STUDY MATERIAL

Subject: **Banking Operations**
Class: **B.Com Second Semester**
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Concerned Faculty: **Dr. Wasif Ali**

Unit III Topics

(1) Negotiable Instruments: Promissory Note and Bill of Exchange

(2) E-banking

(1)Negotiable Instruments: Promissory Note and Bill of Exchange,

Definition of a Negotiable Instrument

The law relating to negotiable instruments is contained in the Negotiable Instruments Act, 1881. It is an Act to define and amend the law relating to promissory notes, bills of exchange and cheques. The term *"negotiable instrument"* means a document transferable from one person to another. However the Act has not defined the term. It merely says that "A .negotiable instrument" means a promissory note, bill of exchange or cheque payab1e either to order or to bearer. [Section 13(1)]

The Act recognises only three types of instruments viz., ci Promissory Note, a Bill of. Exchange and a Cheque as negotiable instruments. Howe~er, it does not mean that other instruments are not negotiable instruments provided that they satisfy the following conditions of negotiability:

1. The instrument should be freely transferable by the custom of trade.
   Transferability may be by (i) delivery or (ii) endorsement and delivery.
2. The person who obtains it in good faith and for consideration gets it free from
   all defects and can sue upon it in his own name.
3. The holder has the right to transfer. The negotiability continues till the
   maturity.

Important Characteristics of Negotiable Instruments

Following are the important characteristics of negotiable instruments:

(1) The holder of the instrument is presumed to be the owner of the property contained in it.

(2) They are freely transferable.

(3) A holder in due course gets the instrument free from all defects of title of any previous holder.

(4)The holder in due course is entitled to sue on the instrument in his own name.

(5) The instrument is transferable till maturity and in case of cheques till it becomes stale (on the expiry of 6 months from the date of issue).

I. Promissory Note

A "promissory note" is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking, signed by the maker to pay a certain sum of money to, or to the order of, a certain person, or only to bearer of the instrument. (Section 4)

Parties to a *Promissory Note:*

A promissory note has the following parties:

(a) *The maker:* the person who makes or executes the note promising to pay the amount stated therein.

(b) *The payee:* one to whom the note is payable.

(c) *The holder:* is either the payee or some other person to whom he may have endorsed the note.

(d) *The endorser.*

(e) *The endorsee.*

Essential features of a Promissory Note:

To be a promissory note.

An instrument must possess the following essentials:

(a) It must be in writing. An oral promise to pay will not do.

(b) It must contain an express promise or clear undertaking to pay. A promise to pay cannot be inferred. A mere acknowledgement of debt is not sufficient. If A writes to B "I owe you (I.O.U.) Rs. 500",there is no promise to pay and the instrument is not a promissory note.

(c) The promise or undertaking to pay must be unconditional. A promise to pay "when able", or "as soon as possible", or "after your marriage to I?", is conditional. But a promise to pay after a specific' time or on the happening of an event which must happen, is not conditional, e.g. "I promise to pay Rs. 1,000 ten days after the death of B", is unconditional.

(d) The maker must sign the promissory note in token of an undertaking to pay

to the payee or his order.

(e) The maker must be a certain person, i.e., the note must show clearly who is the person engaging himself to pay.

(f) The payee must be certain. The promissory note must contain a promise to pay to some person or persons ascertained by name or designation or to their order.

(g) The sum payable must be certain.

II. Bill of Exchange

A bill of exchange is generally drawn by the creditor on his debtor. It should be accepted either by the debtor or any person(s) on his/her behalf. It is worth mentioning that before its acceptance by the debtor, it is just a draft. It should be accepted either by a person upon whom it is drawn or someone else on his/her behalf. The stage at which the purchaser of goods signs the draft and writes 'Accepted' on it, it becomes a bill of exchange.

—Section 5 of the Negotiable Instruments Act, 1881.

A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.

