

BASEL NORMS AND INDIAN BANKING SECTOR

Abstract

The impact of globalisation and deregulation brought sweeping changes in the banking sector across countries. New vistas opened for augmenting revenues of banks, increased competition in the wake of new products, new processes and technological progress exposed banking to higher risks. The setting up of the Basel Committee on Banking Supervision (BCBS) in 1975 was a significant contribution of the BIS towards international harmonisation of supervisory standards. The BCBS contributed to supervisory standards through issuance of 'best practices' papers. Although these standards are not legally binding, they have made substantial impact on banking supervision, in general, and bank capital regulation, in particular. Robust risk management and strong capital position have come to be recognised to be crucial to ensuring safety and soundness of individual banking organisations as also for fostering stability in the financial system.

The Basel Core Principles provide a framework of minimum standards for sound supervisory practices. The principles emphasise capital adequacy and risk management process as one of the significant prudential regulation and requirements.

The paper aims to research how Indian banks' risk attitudes and capital have been affected by Basel norms. It also aims to analyse the status of implementation of Basel norms by banks in India.

Keywords: Indian banking Sector, basel norms, Basel Core Principles.

Authors

Dr. Saurabh Chandra

Associate Professor
School of Law
Bennett University
Greater Noida

Ms. Simran Sharma

Legal Professional

I. INTRODUCTION

In any economy's financial sector, banks are a major player. They are the most significant financial middlemen, and every economic sector is impacted by what they do. Their primary activity is to mobilise deposits and lend money to clients in accordance with their capacity for lending. Consumers, SMEs, large corporations, and governments can all benefit from the essential services that banks provide to them in order to do their everyday business both domestically and internationally. Banks are essential to the functioning of the payment system, the facilitation of credit, and the expansion of the economy.

This sector has seen significant financial volatility over the previous few decades. Additionally, numerous banks all around the world saw a fall in their capital standards. The risk that banks around the world confront was made clear by this upheaval. Regulators began to worry a lot about bank capital in the 1980s, but there was no law defining minimum capital requirements for banks. Therefore, the financial crises that occurred in many nations highlighted the necessity of strong capital regulation as well as the crucial role that capital plays in protecting against negative economic shocks. In order to protect depositors from unfavourable developments that could endanger banks' solvency, authorities felt that banks' soundness and stability needed to be strengthened.

Therefore, control of bank capital is essential for long-term financing and solvency; moreover, it helps prevent bankruptcies by offering a safety net against losses. In particular, capital management has been utilised to reduce the discrepancy between the anticipated and actual amount of losses by protecting lenders from the risk of making loans to borrowers with different creditworthiness and repayment patterns.

So, for this purpose, Basel Committee was established which result into first Basel Accord in 1987. The financial industry has an impact on the fiscal and economic policies of the nation. The projected economic progress of India had been thought to depend on the social orientation of banking.

The initial stage of bank development between 1913 and 1948 was characterised by intermittent failures. Approximately 1100 banks existed, the of which the majority were small. The Indian government adopted the Finance Companies Act, 1949 to modernise the functions and pursuits of commercial banks. The Banking Act Act, 1949 was later renamed as a result of the Reworking Act of 1965. Deposit mobilisation has been delayed since public confidence in banks has declined throughout the day.

Following independence, the government made some significant changes to the Indian banking industry. It nationalised Imperial Bank of India in 1955, primarily in rural and semi-urban areas, but on a massive scale. Seven banks that were subsidiaries of SBI were nationalised in 1960, and the major nationalisation process was completed in July 1969. In 1980, the nationalisation of 7 banks with 200 crore deposits takes place. After being nationalised, the public sector bank's branches saw a massive increase in deposits and advances of about 800%.

When the Narasimham Committee's report on banking sector reform was released in 1991, the banking industry underwent significant changes. Following this, reform centred on

administrated interest rate structures that simplify policy frameworks, credit provision to specific sectors and high rates of pre-emption in the form of reserve requirements, as well as an overview of prudential norms and guidelines for sound understanding.

A committee by the name of Mr. Narasimham was established in 1991 and served to promote the liberalisation of banking processes. The country is overrun with numerous ATMs and foreign banks. To give clients a satisfying service, efforts are being done. The entire system got more convenient and quick after setting up phone banking and internet banking. Money is not valued as highly as time.

Over the course of the financial year 2021–2022, bank credit growth increased steadily until it reached double figures in March 2022. Metropolitan areas, which make up the majority of SCBs' total bank credit, saw credit growth of 9.7% in March 2022 (1.7% a year earlier); loan growth in urban sector stayed in double digits throughout 2021–2022.

Private sector banks continued to have double digit year-on-year lending growth, which accelerated over the course of the following quarters to reach 15.1% in March 2022. Lending growth by public sector lenders increased dramatically, rising from 3.6% in March 2021 to 7.8% in March 2022.

The paper aims to research how Indian banks' risk attitudes and capital have been affected by Basel Accord restrictions. It also aims to analyse the status of implementation of Basel norms by banks' in India.

