

BANKING

Evolution of Banking in India

- Bank of Hindustan established in 1779 was the first bank to be established in India.
- First bank to be established by Indians was Awadh Commercial Bank in 1881.
- Punjab National Bank was the second bank to be established by Indians. It was established in 1894.
- First Bank established by East India Company was Presidency Bank of Bengal in 1806. Further it established two more banks, Presidency Bank of Bombay in 1840 and Presidency Bank of Madras in 1843.
- In 1921 these Presidency banks were merged in Imperial Bank of India which was restructured as State Bank of India in 1955.
- In 1959 Central Government took over banks from states/princely states government and associated them with State Bank of India.
- Recently two associate banks - State Bank of Indore and State Bank of Saurashtra have been merged into S.B.I.

Associate Banks:-

1. State Bank of Bikaner & Jaipur
2. State Bank of Indore
3. State Bank of Hyderabad
4. State Bank of Mysore
5. State Bank of Travancore
6. State Bank of Saurashtra
7. State Bank of Patiala

Nationalisation of Banks

- In 1969, 14 banks whose deposits were more than ₹50 crore were nationalised.
- Central Bank of India, Bank of Maharashtra, Dena Bank, Punjab National Bank, Syndicate Bank, Canara Bank, Indian Bank, Indian Overseas Bank, Bank of Baroda, Union Bank, Allahabad Bank, United Bank of India, UCO Bank, Bank of India are the 14 banks which were nationalised.
- In 1980, Government nationalised 6 more banks. These banks are – Punjab & Sindh Bank, Andhra Bank, Oriental Bank of Commerce, Corporation Bank, Vijaya Bank and New Bank of India.
- Public Sector Banks (owned by Central government) – The State Bank Group, 19 Nationalised Banks and IDBI Bank. Total number of public sector banks is 19.

Objective of Nationalisation

- To Induce Confidence of Public in Banking Sector
- To provide social orientation like loan to weaker sections of society, opening accounts in rural areas
- To reduce inequalities in society

Assessment of Nationalisation

- **Achievements**
 - Most of the social objectives were achieved.
 - Bank deposits increased significantly.
 - Branches of banks in rural areas increased substantially.
 - Loans to priority sector increased
- **Failure**
 - Efficiency and profitability of Banks declined drastically
- **Banking Sector Reforms (Narasimham Committee)**
 - Reduce CRR and SLR
 - Reduction in priority sector lending quota
 - New Banks to be set up
 - Basel Norms to be adopted
 - More autonomy to Public Sector Banks
 - Banking Ombudsman should be established
 - Debt recovery tribunals should be established
 - Interest rates should be de-regulated

Causes of Losses:-

- Lending to priority sector
- Non-Performing assets
- Concessional rate of Interest
- Cost of servicing of loans
- High CRR and SLR
- Over Staffing
- Trade Union

Non-Performing assets are those an asset on which loan or interest remains pending for over 90 days

- **Narasimham Committee – II**
 - 4 tier bank structure
 - International Level
 - National Level
 - Regional Level
 - Rural Level

The Narasimham-II Committee was tasked with the progress review of the implementation of the banking reforms since 1992 with the aim of further strengthening the financial institutions of India.

It focussed on issues like size of banks and capital adequacy ratio among other things. M. Narasimham, Chairman, submitted the report of the Committee on Banking Sector Reforms (Committee-II) to the Finance Minister Yashwant Sinha in April 1998.

BASEL Norms

- Basel Norms were established by Bank for International Settlements in 1930.
- It is the Bank of Central Banks as only Central Banks can be its members.
- In 1988 Basel Norms established a committee on Banking Supervision.
 - Objective of this committee is to recommend various norms which should be adopted by the Central Banks to regulate banking sector.
 - These norms are called Basel Norms
 - These norms were revised in 2004 and into Basel II
 - These norms were further revised in 2010 into Basel III
- Focus of Basel Norms is to ensure Capital Adequacy
- Capital Adequacy Ratio (CAR) = $\frac{\text{Capital}}{\text{Risks Weighted Assests}} \times 100$

Basel III was released in December, 2010 under the title

Basel III: International framework for liquidity risk measurement, standards and monitoring

The revised version was released in 2011 under the title

Basel III: A global regulatory framework for more resilient banks and banking systems - revised version June 2011

CAPITAL

- **Tier I Capital (Core Capital)**
 - It includes pure equity capital
 - Equity means share thus it includes Share Capital (Paid up Capital)
 - It also includes Undistributed Profits (Reserves)
 - It includes Preference shares
- **Tier II Capital (Supplementary Capital)**
 - Mixture of equity & Debt Capita
 - E.g. - subordinated debt

The Major Changes Proposed in Basel III over earlier Accords i.e. Basel I and Basel II

1. **Better Capital Quality:** One of the key elements of Basel 3 is the introduction of much stricter definition of capital. Better quality capital means the higher loss-absorbing capacity. This in turn will mean that banks will be stronger, allowing them to better withstand periods of stress.
2. **Capital Conservation Buffer:** Another key feature of Basel iii is that now banks will be required to hold a capital conservation buffer of 2.5%. The aim of asking to build conservation buffer is to ensure that banks maintain a cushion of capital that can be used to absorb losses during periods of financial and economic stress.
3. **Countercyclical Buffer:** This is also one of the key elements of Basel III. The countercyclical buffer has been introduced with the objective to increase capital requirements in good times and decrease the same in bad times. The buffer will slow banking activity when it overheats and will encourage lending when times are tough i.e. in bad times. The buffer will range from 0% to 2.5%, consisting of common equity or other fully loss-absorbing capital.

4. **Minimum Common Equity and Tier 1 Capital Requirements:** 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.
5. **Leverage Ratio:** A review of the financial crisis of 2008 has indicted that the value of many assets fell quicker than assumed from historical experience. Thus, now Basel III rules include a leverage ratio to serve as a safety net. A leverage ratio is the relative amount of capital to total assets (not risk-weighted). This aims to put a cap on swelling of leverage in the banking sector on a global basis. 3% leverage ratio of Tier 1 will be tested before a mandatory leverage ratio is introduced in January 2018.
6. **Liquidity Ratios:** Under Basel III, a framework for liquidity risk management will be created. A new Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) are to be introduced in 2015 and 2018, respectively.
7. **Systemically Important Financial Institutions (SIFI):** In addition to meeting the Basel III requirements, global systemically important financial institutions (SIFIs) must have higher loss absorbency capacity to reflect the greater risks that they pose to the financial system. The Committee has developed a methodology that includes both quantitative indicators and qualitative elements to identify global systemically important banks (SIBs). The additional loss absorbency requirements are to be met with a progressive Common Equity Tier 1 (CET1) capital requirement ranging from 1% to 2.5%, depending on a bank's systemic importance.

Basel III norms have not been adopted till now. These norms will be adopted in USA and Europe and in other nations gradually from 2013 – 2018.

Why Basel – III norms have not been adopted as Profitability of the banks will be reduced if these norms are adopted.

In India, RBI announced that Banks will adopt Basel III norms from April 1, 2013 and will be fully adopted by 2018.