Example:

On 1.1.2011, Pawan sold goods to Harish on credit for Rs. 25,000. Pawan drew a bill for the same amount for two months and sent it to Harish for his acceptance on the same day. On 5.1.2011 Pawan got the acceptance of Harish. In this case, before 5.1.2011 it is known as mere draft. It becomes a bill of exchange only on 5.1.2011 when Harish accepted the bill.

FORMAT OF BILL OF EXCHANGE

Nand Ram
₹ 20,000

Mumbai
1st April, 2011

Stamp

Four months after date pay to me or my order, the sum of Twenty Thousand only, for value received.

"Accepted"
(Signed)
Madho Ram
1.4.2011
A-324, Kamla Nagar,
Delhi

(Signed)
Nand Ram
B- 96, Roop Nagar,
Delhi

To
Hari Chand
189, Karol Bagh
New Delhi

Essential Features of Bills of Exchange:

1. It should be in writing.
2. It is an order to make payment.
3. The order of payment is unconditional.
4. It should contain a certain amount to be paid.
5. The date of payment should be certain.
6. The amount must be payable either to a certain person or to his order or to the bearer of the bills of exchange.
7. It should be paid either on the expiry of a fixed period of time or on demand.
8. Bill of exchange must be signed by its maker.
9. In certain cases, it must be stamped also.

Parties to a Bill of Exchange:

There are three parties viz. 'Drawer', 'Drawee' and 'Payee' to a bill of exchange.

(i) Drawer:

A bill of exchange is drawn upon the buyer/debtor by the seller/creditor and the drawer is the person who makes and draws the bill. The drawer is entitled to receive money from the debtor.

(ii) Drawee:

The person upon whom the bill of exchange is drawn is known as drawee. Bill of exchange is drawn on the drawee who is the purchaser of goods. The drawee of a bill is called the acceptor when he writes the words "accepted" and puts his signatures on it. This process is known as acceptance.

After acceptance, the bill of exchange becomes a legal document. This document now binds the drawee to honour the bill on due date. This acceptance may be general or qualified. In the case of general acceptance, without stating any conditions, only signature of the accepter is required. However, in the case of qualified acceptance, name of the bank or specified place for payment is mentioned.

(iii) Payee:

The person to whom the payment is made is known as payee. In some cases, the drawer of the bill also becomes the payee when he himself keeps the bill till the date of maturity. Drawer and Payee is usually the same person.

However, in the following cases drawer and payee are two different persons:

(i) When the bill is discounted by the drawer, the person who discounted the bill becomes the payee.

(ii) When the bill is endorsed to a creditor, the endorsee will become the payee.

Contents of Bills of Exchange:

(i) Date:

The date of the bill on which it is drawn should be written on the top right comer of the bill. This aspect is very important to determine the maturity date of the bill.

(ii) Term:

This is the tenure of the bill and runs from the date of the bill. This should be specified in the body of the bill. Grace period of three days should be given after the expiry of the term from the date of the bill.

(iii) Amount:

Amount of the bill should be given both in figures and words. Amount in figures should be mentioned on the top left corner of the bill and amount in words should be mentioned in the body of the bill.

(iv) Stamp:

Stamp of proper value which depends on the amount of bill shall be affixed on the bills of exchange.

(v) Parties:

There may be three parties to the bills of exchange, drawer, drawee and payee. However, in some cases drawer and payee may be the same person. All the names of the parties and their addresses should also be invariably mentioned in the bills of exchange.

(vi) For Value Received:

This aspect is most important in the sense that law does not consider those agreements which have been made without consideration. Consideration means in lieu of and in the context of bills of exchange, it means that the bill has been issued in exchange of some consideration i.e., benefit has already been received.

Bill of Exchange V/S Promissory Note

(1) Parties.

There are three parties to a bill of exchange, namely, the drawer, the drawee and the payee; while in a promissory note there are only two parties – maker and payee.

(2) Nature of payment.

In a bill of exchange, there is an unconditional order to pay, while in a promissory note there is an unconditional promise to pay.

(3) Acceptance.

