IJCRT.ORG ISSN : 2320-2882

INTERNATIONAL JOURNAL OF CREATIVE RESEARCH THOUGHTS (IJCRT)

An International Open Access, Peer-reviewed, Refereed Journal

The Evolution Of D-Sibs In India: A Study Of The "Too Big To Fail" Concept.

Ms. Ayeshi Verma[1]

Dr. Jyoti Bhargava[2]

[1]Research Scholar, Department of Commerce, University of Lucknow, Lucknow, ORCID ID: 0009-0006-6479-3304,

[2]Professor and Head, Department of Commerce, National P.G. College, Lucknow,

ABSTRACT

The worldwide financial system has been through several major crises, notably the Great Depression and the recession of 2008, which have highlighted modern finance's interdependence and vulnerability. A crucial concept emerging from these events is the idea of "too big to fail" banks, which are financial organizations that are so enormous and intertwined that their failure might have catastrophic effects for the entire economy. In India, these institutions are commonly known as Domestic Systemically Important Banks (D-SIBs). This study investigates the concept of "too big to fail" banks in the Indian setting. It examines the features of these institutions as well as the regulatory structure established in place by the Reserve Bank of India (RBI) to identify and manage D-SIB .The paper examines the RBI's method for determining systemic importance, which depends on factors such as scale, interconnectivity, substitutability, and complexity. While the framework offers a foundation for addressing systemic risks, more study is needed to assess its effectiveness and investigate the larger effects of D-SIBs on the Indian financial system.

Key words: Domestically Systemically important banks, too big to fail, global financial crisis, Financial Stability.

1.0 INTRODUCTION

The Financial Stability Board (FSB) defines SIFIs as "financial institutions whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity" (Financial Stability Board, 2011).

The worldwide financial landscape has been marked by recurring crises, such as the Great Depression of the 1930s and the recession of 2008, demonstrating the complex interconnectivity and inherent vulnerability of the current financial system. A fundamental issue raised by these occurrences is the dilemma of "too-big-to-fail" (TBTF) organizations. In light of their systemic importance, these financial giants present policymakers with a unique problem: their failure might have disastrous effects for the economy as it stands, but their very existence encourages risky conduct.

The notion of TBTF became popular after the Great Depression, when the collapse of multiple significant banks worsened the economic depression. However, the recession of 2008 triggered by the collapse of Lehman Brothers, which pushed the TBTF issue to the centre of global policy agendas. In response, regulatory agencies around the world, including India, implemented mechanisms to identify and monitor systemically important financial institutions (SIFIs). The Basel Committee on Banking Supervision (BCBS) identified Global Systemically Important Banks (G-SIBs) using characteristics such as size, connectivity, and complexity.

In India, the Reserve Bank of India (RBI), under the direction of Raghuram Rajan, began the process of recognizing D-SIBs in 2015. The RBI designated D-SIBs as banks whose distress or collapse would significantly affect the financial sector and economy. This was a proactive reaction to the potential threats posed by big domestic banks.

2.0 LITERATURE REVIEW

Mohan, R. (2008), the study explores how the 2008 worldwide financial crisis affected India and other Asian nations with emerging markets. It begins by describing how India, unlike advanced economies, remained remarkably unscathed by the crisis. The report then looks at how the crisis may affect India and other Asian economies in the near future. It also addresses the steps taken by the Indian government to mitigate the dangers created by the collapse of major financial institutions in the United States. Finally, it examines the Asian economies' vulnerability to the worldwide financial crisis.

Flannery, M. J. (2010, May), the study claims that huge financial institutions (TBTF) have an unfair advantage because of the implicit government guarantee against failure. This encourages higher risk-taking because these organizations know they will be bailed out in situations of crisis. The report suggests addressing this issue with a combination of stronger rules, such as greater capital requirements and size limits, and also potential insurance arrangements.

Strahan, P. E. (2013), the author contends that massive financial institutions are a significant risk to the economy since governments are more inclined to bail them out if they fail. This "too big to fail" dilemma encourages these institutions to take on too much risk, which can lead to financial disasters. While much has changed since the 2008 crisis, the problem of giant banks dominating the financial landscape and the possibility of new bailouts remains.

Moore, K., & Zhou, C. (2014), in this study, researchers investigate why certain banks are more prone to generate issues for the broader economy. They discover that, while size is significant, there is another consideration: the kind of business a bank conducts. Banks that participate in complex or risky activities, such as depending significantly on money market funds, are also more probable to pose a risk to the financial system.

Sorin-George, T., & CĂTĂLIN, G. (2018), the paper addresses the problem of "too big to fail" banks. It states that during the 2008 financial crisis, authorities realized that some banks were so big and essential that their collapse would have terrible consequences for the economy. These banks commonly referred to as "systemically important," can be found in a variety of nations, particularly in Europe, North America and Asia. The study claims that globalization and previous financial crises contributed to the formation of these megabanks.

3.0 OBJECTIVES OF THE STUDY

- To thoroughly investigate the concept of "too big to fail" banks.
- To Describe the features of existing "too big to fail" banks in India.
- To evaluate the Indian regulatory framework for handling "too big to fail" banks.

4.0 RESEARCH METHODOLOGY

4.1 Research Design

This study employs a descriptive and analytical research design to investigate the idea of "too big to fail" banks within the Indian context. A mixed-methods approach will be used, which combines qualitative and quantitative research techniques.

