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Important highlights from BIS website

Bank For internationalisation Settlements

- Established in 1930, the BIS is owned by 60 central banks, representing countries from around the world that together account for about 95% of world GDP.
- Its head office is in Basel, Switzerland.
- The Bank for International Settlements is often called the "central bank for central banks" because it provides banking services to institutions such as the European Central Bank and Federal Reserve.
- Its mission is to serve central banks in their pursuit of monetary and financial stability, to foster international cooperation in those areas and to act as a bank for central banks.
- The Basel Committee for Banking Supervision (BCBS), while technically separate from the BIS, is a closely associated international forum for financial regulation that is housed in the BIS' offices in Basel, Switzerland.
  - The BCBS is responsible for the Basel Accords, which recommend capital requirements and other banking regulations that are widely implemented by national governments.
  - The bank does not handle transactions for, or provide loans to, governments. It also does not do business with corporations or consumers.
- The BIS also conducts research into economic issues and publishes reports.

Basel Accords

Basel Accords are a set of international banking regulations that provide a framework for the supervision, regulation, and risk management of banks. These norms were developed by the Basel Committee on Banking Supervision, a group of central bankers and bank supervisors from around the world, in response to the global financial crises of the 1980s and 1990s.

- **Basel-I**
  - It was introduced in 1988.
  - It **focused almost entirely on credit risk.**
  - Credit risk is the possibility of a loss resulting from a borrower's failure to repay a loan or meet contractual obligations. Traditionally, it refers to the risk that a lender may not receive the owed principal and interest.
  - It defined capital and structure of risk weights for banks.
  - The minimum capital requirement was fixed at 8% of risk weighted assets (RWA).
  - RWA means assets with different risk profiles.
  - For example, an asset backed by collateral would carry lesser risks as compared to personal loans, which have no collateral.
  - **India adopted Basel-I guidelines in 1999.**

- **Basel-II**
  - In 2004, Basel II guidelines were published by BCBS.
  - These were the refined and reformed versions of Basel I accord.
  - The guidelines were **based on three parameters, which the committee calls it as pillars.**

        - **Capital Adequacy Requirements:** Banks should maintain a minimum capital adequacy requirement of 8% of risk assets
        - **Supervisory Review:** According to this, banks were needed to develop and use better risk management techniques in monitoring and managing all the three types of risks that a bank faces, viz. credit, market and operational risks.
        - **Market Discipline:** This needs increased disclosure requirements. Banks need to mandatorily disclose their CAR, risk exposure, etc to the central bank.
    - **Basel II norms in India and overseas are yet to be fully implemented though India follows these norms.**

- **Basel III**
    - In 2010, **Basel III** guidelines were released.
    - These guidelines were introduced in response to the financial crisis of 2008.
    - A need was felt to further strengthen the system as banks in the developed economies were under-capitalized, over-leveraged and had a greater reliance on short-term funding.
    - It was also felt that the quantity and quality of capital under Basel II were deemed insufficient to contain any further risk.
- The guidelines aim to promote a more resilient banking system by focusing on four vital banking parameters **viz. capital, leverage, funding and liquidity.**
    - **Capital:** The capital adequacy ratio is to be maintained at 12.9%. The minimum Tier 1 capital ratio and the minimum Tier 2 capital ratio have to be maintained at 10.5% and 2% of risk-weighted assets respectively.
        - In addition, banks have to maintain a capital conservation buffer of 2.5%. **Counter-cyclical buffer** is also to be maintained at 0-2.5%.
    - **Leverage:** The leverage rate has to be at least 3 %. The leverage rate is the ratio of a bank's tier-1 capital to average total consolidated assets.
    - **Funding and Liquidity:** Basel-III created **two liquidity ratios: LCR and NSFR.**
        - The **liquidity coverage ratio (LCR)** will require banks to hold a buffer of high-quality liquid assets sufficient to deal with the cash outflows encountered in an acute short term stress scenario as specified by supervisors.
        - This is to prevent situations like **"Bank Run".** The goal is to ensure that banks have enough liquidity for a 30-days stress scenario if it were to happen.
        - The **Net Stable Funds Rate (NSFR)** requires banks to maintain a stable funding profile in relation to their off-balance-sheet assets and activities. NSFR requires banks to fund their activities with stable sources of finance (reliable over the one-year horizon).
        - The minimum NSFR requirement is 100%. Therefore, LCR measures short-term (30 days) resilience, and NSFR measures medium-term (1 year) resilience.