



September 23, 2010

Proposed Basel III Guidelines: A Credit Positive for Indian Banks

The proposed Basel III guidelines seek to improve the ability of banks to withstand periods of economic and financial stress by prescribing more stringent capital and liquidity requirements for them. ICRA views the suggested capital requirement as a positive for banks as it raises the minimum core capital stipulation, introduces counter-cyclical measures, and enhances banks' ability to conserve core capital in the event of stress through a capital conservation buffer. The prescribed liquidity requirements, on the other hand, are aimed at bringing in uniformity in the liquidity standards followed by banks globally. This requirement, in ICRA's opinion, would help banks better manage pressures on liquidity in a stress scenario.

Regulatory Capital Adequacy Levels—Proposed vs. Existing RBI Norm

	Proposed Basel III Norm	Existing RBI Norm
Common equity (after deductions)	4.5%	3.6% (9.2%)
Conservation buffer	2.5%	Nil
Countercyclical buffer	0-2.5%	Nil
Common equity + Conservation buffer + Countercyclical buffer	7-9.5%	3.6% (9.2%)
Tier I (including the buffer)	8.5-11.0%	6.0% (10.0%)
Total capital (including the buffers)	10.5-13.0%	9.0% (14.5%)

Source: Basel committee documents, RBI, Basel II disclosure of various banks; Figures in parenthesis pertain to aggregated capital adequacy of banks covering over 95% of the total banking assets as on March 31, 2010.

The capital requirement as suggested by the proposed Basel III guidelines would necessitate Indian banks¹ raising Rs. 6 lakh crore in external capital over next nine years, besides lowering their leveraging capacity. It is the public sector banks that would require most of this capital, given that they dominate the Indian banking sector. Further, a higher level of core capital could dilute the return on equity for banks. Nevertheless, Indian banks may still find it easier to make the transition to a stricter capital requirement regime than some of their international counterparts since the regulatory norms on capital adequacy in India are already more stringent, and also because most Indian banks have historically maintained their core and overall capital well in excess of the regulatory minimum.

As for the liquidity requirement, the liquidity coverage ratio as suggested under the proposed Basel III guidelines does not allow for any mismatches while also introducing a uniform liquidity definition. Comparable current regulatory norms prescribed by the Reserve Bank of India (RBI), on the other hand, permit some mismatches, within the outer limit of 28 days. However we do not expect any significant issues for the Indian banks to adapt to these as and when they become applicable.

For further details please contact:

Analyst Contacts:

Ms. Vibha Batra, (Tel. No. +91 124 4545302)

vibha@icraindia.com

Analyst Contacts:

Mr. Karthik Srinivasan, (Tel No. +91-22-30470028)

karthiks@icraindia.com

¹ Except foreign banks