Indian Journal of Accounting (IJA)
ISSN : 0972-1479 (Print) 2395-6127 (Online) Vol. XLIX (2), December, 2017, pp. 115-120

BASEL III AND STRENGTHENING OF INDIAN BANKING SECTOR

Vijila.V*
Dr. G. Raju**

ABSTRACT

The banks with better risk management skills would not only have competitive advantages in the market but would also be better positioned to capitalize on the opportunities for organic and inorganic growth. While the Basel I, II and III framework creates an enabling environment for enhancing the risk management capability in the banks by providing the right incentives, it is entirely up to the individual banks to upgrade the risk governance in their organization to achieve a sharper risk reward profile. Thus the implementation of Basel III has been described as a long journey rather than a destination by itself. It would require commitment of substantial capital and human resources on the part of both banks and the supervisors.

KEYWORDS: *Risk Management, Organic and Inorganic Growth, Basel I, II and III, Risk Governance.*

Introduction

Basel norms are a set of standards and practices that were put in place by the Basel Committee of Banking Supervision (BCBS) with the aim of ensuring that banks maintain adequate capital to withstand periods of economic stress and improve risk management and disclosures in the banking sector. Basel I norms were introduced in 1988 followed by release of Basel II norms in 2004 as an improvement over Basel I norms. With the global financial crisis of 2008, it was widely felt that Basel II norms were inadequate in capturing systemic risk–subprime loan defaults started impacting financial institutions and it became a systemic problem. Exposure to risky assets in the form of subprime loans and securitization products resulted in significant losses and the low quality and quantity of banks 'capital could not absorb these losses. Basel III was BCBS's response to the global financial crisis aimed at strengthening the banking system by eliminating weaknesses in Basel II. Basel III norms prescribe higher risk weights for risky assets, higher regulatory capital requirements and high quality of capital thereby strengthening the global capital and liquidity rules.

Statement of the Problem

The Basel framework is the progressive refinement and sophistication of the risk management configuration of the banking system. The banks with better risk management skills would not only have competitive advantages in the market but would also be better positioned to capitalize on the opportunities for organic and inorganic growth. While the Basel I, II and III framework creates an enabling environment for enhancing the risk management capability in the banks by providing the right incentives, it is entirely up to the individual banks to upgrade the risk governance in their organization to achieve a sharper risk reward profile. Thus the implementation of Basel III has been described as a long journey rather than a destination by itself. It would require commitment of substantial capital and human

* Assistant Professor, PG Department of Commerce. Government College, Attingal, Thiruvananthapuam, Kerala, India.

** Professor, Department of Commerce, School of Business Management and Legal Studies, University of Kerala, Thiruvananthapuram, Kerala, India.

resources on the part of both banks and the supervisors. It is designed to ensure that a bank holds capital in tune with lending and investment practices. These rules mean that the greater the risk to which the bank is exposed, the greater the amount of capital the bank needs to hold to safeguard its solvency and overall economic stability. In the present study, the researcher has tried to study the probable effects of Basel III norms on the banking sector.

Objectives of the Study

This study intends to measure the awareness level of bank managers who are primarily responsible for following the Basel III norms in their branches. The steps initiated in this effort, the expected problems and the hindrances associated the implementation of the Basel III are also studied here.

Methodology

In India, all the commercial banks are directly under the regulatory control of RBI. RBI issues common guidelines to be followed by the banks irrespective its state of registration or operation. The nature of operation of all Indian banks is more or less uniform and hence the researcher had randomly selected Kerala state for primary data collection. For the proper collection of data, the state of Kerala was classified into three regions namely Southern, Central and Northern region. From each region, one district each is selected so as to identify the sample bank branches for the study. Accordingly Thiruvanathapuram from South, Ernakulam from Central and Malappuram from North were selected. A total of 634 branches (461 public sector, 49 new generation private sector banks, and 124 old generation private sector banks) are operating in Thiruvananthapuram; 869 branches (539 public sector, 93 new generation private sector banks and 237 old generation private sector banks) are operating in Ernakulam dist. 428 branches (297 public sector, 46 new generation private sector banks and 85 old generation private sector banks) are operating in Malappuram dist. Thus there are a total of 1931 bank branches in the sample dist. The researcher included 10 per cent (193) of these bank branches in the selected districts as the sample for the study, i.e. 130 public sector bank branches, 44 private sector old generation banks & 19 private sectors new generation bank branches constitute the sample bank branches for the study. A structured questionnaire has been administered among the sample bank branch managers.The questionnaire consists of statements related to the level of awareness, expected benefits, steps completed and expected threats of bank managers in a five point scale with five alternative answers, i.e. very high (5 points), high (4 points) medium (3 points), low (2 points) and very low (1 point) the results of which are presented in the respective variables.

