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Basel III: New Norms of RBI

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Abstract-

Basel III is a global, voluntary regulatory framework on bank capital adequacy, stress testing, and market liquidity risk. It was agreed upon by the members of the Basel Committee on Banking Supervision in 2010–11, and was scheduled to be introduced from 2013 until 2015; however, changes from 1 April 2013 extended implementation until 31 March 2018 and again extended to 31 March 2019. The third installment of the Basel Accords was developed in response to the deficiencies in financial regulation revealed by the financial crisis of 2007–08. Basel III is intended to strengthen bank capital requirements by increasing bank liquidity and decreasing bank leverage. The present paper highlights the new capital adequacy norms of RBI.

Key Words- BASEL-III, Capital Adequacy, Norms, BCBS

Introduction- It is very common that after any financial crisis the natural tendency is to firm up and strengthen the regulatory process. In this regard "Basel Committee" was formed in 1974 by a group of central bank Governors from 10 countries. This committee is known as 'BCBS'. Inspite of implementation of BASEL-I and BASEL-II guidelines the financial world saw the worst crisis in early 2008 and whole financial market tumbled. In this situation it become necessary to revisit BASEL-II and plug the loopholes and makes BASEL norms winder.

In December 2010 at the end of the meet at BASEL in which 28 countries including India and representative from IMF and the European Commission participated, the new norms relating to the capital base, liquidity and other recruitments to Banks as proposed by the BCBS where agreed upon. These new norms are now called as 'BASEL-III'. Main objectives of BASEL-III

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- To strengthen the regulations regarding and liquidity of banks with the goal of promoting a more resilient banking sector
- To improve the banking sectors ability to absorb shocks arising from financial and economic stress

To achieve these twin objectives BCBS, through BASEL-III, put forward norms aimed at strengthening both side of balance sheets of banks. These norms are :

1. Improving the quality of capital base
2. Enhancing the quantum of common equity
3. Optimising the leverage through leverage ratio
4. Creation of capital buffers to absorb shocks
5. Bringing further transparency and market discipline under Pillar-III
6. Creating more space for banking supervision by regulators under Pillar-II
7. Improving liquidity of assets It is notable that above norms were released by BCBS and individual Central Banks of different countries were asked to implement these norms of BCBS, the final guidelines have been issued by RBI on 2nd May 2012.

Major features of guidelines issued by RBI regarding BASEL-III

1. These guidelines would become effective from Jan 1, 2013 in a phased manner. But it is notable that in Dec 2012, the RBI has rescheduled the start date from implementation of BASEL-III to April 1,2013 from Jan 1,2013 and BASEL-III capital ratios will be fully implemented as on 31 March 2018.

2. The capital requirements for the implementations of BASEL-III guidelines may be lower during the initial periods.

3. Indian banks under BASEL-II are required to maintain Tier I capital of 6% which has been raised to 7% under BASEL-III.

4. New norms do not allow banks to use the consolidated capital of any insurance or non financial subsidiaries for calculating capital adequacy.

5. Under BASEL-III the liquidity coverage ratio(LCR) requires banks to hold enough unencumbered liquids

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assets to cover expected net outflows during a 30 days stress period.

6. For the financial year ending March 31, 2013 banks will have to disclose the capital ratios computed under the existing guidelines of BASEL-II on capital adequacy as well as those computed under the BASEL-III capital adequacy framework.

7.Under the new set of guidelines banks to maintain a minimum total capital(MTC) of 9% against 8%(international) prescribed by the Based committee of total risk weighted assets(TRWA)

8.New norms require common equity Tier I(CET-I)capital must be at least 5.5% of risk weighted asset

9. Banks are also required to maintain a CCB(capital conservation buffer)of 2.5%of RWAs in the form of CET-I capital

Leverage Ratio:

Basel III introduced a minimum "leverage ratio". This is a non-risk-based leverage ratio and is calculated by dividing Tier 1 capital by the bank's average total consolidated assets (sum of the exposures of all assets and non-balance sheet items). The banks are expected to maintain a leverage ratio in excess of 3% under Basel III.

