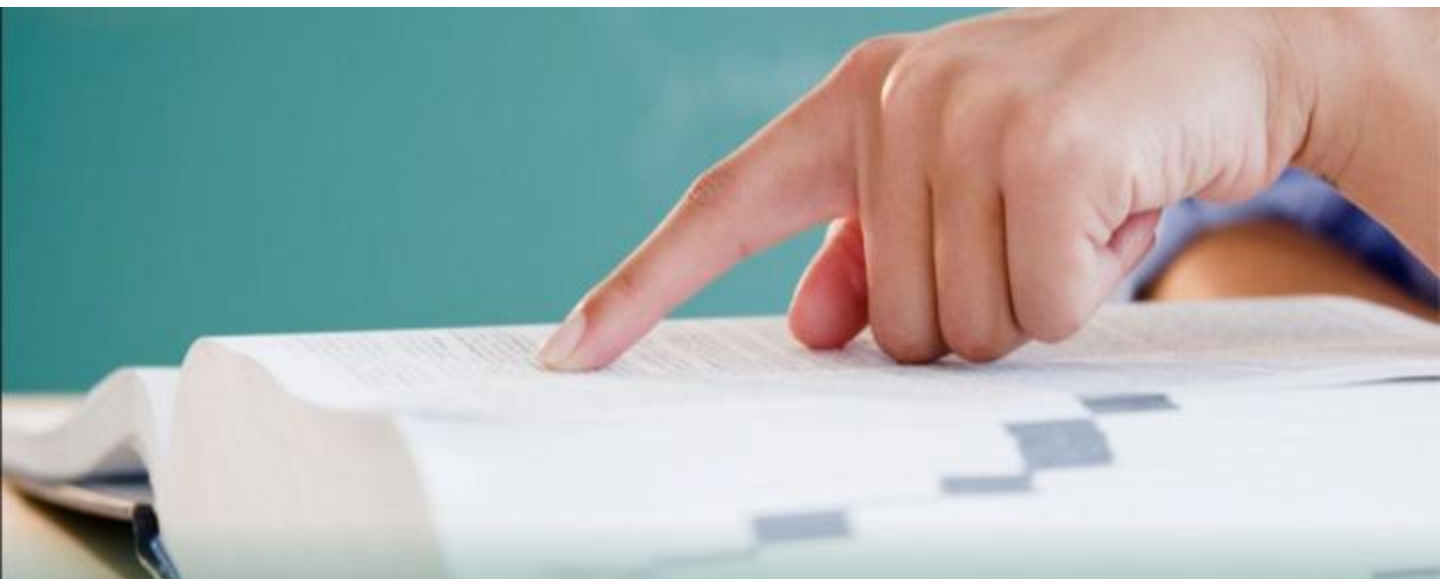


5 June 2014

The RBI clarifies certain provisions of the unhedged foreign currency exposure guidelines



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The Reserve Bank of India (RBI) had issued guidelines on 'capital and provisioning requirements for exposures to entities with unhedged foreign currency exposure' ('the Guidelines') on 15 January 2014. The guidelines effective from 1 April 2014 prescribed the methodology to be followed for calculating incremental provisioning and capital requirements for bank exposures to entities with unhedged foreign currency exposures (UFCE).

Subsequently, the RBI received a number of queries from banks on certain provisions of these guidelines. RBI through its notification dated 3 June 2014 has provided the following clarifications:

1. Based on the way the guidelines were framed, the required provisioning would have been calculated for the first time in June 2014, which would impact the June 2014 quarter earnings with the entire provisioning required to be made in the said period. The RBI has now clarified that the additional provisioning requirement applicable for April-June 2014 quarter may be distributed equally during the financial year 2014-2015. However, such relaxation would not be available for capital requirements.
2. The RBI has clarified that quarterly information on UFCE may be obtained from all entities on self certification basis and should preferably be internally audited by that entity. However, at least on an annual basis, UFCE information (other than exposure of overseas branches/subsidiaries) should be audited and certified by the statutory auditor of the entity. It has also clarified that in case of exposures of overseas branches/subsidiaries, audit may not be insisted upon.
3. The guidelines assessed riskiness of UFCE from the volatility of USD – INR exchange rates. It is now clarified that foreign currency exposures in currencies other than USD may be converted into USD using the current market rates.

4. The guidelines required banks to calculate USD – INR annualised volatility, which would have varied from bank to bank. To ensure consistency, the RBI will request Foreign Exchange Dealers' Association of India (FEDAI) to compute USD – INR volatility rate based on the RBI reference rate which can be used for computing extent of likely loss on UFCE. However, till the time FEDAI starts placing the information on its website on a daily basis, banks have been advised to continue to compute the volatility figure as per the provisions of the guidelines.
5. The guidelines required the likely loss on account of exchange rate movement to be compared with the annual EBID (defined as profit after tax plus depreciation plus interest on debt plus lease rentals, if any) as per the last quarterly results certified by the auditors. RBI has now clarified that where audited results of the last quarter are not available, latest audited quarterly or yearly results should be used. It is also clarified that no differentiation is made between limited audited results and full audited results.
6. The guidelines introduced incremental provisioning and capital requirements over and above the present requirements. It is now clarified that incremental provisioning and capital requirements for UFCE should be based respectively on the exposure amount used for computing standard asset provisioning and credit risk capital requirements respectively.
7. It has also been clarified that inter-bank exposures may be excluded from the ambit of the guidelines.
8. The guidelines are applicable to all entities irrespective of the size of the entity, which was highlighted by the banks to be operationally cumbersome. RBI has clarified that in case of smaller entities (i.e. entities on which total exposure of the banking system is at INR 25 crore or less) having UFCE, banks have the option of following a standardised method which would require an incremental provisioning of 10 basis points over and above the extant standard asset provisioning requirements. Banks following standardised method will not be required to get UFCE data from small entities, and therefore will not be required to compute incremental capital and provisioning as prescribed for others.
9. RBI has clarified that the incremental provision required is in addition to the present standard asset provisioning requirement and may, therefore, be treated as general provision for disclosures and inclusion in Tier 2 capital, similar to the existing treatment applicable to general provisions. Where the total expected loss amount is less than total eligible provisions, banks may recognise the difference as Tier 2 capital up to a maximum of 0.6 per cent of credit-risk weighted assets calculated under the Internal Rating Based approach.
10. In case where banks are not able to get the required data from all the entities to compute UFCE, RBI has clarified that it may take a conservative view and place the exposure at the last bucket which requires incremental provisioning of 80 basis points and a 25 per cent increase in risk weight. It is also clarified that the cost of compliance with the guidelines may be priced by the bank on its lending rate for the borrower in order to improve quality and timeliness of information.

Our comments

The RBI has provided some much required relief and clarification on certain aspects of the guidelines that were operationally difficult to apply. Banks will be happy that their representations and voice have been heard; but challenges remain at a practical level for implementation. It will be interesting to see how much of the impact of provisioning and capital costs will be transmitted on to end customers by banks.

The bottom line

The requirement to track UFCE and costs for a bank in this context are here to stay. Some of the clarifications will help ensure easier compliance for smaller banks with a strong capital base; larger banks are likely to still find this to be an engaging challenge in the current year.

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