Analysis and Interpretation

The bank managers' responses' collected in the five point scale were subject to statistical analysis so as to get inference from the data and the data so analysed are presented here under the following sub headings:

Awareness Level: There are a number of guidelines to be adhered to by the banks towards the implementation of Basel III norms. The Basel III norms must be implemented only after by rectifying the limitations of Basel II norms. The banks have to make a roadmap for the implementation of Basel III norms which will come into existence in March, 2019. Before its implementation, the banks must have complete awareness of the guidelines proposed by Basel III norms. Hence the level of awareness of bank managers regarding the various criteria for the implementation of Basel III norms was studied. The contribution of each of the factors to the overall level of awareness was examined and the ranking of the attributes in terms of their importance as perceived by the respondents was done by the use of Relative Importance Index (RII) which was computed using equation (10) and the results of the analysis are presented in Table 1.

Table 1: Bank Managers' Awareness on Basel III Norms (1=very low, 5=very high)

Awareness	RII	Mean score	SD	Rank
Quality of capital instruments	0.821	3.87	0.54	I
Quantity of capital instruments	0.660	3.62	0.56	
Revision of credit risk weight	0.694	3.37	0.66	
Securitization	0.789	3.45	0.63	II
Counterparty risk	0.718	3.32	0.47	
Market risk capital charge	0.782	3.24	0.45	III
New global liquidity standard	0.727	3.17	0.58	
Leverage ratio	0.741	3.15	0.69	
Strengthening measure	0.776	3.60	0.49	
Compensation practices	0.735	3.40	0.49	

Source: Primary data

From table 1 it is clear that that the bank managers are highly aware about the criteria of quality of capital requirements with RII of 0.821 (Mean score= 3.87 and SD= 0.54) and followed by the factors of securitization (RII=0.789) (Mean score= 3.45 and SD= 0.63), market risk capital charge (RII=0.782) (Mean score= 3.24 and SD=0.45). The bank managers are least aware about the quantity of capital requirement (RII=0.660) (Mean score= 3.62 and SD= 0.56). The relevant hypothesis that formulated here is that the banks are not aware about the various guidelines towards the implementation of Basel III norms. The statistical significant of their awareness was examined by using Chi-square value of goodness of fit and the result of which is illustrated in table 2.

Table 2: Chi- square Value on the Bank Managers' Awareness on Basel III

Awareness	Frequency	(%)	Chi-square value	Sig. value
Average	76	39.4	8.710	0.003**
Good	117	60.6		
Total	193	100		

Source: Primary data **significant at 5% level

From table 2, it is seen that a significant majority (60.6%) of bank managers opined that their awareness level is good about Basel III norms. Chi-square value for goodness of fit is statistically significant since the significant value is less than 0.05. Hence it was proved that the banks were aware about the various guidelines for the implementation of Basel III norms. So null hypothesis was rejected and the researcher accepted the alternative hypothesis that the banks are aware about the various guidelines towards the implementation of Basel III norms

Steps Initiated: There are certain pre-requisites essential for the implementation of Basel III norms. The progress of these steps and the extent to which it was completed to effectively implement Basel III norms were examined. Each of the pre-requisites for Basel III standards has been analysed to find out the percentage of the completion of each of the steps associated with Basel III norms. RII has been used to analyze the progress of the steps completed in order to implement Basel III norms. The contribution of each of the factors to the overall level of steps completed was examined and the ranking of the attributes in terms of their importance as perceived by the respondents was done by the use of Relative Importance Index (RII) and the results of the analysis are presented in Table 3.

Table 3: Basel III norms–Steps Completed (1=below 25%, 5=100%)

Progress of Steps	RII	Mean Score	SD	Rank
Technological Up gradation	0.818	4.09	0.63	IV
Recruitment of skilled personnel	0.784	3.92	0.51	
Disclosure modes	0.889	4.45	0.73	II
Identification of risk	0.765	3.82	0.60	
Customer education	0.849	4.24	0.89	III
Training to employees	**0.891**	**4.46**	**0.70**	**I**
Appropriate MIS	**0.674**	**3.37**	**0.61**	
Detailed implementation roadmap	0.736	3.68	0.64	
Professionalism in management	0.784	3.92	0.54	
Risk measurement framework	0.702	3.51	0.60	

Source: Primary data

The table 3 clearly revealed that the criteria of giving adequate training to employees with respect to Basel III norms was successfully completed and it reveals a RII of 0.891(Mean score= 4.46 and SD= 0.70) followed by the modes of disclosing information to the interested parties and also giving customer education with RII of 0.889 (Mean score= 4.45 and SD= 0.73) and 0.849 (Mean score= 4.46 and SD= 0.70). The maintenance of appropriate MIS with respect to Basel III norms lagged in completion with RII of 0.674 (Mean score= 3.37 and SD= 0.61).The statistical significance of these progress of steps completed were examined by testing the hypothesis that the steps adopted by commercial banks towards the implementation of Basel III norms are not satisfactory. It was tested by using Chi-square value of goodness of fit and the details of which are shown in table 4.

