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Basel norms or Basel accords are the international banking regulations issued by the Basel Committee on Banking Supervision. The Basel norms is an effort to coordinate banking regulations across the globe, with the goal of strengthening the international banking system. It is the set of the agreement by the Basel committee of Banking Supervision which focuses on the risks to banks and the financial system. The Basel Committee on Banking Supervision (BCBS) is the primary global standard setter for the prudential regulation of banks and provides a forum for regular cooperation on banking supervisory matters for the central banks of different countries. It was established by the Central Bank governors of the Group of Ten countries in 1974. The committee expanded its membership in 2009 and then again in 2014. The BCBS now has 45 members from 28 Jurisdictions, consisting of Central Banks and authorities with responsibility of banking regulation. It provides a forum for regular cooperation on banking supervisory matters. Its objective is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide. Banks lend to different types of borrowers and each carries its own risk. They lend the deposits of the public as well as money raised from the market i.e, equity and debt. This exposes the bank to a variety of risks of default and as a result they fall at times. Therefore, Banks have to keep aside a certain percentage of capital as security against the risk of non – recovery. The Basel committee has produced norms called Basel Norms for Banking to tackle this risk. Basel is a city in Switzerland. It is the headquarters of the Bureau of International Settlement (BIS), which fosters cooperation among central banks with a common goal of financial stability and common standards of banking regulations. It was founded in 1930. The Basel Committee on Banking Supervision is housed in the BIS offices in Basel, Switzerland. The Basel Committee has issued three sets of regulations which are known as Basel-I, II, and III. Basel-I It was introduced in 1988. It focused almost entirely on credit risk. Credit risk is the possibility of a loss resulting from a borrower's failure to repay a loan or meet contractual obligations. Traditionally, it refers to the risk that a lender may not receive the owed principal and interest. It defined capital and structure of risk weights for banks. The minimum capital requirement was fixed at 8% of risk weighted assets (RWA). RWA means assets with different risk profiles. For example, an asset backed by collateral would carry lesser risks as compared to personal loans, which have no collateral. India adopted Basel-I guidelines in 1999. Basel-II In 2004, Basel II guidelines were published by BCBS. These were the refined and reformed versions of Basel I accord. The guidelines were based on three parameters, which the committee calls it as pillars. Capital Adequacy Requirements: Banks should maintain a minimum capital adequacy requirement of 8% of risk assets Supervisory Review: According to this, banks were needed to develop and use better risk management techniques in monitoring and managing all the three types of risks that a bank faces, viz. credit, market and operational risks. Market Discipline: This needs increased disclosure requirements. Banks need to mandatorily disclose their CAR, risk exposure, etc to the central bank. Basel II norms in India and overseas are yet to be fully implemented though India follows these norms. Basel III In 2010, Basel III guidelines were released. These guidelines were introduced in response to the financial crisis of 2008. A need was felt to further strengthen the system as banks in the developed economies were under-capitalized, over-leveraged and had a greater reliance on short-term funding. It was also felt that the quantity and quality of capital under Basel II were deemed insufficient to contain any further risk. The guidelines aim to promote a more resilient banking system by focusing on four vital banking parameters viz. capital, leverage, funding and liquidity. Capital: The capital adequacy ratio is to be maintained at 12.9%. The minimum Tier 1 capital ratio and the minimum Tier 2 capital ratio have to be maintained at 10.5% and 2% of risk-weighted assets respectively. In addition, banks have to maintain a capital conservation buffer of 2.5%. Counter-cyclical buffer is also to be maintained at 0-2.5%. Leverage: The leverage rate has to be at least 3 %. The leverage rate is the ratio of a bank’s tier-1 capital to average total consolidated assets. Funding and Liquidity: Basel-III created two liquidity ratios: LCR and NSFR. The liquidity coverage ratio (LCR) will require banks to hold a buffer of high-quality liquid assets sufficient to deal with the cash outflows encountered in an acute short term stress scenario as specified by supervisors. This is to prevent situations like “Bank Run”. The goal is to ensure that banks have enough liquidity for a 30-days stress scenario if it were to happen. The Net Stable Funds Rate (NSFR) requires banks to maintain a stable funding profile in relation to their off-balance-sheet assets and activities. NSFR requires banks to fund their activities with stable sources of finance (reliable over the one-year horizon). The minimum NSFR requirement is 100%. Therefore, LCR measures short-term (30 days) resilience, and NSFR measures medium-term (1 year) resilience. The deadline for the implementation of Basel-III was March 2019 in India. It was postponed to March 2020. In light of the coronavirus pandemic, the RBI decided to defer the implementation of Basel norms by further 6 months. Extending more time under Basel III means lower capital burden on the banks in terms of provisioning requirements, including the NPAs. This extension would impact the perception of Indian Banks and central banks in the eyes of the global players. Bank run It occurs when a large number of customers of a bank or other financial institution withdraw their deposits simultaneously over concerns of the bank's solvency. As more people withdraw their funds, the probability of default increases, prompting more people to withdraw their deposits. Countercyclical capital buffer (CCCB) Following Basel-III norms, central banks specify certain capital adequacy norms for banks in a country. The CCCB is a part of such norms and is calculated as a fixed percentage of a bank’s risk-weighted loan book. The key respect in which the CCCB differs from other forms of capital adequacy is that it works to help a bank counteract the effect of a downturn or distressed economic conditions. With the CCCB, banks are required to set aside a higher portion of their capital during good times when loans are growing rapidly, so that the capital can be released and used during bad times, when there’s distress in the economy. Although the RBI had proposed the CCCB for Indian banks in 2015 as part of its Basel-III requirements, it hasn’t actually required the CCCB to be maintained, keeping the ratio at zero percent ever since. This is based on the RBI’s review of the credit-GDP gap, the growth in GNPA, the industry outlook assessment index, interest coverage ratio and other indicators, as part of the first monetary policy of every financial year. Tier 1 Capital vs. Tier 2 Capital Banks have two main silos of capital that are qualitatively different from one another. Tier 1: It refers to a bank's core capital, equity, and the disclosed reserves that appear on the bank's financial statements. In the event that a bank experiences significant losses, Tier 1 capital provides a cushion that allows it to weather stress and maintain a continuity of operations. Tier 2: It refers to a bank's supplementary capital, such as undisclosed reserves and unsecured subordinated debt instruments that must have an original maturity of at least five years. Tier 2 capital is considered less reliable than Tier 1 capital because it is more difficult to accurately calculate and more difficult to liquidate. RESERVE BANK OF INDIA RBI/2022-23/12 DOR.CAP.REC.3/21.06.201/2022-23 April 1, 2022 All Scheduled Commercial Banks (Excluding Small Finance Banks, Payments Banks and Regional Rural Banks) Madam / Dear Sir, Master Circular – Basel III Capital Regulations Please refer to the Master Circular No. DBR.No.BP.BC.1/21.06.201/2015-16 dated July 1, 2015, consolidating therein the prudential guidelines on Basel III capital adequacy issued to banks till June 30, 2015. 2. This Master Circular consolidates instructions on the above matters issued as on date. A list of circulars consolidated in this Master Circular is contained in Annex 27. 3. Small Finance Banks and Payments Banks may refer to their respective licensing guidelines and operating guidelines issued by Reserve Bank, for prudential guidelines on capital adequacy. Yours faithfully, (Usha Janakiraman) Chief General Manager Encl.: As above Master Circular on Basel III Capital Regulations Part A: Minimum Capital Requirement 1. Introduction 1.1 Basel III reforms are the response of Basel Committee on Banking Supervision (BCBS) to improve the banking sector’s ability to absorb shocks arising from financial and economic stress, whatever the source, thus reducing the risk of spill over from the financial sector to the real economy. During Pittsburgh summit in September 2009, the G20 leaders committed to strengthen the regulatory system for banks and other financial firms and also act together to raise capital standards, to implement strong international compensation standards aimed at ending practices that lead to excessive risk-taking, to improve the over-the-counter derivatives market and to create more powerful tools to hold large global firms to account for the risks they take. For all these reforms, the leaders set for themselves strict and precise timetables. Consequently, the Basel Committee on Banking Supervision (BCBS) released comprehensive reform package entitled “Basel III: A global regulatory framework for more resilient banks and banking systems” (known as Basel III capital regulations) in December 2010. 