A bill of exchange requires an acceptance of the drawee before it is presented for payment, while a promissory note does not require any acceptance since it is signed by the persons who is liable to pay.

(4) Liability.

The liability of the maker of a promissory note is primary and absolute, while the liability of a drawer of bill of exchange is secondary and conditional. It is only when the drawee fails to pay that the drawer would be liable as a surety.

(5) Notice of dishonor.

In case of dishonor of bill of exchange either due to non-payment or non-acceptance, notice must be given to all persons liable to pay. But in the case of a promissory note, notice of dishonor to the maker is not necessary.

(6) Maker's position.

The drawer of a bill of exchange stands in immediate relationship with the acceptor and not the payee. While in the case of a promissory note, the maker stands in immediate relationship with the payee.

(7) Nature of acceptance.

A promissory note can never be conditional, while a bill of exchange can be accepted conditionally.

(8) Copies.

A bill of exchange can be drawn in sets, but a promissory note cannot be drawn in sets.

(9) Payable to bearer.

A promissory note cannot be made payable to a bearer, while a bill of exchange can be so drawn provided it is not payable to bearer on demand.

(10) Payable to maker.

In a promissory note, the maker cannot pay to himself. While in the case of a bill of exchange, the drawer and the payee may be one person.

Holder & Holder-In-Due-Course

1. **Entitlement**: Holder is a person who is entitled for the possession of a negotiable instrument in his own name. Hence he shall receive or recover the amount due thereon. Whereas a Holder-in-due-course is a person who has obtained the instrument for consideration and in good faith and before maturity.

2. **Consideration**: Consideration is not necessary to become a holder. The instrument may also be given by way of a donation or gift and thus, the donee of an instrument can also become a holder of it. However,

consideration is a must to become a holder-in-due-course and thereby the donee of a negotiable instrument can be a holder but not holder-in-due-course.

3. **Maturity**: A holder may acquire the instrument even after its maturity. But a holder-in-due-course must acquire the instrument before its maturity failing which he will not enjoy the rights of a holder-in-due-course.

4. **Title:** A holder does not acquire a better title than that of transferor. In simple words, if the title of any of the prior party is defective, his title will not be defect free. Whereas, a holder-in-due-course derives a good title freed from all defects. His title is better than that of the transferor.

5. **Right to recover amount:** A holder has a right to recover the amount due on the instrument from the transferor (i.e., just preceding party) only from whom he has obtained the instrument. Holder-in-due-course, on the other hand, can recover the amount due on the instrument from any of the prior parties till the instrument is duly discharged. Thus, all prior parties shall remain liable towards the holder-in-due-course, jointly as well as severally, till the instrument is duly discharged.
6. **Notice of defect in the Title**: A holder-in-due-course is not only supposed to have acquired the instrument without any notice of the defect of the title of the person from whom he obtained it, but also there should be no cause on his part to believe that any defect sustains in the transferor's title. But a holder is exempt from this condition. He may have notice of defect in the title but he shall not be liable for it unless he is a party to that defect, fraud, or forgery.
7. **Privileges:** A holder-in-due-course enjoys certain privileges under the Negotiable instruments Act , which are not available to a holder.
8.

NOTING AND PROTESTING

Noting

Noting is a convenient mode of authenticating the fact that a bill or note has been dishonored. When a note or a bill has been dishonored by non- acceptance or nonpayment, the holder causes such dishounour to be noted by a Notary public. Noting is a minute recorded by a notary public on the dishonored instrument. When an instrument, say a bill of exchange, is to be noted for dishonour, it is taken to Notary public who presents it once again for acceptance or payment, as the case may be; and if the drawee or acceptor still refuses to accept or pay the bill, it is noted, i.e., a minute is prepared containing

the date of dishonour, reason for such dishonour, etc.; which is attached to the instrument; and the facts are' noted on the instrument.

Protest

When an instrument is dishonored, the holder may cause the fact not on by to be noted, but also to be certified by a Notary Public that the bill has been dishonolired. Such a certificate is referred to as a protest.

