Extension of time period for implementation of Basel 3 guidelines is credit negative for banks, says Moody's

OUR BUREAU

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The Reserve Bank of India's decision to extend the timeline for the full implementation of Basel 3 guidelines by a year is a credit negative for Indian public sector banks (PSBs), according to Moody's Investors Service.

The RBI's board on Monday decided to ease capital pressure on banks by allowing them one more year to meet the Capital Conservation Buffer (CCB). This buffer is aimed at ensuring that banks build up capital buffers during non-stress periods so that they can be drawn down when losses are incurred.

The transition period to implement the last tranche of 0.625 per cent under CCB has been extended by one year — up to March 31, 2020. Now, banks can achieve CCB of 2.5 per cent of their risk-weighted assets by March-end 2020.

However, the capital to risk-weighted assets ratio (CRAR), which is the amount of capital banks need to hold for making loans and absorbing possible losses, has been retained at 9 per cent.

The global credit rating agency, in a statement, said, "It was our expectation that all PSBs would have a core equity tier 1 (CET1) ratio of at least 8 per cent by the end of March 2019, based on the government's commitment that it would capitalise all these banks to a level sufficient to meet the minimum regulatory capital norms."

With the regulatory timelines now extended, Moody's observed that it may be a case that at least some of the rated PSBs CET1 ratios over the next 12 months would be lower than what it currently expects.

Few benefits

Karthik Srinivasan, Group Head, Financial Sector ratings, ICRA Ltd, said, "With many banks struggling to meet the basic capital ratios, i.e. CRAR of 9 per cent, the decision to extend the transition period for implementing the last tranche of CCB by one year is likely to benefit only a few banks, as most of the PSBs are not maintaining the existing CCB requirement of 1.875 per cent."

"The benefit will hence be limited to banks whose CCB is higher than 1.875 per cent but lower than 2.5 per cent, who can now purse credit growth without a worry of capital breach. While CCB is not a concern for most of the private banks, CCB deferment can increase their capital cushion over regulatory levels."

Further, the decision for RBI to retain the CRAR of banks at minimum 9 per cent is a positive for the banking system, given high unprovided losses against the existing stressed loans. The solvency ratio for PSBs (i.e., Net NPA / Net worth) stood weak at 84 per cent. Lowering CRAR would have meant a further lowering of capital against unprovided losses.

On the RBI board's decision that the central bank will consider a scheme for the restructuring of the stressed standard assets of MSME (micro, small and medium enterprise) borrowers with aggregate credit facilities of up to Rs 25 crore, subject to certain conditions, Moody's said, "while more details are awaited, this approach has the potential for negative implications for the credit profiles of Indian banks."

The agency underscored that the track record of such dispensations on asset classification have largely been unsuccessful in addressing the underlying stress. On the contrary, keeping stressed loans in the standard category has led to an underestimation of the extent of underlying asset quality issues by bank managements and consequently, the severity of the actions they need to take to address the issue.

Karthik assessed that based on the existing framework, almost 17 out of 21 PSBs would come under the PCA (Prompt Corrective Action) framework, even though only 11 of them are formally placed under PCA. With the PCA framework to now be examined by the Board for Financial Supervision (BFS) of RBI, one may explore scenarios for a faster exit of banks from PCA framework, he added. The framework restricts weak banks' lending and expansion so that they can be nursed back to health.

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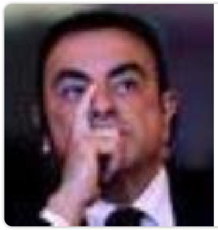

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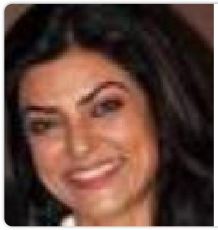

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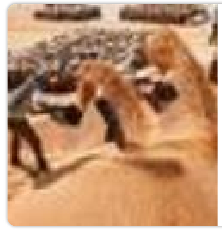

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