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# Ensuring better risk coverage at banks by Basel-III norms

By [Gayatri Nayak](#), ET Bureau | Updated: Jan 27, 2016, 02:59 AM IST

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ET explains the [Basel-III](#) prudential norms aimed at stability of the financial system

**1. What are the Basel-III norms?** These are rules written by the Bank of International Settlements' Committee on Banking Supervision (BCBS) whose mandate is to define the reform agenda for the global banking community. The new rule prescribes how to assess risks, and how much capital to set aside for banks in keeping with their risk profile.

**2. What are the objectives of the new norms?** Higher and improved risk coverage of banks is the objective of Basel III accord. This could be achieved by the introduction of capital conservation buffer, countercyclical buffer and leverage ratio. Capital conservation buffer ensures that banks accumulate capital buffers in times of low financial stress which is handy when banks are hit by losses, and aims to prevent violations of minimum capital requirements. The countercyclical buffers help banks create an armoury of reserves in good times so that they can use them at times of financial stress. The [leverage ratio](#) is incorporated in addition to the riskbased capital requirements in place to curb excessive leverage and strengthen risk-based requirements.



**3. What do these new rules say?** While the key capital ratio has been raised to 7 per cent of risky assets, according to the new norms, tier-I capital that includes common equity and perpetual preferred stock will be raised from 2 per cent to 4.5 per cent starting in phases. This started in January 2013 and will be completed by January 2018. In addition, banks will have to set aside another 2.5 per cent as a contingency for future stress. Banks that fail to meet the buffer would be unable to pay dividends.

**4. How different is the approach now?** The new norms are based on renewed focus of central bankers on macro-prudential stability. The global financial crisis following the crisis in the US sub-prime market has prompted this change in approach. The previous set of guidelines, popularly known as [Basel II](#) focused on macro-prudential regulation. In other words, global regulators are now focusing on financial stability of the system as a whole rather than micro regulation of any individual bank.

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