If the creed it or an acceptor of a bill is shaken by insolvency or otherwise before the date of maturity of the bill, the holder may cause such a fact also to 'be noted and certified, Such a certificate is called a protest for better security. The contents of a protest are given in Section, 101 of the Act.

Neither noting nor protesting is compulsory in the case of inland biis. But under Section 104 every foreign bill of exchange must be protested for dishonour when such a pretest is required by the law of the country where the bill was drawn. The advantage of both noting and protesting is that this constitutes prim facie good evidence in the Court of the fact that instrument has been dishonoured;

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E-Banking

Electronic banking has many names like e banking, virtual banking, online banking, or internet banking. It is simply the use of electronic and telecommunications network for delivering various banking products and services. Through e-banking, a customer can access his account and conduct many transactions using his computer or mobile phone. In this article, we will look at the importance and types of e-banking services.

Types of e banking

Banks offer various types of services through electronic banking platforms. These are of three types:

Level 1 – This is the basic level of service that banks offer through their websites. Through this service, the bank offers information about its products and services to customers. Further, some banks may receive and reply to queries through e-mail too.

Level 2 – In this level, banks allow their customers to submit instructions or applications for different services, check their account balance, etc. However, banks do not permit their customers to do any fund-based transactions on their accounts.

Level 3 – In the third level, banks allow their customers to operate their accounts for funds transfer, bill payments, and purchase and redeem securities, etc.

Most traditional banks offer e-banking services as an additional method of providing service. Further, many new banks deliver banking services primarily through the internet or other electronic delivery channels. Also, some banks are ‘internet only’ banks without any physical branch anywhere in the country.

Banking websites can be classified into two types:

Informational Websites – These websites offer general information about the bank and its products and services to customers.

Transactional Websites – These websites allow customers to conduct transactions on the bank’s website. Further, these transactions can range from a simple retail account balance inquiry to a large business-to-business funds transfer.

Importance of e-banking

We will look at the importance of electronic banking for banks, individual customers, and businesses separately.

Importance for Banks

- Lesser transaction costs – electronic transactions are the cheapest modes of transaction
- A reduced margin for human error – since the information is relayed electronically, there is no room for human error
- Lesser paperwork – digital records reduce paperwork and make the process easier to handle. Also, it is environment-friendly.
- Reduced fixed costs – A lesser need for branches which translates into a lower fixed cost.
- More loyal customers – since e-banking services are customer-friendly, banks experience higher loyalty from its customers.

Importance for Customers

- Convenience – a customer can access his account and transact from anywhere 24x7x365.
- Lower cost per transaction – since the customer does not have to visit the branch for every transaction, it saves him both time and money.
- No geographical barriers – In traditional banking systems, geographical distances could hamper certain banking transactions. However, with e-banking, geographical barriers are reduced.

Importance for Businesses

- Account reviews – Business owners and designated staff members can access the accounts quickly using an online banking interface. This allows them to review the account activity and also ensure the smooth functioning of the account.
- Better productivity – Electronic banking improves productivity. It allows the automation of regular monthly payments and a host of other features to enhance the productivity of the business.
- Lower costs – Usually, costs in banking relationships are based on the resources utilized. If a certain business requires more assistance with wire transfers, deposits, etc., then the bank charges it higher fees. With online banking, these expenses are minimized.
- Lesser errors – Electronic banking helps reduce errors in regular banking transactions. Bad handwriting, mistaken information, etc. can cause errors which can prove costly. Also, easy review of the account activity enhances the accuracy of financial transactions.
- Reduced fraud – Electronic banking provides a digital footprint for all employees who have the right to modify banking activities. Therefore, the business has better visibility into its transactions making it difficult for any fraudsters to play mischief.

E-banking in India

In India, since 1997, when the ICICI Bank first offered internet banking services, today, most new-generation banks offer the same to their customers. In fact, all major banks provide e-banking services to their customers.