Table 4: Chi- square value on the Effectiveness of Steps towards Basel III Adoption

Effectiveness of Steps	Frequency	Percent (%)	Chi-Square Value	Sig. Value
Average	14	7.3	141.062	0.000**
Good	179	92.7		
Total	193	100		

Source: Primary data **significant at 5% level

Table 4 showed a significant majority (92.7%) of bank managers have good opinion about the overall progress of steps completed regarding Basel III norms. Chi-square value for goodness of fit is statistically significant since the significant value is less than 0.05. Hence It is inferred that adequate steps were adopted by the commercial banks for the implementation of Basel III norms. So null hypothesis was rejected and the researcher accepted the alternative hypothesis that the steps adopted by commercial banks towards the implementation of Basel III norms are satisfactory

Expected Benefits: Indian banks expect a number of benefits from the implementation of Basel III norms. Apart from the tool of reducing the credit risk of banks, the banks expect a number of benefits like cost effectiveness, proper communication facility, strengthening the financial system of the economy, increasing the quality and quantity of capital etc. Apart from an international standard of reducing bank crisis with regard to non-performing assets, the banks expect the strengthening of the Indian banking system to an international standard. The contribution of each of the factors to the overall level of benefits was examined and the ranking of the attributes in terms of their importance as perceived by the respondents was done by use of Relative Importance Index (RII) and the results of the analysis are presented in Table 5.

Table 5: Basel III norms–Benefits to Banks (1=very low, 5=very high)

Benefits	RII	Mean score	SD	Rank
Cost effective	0.764	3.82	0.39	II
Comfort	0.770	3.85	0.36	I
Reduction of probability of bank crisis	0.711	3.55	0.57	
Proper communication	0.662	3.31	0.51	
Rectifying the weaknesses in the measurement of risk	0.722	3.61	0.49	III
Strengthening the financial system	0.694	3.47	0.56	
Increasing quality and quantity of capital	0.720	3.60	0.64	IV
Provisioning norms	0.627	3.13	0.40	
Disclosure requirement	0.661	3.31	0.58	
Liquidity standard	0.661	3.31	0.50	

Source: Primary data

Table 5 clearly shows that the more comfort to banks with regard to their operation has got the highest RII of 0.770 (Mean score= 3.85 and SD= 0.36) followed by the benefits of cost effectiveness and proper measurement of credit risk with RII of 0.764 (Mean score= 3.82 and SD= 0.39) and 0.722 (Mean score= 3.61 and SD= 0.49). The opinion regarding provisioning norms with respect to lending of loans got the least score with RII of 0.627 (Mean score= 3.13and SD= 0.40). The statistical significance of these expected benefits was examined by testing the hypothesis that Basel III norms will not provide any benefit to the banking operations with regard to its implementation. Chi-square value of goodness of fit was employed for this purpose and the test results are given in Table 6.

Table 6: Chi- square Value on the Opinion of Bank Managers with Respect to Overall Expected Benefits

Effectiveness	Frequency	Per cent (%)	Chi-square Value	Sig. Value
Average	67	34.7	18.036	0.000**
High	126	64.3		
Total	193	100		

*Source: Primary data **significant at 5% level*

From table 6 it can be derived that a significant majority (64.3%) of bank managers have high opinion about overall expected benefits from Basel III norms. Chi-square value for goodness of fit is statistically significant since the significant value is less than 0.05.The expected benefits from the implementation of Basel III norms were thus found good. So null hypothesis was rejected and the researcher accepted the alternative hypothesis that Basel III norms will provide benefits to the banking operations with regard to its implementation.

Hindrances: It is feared that the Indian banks have to face a number of hindrances while implementing Basel III norms. As a precaution for overcoming credit risk and consequent bank failures, banks are adopting numerous standards laid down by the Basel Committee. The intensity of these hindrances varied with respect to different category of banks. The intensity of the hindrances as laid down as per Basel III norms like minimum capital requirement, liquidity standards, SME lending, disclosure measures etc. invariably changed according to the category of banks. The contribution of each of the factors to overall level of hindrances was examined and the ranking of the attributes in terms of their importance as perceived by the respondents was done by the use of Relative Importance Index (RII) and the results of the analysis are presented in Table 7.

