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Anlaysing the Effect of Basel III Norms on Asset Quality of Commercial Banks in India

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Abstract:- Financial sector reforms have made significant transformation in Indian banking sector. India has adopted international best practices to make more efficient and strong banking sector in India. Different prudential norms and provisioning norms are issued to improve the overall effectiveness of the banking sector, bringing down non-performing assets level and increasing the profitability of the banks. RBI had implemented Basel I & II norms in the year 1999 and 2003 respectively. It is also in the stage of implementation of Basel III guidelines by March 2019. Although the adoption of global regulatory norms is in process, the percentage of weak assets into the banking sector is also increasing which may become a hindrance in effective compliance with the regulatory norms.

***Keywords**:- Basel III Capital Adequacy Ratio (CAR), Capital to Risk Weighted Assets Ratio (CRAR), Non – Performing Assets (NPA).*

I. INTRODUCTION

Basel committee on Banking Supervision (BCBS) , the committee formed under the auspices of Bank of International Settlement (BIS) has issued Basel banking Accords. The committee formulates guidelines and makes recommendation on best practices in the banking industry. The basic purpose of Basel Accords is to ensure financial stability and thereby increase risk absorbing capability of the banks. The issue of mounting weak assets is one of the most important aspects in many developing countries. An analytical study of such non performing assets in the era of regulatory compliance is done to find the roadmap towards compliance. As per the report, public sector banks had accounted for Rs. 2.16 lakhs crores NPA in the financial year 2013-14 and private sector banks had accounted for Rs. 22738 crores NPA in the same year. As per the RBI report of the year 2014-15, the gross NPA ratio reached to 4.45% in the year as compared to the last year i.e. 4.1%.

II. REVIEW OF LITERATURE

Literature review was done in the areas of quality of assets of banking sector, problem of non-performing assets, its effects on the profitability and liquidity of the banks and thereby its effect on the implementation of Basel III norms in India.

Vivek Rajbahadur Singh (2016), has analyzed that the banking sector in India has faced and are facing serious problem of raising non- performing assets. The mounting NPA has a direct impact on the profitability of the banks. NPAs affect the liquidity and profitability of banks. It also creates threat on quality of assets and survival of banks. The whole economy is also facing the problem due to rise in the NPAs of the banks The author concluded that the NPA problem needs to be tackled immediately so as to maintain the profitability of the banks in India.

According to Chandan Chatterjee, Jeet Mukherjee, Ratan Das (2012), financial sector reforms made Indian banking sector transformed significantly. Introduction of prudential norms, payment system, integrating and provisioning norms resulted into improving the efficiency of the banking sector and curtailing down the NPAs. The overall profitability of the banks curtailed down due to provisioning requirement for NPAs. The authors has mainly focus on the reasons and effects of NPAs, policy measures of RBI , curative steps of Indian government , and sector-wise NPAs in the banking sector. The author is of the opinion that RBI, Ministry of Finance should take continuous and considerable efforts to control the menace of NPAs. The author pointed out that when banks are backed by the strong political and financial consciousness, there will be satisfactory solutions to the increasing problems of mounted NPAs.

Sulagna Das, Abhijit Dutta (2014), focus on the factor contributing for NPA in banking industry and its impact thereon. The authors had studied the SBI & its associates and other public sector banks for 6 years period and concluded that banks irrespective of their operations have similar NPA level.

On the review of above literature there is a need to conceptualize the non performing assets, the Basel III regulation and its effect on quality of assets of the banking sector.

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III. OBJECTIVES

To anlayse impact of Basel III norms on quality of assets of commercial banks in India.

A. *Concept of NPA*

RBI has classified banking assets and has defined non-performing Assets (NPA) as the asset which stops to earn the income. Any loan or advance becomes NPA if the interest or instalment of the principal remains overdue for a period of 90 days in respect of term loan. In case of cash credit /overdraft facility the account should be treated as NPA if it becomes 'Out of order' i.e. the outstanding balance remains continuously in excess of the sanctioned limit or drawing power.

B. *Types of NPA*

There are three major types of NPA:

- *Sub-standard assets:*

If the assets remained NPA for a period less than or equal to 12 months, it is classified as substandard assets. Such an asset will have well defined credit weaknesses that jeopardise the liquidation of the debt and are characterised by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.

- *Doubtful assets:*

If the asset has remained in the sub-standard category for a period of 12 months, then it needs to be transferred to doubtful category. These assets has all the weaknesses inherent in assets that were classified as sub-standard adding to this with the added characteristic that the weaknesses make collection or liquidation in full, highly questionable and improbable.