Popular services under e-banking in India

- ATMs (Automated Teller Machines)
- Telephone Banking
- Electronic Clearing Cards
- Smart Cards
- EFT (Electronic Funds Transfer) System
- ECS (Electronic Clearing Services)

- Mobile Banking
- Internet Banking
- Telebanking
- Door-step Banking

Further, under Internet banking, the following services are available in India:

- Bill payment – Every bank has a tie-up with different utility companies, service providers, insurance companies, etc. across the country. The banks use these tie-ups to offer online payment of bills (electricity, telephone, mobile phone, etc.). Also, most banks charge a nominal one-time registration fee for this service. Further, the customer can create a standing instruction to pay recurring bills automatically every month.
- Funds transfer – A customer can transfer funds from his account to another with the same bank or even a different bank, anywhere in India. He needs to log in to his account, specify the payee's name, account number, his bank, and branch along with the transfer amount. The transfer is effected within a day or so.
- Investing – Through electronic banking, a customer can open a fixed deposit with the bank online through funds transfer. Further, if a customer has a demat account and a linked bank account and trading account, he can buy or sell shares online too. Additionally, some banks allow customers to purchase and redeem mutual fund units from their online platforms as well.
- Shopping – With an e-banking service, a customer can purchase goods or services online and also pay for them using his account. Shopping at his fingertips.

<u>Unit IV Topics</u>

(1) Employment of funds by Commercial Banks

(2) Basel Norms for Banking

I. Employment of funds by Commercial Banks

Employment or investment or advancing of funds by a commercial bank means the safe utilization and profitable use of its funds. The bank, as we know, obtains money from different sources and pays interest on them. It is the utmost desire of every commercial bank that it should invest its funds in a manner which serves its own as well as customer's interest. Its own interest is to earn profit for the shareholders. The other interest is of the customers. The bank should keep sufficient cash at its disposal to pay back money to the customers along

with interest as and when demanded by them. These two objectives of liquidity and profitability are obtained by utilizing the surplus funds into ready convertible securities. The main types of earning assets of a bank are as follows (1) money at call and short notice (ii) investment in government and semi government securities (iii) short and medium term loans (iv) discounting of bills.

Factors of Good Advancing

The primary purpose of the bank is to grant loans to households, firms and companies. A major portion of its funds is used for giving loans. Loans are the major source of income of the bank. However, the lending of money is not without risk. A bank takes a number of precautions while sanctioning loans. The main considerations or factors which are taken into account while lending money by the bank are as follows:

(1) Liquidity:

Liquidity is the first and the most important principle of bank's investment policy. By liquidity is meant the relative ease and speed with which an asset can be converted into cash without incurring large costs. If is the policy of every commercial bank that it should invest its surplus funds in those assets which can be easily converted into cash and also yield profit. The reason behind it is that if the bank's investments are not in liquid form, it may fail to meet its obligations towards its depositors. This may land the bank into difficultly. Every bank therefore, tries to invest its funds into ready convertible securities and not in immovable properties.

(2) Safety:

The principle of safety is of utmost importance for investment of funds by a bank. The bank, in its lending activity, takes into account the borrower's ability to pay the loan. It also sees that in case of nonpayment of loan, the security offered can be disposed off without loss and delay.

(3) Profitability:

Banking is a business. Like any other business, it also aims at earning profit. Profit can only be earned if a major portion of the deposits are invested in securities yielding high returns. While making advances, the bank cannot ignore this aspect that the funds invested remain fairly safe, liquid and give also a reasonable return. In order to achieve this objective, the bank keeps in its investment portfolio three types of investments, liquid, semi liquid and income earning investment.

(4) Purpose of loan:

While advancing money, the banker must examine and investigate the purpose of the loan. If the loan is for productive purposes, it will not only ensure the safety of money but also provide a definite source of repayment.

Truly speaking, short term productive loans are ideal loans. The advances for hoarding, or for speculative activities, for marriages, pleasure tours etc., etc. are not safe and liquid. As such these should be discouraged.

