BASEL NORMS - Explained in Simple Language

. Introduction

Basel is a city in Switzerland which is also the headquarters of Bureau of International Settlement (BIS).

- BIS fosters co-operation among central banks with a common goal of financial stability and common standards of banking regulations.
- The Bank for International Settlements (BIS) established on 17 May 1930, is the world's oldest international financial organisation. There are two representative offices in the Hong Kong and in Mexico City. In total BIS has 60 member countries from all over the world and covers approx 95% of the world GDP.

Objective

- The set of the agreement by the BCBS (BASEL COMMITTEE ON BANKING SUPERVISION), which mainly focuses on risks to banks and the financial system are called Basel accord.
- The purpose of the accord is to ensure that financial institutions have enough capital on account to meet the obligations and absorb unexpected losses.
- India has accepted Basel accords for the banking system.
- BASEL ACCORD has given us three BASEL NORMS which are BASEL 1,2 and 3.

Before coming to that we have to understand following terms-

- *CAR/CRAR- Capital Adequacy Ratio/ Capital to Risk Weighted Asset Ratio*
- *RWA- Risk Weighted Assets*

*⇒Formulae for CAR=Total Capital/RWA*100*

⇒ Now here, Total Capital= Tier1+ Tier2 capital

Tier 1 - The Tier- I Capital is the core capital

Paid up Capital, Statutory Reserves, Other disclosed free reserves, Capital Reserves which represent surplus arising out of the sale proceeds of the assets, other intangible assets belong from the category of Tier1 capital.

Tier 2 - Tier-II capital can be said to be subordinate capitals.

Undisclosed reserves, Revaluation Reserves, General Provisions and loss reserves , Hybrid debt capital instruments such as bonds, Long term unsecured loans, Debt Capital Instruments etc belong from the category of Tier 2 capital.

Risk Weighted Assets

RWA means assets with different risk profiles; it means that we all know that is much larger risk in personal loans in comparison to the housing loan, so with different types of loans the risk percentage on these loans also varies.

BASEL-I

- In 1988, The Basel Committee on Banking Supervision (BCBS) introduced capital measurement system called Basel capital accord, also called as Basel 1.
- It focused almost entirely on credit risk, It defined capital and structure of risk weights for banks.
- The minimum capital requirement was fixed at 8% of risk-weighted assets (RWA).
- **India adopted Basel 1 guidelines in 1999.**

BASEL-II

In 2004, Basel II guidelines were published by BCBS, which were considered to be the refined and reformed versions of Basel I accord.

The guidelines were based on three parameters which are as follows

- Banks should maintain a minimum capital adequacy requirement of 8% of risk assets.
- Banks were needed to develop and use better risk management techniques in monitoring and managing all the three types of risks that is credit and increased disclosure requirements.
- The three types of risk are- operational risk, market risk, capital risk.
- Banks need to mandatory disclose their risk exposure, etc to the central bank.
- Basel II norms in India and overseas are yet to be fully implemented.

The three pillars of BASEL-3 can be understood from the following figure

BASEL-3

Basel III

- In 2010, Basel III guidelines were released. These guidelines were introduced in response to the financial crisis of 2008.
- In 2008, Lehman Brothers collapsed in September 2008, the need for a fundamental strengthening of the Basel II framework had become apparent.
- Basel III norms aim at making most banking activities such as their trading book activities more capital-intensive.
- The guidelines aim to promote a more resilient banking system by focusing on four vital banking parameters viz. capital, leverage, funding and liquidity.
- Presently Indian banking system follows Basel II norms.

- The Reserve Bank of India has extended the timeline for full implementation of the Basel III capital regulations by a year to March 31, 2019.

Important Points Regarding Implementation of Basel III

- The government of India is scaling disinvesting their holdings in PSBs to 52 per cent.
- The government will soon infuse Rs 6,990 crore in nine public sector banks including SBI, Bank of Baroda (BoB), Punjab National Bank (PNB) for enhancing their capital and meeting global risk norms.
- This is the first tranche of capital infusion for which the government had allocated Rs 11,200 crore in the Budget for 2014-15.
- The government has infused Rs 58,600 crore between 2011 to 2014 in the state-owned banks.
- Finance Minister Arun Jaitley in the Budget speech had said that "to be in line with Basel-III norms there is a requirement to infuse Rs 2,40,000 crore as equity by 2018 in our banks. To meet this huge capital requirement we need to raise additional resources to fulfil this obligation.

EDUCATERER