Basel Norms (Introduction)

- What are they? International banking rules for safety & stability.
- Who makes them? BCBS (Basel Committee on Banking Supervision), Switzerland.
- Why? To avoid bank failures & protect depositors' money.

Basel I (1988)

- Focus: Mainly Credit Risk (risk of loan default).
- Key Rule: Minimum Capital Requirement set at 8% of Risk-Weighted Assets (RWA).
- Defined Capital structure into Tier 1 & Tier 2.
- Adopted in India in 1999.

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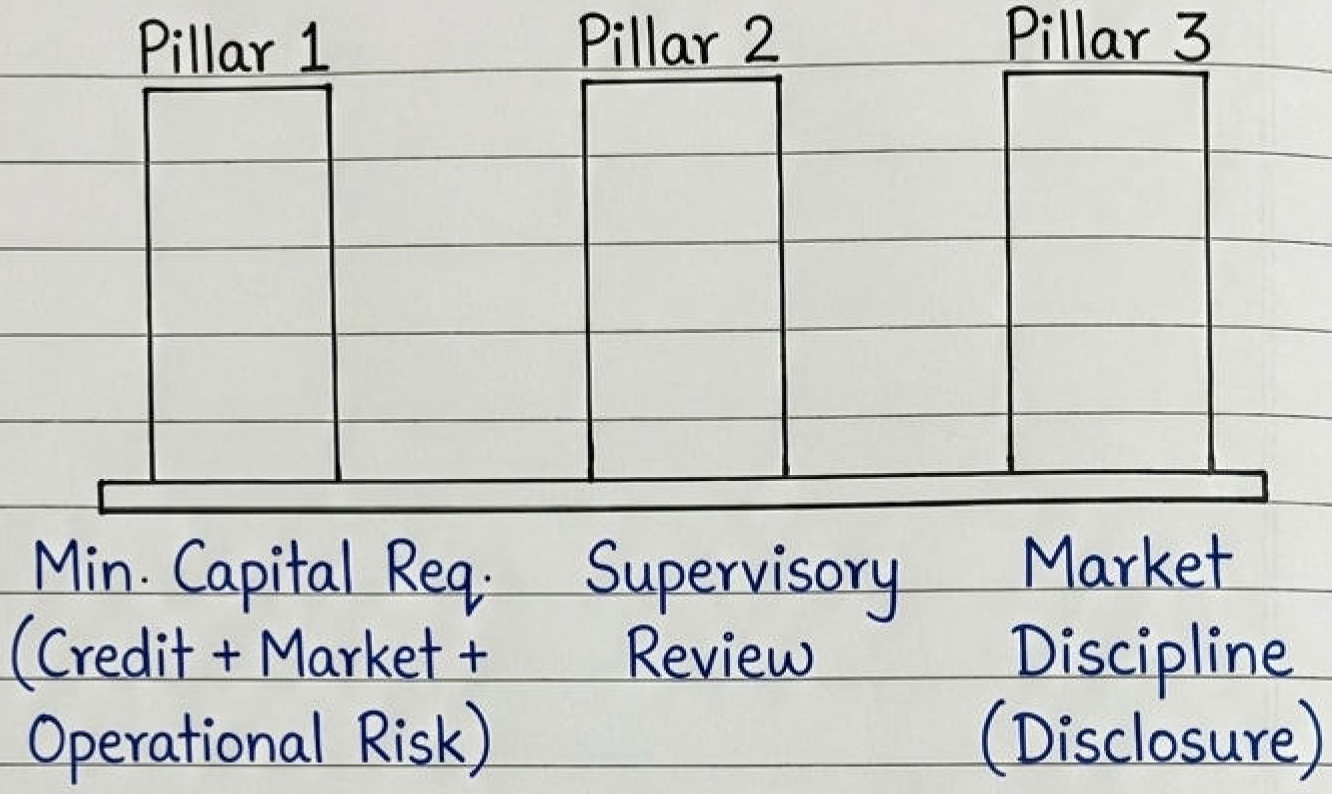
Basel II (2004)

- Improved version of Basel I.
- Introduced '3 Pillars' approach:



Basel III (2010, post-crisis)

- Focus: Stronger capital, Liquidity & Leverage control.
- Key Changes:
  - → Higher Tier 1 Capital req.
  - → New Buffers: Capital Conservation Buffer (CCB) & Countercyclical Capital Buffer (CCCB).
  - → Liquidity Ratios: LCR (short-term) & NSFR (long-term).
  - → Leverage Ratio introduced.
- In India, RBI norms are stricter (higher minimum CAR).

Capital Adequacy Ratio (CAR) / CRAR

- Definition: Ratio of a bank's capital to its risk-weighted assets.

- Importance: Shows bank's financial strength to absorb losses.
  Protects depositors.

- Formula:

☆
$$\boxed{CRAR = \frac{\text{Total Eligible Capital}}{\text{Total Risk-Weighted Assets}} \times 100}$$

OR,

$$CAR = \frac{\text{Tier 1 Capital} + \text{Tier 2 Capital}}{\text{RWAs for Credit} + \text{Market} + \text{Operational Risk}} \times 100$$

Simple Example:

- Bank has Capital = ₹150 cr.
- Total RWA = ₹1000 cr.

- $CAR = \frac{150}{1000} \times 100 = 15\%$

Components of Capital (Tier 1 & Tier 2)

★ Tier 1 (Core Capital) *

- 'Going-concern' capital (absorbs losses while bank runs).
- Most reliable, permanent.
- Eg: Paid-up equity capital, retained earnings, disclosed reserves.

Tier 2 (Supplementary Capital)

- 'Gone-concern' capital (absorbs losses during winding-up).
- Less reliable cushion.
- Eg: Undisclosed reserves, subordinated debt.

Risk-Weighted Assets (RWA)

- Concept: Different assets have different risk levels.
- RWA = Asset Value * Risk Weight %.
- Example:
  → Cash / Govt. Bonds: 0% risk (low RWA).
  → Personal Loans: 100% risk (high RWA).