

# RBI Announcements to Ease Capital Requirements for Banks

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## Synopsis

The RBI's Monetary Policy Committee has proposed two key regulatory changes: dissolution of the Investment Fluctuation Reserve (IFR), and permission for banks to include quarterly profits in capital adequacy calculations subject to audit or limited review and prescribed conditions. The inclusion of IFR into CET I capital would improve the ratios by 26-31 bps across banks.

## Overview

The Monetary Policy Committee of Reserve Bank of India (RBI) in the Statement on Developmental and Regulatory Policies has proposed the following steps.

- The dissolution of the Investment Fluctuation Reserve (IFR) while merging extant amount 'below the line' to Statutory Reserve, General Reserve, or Balance of Profit & Loss Account
- It has also permitted banks to add quarterly profits to their capital calculation conditional on the financials being audited or subjected to limited review and using the prescribed formula.

## Extant Norms

- Banks are permitted to include quarterly net profits in the calculation of CRAR provided that the incremental provisions made for Non-Performing Assets (NPAs) at the end of any of the four quarters of the previous financial year, have not deviated more than 25% of the average of the four quarters.
- Banks are required to maintain an Investment Fluctuation Reserve (IFR) to mitigate risks arising from fluctuations in bond yields. IFR is built on a continuing basis to a minimum of 2% of the AFS and FVTPL (including HFT) investment portfolio through annual transfers equal to the lower of net profit on sale of investments or net profit for the year after mandatory appropriations. The reserve is utilised to absorb mark-to-market losses or diminution in the value of investments and is eligible for inclusion in Tier II capital up to 1.25% of risk-weighted assets. Banks may draw down IFR balance in excess of the prescribed 2% and credit the same to the profit and loss account at the end of the accounting year; however, where the IFR balance is below 2%, drawdown is permitted only to meet CET I/Tier I capital adequacy shortfalls and is limited to the extent that MTM losses or provisions during the year exceed net profit on sale of investments for that year.

## CareEdge View

The monetary policy impact has been analysed at [RBI Policy: Status Quo Maintained Amid Elevated Uncertainty](#).

These changes can be viewed through a broad lens of the BASEL framework. The banks already maintain a capital charge for market risk and follow revised norms on classification, valuation, and operation of investment portfolio, hence the IFR requirement for such banks has been removed.

**Figure 1: Impact Analysis of the removal of IFR**

FY25	Reported CET 1	Adjusted CET 1	Difference
PVB	16.72%	16.98%	0.26%
PSB	13.85%	14.16%	0.31%
SCB	15.24%	15.53%	0.29%

Source: Ace Equity (Includes 17 PVBs and 12 PSBs)

The inclusion of the Investment Fluctuation Reserve (IFR) into Common Equity Tier 1 (CET1) capital would have a positive impact on a bank's core capital ratios, while reducing locked in reserves. As can be observed above, CET1 ratios could likely improve by 26bps - 31bps, the overall Capital to Risk-Weighted Assets Ratio (CRAR) might see adjustments as these funds move from Tier 2 to Tier 1 capital. Without a mandated buffer, banks would have to further build up internal risk management to absorb mark-to-market (MTM) shocks in volatile interest rate environments. Further the inclusion of quarterly profits on an ongoing basis would lead to more stable capital reporting across quarters.

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