Basel Committee Lauds RBI on Strict Rules

According to a regulatory consistency assessment programme (RCAP) conducted by the Basel committee on banking supervision, the **Reserve Bank of India's (RBI)** rules on large exposures framework (LEF) are stricter those recommended by the Basel committee.

- The assessment focused on the completeness and consistency of the domestic regulations in force on 7 June 2019, as applied to commercial banks in India.
- **Basel Committee on Banking Supervision (BCBS)** is the primary global standard setter for the prudential regulation of banks. It has 45 members, comprising central banks and bank supervisors from 28 jurisdictions.
- The RBI implemented the large exposures framework in December 2016 through a circular modified in June 2019. Most of the requirements came into effect on April 1, 2019.
    - The requirements apply to all scheduled commercial banks with the exception of regional rural banks.

Regulatory Consistency Assessment Programme

- The Basel Committee established a comprehensive Regulatory Consistency Assessment Programme (RCAP) in 2012 to monitor and assess the adoption and implementation of its standards, while encouraging a predictable and transparent regulatory environment for internationally active banks.
- The RCAP consists of two distinct but complementary workstreams:
    - **Monitoring:** The transposition of Basel III regulatory standards into domestic regulations is monitored on a semiannual basis based on information provided by each member jurisdiction.
    - **Assessment:** The committee evaluates the consistency and completeness of the adopted standards, including the significance of any deviations from the Basel III regulatory framework. These consistency assessments are carried out on a jurisdictional and thematic basis.
    - **Jurisdictional assessments (consistency) review** the extent to which domestic regulations are aligned with the minimum Basel requirements agreed by the Committee and help identify material gaps in such regulations.
    - **Thematic assessments (outcomes) examine** the implementation of the Basel requirements at the individual bank level and seek to ensure that prudential ratios are calculated consistently by banks across jurisdictions to improve comparability across outcomes.

Key Findings

- While Basel large exposures framework limits the sum of all exposures of a bank to a single counterparty to 25% of Tier 1 capital, Indian regulations establish the large exposure limit at 20%.

    - In exceptional cases, bank's boards may allow an additional 5% exposure of the bank's available eligible capital base.
- In case of India, banks' exposures to global systemically important banks are subject to stricter limits, in line with the letter and spirit of the Basel Guidelines, and the scope of application of the Indian standards is wider than just the internationally active banks covered by the Basel framework.
- The Basel large exposures framework requires banks to identify third parties that may constitute an additional risk factor inherent in the structure itself rather than in underlying assets.
    - Third parties can include originator, fund manager, liquidity provider and credit protection provider.
    - In cases where there are multiple third parties considered to be potential drivers of additional risk, the bank must assign the exposures resulting from the investment in the structures to each of the third parties. However, the RBI's large exposures framework does not specify the identification of additional risks, nor provide instructions for banks to group these exposures.

RBI's Response

- Based on these findings, the RBI has decided to incorporate economic interdependence criteria for determining a group of connected counterparties in all cases where the sum of all exposures to each such counter-party exceeds 5% of the eligible capital base.
- In order to provide time to the banks to adjust to the new requirement, the introduction of economic interdependence criteria in the definition of connected counterparties will be effective from April 1, 2020.