Lowering leverage ratio threshold can offer leeway to expand balance sheet of banks

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Impact on large banks sporting a high ratio will be minimal

The RBI lowered the minimum leverage ratio (LR) against which banks are monitored from 4.5 per cent to 4 per cent for Domestic Systemically Important Banks (DSIBs) and 3.5 per cent for other banks. This allows some leeway for banks to take additional exposure (vis-à-vis capital) and expand their balance sheets.

Given that an underlying cause of the global financial crisis was the build-up of excessive on- and off-balance sheet leverage, despite strong risk-based capital ratios, Basel-III framework introduced a simple and non-risk-based leverage ratio to supplement risk-based capital requirements. The intent was to restrict the build-up of leverage in the banking system.

The final minimum LR requirement by the RBI for Indian banks was to be laid down after taking into account the final rules prescribed by the Basel Committee.

In the interim, the RBI had given an indicative LR of 4.5 per cent against which banks were to be monitored.

The leverage ratio is computed as capital (Tier I capital — numerator) divided by the bank's exposures (denominator). Hence, a rise in exposure would lead to a fall in LR. Hence if a bank's LR falls below the RBI's threshold, it would serve as a warning signal for the regulator.

By bringing down the threshold level, the RBI has offered more scope for banks to up lending/exposures and expand their balance sheet.

Going by the latest numbers disclosed by banks, most of them are well within the threshold. Central Bank of India, however, has an LR of 3.3 per cent and may need to trim some exposures to meet the RBI's threshold.

For some others, LR is in and around the 4-per cent mark, RBI lowering LR requirement to 3.5 per cent (from 4.5 per cent) offers scope to increase exposures.

RBI named three banks — SBI, ICICI Bank and HDFC Bank — as DSIBs, in its March 2019 communiqué. These banks have LR above the RBI's mandated requirement.

For ICICI Bank and HDFC Bank, the leverage ratio is 9-10 per cent, way above the 4 per cent (earlier 4.5 per cent) threshold.

Hence lowering of the threshold would not make any significant impact for these banks.

banking

COMMENTS

Where they stand

Basel III leverage ratio (%) as of March 2019

Allahabad Bank	4.74
Andhra Bank*	4.63
Bank of India*	4.62
Canara Bank*	5.10
Central Bank	3.30
Indian Overseas Bank	3.89
IDBI Bank	4.69
Indian Bank*	6.33
Punjab National Bank	3.88

State Bank of India	5.25
HDFC Bank	10.84
ICICI Bank	9.31
Axis Bank	7.69
YES Bank	7.39

*As of Dec 2018

Source: Bank websites, annual report

Published on June 06, 2019

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