(5) Security:

The banker advances loans by considering the credit worthiness, honesty, good-will, business integrity of the borrower. Apart from these attributes in credit selection, the banker as for as possible secures loan by getting tangible security from the borrower. The security is considered as an insurance against risk of nonpayment of loan. The banker is to see that the security offered against loan is adequate, highly liquid, easy to handle and free from any default.

(6) Spread of risk:

An element of risk is present in every advance, however, secure it may be. It is therefore advised that the loans should be spread over (i) large number of borrowers (ii) over a large number of industries (iii) over a large number of areas (villages' towns, cities etc.) Diversification of advances thus minimizes the risk of defaults of loans.

(7) Management of cash reserve:

A bank has to keep a certain minimum percentage of its deposits in ready cash to meet it liability towards depositors. There is, however no limit on the maximum reserve to be kept by it. The bank, therefore, through its experience must keep an effective amount to meet the liability of the depositors. (8) National interest. The loans should be advanced keeping in view the national interest of the country If central bank directs that advances be given to small scale industries and agriculture and for export, the instructions should be followed in the national interest.

Summing up, an ideal advance is one which is granted to a reliable customer for an approved purpose, against marketable securities, is liquid and profitable. Sentiments and personal relations have no place in lending as a function.

II. Basel Norms for Banking

Banks lend to different types of borrowers and each carries its own risk. They lend the deposits of public as well as money raised from the market – equity and debt. The inter-mediation activity exposes the bank to a variety of risks. Cases of big banks collapsing due to their inability to sustain the risk exposures are readily available.

Therefore, Banks have to keep aside a certain percentage of capital as security against the risk of non – recovery. Basel committee has produced norms called Basel Norms for banking to tackle the risk.

Basel is a city in Switzerland. It is the headquarters of Bureau of International Settlement (BIS), which fosters cooperation among central banks with a common goal of financial stability and common standards of banking regulations. Every two months BIS hosts a meeting of the governor and senior officials of central banks of member countries.

Basel guidelines refer to broad supervisory standards formulated by these groups of central banks – called the Basel Committee on Banking Supervision (BCBS). The set of the agreement by the BCBS, which mainly focuses on risks to banks and the financial system is called Basel accords/Basel Norms. The purpose of the accord is to ensure that financial institutions have enough capital on account to meet obligations and absorbs unexpected losses. India has accepted Basel Norms for Banking. In fact, on a few parameters, the RBI has prescribed stringent norms as compared to the norms prescribed by BCBS.

Basel I:

In 1988, BCBS introduced capital measurement system called Basel capital accord, also called Basel 1. It focused almost entirely on credit risk. 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 e.g.: An asset backed by collateral would carry lesser risks as compared to personal loans, which have no collateral.

Assets of banks were classified and grouped into five categories according to credit risk, carrying risk weights of:

- 0% (for example cash, home country debt like Treasuries),
- 20% (securitizations such as MBS rated AAA)
- 50%,
- 100% (for example, most corporate debt), and
- Some assets are given no rating

India adopted Basel 1 guidelines in 1999. The twin objectives of Basel I was:

- To ensure an adequate level of capital in the international banking system
- To create a more level playing field in the competitive environment

