Safety of Indian Banks

Why in news?

The failure of Silicon Valley Bank and Signature Bank in the US raises questions on the safety of depositors' wealth in India.

What is the background of the issue?

- **Safe haven –** India remained a safe haven during the global financial crisis triggered by the collapse of investment bank Lehman Brothers in 2008.
- **Sound domestic banks –** This is because of the domestic banks, backed by sound regulatory practices, showing strength and resilience.
- **Unaffected –** Indian banks remained unaffected by the failure of Silicon Valley Bank (SVB) and Signature Bank, despite the global interconnectedness in the financial sector.

What is the basis for the confidence in the resilience of Indian banks?

- **Balance sheet –** A reason why an SVB-like failure is unlikely in India is that domestic banks have a different balance sheet structure.
- **No large withdrawals –** In India we don't have a system where deposits are withdrawn in such bulk quantities.
- **Household savings –** It constitute a major part of bank deposits in India, this is different from the US, where a large portion of bank deposits are from corporates.
- **Public sector banks –** A large chunk of Indian deposits is with public sector banks, and the rest is with very strong private sector lenders.
- **Importance to depositor's money –** In India, the approach of the regulator has generally been that depositors' money should be protected at any cost.
- The best example is the rescue of Yes Bank where a lot of liquidity support was provided.

Which banks are classified as D-SIBs?

- **D-SIBs –** RBI has classified SBI, ICICI Bank, and HDFC Bank as Domestic Systemically Important Banks (D-SIBs).
- It means that these banks have to earmark additional capital and provisions to safeguard their operations.
- **CET1 –** The additional Common Equity Tier 1 (CET1) requirement for D-SIBs was phased-in from 2016, and became fully effective from 2019.

> *The Basel III accord introduced a regulation that requires commercial banks to maintain a minimum capital ratio of 8%, 6% of which must be Common Equity*

Tier 1.

- **Capital conservation buffer –** The additional CET1 requirement was in addition to the capital conservation buffer.

The Basel, Switzerland-based Financial Stability Board (FSB), an initiative of G20 nations, has identified, in consultation with the Basel Committee on Banking Supervision (BCBS) and Swiss national authorities, a list of global systemically important banks (G-SIBs).

- **G-SIBs –** There are 30 G-SIBs currently, including JP Morgan, Citibank, HSBC, Bank of America, Bank of China, Barclays, BNP Paribas, Deutsche Bank, and Goldman Sachs.
- No Indian bank is on the list.

How does RBI select D-SIBs?

- The RBI follows a 2 step process to assess the systemic importance of banks.

Sample set

- **Size of GDP –** Banks are selected for computation of systemic importance based on an analysis of their size as a percentage of GDP.
- Banks having a size *beyond 2% of GDP* will be selected in the sample.
- **D-SIBs –** Banks that have a systemic importance above a certain threshold are designated as D-SIBs.

Segregation

- **Buckets –** D-SIBs are segregated into buckets based on their systemic importance scores.
- **Capital Charge –** A D-SIB in the lower bucket will attract a lower capital charge, and a D-SIB in the higher bucket will attract a higher capital charge.

A capital charge is levied on an agency and is designed to be a substitute for interest costs and a return on capital. At a minimum, the charge should cover the government's cost of borrowing.

Why was it felt important to create SIBs?

- **SIFIs –** FSB said all member countries should put in place a framework to reduce risks attributable to *Systemically Important Financial Institutions (SIFIs)* in their jurisdictions.
- **TBTF –** SIBs are perceived as banks that are '*Too Big To Fail (TBTF)*', due to which these banks enjoy certain advantages in the funding markets.

- **Basel III norms –** While the Basel-III Norms prescribe a capital adequacy ratio (CAR) of 8%, the RBI has mandated a CAR of 9% for scheduled commercial banks and 12% for public sector banks.

  Capital Adequacy Ratio is the bank's ratio of capital to risk.

What is the need to take these precautions?

- **Damage domestic activity –** The failure of a bank will cause greater damage to the domestic economy.
- **Domino effect –** Failure of one bank could potentially increase the probability of failure of other banks.
- **Funding & asset side –** This chain effect operates on both sides of the balance sheet, there may be interconnections on the funding side as well as the asset side.
- **Impact on customer –** The costs for customers of a failed bank for the same service at another bank would be much higher.

Reference

1. The Indian Express |What makes Indian banks safe?

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