IMPACT OF BASEL III ON PERFORMANCE OF SBI

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Abstract

The Basel Accord I, II, III has been implemented to regulate the performance of the banks in India. Basel I has focused more on liquidity requirements basel II has focused more on individual financial institutions and ignored the systematic risk arising from the interconnectedness across institutions and marker which led to the crisis in financial market. Since then Basel III was formulated and implemented with view of address the weakness of the past crisis and to make banking sector stringer and efficient enough to face any crisis., These frame work have been framed to enhance the banking sector's safety and stability, emphasizes the need to improve the quality and quantity of capital components leverage ratio liquidity standards and enhanced disclosure. This article emphasis the implementation of Basel III and the performance of banks with special reference to SBI. This article emphasizes the areas like capital requirement, growth of financial stability in terms of asset liability ratio liquidity ratio, enhanced profitability and management of risk.

Key words – Basel I, II, III, capital regulations, risk management, performance of SBI.

<u>Introduction</u>

Banking means Accepting deposits for the purpose of mending or investment of deposits of money from the public repayable on demand or otherwise and withdraw by cheque, draft or otherwise.

Banking companies' regulation act 1949. The origin of banking can be traced from authentic history. From barter system, the transactions were carried out in term of goods and difficulty of barter system has made a way for transaction through money. The benefits of money as a medium of exchange have been the prime motive of banks. Banks were developed to provide the safer place to store the money. It leads to development of financial institution that accepts deposits and lend loans which were called as commercial banks.

With the liberalization of Indian economy in 1991, and the banking sector reforms of 1998 the Indian banking sector witnessed an implementation of credible paradigm shift. Ever since the Indian banking sector has been engineered towards compliance to the basel accords with the authoritative assertiveness of the RBI. These regulations aimed at easing directed credit restrictions under the priority sector lending arrangements, reduction of statutory preemptions deregulations of the interest rates and fostering prudential norms.

In this era of holistic convergence to the Basel norms, the weakening of the entry barriers due to the financial liberalization brought in the inception of competition in the sector along with the technological advancement and challenged the adaptive potential of the existing banks compliance to these norms and the existence of competitive environment banks objectively incubated diverging portfolio of products and services leading to a change in the capital allocation and business operations of the banks.

Adherence to the capital adequacy standards measures in terms of the capital adequacy ratio (CAR) prescribed by the Basel accords to balance the profitability and stability of the banks brought about significant shift in the portfolio composition of the banks. Thus this study aims in examining the changes in performance of SBI with reference to the Basel III on various parameters.

Data & Methodology

The data used in the study comprises bank level data and country level data. The sources are from banks balance sheet and income statement data, effective bank supervision during 2013-2017 (survey on bank regulation supervision and monitoring World Bank economic indicators data base (WDI).

Objectives of the study

- To study significant features of Basel III norms and its framework for implementations.

- ❖ To understand and examine the impact of implementation of Basel III on SBI bank.
- ❖ To find out capital adequacy, profitability, liquidity and control effect and strategies.

Period of study

The study cover a period of 4 financial years 2013-2014, 2014-2015, 2015-2016, and 2016-2017.

Limitation

1. The study is based on the secondary data; this was taken from annual reports of SBI and other resources.
2. The study is restricted to financial year 2013- 2014 to 2016 – 2017.

Review of literatures.

Ibrahim (2011) evaluated the operational performance of the commercial banks in India with special reference to the SCBs since 2000. The study finds and concludes that the SCBs in India have significantly improved their operational performance over the years. The analysis had been carried out through statistical tools like descriptive statistics, t-test and correlation.

Dhanda and Rani (2011) examined Capital Adequacy Ratios (CAR) of different categories of scheduled commercial banks in India and also ascertained the impact of application of Basel II norms on Capital Adequacy Ratio (CAR) for the period 1998-99 to 2008-09. However, the impact of Basel II on CAR of banks was studied for the financial year 2008-09 only. The finding was that Basel II norms had not adversely affected the CAR of banks in India.

Narasimhan and Goel (2013) analyzed the performance of the top Indian banks, both private and public sector for the period FY 2008 - 2012, the years since the last world recession. The paper demonstrated that the Indian banks exhibit stability in such times of crisis due to their capital structure and regulatory environment and also showed an increasing trend in the capital adequacy ratio in the years 2008-2012.

All the study had emphasized that concept of basel norms and impact of basel I, II norms on CRAR on commercial banks in India. All studies stated that banks in India are in a stronger position in terms of CRAR. But no empirical studies have been made on impact on parameters of basel III on performance of SBI.

Basel III

In the awake of the financial crisis of 2008 basel III accord was released in 2010. It identified the loopholes of basel II accord on the banks' debt regulations.