1.2 Basel III reforms strengthen the bank-level i.e., micro prudential regulation, with the intention to raise the resilience of individual banking institutions in periods of stress. Besides, the reforms have a macro prudential focus also, addressing system wide risks, which can build up across the banking sector, as well as the procyclical amplification of these risks over time. These new global regulatory and supervisory standards mainly seek to raise the quality and level of capital to ensure banks are better able to absorb losses on both a going concern and a gone concern basis, increase the risk coverage of the capital framework, introduce leverage ratio to serve as a backstop to the risk-based capital measure, raise the standards for the supervisory review process (Pillar 2) and public disclosures (Pillar 3) etc. The macro prudential aspects of Basel III are largely enshrined in the capital buffers. Both the buffers i.e., the capital conservation buffer and the countercyclical buffer are intended to protect the banking sector from periods of excess credit growth. 2. Approach to Implementation and Effective Date 2.1 The Basel III capital regulations continue to be based on three-mutually reinforcing Pillars, viz. minimum capital requirements, supervisory review of capital adequacy, and market discipline of the Basel II capital adequacy framework1. Under Pillar 1, the Basel III framework will continue to offer the three distinct options for computing capital requirement for credit risk and three other options for computing capital requirement for operational risk, albeit with certain modifications / enhancements. These options for credit and operational risks are based on increasing risk sensitivity and allow banks to select an approach that is most appropriate to the stage of development of bank’s operations. The options available for computing capital for credit risk are Standardised Approach, Foundation Internal Rating Based Approach and Advanced Internal Rating Based Approach. The options available for computing capital for operational risk are Basic Indicator Approach (BIA), The Standardised Approach (TSA) and Advanced Measurement Approach (AMA). 2.2 Keeping in view the Reserve Bank’s goal to have consistency and harmony with international standards, it was decided in 2007 that all commercial banks in India (excluding Local Area Banks and Regional Rural Banks) should adopt Standardised Approach for credit risk, Basic Indicator Approach for operational risk by March 2009 and banks should continue to apply the Standardised Duration Approach (SDA) for computing capital requirement for market risks. 2.3 Banks were advised to undertake an internal assessment of their preparedness for migration to advanced approaches and take a decision with the approval of their Boards, whether they would like to migrate to any of the advanced approaches. Based on bank’s internal assessment and its preparation, a bank may choose a suitable date to apply for implementation of advanced approach. Besides, banks, at their discretion, would have the option of adopting the advanced approaches for one or more of the risk categories, as per their preparedness, while continuing with the simpler approaches for other risk categories, and it would not be necessary to adopt the advanced approaches for all the risk categories simultaneously. However, banks should invariably obtain prior approval of the RBI for adopting any of the advanced approaches. 2.4 Effective Date: The Basel III capital regulations were implemented in India with effect from April 1, 2013 and have been fully implemented as on October 1, 2021. Banks have to comply with the regulatory limits and minima as prescribed under Basel III capital regulations, on an ongoing basis. 3. Scope of Application of Capital Adequacy Framework 3.1 A bank shall comply with the capital adequacy ratio requirements at two levels: (a) the consolidated (“Group”) level2 capital adequacy ratio requirements, which measure the capital adequacy of a bank based on its capital strength and risk profile after consolidating the assets and liabilities of its subsidiaries / joint ventures / associates etc. except those engaged in insurance and any non-financial activities; and (b) the standalone (“Solo”) level capital adequacy ratio requirements, which measure the capital adequacy of a bank based on its standalone capital strength and risk profile. Accordingly, overseas operations of a bank through its branches will be covered in both the above scenarios. 3.2 For the purpose of these directions, the subsidiary is an enterprise that is controlled by another enterprise (known as the parent). Banks will follow the definition of ‘control’ as given in the applicable accounting standards. 3.3 The components, elements and eligibility criteria of the regulatory capital instruments for foreign banks operating in India under the Wholly Owned Subsidiary (WOS) model would be as applicable to the other domestic banks as stipulated in this Master Circular. The WOS shall meet the Basel III requirements on a continuous basis from the time of its entry / conversion. WOS shall, however, maintain a minimum capital adequacy ratio, on a continuous basis for an initial period of three years from the commencement of its operations, at 10 per cent. In addition, the WOS shall maintain the Capital Conservation Buffer and other buffers as applicable3. 3.4 Capital Adequacy at Group / Consolidated Level 3.4.1 All banking and other financial subsidiaries except subsidiaries engaged in insurance and any non-financial activities (both regulated and unregulated) should be fully consolidated for the purpose of capital adequacy. This would ensure assessment of capital adequacy at the group level, taking into account the risk profile of assets and liabilities of the consolidated subsidiaries. 