



CIRCULAR

F. No 172/ IFSCA/Finance Company/Unit Regulations/2021-22/2

April 26, 2021

To,
All Finance Company / Finance Unit in the International Financial Services Centre (IFSC)

Subject: Computation of Regulatory Capital¹

The Finance Company's (FCs)/Finance Units (FUs) may draw reference to regulation 4 of the "International Financial Services Centres Authority (Finance Company) Regulation 2020 dated March 25, 2021", issued by the Authority. As per sub regulation (2) of regulation 4, each FC/FU shall maintain a capital ratio of 8%.

2. The International Financial Services Centres Authority (herein referred to as 'IFSCA'), in order to facilitate the undertaking of core and specialized services by an FC / FU in the International Financial Services Centres (herein referred to as "IFSCs") in India, provides the following framework defining the components of regulatory capital and its computation.

A. Applicability:

3. This circular shall be adopted for computation of regulatory capital prescribed for an FC/FU as the case may be, registered under section 3 of IFSCA (Finance Company) Regulations, 2021 and intending to undertake the activities as mentioned in point 5 and point 6 of the Schedule therein, viz.;

- (i) Undertaking one or more core activities with or without non-core activities, and;
- (ii) Undertaking specialized activities with or without core or non-core activities.

¹ For computation of Credit Risk Weighted Assets please refer to corrigendum on the captioned subject dated May 06, 2021.

B. Definitions:

4. For the purpose of this circular, the definition, classification and computation of risk weighted assets and computation of capital ratios shall be in alignment with the prescriptions under BASEL III: A global regulatory framework for more resilient banks and banking systems.

(i) Components of Regulatory Capital for Finance Company:

- a. Common Equity Tier 1 (CET 1) for FCs; shall consist of sum of common shares issued by the FC that meet the criteria for classification as common shares for regulatory purposes, stock surplus (share premium) resulting from issue of instruments included in CET1 capital, retained earnings, accumulated other comprehensive income and disclosed reserves, qualifying minority interest and less regulatory adjustments/deductions and shall exclude dividends;
- b. Additional Tier 1 capital for FCs(AT1); shall consist of sum of capital instruments meeting the criteria for AT1 capital, stock surplus (share premium) resulting from the issue of instruments included in AT1 capital, additional qualifying minority interest and regulatory adjustments/deductions;
- c. Tier 2 capital for FCs(T2); shall consist of sum of the instruments issued by the FC/FU that meet the criteria for inclusion in T2 capital, stock surplus (share premium) resulting from the issue of instruments included in T2 capital, additional qualifying minority interest, qualifying loan loss provisions and regulatory adjustments/deductions;

(ii) Components of Regulatory Capital for Finance Unit:

- a. Common Equity Tier 1 (CET1) for FUs; shall consist of interest free funds from parent kept in a separate account in the IFSCs specially for the purpose of meeting the regulatory capital requirement, remittable surplus retained in IFSCs books which is not repatriable as long as the operations in IFSCs continue ,interest free funds remitted from abroad for the purpose of acquisition of property in IFSCs and kept in a separate account in books of FU, capital reserves representing surplus arising out of sale of assets in IFSCs held in a separate account and which is not eligible for repatriation as long as the operations in IFSCs continue and less regulatory adjustments/deductions applied in the computation of CET 1 as per

- BASEL III prescriptions. An auditor certificate shall be submitted on an annual basis for the same;
- b. Additional Tier 1 for FUs(AT1); shall consist of sum of capital instruments meeting the criteria for AT1 capital raised for the parent by the FU in the IFSCs in any freely convertible foreign currency, any other item specifically allowed by the IFSCA from time to time for inclusion and less regulatory adjustments/deductions;
 - c. Tier 2 capital for FUs(T2); shall consist of general provisions and loss reserves, parent borrowing in freely convertible foreign currency received as part of T2, and meets the criteria under BASEL III prescriptions, revaluation reserves at a discount of 55% and less regulatory adjustments/deductions.
- (iii) Regulatory Capital; shall be the sum of Tier 1 (CET 1 and AT 1) and Tier 2 capital;
 - (iv) Tier 1 capital; shall consist of sum of CET1 capital and AT1 capital.

C. Computation of Risk Weighted Assets (RWA):

5. The Risk Weighted Assets for computation of capital ratios shall be computed by method as specified in the below table:

Risk Category	Computation Method
Credit Risk RWA	Internal Rating Based Approach (IRB) as prescribed under BASEL III framework.
Market Risk RWA	Standardized Approach as prescribed under BASEL III framework.
Operational Risk RWA	Basic Indicator Approach as prescribed under BASEL III framework or other available advance approaches as appropriate for the risk profile of the institution.

D. Computation of Capital Ratios

6. The manner in which an FC/FU shall compute capital ratios and the minimum percentage of the RWA to be maintained in the form of specific categories of capital is outlined in the table below:

Capital Ratio	Computation	Minimum
Common Equity Tier 1	$\frac{\text{Common Equity Tier 1 Capital}}{\text{Credit Risk RWA} + \text{Market Risk RWA} + \text{Operational Risk RWA}}$	4.5 % of RWA
Tier 1	$\frac{\text{Eligible Tier 1 Capital}}{\text{Credit Risk RWA} + \text{Market Risk RWA} + \text{Operational Risk RWA}}$	6.0 % of RWA
Total Regulatory Capital	$\frac{\text{Total Regulatory Capital}}{\text{Credit Risk RWA} + \text{Market Risk RWA} + \text{Operational Risk RWA}}$	8.0 % of RWA

7. In view of the above, the minimum regulatory capital would consist of:

No.	Regulatory Capital	As % of RWA
(i)	Minimum Common Equity Tier 1	4.5
(ii)	Additional Tier 1	1.5
(iii)	Tier 1 (sum of (i) and (ii))	6.0
(iv)	Tier 2	2.0
(v)	Regulatory Capital (sum of (iii) and (iv))	8.0

8. All Finance Company's and Finance Units for which this circular is applicable, are directed to ensure compliance with this circular.

Yours faithfully,

(R. Kumar)
Head, Banking Division
rag.kumar@ifsc.gov.in