RBI introduced adequacy norms required by Basel committee in April 1992. As per guidelines, risk weights are to be assigned to banks balance sheet assets non funded item and off balance sheet exposure. As per the guidelines all banks operating in India are to maintain capital funds at 9 per cent total risk weight assets and a limit of 50 percent of Tier I is applicable for subordinated term debt. Basel II was implemented in march 2008 and other commercial banks by march 31 2009. RBI proposes to implement starting from April 1 2010. It emphasized on Tier III capital comprised of short term subordinated debt covering market risk limited to 250 percent of Tier I capital required supporting the market risk. Hence Basel 1 & II did not have much regulation on the amount of debt the banks could take on the short term funding regulation. RBI guidelines on Basel III reform on capital regulation on May 2 2012. Main requirement under Basel III on common equity tier I capital must be at least 5.5 per cent of risk weighted asset for credit risk and market risk and operational risk on ongoing basis. Basel III norms are targeting on capital intensive activities. The main aim of these rules is to increase the stock absorbing capacity of the banks at the time of crisis and to decrease the probability of the crisis. ABI has made March 2014 as extended transitional period for full implementation of Basel III capital regulation in India up to March 31 2019 instead of March 31 2018.

SBI is the largest nationalized commercial bank in India interims of assets number of branches deposits, profits and workforce SBI has been facing still competition from private sector and foreign banks where resulted in significant loss of its market share. The efforts of SBI to recover its lost market share by undergoing a major restructuring exercise which involved redesigning its branch network, providing alternate banking channels and technology up gradation the banking performance is also regulated by basel accords. This study aims at exploring the impact of basel III on performance of SBI.

Analysis and Discussion

	Basel-III – CAR					
Year	**Total (in crore)**	**Total (%)**	**Tier I (in crore)**	**Tier I in %**	**Tier II (in crore)**	**Tier II in %**
2013-2014	1,40,151	12.44	1,09,547	9.72	30,604	2.72
2014-2015	1,46,519	12.00	1,17,157	9.60	29,362	2.40
2015-2016	1,75,903	13.12	1,33,035	9.92	42,868	3.20
2016-2017	2,04,731	13.11	1,61,644	10.35	43,087	2.76

TIER 1 CAPITAL = (paid up capital + statutory reserves + disclosed free reserves) - (equity investments in subsidiary + intangible assets + current & brought-forward losses)

TIER 2 CAPITAL = A) Undisclosed Reserves + B) General Loss reserves + C) hybrid debt capital instruments and subordinated debts

$$\text{Common Equity Tier 1 capital ratio} = \frac{\text{Common Equity Tier 1 Capital}}{\text{Credit Risk RWA* + Market Risk RWA + Operational Risk RWA}}$$

$$\text{Tier 1 capital ratio} = \frac{\text{Eligible Tier 1 Capital}}{\text{Credit Risk RWA* + Market Risk RWA + Operational Risk RWA}}$$

$$\text{Total Capital (CRAR}^{\#}\text{)} = \frac{\text{Eligible Total Capital}}{\text{Credit Risk RWA + Market Risk RWA + Operational Risk RWA}}$$

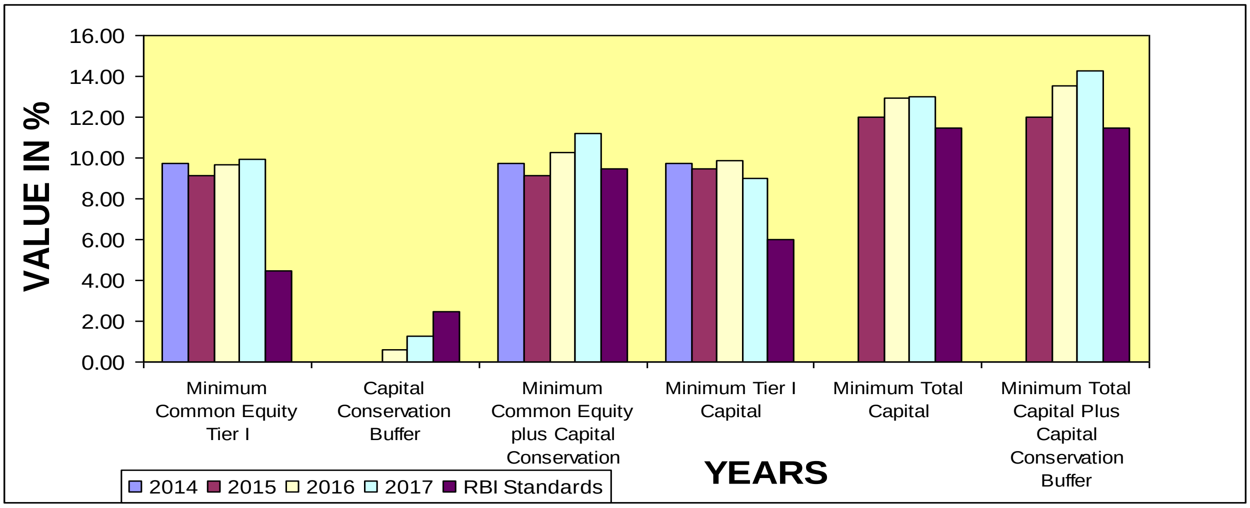
* RWA = Risk weighted Assets;
\# Capital to Risk Weighted Asset Ratio

