Capital Conservation Buffer

Why in news?

A major decision was taken at the recent Reserve Bank of India board meeting to push back the deadline for banks to set aside an additional 0.625 per cent as capital conservation buffer.

What is capital conservation buffer (CCB)?

- CCB is a relatively new concept, introduced under the international Basel III norms.
- The concept says that during good times, banks must build up a capital buffer that can be drawn from when there is stress.
- In India, the minimum capital requirement is 9 per cent.
- The CCB would be 2.5 percentage points over and above the minimum capital requirement

Why is it important?

- In simple terms, this is savings for the future as this capital can be drawn when a bank is incurring losses.
- Since it is a buffer, or extra capital, banks' minimum capital is not violated.
- The CCB is being implemented in a phased manner of 0.625 per cent per year from January 1, 2016.
- The final phase is now delayed by a year, till March 31, 2020.

Why was the CCB introduced?

- India follows the international Basel III norms, and the CCB is an integral part of those norms.
- After the credit crisis of 2008 the CCB concept gained attention, when large banks witnessed their capital eroding at a fast phase.
- The CCB was aimed to cover for their losses on risky investments.
- The Basel Committee on Banking Supervision released its capital buffer norms wherein two kinds of structures were introduced — one, the CCB, and the other was countercyclical capital buffers.
- The Reserve Bank of India (RBI) has decided to implement both.

Why is the implementation of the final phase of CCB being delayed?

- As banks are struggling to preserve their capital and the government is finding it difficult to provide adequate funds implementation of, CCB's implementation is delayed.
- Delaying the CCB frees up capital for the banks, and gives the government time to mobilize resources.
- That apart, higher capital would also mean that banks will now be able to lend more.
- More the amount of capital with banks, the more they can leverage it and lend.
- According to estimates, the delay in implementing the final phase of CCB would free up as much as Rs 3 trillion in additional capitals for Indian lenders till the end of the next financial year.
- The saving for the government on this count is expected to be around Rs 350 billion in the current financial year.

What are the ways in which banks can rebuild such buffer given the overall stress in the system?

- The CCB is largely driven by banking regulator RBI and banks will have to fulfill their CCB requirement by 2020.
- But that is not a problem for, as they have capital at more than the regulatory minimum.
- Most private sector banks fall under well capitalized banks category and fulfilling the CCB norm will not be a problem.
- But the problem lies with banks that are struggling to maintain even the basic minimum capital requirement.
- These public sector banks will have to likely ask the government for more capital, or aggressively sell non-core assets to generate own capital, since profitability of these banks have taken a hit due to bad debts.

Is there a penalty if a country fails to implement CCB norms in its entirety?

- Basel norms are a standard set of rules, and it is left to the individual country to implement the norms at a pace that is suitable to it.
- However there won't be any penalty for not attaining CCB norms.
- However, in a connected world, the sooner a bank become international norm compliant, the better it is poised to raise funds and expand operations overseas.

Source: Business Standard