- *Loss Assets:*

In this case a loss has been identified by the bank or internal or external auditors or the RBI inspection. The amount of loss has not been written off wholly. Such assets are considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.

IV. TYPE OF NPAS

A. *The accounting wise NPA is classified into:*

Gross NPA: Gross NPA is the addition of Sub-standard assets, Doubtful Assets and Loss assets of the banks on the balance sheet date. It can be calculated with the help of following ratio.

$$\text{Gross NPA Ratio} = \frac{\text{Gross NPAs}}{\text{Gross Advances}}$$

Net NPA: Net NPAs are calculated after deducting the provision regarding NPAs. This is the actual burden of banks**.** Being a time consuming task of resolving the NPA problems, banks can seek the guidance from the central government regarding restoring the NPA.It can be calculated by following.

$$\text{Net NPA Ratio} = \frac{\text{Gross NPAs - Provisions}}{\text{Gross Advances- Provisions}}$$

B. *Basel III*

In 2010, Basel III guidelines were released. .This enhanced the regulatory framework of banks. Its main aim is to reduce the economic and financial stress of banks, strengthening of transparency and improving the risk management techniques. This was made primarily to fight the 2008 financial crises. Its main target was to make the activities of banks more capital intensive. As per the set deadlines all the Indian banks and international banks should become compliant with Basel III norms by March 31, 2019 .Implementation of this accord is aimed at considerable increase in banks' capital. It will introduce the new global liquidity standards. The complete adoption of Basel II has laid down the foundation for Basel III. It is believed that after successful implementation of Basel III the GDP is expected to increase from 0.05% to 0.15%. It will regulate the banks to take early remedial actions for risk management.

C. *Trends in NPA Levels*

For assessing comparative position of NPAs before and after implementation of Basel III norms, the data has been collected from the year 2001-2002 to 2016-2017 using RBI reports on banks i.e. Annual Financial Reports, data available in the research papers published.

Table 1. lists the percentage of non-performing assets public sector banks and private sector banks.

	Public Sector Banks		Private Sector Banks	
years	Gross NPAs (%)	Net NPAs(%)	Gross NPAs (%)	Net NPAs (%)
2008-09	2.00	0.94	2.36	0.90
2009-10	2.20	1.09	2.32	0.82
2010-11	2.40	1.20	1.97	0.53
2011-12	3.30	1.70	1.80	0.60
2012-13	4.10	2.00	2.00	0.50
2013-14	5.25	2.25	2.15	0.55
2014-15	6.00	2.30	2.25	1.25
2015-16	9.30	5.70	2.80	1.40
2016-17	11.70	6.90	4.10	2.20

Table 1. Percentage of Gross and Net Non-Performing Assets (NPAs) of Public Sector Banks and Private Sector Banks : 2008-2009 To 2016-2017

Source: Report on trend and progress of Banking in India from 2008- 09 to 2016-17.

An analysis of NPAs of important banking sectors of the Indian economy indicates that there is rise in the NPA of the public sector banks during the phase of Basel III implementation as compared to the Basel II era. The percentage of gross NPA and Net NPA of the public sector banks increased sharply since 2010-11 to 2016-17. Whereas private sector banks are showing gradual increase in the NPA percentage in the same period. Sharp increase in NPA is seen during Basel III era. RBI had conducted Asset Quality Review (AQR) during the period August 2015 to December 2016 to surgically restructure the balance sheets of the banks. The major reasons for the declining assets quality of the banks in India is ineffective governance and weakness in the credit appraisal system. Proper credit risk assessment needs to be done. Conduct of post sanction appraisal activity by the banks will lead to reduction in the problem of rising NPA and will lead to maintain asset quality of the banks.

V. CONCLUSION

The financial conditions of the bank are determined on the basis of quality of the assets the banks are having. Indian banks are facing the problem of deterioration in the quality of the asset. One of the important tasks in case of bank management is to maintain sound asset quality. During the period of depression, banks management should focus on managing the sound asset quality .An attempt is made to identify the impact of Basel reforms on the asset quality of two important banking sector in India.

Non-performing assets have the impact of reducing the capital adequacy ratio in case of banking sector of the economy. Banks have to take lead role in reducing the NPAs. Continuous decrease in NPAs will improve the asset quality of the banks and will help to face the challenges in the implementation of new Basel framework i.e. Basel III.

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