Summary and Conclusions

Several broad conclusions can be inferred from the above study. These are listed as under:

1. Given the wide heterogeneity across public sector banks in terms of their product sophistication and customer orientation as well as their adjustment response, the regulatory framework should be designed so as to encourage individual banks to maintain higher CRAR than the stipulated minimum so as to reflect their differential risk profiles.

2. The second aspect of the Study has been to test the hypothesis of how CRAR is impacted upon by a range of conditioning variables and whether there has been any discernible shift from towards relatively less risky assets, during our period of study. Such an econometric exercise has two advantages, viz., it allows a distinction between long-run and short-run capital ratios and secondly, it allows for testing the impact of various regime shifts. Our analysis reveals that (a) capital remains a useful regulatory tool in the hands of policy makers for influencing bank behaviour, and (b) there is no conclusive evidence to support a shift from high-risk towards low-risk asset category by banks.

3. In view of the composite rating for banks introduced by the Reserve Bank in June 2000 and the need to evolve a system wherein regulators might need to take corrective action depending on the bank's risk profile, the study examines the impact of putting in place a Prompt Corrective Action (PCA) based on capital for the PSBs. Based on data availability, the framework is studied only for the year 1998. Our analysis reveals that PCA might prove to be an effective framework for arresting bank deterioration and prevent systemic failure of banks.

4. Fourthly, in view of the growing internationalization and univeralisation of banking operations, the risks emanating from idiosyncratic failures might have far more serious repercussions throughout the system as a whole than ever before. In view of the above,

the Basle Committee on Banking Supervision (BCBS) has proposed the New Capital Adequacy Accord which not only endeavours banks to hold higher levels of capital, but also envisages a greater role for the market (or, for that matter, the credit rating agencies). Although the role of internationally acclaimed rating agencies has been put under a cloud ever since the South-East Asian crisis, the fact nonetheless remains that rating agencies would need to play a far more important role in the future, once the New Accord is put in place. In view of the above, Chapter 5 examines, within the framework of the extant model, the *possible* impact of capital adequacy on credit rating. Our analysis reveals that capital ratios of banks are a crucial determinant of bank ratings, especially in the short-term.

5. Finally, to the extent that the role of the market is expected to be far more important under the new Accord and an increased emphasis is going to be placed on market risks, newer models of measurement of market risks viz., Value at Risk (VaR) and the Pre-Commitment Approach (PA) have gained currency in recent years. International experience with their applicability is also a testimony to the growing popularity of these models. In view of the above, the final Chapter sums up the Indian experience and provides a view point as to the plausibility of the usage of these models in the foreseeable future, especially by Indian banks.

To syncopate, banking regulation and supervision are extremely complex areas where the regulator has to tread a careful middle path between the *ex-cathedra* overzeal for intervention and a complacent belief in the ability of the banking system to self-rectify all its own deficiencies. In a recent contribution, Caprio and Honohan (1999) remind us in a similar vein “banking regulation must be seen as an evolutionary struggle and regulatory innovation will remain a constant challenge”.