FAQs

Basel III compliant Bonds

Why is this in news?

- The country's largest lender State Bank of India has raised Rs 7,000 crore by issuing Basel III compliant bonds.

What are Basel III compliant Bonds?

- The bonds qualify as tier II capital of the bank, and has a face value of Rs 10 lakh each, bearing a coupon rate of 6.24 per cent per annum payable annually for a tenor of 10 years.
- There is a call option after 5 years and on anniversary thereafter.
- Call option means the issuer of the bonds can call back the bonds before the maturity date by paying back the principal amount to investors.

What are Basel Norms?

- Basel is a city in Switzerland. It is the headquarters of the Bureau of International Settlement (BIS), which fosters co-operation among central banks with a common goal of financial stability and common standards of banking regulations.
- Basel guidelines refer to broad supervisory standards formulated by this group of central banks – called the Basel Committee on Banking Supervision (BCBS).
- The set of the agreement by the BCBS, which mainly focuses on risks to banks and the financial system is called Basel accord.
- The purpose of the accord is to ensure that financial institutions have enough capital on account to meet obligations and absorb unexpected losses.
- India has accepted Basel accords for the banking system.

What are BASEL I, BASEL II and BASEL III norms?

Basel I

- In 1988, BCBS introduced a capital measurement system called Basel capital accord, also called as Basel 1.
- It focused almost entirely on credit risk. It defined capital and structure of risk weights for banks.

FAQs

- 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 1 guidelines in 1999.

Basel II

- In June '04, Basel II guidelines were published by BCBS, which were considered to be 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.

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.
- Also, the quantity and quality of capital under Basel II were deemed insufficient to contain any further risk.
- Basel III norms aim at making most banking activities such as their trading book activities more capital-intensive.
- The guidelines aim to promote a more resilient banking system by focusing on four vital banking parameters viz. capital, leverage, funding and liquidity.