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Basel III Norms and its Implications on Indian Banking Industry

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ABSTRACT

To reduce the gaps in international supervisory coverage so that no any foreign banks should get away from banking supervision and that should be appropriate, is the main aim of BASEL-III Norms. Basel committee has focused on the capital adequacy in recent years. For this purpose, the committee has proposed Basel I, Basel II and Basel III Accord. The current accord has been implemented in December-2010 is Basel III, Which is third in the series of Basel Accords. In this paper, the researcher has discussed the salient features of Basel-III Accord and its expected implications on the Indian banks. The researcher says that the effective implementation of Basel III will make the Indian banks stronger, financially stable and sound so that it would help in delivering value to the real sectors of the economy. It would also help the Indian banks to manage their capital more efficiently and enhance their profitability.

KEYWORDS : Basel III, Basel Committee, Capital requirements, Indian Banks

INTRODUCTION

Basel Committee of Banking Supervision formed by the Governors of the central bank of the G-10 countries in 1974 developed the Basel Banking Norms under the support of Bank of International Settlements, Basel, Switzerland. On the bases of capital risk, market risk and operational risk, The Basel Committee devises norms and gives recommendations.

In 1973, the breakdown of Bretton Woods System led to the development of casualties in 1974 such as withdrawal of Backhaus Herstatt banking license in Germany and in October of the same year close down of Franklin National Bank in New York. In 1975, for that the Central Bank governors of the G-10 countries took the initiative to form a committee on Banking Regulations and Supervisory Practices. Later, the committee was renamed as Basel Committee on Banking Supervision. At present there are 28 member countries in the committee. These member countries are being represented by their central bank and the authority responsible for the prudential supervision of the banking business.

THE BASEL III ACCORD

Basel III is a set of standards and practices. It is created to ensure that international banks maintain adequate capital to sustain themselves during periods of economic strain. Basel III improves further the limitations prevailing in the Basel-I and Basel-II..

The Basel III guidelines aim to improve the banking sector's ability to endure long periods of economic and financial stress by laying down more precise capital and liquidity requirements for them. The Basel Committee on Banking Supervision (BCBS) published its latest recommendations on bank solvency and liquidity in December 2010 and January 2011. The new regulations are aimed at enhancing the quality, consistency and transparency of the capital base and strengthening the risk coverage of the capital framework:

BASEL III ACCORD

The Basel Committee on Banking Supervision (BCBS) introduced Basel III Accord with the aim to enhance global capital and liquidity standards to promote a resilient banking sector and to enhance the ability to face the financial and economic stress which in turn decrease the risk of overflow from the financial sector to the real economy. To achieve these aims Basel III proposals have been divided into three parts on the basis of the key areas. The main Highlights are as under:

Highlights of Basel-III accord:

Enhanced capital requirement: Banks require to hold more reserves by January 2015 ,with common equity requirements raised to 4.5% from 2% at present

Capital conservation buffer: This buffer is newly introduced to meet the crises in the time of stress. It's an additional reserve of 2.5%which brings the total Tier I Capital Reserves to 7%.

Counter cycle buffer: At any point of time if a nations economy credit is expanding faster in comparison to GDP ,then Capital requirement can be increased with the help of countercyclical Buffer, which varies between 0% -2.5% .

Leverage ratio: Basel III proposes that Tier I capital has to be atleast 3% of the Total Assets even where there is no risk weighting. It agrees to test a minimum Tier 1 leverage ratio of 3% by year 2017.

Liquidity risk measurement: Liquidity Coverage Ratio (LCR) is newly introduced It is designed to ensure that a bank maintains an adequate level of unencumbered ,High quality Assets that can be converted into cash to meet its liquidity needs for a 30 days' time frame under acute liquidity stress. The standard requires ratio to be 100%.

Net funding stability ratio (NFSR)**:** It is the ratio, for a bank, of its "available amount of stable funding" divided by its "required amount of stable funding". The standard requires the ratio be no lower than 100%.

VARIOUS IMPACT OF BASEL-III NORMS ON INDIAN BANKING:

7.1 Impact of capital adequacy norms on Indian banks: Given that most Indian banks are capitalized well beyond the stipulated norms, they may not need substantial capital to meet the new stricter norms. However, there are differences among various banks. While core capital in most of the private sector banks and foreign banks exceeds 9%, there are some public sector banks that fall short of this benchmark. These public sector banks, which account for more than 70% of the assets in the banking sector and are a major source of funding for the productive sectors, are likely to face some constraints due to the implementation of the Basel III norms

7.2 Impact of leverage ratios on Indian banks: RBI already had Statutory Liquidity Ratio (SLR) as a regulatory mandate. The SLR portfolio of Indian banks is structured only for moderate risk i.e. Market risk and leverage ratio is excluded. The Tier I capital of most of the banks in India is under comfort zone and their derivatives activities are not very large .It can be figured out that the leverage ratio cannot be a constraint for Indian Banks .LCR should be complemented with the net stable funding ratio (NFSR) of 100% or more.

7.3 Impact of counter cyclical buffer on Indian banks: The concept of a countercyclical buffer is intuitively appealing, operationalizing it has many challenges. These include defining a business cycle in a global setting although business cycles are not globally synchronized, identifying an inflection point in the business cycle to indicate when to initiate building up the buffer, choosing the appropriate indicator that identifies both good and bad times, determining the right size of the buffer, etc.

7.4 Impact of liquidity risk management on Indian banks: Banks have made significant progress toward changing their risk governance frameworks in the wake of the financial crisis. Board risk committees are nearly universal, and members have received appropriate training in risk management.

8. CONCLUSION

8.1 The Basel III accords are expected to generate positive response for economy. It will be of sure help and support as far as the leverage ratio, capital buffer and the proposal to deal with pro cyclicality is concerned.

8.2 It is interesting to note that though risk capital may be the necessary safety cushion for banks, capital alone may not be sufficient to protect them from any extreme unexpected loss events.

8.3 Basel II has not fully addressed many factors that were responsible for crises and the fundamental problems with BASEL I and BASEL II. More challenges lie ahead of banks, like sustainablity,recovery of profitability,etc.

8.4 Monetary policies of RBI like CRR, SLR, REPO etc make it difficult to uniformly implement BASEL norms exercising control on the capital liquidity and leverage will ensure that they have the ability to withstand crises.

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