3.4.2 The insurance and non-financial subsidiaries / joint ventures / associates etc. of a bank should not be consolidated for the purpose of capital adequacy. The equity and other regulatory capital investments in the insurance and non-financial subsidiaries will be deducted from consolidated regulatory capital of the group. Equity and other regulatory capital investments in the unconsolidated insurance and non-financial entities of banks (which also include joint ventures / associates of the parent bank) will be treated in terms of paragraphs 4.4.9 and 5.13.6 respectively. 3.4.3 All regulatory adjustments indicated in paragraph 4.4 are required to be made to the consolidated capital of the banking group as indicated therein. 3.4.4 Minority interest (i.e., non-controlling interest) and other capital issued out of consolidated subsidiaries as per paragraph 3.4.1 that is held by third parties will be recognized in the consolidated regulatory capital of the group subject to certain conditions as stipulated in paragraph 4.3. 3.4.5 Banks should ensure that majority owned financial entities that are not consolidated for capital purposes and for which the investment in equity and other instruments eligible for regulatory capital status is deducted, meet their respective regulatory capital requirements. In case of any shortfall in the regulatory capital requirements in the unconsolidated entity, the shortfall shall be fully deducted from the Common Equity Tier 1 capital. 3.4.6 It is clarified that group/ consolidated level capital adequacy would also mean application of consolidated capital adequacy norms to the Non-Operative Financial Holding Company (NOFHC) after consolidating the relevant entities held by it in terms of paragraph 3.1(a) above, in conjunction with the Guidelines for consolidated accounting and other quantitative methods to facilitate consolidated supervision issued vide circular dated DBOD.No.BP.BC.72 /21.04.018/2001-02 dated February 25, 20034. 3.4.7 Banks may refer to Annex 21 for guidelines on general permission for infusion of capital in overseas branches and banking subsidiaries and retention/ repatriation/ transfer of profits in these centres. 3.5 Capital Adequacy at Solo Level 3.5.1 While assessing the capital adequacy of a bank at solo level, all regulatory adjustments indicated in paragraph 4.4 are required to be made. In addition, investments in the capital instruments of the subsidiaries, which are consolidated in the consolidated financial statements of the group, shall be deducted from the corresponding capital instruments issued by the bank. 3.5.2 In case of any shortfall in the regulatory capital requirements in the unconsolidated entity (e.g., insurance subsidiary), the shortfall shall be fully deducted from the Common Equity Tier 1 capital. 4. Composition of Regulatory Capital 4.1 General Banks shall maintain a minimum Pillar 1 Capital to Risk-weighted Assets Ratio (CRAR) of 9% on an on-going basis (other than capital conservation buffer and countercyclical capital buffer etc.). The Reserve Bank will take into account the relevant risk factors and the internal capital adequacy assessments of each bank to ensure that the capital held by a bank is commensurate with the bank’s overall risk profile. This would include, among others, the effectiveness of the bank’s risk management systems in identifying, assessing / measuring, monitoring and managing various risks including interest rate risk in the banking book, liquidity risk, concentration risk and residual risk. Accordingly, the Reserve Bank will consider prescribing a higher level of minimum capital ratio for each bank under the Pillar 2 framework on the basis of their respective risk profiles and their risk management systems. Further, in terms of the Pillar 2 requirements, banks are expected to operate at a level well above the minimum requirement. A bank should compute Basel III capital ratios in the following manner: Notes:- 1 For reference, please refer to the Master Circular on Prudential Guidelines on Capital Adequacy and Market Discipline – New Capital Adequacy Framework (NCAF) issued vide circular DBOD.No.BP.BC.4/21.06.001/2015-16 dated July 1, 2015. 2 In terms of guidelines on preparation of consolidated prudential reports issued vide circular DBOD. No.BP.BC.72/21.04.018/ 2001-02 dated February 25, 2003, a consolidated bank may exclude group companies which are engaged in insurance business and businesses not pertaining to financial services. A consolidated bank should maintain a minimum Capital to Risk-weighted Assets Ratio (CRAR) as applicable to a bank on an ongoing basis. Please also refer to circular DBOD.No.FSD.BC.46/24.01.028/2006-07 dated December 12, 2006. 3 Please refer to the Framework for setting up of Wholly Owned Subsidiaries by Foreign Banks in India dated November 6, 2013. 4 Please refer circular no. DBR.No.BP.BC.57/21.06.201/2015-16 dated November 19, 2015 on Non-Operative Financial Holding Company (NOFHC) – Application of Capital Adequacy Norms. Download Full text of Master Circular – Basel III Capital Regulations

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