Table 7: Basel III Norms–Hindrances to Banks *(5=very high, 1= very low)*

Factors Hindrances	RII	Mean Score	SD	Rank
Capital requirement	0.742	3.71	0.50	I
Liquidity standard	0.738	3.69	0.46	II
Provisioning norms	0.691	3.46	0.54	
Disclosure measures	0.650	3.25	0.54	
Cost	0.645	3.22	0.57	
Securitization	0.627	3.13	0.49	
Compensation practices	0.640	3.20	0.56	
Competitiveness	0.706	3.53	0.64	III
SME lending	0.673	3.36	0.52	
Uniformity in banking operations	0.630	3.15	0.46	

Source: Primary data

The table 7 clearly shows the intensity of various hindrances associated with the implementation of Basel III norms by using the technique of RII. The highest hindrance was with respect to the capital requirements of banks with a RII of 0.742 (Mean score=3.71 and SD=0.50) followed by the liquidity standards of banks and the competitiveness of banks with a RII of 0.738 (Mean score=3.69 and SD=0.46) and 0.706(Mean score= 3.53 and SD= 0.64). The hindrances of securitization of banks got the lowest RII of 0.627 (Mean score=3.13 and SD=0.49). The statistical significant of these expected hindrances were examined by testing the hypothesis that will not have any hindrances associated with the implementation of Basel III norms. It was tested by using Chi-square value of goodness of fit and the details of the test results are given in Table 8.

Table 8: Chi-square Value on the Hindrances Faced by Banks on Basel III Implementation

Extent of Hindrances	Frequency	Per cent (%)	Chi-square Value	Sig. Value
Average	57	29.5	18.036	0.000**
High	136	70.5		
Total	193	100		

*Source: Primary data **significant at 5% level*

The inference derived from table 8 is that a significant majority (70.5%) of bank managers had a high opinion about the expected hindrances of Basel III norms. Chi-square value for goodness of fit is statistically significant the significant value is less than 0.05.Hence it was proved that there are hindrances associated with the implementation of Basel III norms. So null hypothesis was rejected and the researcher accepted the alternative hypothesis that there are hindrances associated with the implementation of Basel III norms.

Conclusion

The study which focuses on the perspectives of commercial banks towards the implementation of Basel III norms confirms that the bank managers are familiar with the Basel III norms (RII > 0.50) even though the deadline for its implementation is 31 March 2019. Among the various steps initiated for it implementation, training to employees is almost completed (RII 0.891) and all the other steps too secured an RII of greater than 0.50 with the lowest score to MIS (0.674). Certainly the banks expect a number of benefits from Basel III implementation like cost effectiveness, reduction of probability of bank crisis, proper communication to all the interested stakeholders and overall the strengthening of financial system, all with a statistically significant RII of above 0.50 score. This does not mean that its implementation is hindrance free. The hindrances expected are in the field of additional capital requirements, SME lending, Cost of lending, Liquidity standards, Compensation practices etc. All the hindrances are statistically significant since the RII is above 0.50. From these findings it is inferred that Indian banks are serious about the implementation of Basel III norms.

Implications of the Study

The present study is focussed on the importance of Basel III norms in order to overcome the various kinds of risk of banks. The implementation of Basel III standard is imperative for the existence of a sound banking sector of our economy. It reduces the chances of bank failures and consequent economic crisis. At the same time, it is feared that these norms unfavourably affect the various sectors of the lending community especially Small and Medium Enterprises. SMEs are the backbone of Indian economy and hence specific steps should be initiated so as to implement the Basel III norms without affecting the flow of credit the needy sectors of the economy. The results of this study will hopefully assist the banking community and the Government in taking adequate measures to solve the problems confronted them.

References

⇒ *Reserve Bank of India (2012), "Report on Trend and Progress of Banking in India 2012-13," Reserve Bank of India Publications.*

⇒ *Reserve Bank of India, (2008): Report on Trend and Progress of Banking in India, 2007-08, p.308.*

⇒ *Stephen M Schaefer and Loriana Pelizzon (2005) Pillar 1 Vs. Pillar 2 under Risk Management under Basel II: The Case of the Spanish Financial Services, SSRN Working Paper Series, Rochester, March.*

⇒ *Suparna Chakraborty, Linda Allen (2007): Revisiting the Level Playing Field: Intenational Lending Responses to Divergences in Japanese Bank Capital Regulations from the Basel Accord, SSRN Working Paper Series, Rochester, and February.*

⇒ *Thilo Liebig, Daniel Porath, Beatrice Wedow (2004): How will Basel II affect Bank Lending to Emerging Markets? An Analysis Based on German Bank Level Data. SSRN Working Paper Series, Rochester, December.*

⇒ *Word Jonathan (2002): The New Basel Accord and Developing Countries: Problem and Alternatives, Working Paper No.04, ESRC, Centre for Business Research, Cambridge University.*

❍☯❍