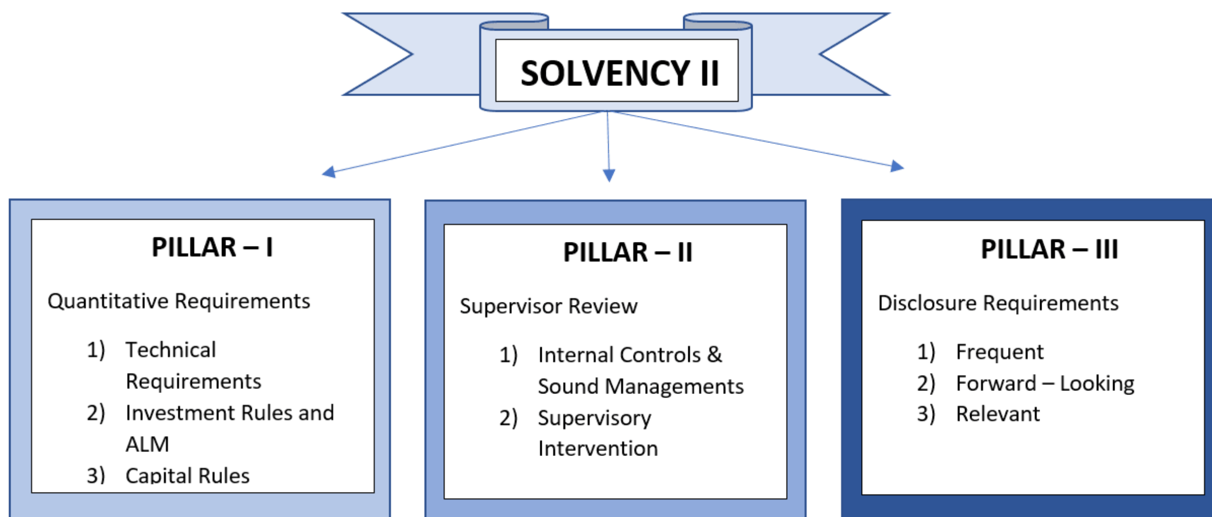
Basel II:

In 2004, Basel II guidelines were published by BCBS, which were considered to be the refined and reformed versions of Basel I accord.

The guidelines were based on three parameters:

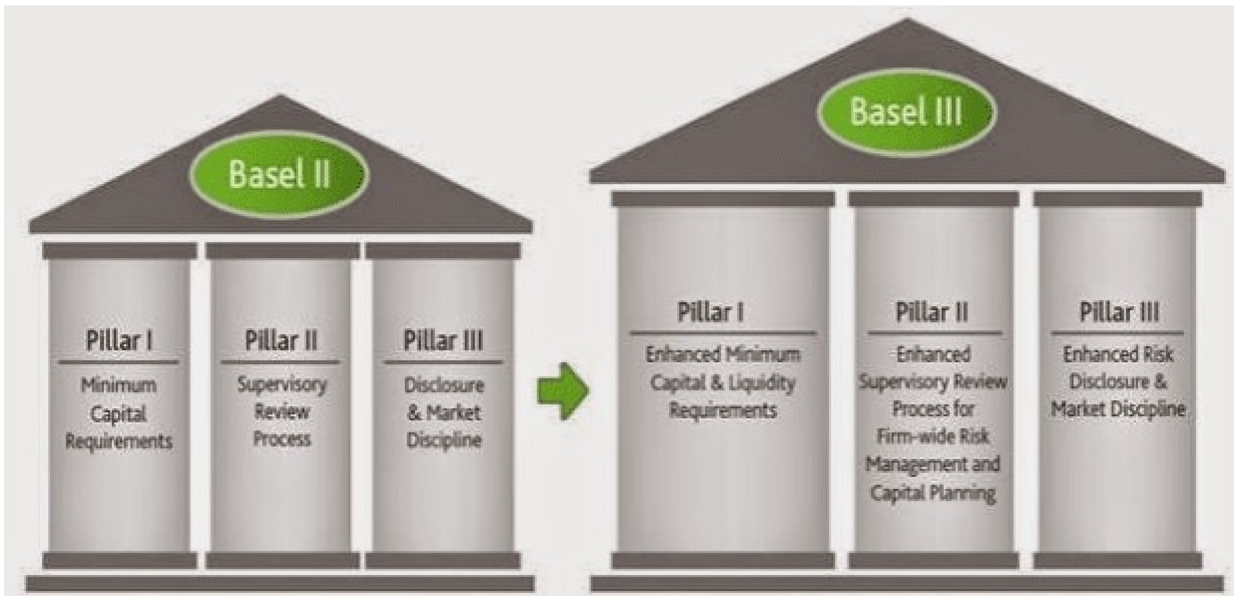
1. Banks should maintain a minimum capital adequacy requirement of 8% of risk assets.
2. Banks were needed to develop and use better risk management techniques in monitoring and managing all the three types of risks
3. Banks need to mandatorily disclose their risk exposure, etc. to the central bank.