Capital adequacy ratio

As per RBI norms Capital adequacy ratio for commercial banks are required to maintain CAR of 9 percent while Indian public sector are emphasized to maintain CAR of 12 percent.

SBI is in a position to maintain capital adequacy ratio (CAR) as specified by RBI basel III norms. In 2013-14 it was 12.44 against 12 percent and it decreased to 12 and then from 2015 onwards it has increased to 13.12 and 13.11. Tier I capital it was 10 in 2014 and declined to 9.6 and it has an increasing trend since then. Tier II capital has a mixed trend, it shows that SBI could not maintain its tier II position.

Basel -III Parameter	**2014**	**2015**	**2016**	**2017**	**RBI Standards**	**Mean**	**SD**
Minimum Common Equity Tier I	9.72	9.13	9.67	9.92	4.50	9.61	0.34
Capital Conservation Buffer	-	-	0.63	1.25	2.50	0.47	0.60
Minimum Common Equity plus Capital Conservation Buffer	9.72	9.13	10.30	11.17	9.50	10.08	0.87
Minimum Tier I Capital	9.72	9.49	9.87	9.00	6.00	9.52	0.38
Minimum Total Capital	-	12.00	12.92	13.03	11.50	9.49	6.34
Minimum Total Capital Plus Capital Conservation Buffer	-	12.00	13.55	14.28	11.50	9.96	6.71
Phase-in of all deductions from Common Equity Tier I	40	60	80	100	100	70.00	25.82



The above table displays the key parameters of Basel III which compared with RBI standards for the year 2013-2014 to2016- 2017, where

1. The minimum requirement for common equity, the highest form of loss-absorbing capital, has been raised under Basel III from 2% to 4.5% of total risk-weighted assets. The overall Tier 1 capital requirement, consisting of not only common equity but also other qualifying financial instruments, will also increase from the current minimum of 4% to 6%.Although the minimum total capital requirement will remain at the current 8% level, yet the required total capital will increase to 10.5% when combined with the conservation buffer.

Since SBI is larger bank in the country they could achieve the RBI standards and doubled it easily, for the year 2017 and it stands at 9.92.

2. The capital conservation buffer is designed to ensure that banks build up capital buffers outside periods of stress which can be drawn down as losses are incurred. The

requirement is based on simple capital conservation rules designed to avoid breaches of minimum capital requirements.

SBI facing lot of stress in the quality of assets and their non performing assets are rising year on year, hence this parameter facing shortfall than the required standards.

3 The combination of minimum capital requirement and capital conservation buffer of SBI is kept above the standard requirement of RBI except the year 2016.

4. Tier 1 capital is the core measure of a bank's financial strength from a regulator's point of view.SBI could achieve the minimum standards and their positions are well ahead of it during 2016 this was at 9.87 and 2017 this was standing at 9.00 though there was a fall compared to Year on Year, but its standing tall than the standards at 6.00.

5. Academics, practitioners, and regulators all recognise and agree that capital is required for banks to operate smoothly because capital provides protection. The critical question is how much, and what type of, capital a bank needs to hold so that it has adequate protection.

6. Minimum total capital and Capital conservation buffer has been kept above the standards of RBI from 2013 till 2017.That shows SBI could able to maintain and meet the requirement of RBI.

	Liquidity Ratio		
Year	**Current Ratio(x)**	**Quick Ratio(x)**	**Profitability**
2013-14	0.45	13.88	7.98
2014-15	0.49	10.78	8.59
2015-16	0.87	10.84	6.07
2016-17	0.99	11.94	5.97

Liquidity ratios measure a company's ability to pay debt obligations and its margin of safety through the calculation of metrics including the current ratio, quick ratio and operating cash flow ratio.

The above table shows the liquidity and profitability ratio for the year 2013-2014 to 2016-2017, the profitability ratio is an indicator to measures a company's ability to generate cash flow relative to some metric. It is also a measuring yard stick for the financial health of the company. The profitability was showing ups and downs during the period of study, but during 2016-2017 it touches the lowest among the years due to the following factors

1. Elevated credit costs

2. This financial year was also special owing to the impact of demonetization in Q3 and

3. Severe drought conditions in South India.

During the financial year 2016 profitability (declined by 24.05% from Rs. 13,102 crores in FY15 to Rs. 9,951 crores in FY16) was expected to be under pressure due to two reasons.