II. CONCEPTUAL FRAMEWORK OF BASEL NORMS

Basel I, the initial set of three of international banking regulations, was formed by the Basel Committee on Banking Supervision, which has its headquarters in Basel, Switzerland. Basel II & Basel III have now been added to it, with Basel III still being in place as of 2022. To reduce risk to customers, financial institutions, and the whole economy, Basel I was created. The capital reserve requirements for banks were lowered when Basel II was introduced a few years later. This drew some criticism. The fact that Basel I helped to continue the modification of banking regulations and best practises, preparing the door for additional protective measures, was possibly its greatest legacy.

Basel I have received criticism for obstructing bank operations and slowing down the expansion of the world economy by lowering the quantity of lending capital available.

The Basel I reforms, according to those on the opposing side of that debate, did not go far enough. Basel I and Basel II received criticism for their inability to stop the financial crisis and Great Recession of 2007–2009, which served as the impetus for Basel III.

III. BASEL II ACCORD

Basel II, a set of global banking rules, was first introduced in 2004 by the Committee on Banking Supervision. It created a system for regulation and oversight and established new standards for bank capital adequacy disclosure. Additionally, Basel I, the first worldwide regulatory accord, expanded the standards for minimum capital requirements.

The Basel II Accord expanded and clarified the rules that Basel I had originally enacted. Additionally, it assisted regulators in starting to deal with some of the financial advancements and new financial products which had emerged since the 1988 launch of Basel I.

Basel II's main objective, which was to make the financial system safer, was not entirely met, and it's even been called a disastrous failure.

Despite Basel II's regulations, the finance industry became heavily indebted & overfunded, as shown by the subprime lending crisis and the Economic Downturn of 2008. Basel II overstated the hazards associated with current banking practises.

In order to improve Basel II, the Basel Committee released updated risk management and supervisory standards in 2008 and 2009. The Basel III Accord, which is still being phased in as of 2022, was born out of those reforms and others released in 2010 and subsequently.

IV. BASEL III ACCORD

Basel III is indeed a multilateral accord that brings about a set of regulations aimed to keep things on track within the global financial system by requiring banks to maintain particular leverage ratios and hold higher level of emergency capital on hand. By 2022, it will still be in use after starting in 2009.

There are certain objectives of Basel norm III:

- increase the banking sector's capacity to withstand fluctuations brought on by monetary and economic volatility
- Boost the financial sector's capacity for risk management and governance.
- Increasing bank disclosures and transparency

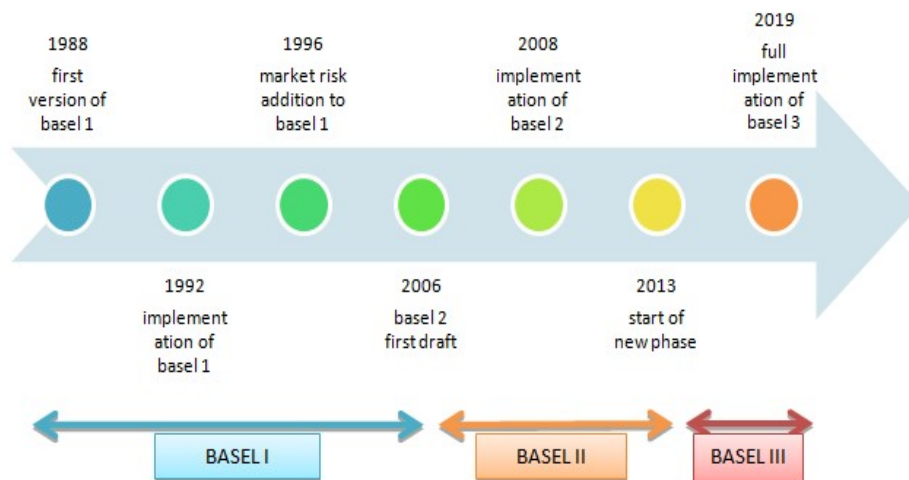


Figure 2: Bank regulatory capital accords Timeline

V. CONCLUSION

It is observed that According to regulatory pressure, there is discernible effect of Basel criteria on changes in the position of Indian banks as well as effect on modifications in the risk threshold of Indian banks.

In the answer to the research questions, it is observed that there was genuine need of basel norms in India as with the increase in the globalisation of the world, the economies have also been expanding, and with the increasing income and economies, the threats have been increasing. To regulate the banks globally with the same pace and safeguard the business transaction, basel norms were the need of the time and with the advancing of technologies, same improvement required in the basel norms. These thought of improvement helps in basel accord 1,2,3.

A bank must not rely exclusively on "regulatory capital," which is essential. A dynamic risk mitigation approach is required, in which each person manages risks in their respective functional areas.

For India's banks, complying with BASEL III rules is a difficult process because they must raise capital, enhance liquidity, and decrease leverage. The profit margins of Indian banks may be impacted by this. Additionally, banks' ability to lend money is decreased when they set aside more money as capital or liquidity. The majority of the earnings made by banks come from loans. Additionally, banks in India must adhere to LCR requirements as well as SLR and CRR standards set by the RBI. This would necessitate setting aside additional money, further straining balance sheets.

In order for bank personnel to have a better understanding of Basel-III Accord, banks must teach them in risk management.

In the majority of Indian banks, the technology infrastructure for computerization is still in its infancy. Computerizing branches will be a difficult operation, especially for banks whose network is dispersed throughout remote regions.

A significant amount of information technology investment would be needed to implement Basel-III. As a result, each bank must concentrate on modernising its IT infrastructure.