This Basel capital Accord focuses on three pillars:



Basel III:

Basel III or Basel 3 released in December 2010 is the third in the series of Basel Accords. These guidelines were introduced in response to the financial crisis of 2008. These accords deal with risk management aspects for the banking sector. In a nutshell, we can say that Basel iii is the global regulatory standard (agreed upon by the membersof the Basel Committee on Banking Supervision) on bank capital adequacy, stress testing, and market liquidity risk.



Objectives/aims of the Basel III:

- Improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source
- Improve risk management and governance
- Strengthen banks' transparency and disclosures

Pillars of the Basel Norms for Banking

Pillar 1:

Minimum Regulatory Capital Requirements based on Risk Weighted Assets (RWAs): Maintaining capital calculated through credit, market and operational risk areas.

Pillar 2:

Supervisory Review Process: Regulating tools and frameworks for dealing with peripheral risks that banks face.

Pillar 3:

Market Discipline: Increasing the disclosures that banks must provide to increase the transparency of banks

Major Changes in Basel Norms for Banking

The Major Changes Proposed in Basel III over earlier Accords i.e. Basel I and Basel II or the Major Features of Basel III.

- Better Capital Quality: One of the key elements of Basel 3 is the introduction of a much stricter definition of capital. Better quality capital means the higher loss-absorbing capacity. This, in turn, will mean that banks will be stronger, allowing them to better withstand periods of stress.

- Capital Conservation Buffer: Another key feature of Basel iii is that now banks will be required to hold a capital conservation buffer of 2.5%. The aim of asking to build conservation buffer is to ensure that banks maintain a cushion of capital that can be used to absorb losses during periods of financial and economic stress.

- Countercyclical Buffer: This is also one of the key elements of Basel III. The countercyclical buffer has been introduced with the objective to increase capital requirements in good times and decrease the same in bad times. The buffer will slow banking activity when it overheats and will encourage lending when times are tough i.e. in bad times. The buffer will range from 0% to 2.5%, consisting of common equity or other fully loss-absorbing capital.

- Minimum Common Equity and Tier 1 Capital Requirements: The minimum requirement for common equity, the highest form of loss-absorbing capital, has been raised under Basel III from 2% to 4.5% of total risk-weighted assets. The overall Tier 1 capital requirement, consisting of not only common equity but also other qualifying financial instruments, will also increase from the current minimum of 4% to 6%. Although the minimum total capital requirement will remain at the current 8% level, yet the required total capital will increase to 10.5% when combined with the conservation buffer.

- Leverage Ratio: A review of the financial crisis of 2008 has indicated that the value of many assets fell quicker than assumed from historical experience. Thus, now Basel III rules include a leverage ratio to serve as a safety net. A leverage ratio is a relative amount of capital to total assets (not risk-weighted). This aims to put a cap on swelling of leverage in the banking sector on a global basis. 3% leverage ratio of Tier 1 will be tested before a mandatory leverage ratio is introduced in January 2018.

- Liquidity Ratios: Under Basel III, a framework for liquidity risk management will be created. A new Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) are to be introduced in 2015 and 2018, respectively.

- Systemically Important Financial Institutions (SIFI): As part of the macro-prudential framework, systemically important banks will be expected to have loss-absorbing capability beyond the Basel III requirements.

According to new Basel-III norms, which had kicked from March 2019, Indian banks need to maintain a minimum capital adequacy ratio (CAR) of nine percent, in addition to a capital conservation buffer, which would be in the form of common equity at 2.5 percent of the risk-weighted assets. Basel III guidelines are aimed at to improve the ability of banks to withstand periods of economic and financial stress as the new guidelines are more stringent than the earlier requirements for capital and liquidity in the banking sector.

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