1. The interest income growth moderated to 2.96% during FY16.

2. Front loading of provisioning on account of RBI’s Asset Quality Review (AQR) during Q3 & Q4 also adversely impacted the Net Profit of the Bank.

During FY2015, the deposits growth outpaced the advances by a substantial margin due to a fall in consumption demand. Thus, preserving profitability remained a challenge during the year. Despite this, the Bank`s standalone net profit increased by 20.30% to Rs. 13,102 crores during FY2015. The robust growth in profit was achieved by a two-pronged approach.

Firstly, the Bank efficiently deployed the available funds in capital markets which boosted its other income by Rs. 4,023 crores in FY2015.

Secondly, to prevent the erosion in interest income, the Bank monitored its loan book rigorously.

During the study period, the current assets ratio shown a good progress due to Cash and Balances with Reserve Bank of India, Balances with Banks and money at call and short notice helps bank to have more liquid assets. Resulting to this, the ratio was grown from 0.45 (year ending 2013) to 0.99 (year ending 2017).

The quick ratio is a measure of how well a company can meet its short-term financial liabilities. Also known as the acid-test ratio, this indicator shows a swing from 13.88 FY2013 – 2014, a dip of 3 % during 2015, later in Financial Year 2016 and Financial Year 2017, there was improvement due to the stability and growth in terms of cash reserves and reduction of short term liability.

Prolonged slowdown in general macroeconomic conditions over the last three years has impacted business and profit of your Bank. However, the impact of slowdown was not symmetric across all the business verticals. Due to higher provisioning requirement, the growth in Bank's interest and non-interest income did not translate into higher profit figures for this year.

Apart from increase in provision on NPA's, Bank also made additional provision to cover expenses towards wage revision, one time provision for pension due to change in mortality table and payment for pension and gratuity.

Strategies Adopted

SBI has started showing stability sign towards asset quality. It reported gross NPA declined). % per cent on back of strong write off as well as healthy upgradation and cash recovery.

Cost rationalization seems to be under controls which translate to decline in cost to income ratio to below 50 per cent by fiscal end. SBI cost to income ratio 51 per cent.

SBI entered into partnership with several e-commerce payers like Amazon, Snap deal and ola cabs, which has increased the revenue. SBI has lounged its mobile wallet and buddy to strengthen its digital presence. Bank has initiated risk based budgeting and risk assessing process on ongoing on to facilitate immediate corrective action. As a result the risk mitigated port polio of small and medium enterprises sector grown from 25.3 percent to 30.9.

SBI life insurance joint venture partner BNP paribas card if over a potential state sale. It has dismissed immediate plan to merge SBI's five subsidiaries known as associate bank to strengthen operators. Business per employees makes difference between total employees and trained employees decreased 2.45 to march end from 55.45

Findings of the study

1. The capital adequacy ratio has been maintained by SBI.

2. It has been found that the SBI banks have shown the highest annual expansion in terms of number of branches.

3. The capitalization profile of SBI banks continues to perform better since 2013. However, continuous government support (via capital infusion) to enable SBI is maintain a minimum Tier I capital of 9.61% is likely to result in these banks being able to maintain a comfortable capitalization profile over short to medium term.

4. Capital adequacy ratio of SBI is maintained by 9.61 compared to 4.5 of RBI.

5. Minimum capital and conservation buffer is maintained at 10.08 compared to 9.5 of RBI.

6. SBI banks have very good minimum Tier I capital 9.52 compared to 6 of RBI.

7. Minimum total capital plus conservation buffer has been maintained at 9.96 compared to 11.5.

8. SBI Bank group-wise, accounted for the largest CAGR (51.19 per cent) in total deposits.

9. SBI banks have the highest business per employee as well as profit per employee.

10. The NPA of public sector bank was also significantly higher, which indicates the asset quality of banks is comparatively poor.

Conclusion

The present study describes the understanding of Basel III norms and its impact on the SBI Banking System. The summarized findings focus on the positive and negative impact of adopting Basel Accord on the SBI banks. It outlines that even though there are a few loopholes in the Basel III framework which has some demerits, but it has far longer list of benefits which outweighs all the disadvantages. Hence, implementation of Basel III framework by SBI bank has resulted in better performance of banks, benefitting all its stakeholders. Due to radical changes in the banking sector in the recent years, the central banks all around the world have improved their supervision quality and techniques. It is concluded that implementation of Basel III has improve the SBI performance and strategy adopted by SBI has improved their profit and decreased their non performing asset.

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