PREFERENCE SHARES AND CAPITAL ADEQUACY RATIO. A STUDY OF INDIAN BANKS

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Abstract

In line with the norms suggested by the Basel Committee on Banking Supervision (BCBS) of the Bank for International Settlements (BIS), Reserve Bank of India (RBI) has issued capital adequacy guidelines for Indian Banks. The latest guidelines effective from April, 2013, known as Basel III, have provided for capital components which carry more stringent conditions, relative to earlier ones (Basel II), including cancellation of dividend or interest and writing off/ conversion of hybrid or debt instruments into equity on occurrence of specified trigger points resulting in loss allocation. The primary focus in Basel III is on common equity capital. However, the capital components qualifying for the purpose of capital adequacy also include preference capital both in Tier 1 and Tier 2 capital subject to satisfaction of conditions prescribed by RBI. The new capital adequacy framework is to be implemented in phases with full implementation is to be achieved by March, 2019. On full implementation, total eligible capital with reference to risk assessed assets is required to be 9% with common equity Tier 1 ratio at 5.5%, Tier 1 ratio at 7% and Tier 2 capital ratio at 2%. The paper examines the role played by preference capital in the composition of capital adequacy of Indian banks.

Keywords: Capital adequacy, Common equity, Preference capital, Risk weights, Tier 1, Tier 2

JEL Classification: G200, G210