THE HINDU BusinessLine

Liquidity coverage ratio will impact profitability of banks: India Ratings

Our Bureau
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The introduction of liquidity coverage ratio (LCR) is a positive step for the banking sector, but it could come at a high transition cost for some banks, according to India Ratings and Research.

“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,” Kunaey Garg, analyst, said in a report.

LCR is a regulatory requirement for banks to set aside a certain amount of highly-liquid assets, such as cash or Treasury bonds, to meet short-term liquidity disruptions. Hence, banks have that much less availability of short-term funds.

The monthly average ratio stood at 101.5 per cent for Indian banks as of March 2015 against the required regulatory minimum requirement of 60 per cent. This requirement will be ratcheted up to 100 per cent 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. 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,” the report said.

It added that this would necessarily be a drag on their profitability owing to the low-yielding statutory liquidity ratio (SLR) securities replacing high-yielding advances.

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