

# 'LCR transition to impact banks' profitability and credit growth'

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COIMBATORE: Though the introduction of liquidity coverage ratio (LCR) is a positive step for the banking sector, it could come at a high transition cost for some banks, India Ratings and Research has said. "Any short-term liquidity crunch could lead to solvency issues with banks that do not have contingent liquidity plans in place. Basel III regulations have introduced LCR to quantify this risk," it said.

The reported yearly ratios are monthly averages recorded by banks, the median of which stood at 101.5% for Indian banks as of March 2015 against the required regulatory minimum requirement of 60%. This requirement will be phased up to 100% by March 2019.

"Banks may explore liability or asset side improvements to shore up their LCR ratios. Improvements on the liability side may take time to materialise depending upon the pace of retail deposit accretion," the agency said.

"Banks that have been losing retail deposit market share over the last few years or the ones running high asset-liability management (ALM) mismatches in the short-term buckets would be compelled to keep a high proportion of high-quality liquid assets (HQLA) to manage their LCRs," India Ratings said.



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"This would necessarily be a drag on their profitability owing to the low-yielding statutory liquidity ratio (SLR) securities replacing high-yielding advances," it said.

"Banks with below 100% LCR would need, on average, to increase HQLA to the tune of 4% of the total 2014-15 assets," the agency, which is part of the Fitch Group, said.

"The LCR number is quite volatile, and monthly averages may rise or fall significantly based on the state of the 30-day asset-liability profile," it said. India Ratings expects the structural volatility in LCR to increase, given the proposed switch from monthly to daily average LCR calculations by March 2017.

"This transition will impact daily cash management for banks, as they would have to adjust their HQLA components accordingly, restricting available funds on an everyday basis," it said.

Most banks managed to shore up their LCR ratios in the first half of 2015-16, primarily by increasing their HQLA covers and taking some profitability hit. However, improving the liability profile through the transition would be critical for cushioning the impact, India Ratings stated.

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