It is widely felt that the shortcoming in Basel II norms is what led to the global financial crisis of 2008. That is because Basel II did not have any explicit regulation on the debt that banks could take on their books, and focused more on individual financial institutions, while ignoring systemic risk. To ensure that banks don’t take on excessive debt, and that they

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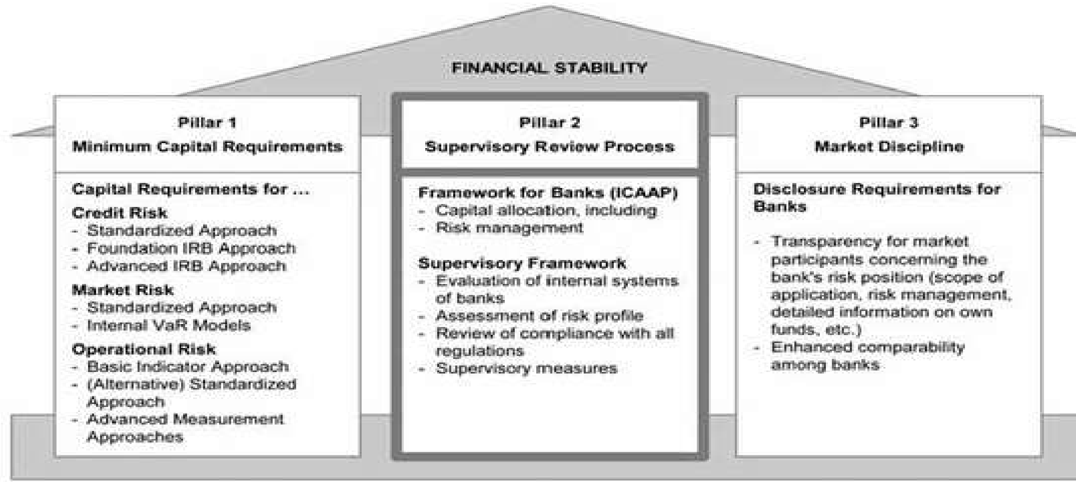
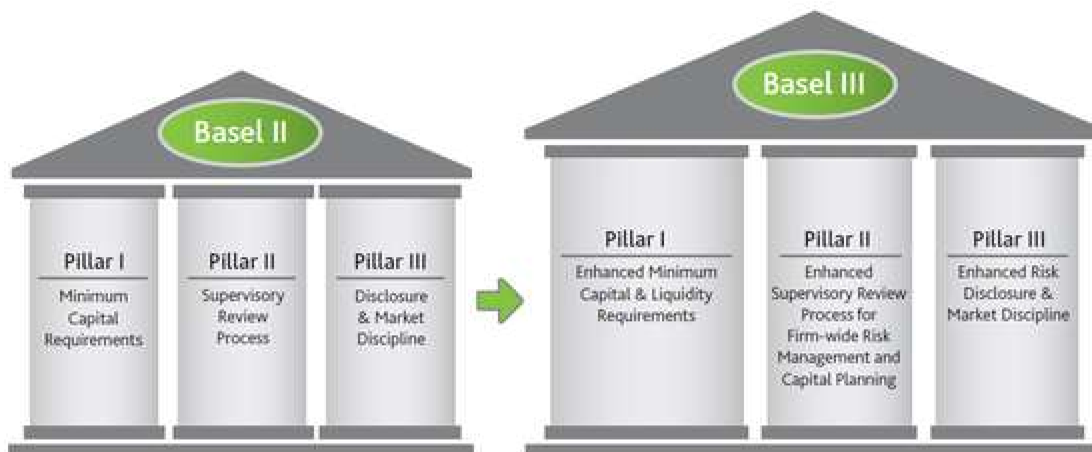
don't rely too much on short term funds, Basel III norms were proposed in 2010.



The Key modifications happened with Basel III are as follows :



Conclusion:

The Basel III norms' aim to improve the banking sector's ability to reduce risk arising from financial and economic stress whatever the source, improve risk management and governance system and strengthen banks' transparency and disclosures. According to the implementation of Basel III guidelines, Indian banks have to plan for more capital in the years further on. They are well placed to

meet the higher capital requirements and can build up their competitive positions The RBI has set a more demanding schedule for Basel III implementation than the Bank for International Settlements. The private sector banks, with their high capital adequacy ratios, enhanced proportion of common equity and better IT and other modern financial skills of the personnel, are well placed to comply with Basel III norms in general. Thus we can say that Basel III guidelines are more stringent than the earlier requirements for capital and liquidity in the banking sector. The framework enhances bank-specific measures and includes macro-prudential regulations to help create a more stable banking sector.

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