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## RBI Working Paper Series 12 / 2012

### RBI Working Paper suggests Alternative Capital Buffer Guidance for India

The Reserve Bank of India today placed on its website a Working Paper titled "[Countercyclical Capital Buffer Guidance for India](#)". The Working Paper has been written by Shri Tulasi Gopinath and Shri A.K.Choudhary.

In the Working Paper published by the Reserve Bank of India it has been argued that the guidance given by Basel Committee on Banking Supervision (BCBS) is not appropriate for India. The finding is based on the analysis of annual banking data for the last 60 years since 1950-51. The authors have also showcased an alternative capital buffer guidance reflecting, among other things, the current status of economic development and the underlying banking business model in India. Using the annual data since 1990-91, the authors have empirically verified the performance of the alternative buffer guidance *vis-à-vis* the BCBS guidance. The salient findings of the research are:

- The BCBS capital buffer guidance has a procyclicality bias. This finding is in agreement with the recent literature on the subject. On the other hand, the proposed alternative capital buffer guidance is countercyclical in nature.
- The proposed alternative guidance is relatively more compatible with the asset market developments than the BCBS capital buffer guidance.

On the basis of the findings, while acknowledging the fact that all indicators potentially emit wrong signals, the authors propose a tool kit for the conduct of capital buffer operations in India.

Recent global financial crisis has brought to center-stage of policy concern, the imperative of strengthening regulation of banks, under the aegis of G-20. Accordingly, international standard setters, namely, Basel Committee on Banking Supervision (BCBS) and Financial Stability Board (FSB) have been formulating and publishing various guidelines. One such major initiative is Basel III framework aimed at augmenting resilience of the banking sector. Countercyclical capital buffer is a critical component of Basel III capital regulations. BCBS released its final guidance in 2010, recommending among other things, a capital buffer guide for the consideration of the national regulatory authorities. The BCBS guidance involves the matric of credit-to-GDP ratio for conducting the buffer operations.

The Reserve Bank of India introduced the RBI Working Papers series in March 2011. These papers present research in progress of the staff members of RBI and are disseminated to elicit comments and further debate. The views expressed in these papers are those of authors and not that of the Reserve Bank of India. Comments and observations may please be forwarded to authors. Citation and use of such papers should take into account its provisional character.

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