4.2 Data Collection:

Secondary data.
Regulatory documents and policies for banking supervision and resolution.
Academic research papers and publications about TBTF banks and financial stability.
Newspaper stories and reports about the Indian banking sector.
Qualitative data:
Overview of regulatory speeches, reports, and policy documents to better understand the regulatory stance on TBTF institutions.

5.0 RESEARCH ANALYSIS

Systemically Important Banks (SIBs), which are sometimes regarded as "too big to fail," benefit from reduced funding expenses due to implicit government guarantees. This moral hazard promotes excessive risk-taking, distorts competitiveness, and raises the prospect of future crises. Recognizing this, governments implemented more stringent restrictions, notably the Basel III framework. To cope with the specific risks posed by SIBs, the FSB recommended the establishment of guidelines for recognizing and overseeing G-SIBs in 2010. In November 2011, the FSB and the BCBS launched efforts to expand this framework to D-SIBs.

5.1 The BCBS framework for addressing D-SIBs

In 2012, the BCBS established a framework for recognizing and supervising DSIBs. Unlike G-SIBs, D-SIBs are evaluated on the basis of their potential influence on the domestic economy. This methodology allows national regulators to identify which banks pose significant risks and set higher capital requirements accordingly. A set of BCBS principles for D-SIBs is provided below:

The BCBS guidelines for D-SIBs are separated into two sections: Assessment methodology and determining higher loss absorbency requirements.

Assessment methodology

Principle 1: To measure the systemic importance of banks in a domestic environment, national regulators should develop a methodology.

Principle 2: A D-SIB's evaluation process should consider the possible impact of a bank's failure, often known as externalities.

Principle 3: To analyse the consequences of a D-SIB failure, use the domestic economy as the reference system.

Principle 4: Home authorities should evaluate the systemic importance of banks at the group level, while host authorities should evaluate the systemic relevance of their own subsidiaries in their jurisdiction.

Principle 5: To evaluate the impact of a D-SIB's failure on the domestic economy, consider bank-specific variables such as size, interconnectedness, substitutability, financial institution infrastructure, and complexity (including cross-border activity).
National authorities can use additional data to determine bank-specific metrics, like the magnitude of the domestic economy.

Principle 6: National authorities should regularly assess the systemic importance of banks in their jurisdictions to reflect the current situation of the relevant financial systems. The interval between D-SIB assessments should not be significantly longer than the G-SIB assessment frequency.

Principle 7: National authorities should openly publish their criteria for assessing banks' systemic relevance in their domestic economy.

Determining higher loss absorbency requirements

Principle 8: National authorities should document the procedures and considerations used to determine the HLA level required by the framework for D-SIBs in their jurisdiction. Quantitative approaches and country-specific considerations should guide the degree of HLA calibrated for D-SIBs, without compromising supervisory discretion.

Principle 9: The HLA requirement for banks should match their level of systemic importance, as outlined in Principle 5.

Principle 10: National authorities should guarantee that the G-SIB and D-SIB frameworks are consistent in their countries. Home authorities should adjust HLA requirements at the parent/consolidated level, whereas host authorities should do so at the sub-consolidated/subsidiary level.

Principle 11: If a bank's subsidiary is identifies as a D-SIB by a host authority, the home and host authorities should coordinate and cooperate on the necessary HLA requirements, while adhering to local laws and regulations.

Principle 12: Common Equity Tier 1 (CET1) should meet the complete HLA criteria. National authorities should implement all necessary policies and standards to mitigate the hazards associated with D-SIBs.

5.2 Process followed by RBI for the identification of D-SIBs

Identifying D-SIBs consists of two primary steps. Because the assessment requires a significant amount of resources, a subset of banks is chosen for extensive investigation first. Smaller banks, with a smaller likelihood of systemic relevance, are eliminated from the early round. Second, a complete review of selected banks is carried out utilizing a variety of variables to determine their systemic relevance score. Banks that exceed a pre-set threshold are classed as D-SIBs and assigned to various levels based on their score. Capital surcharges are applied to D-SIBs in tiers.

Selected group of banks

Banks are selected for systemic importance assessment based on their size relative to GDP, calculated using the Basel III Leverage Ratio Exposure Measure. Those exceeding 2% of GDP are included. While most foreign banks in India do not meet this threshold, their significant role in derivatives and specialized services necessitates the inclusion of a few large foreign banks in the sample.

Assessment framework

The methodology for measuring systemic importance follows the indicator-based approach employed by BCBS to identify G-SIBs. The domestic systemic significance of banks can be assessed using the following four indicators:

1. Size.
2. Interconnectedness.
3. Limited replacements or financial institution infrastructure.
4. Complexity.

The BCBS methodology for identifying G-SIBs assigns equal weight to each indication used to calculate systemic importance, with a cap on the substitutability indicator. The RBI's methodology emphasizes size as a key variable of systemic relevance. Multiple indicators will be used to assess interconnectedness,

substitutability, and complexity. The table outlines the data necessary for computing systemic significance scores. The indicators, sub-indicators, and their weights are as follows:

Si.no.	Indicator	Sub-indicator	Indicator weight
1	Size	-	40%
2	Interconnectedness	Intra-financial system assets	6.67%
		Intra-financial system liabilities	6.67%
		Securities outstanding	6.67%
3	Substitutability	Assets Under Custody	6.67%
		Digital Payments made in INR	6.67%
		Underwritten transactions in debt and equity markets	6.67%
4	Complexity	Notional amount of OTC Derivatives	6.67%
		Cross Jurisdictional Liabilities	6.67%
		Securities in Held For Trading and Available for Sale categories	6.67%

Source: Reserve bank of India.

Size indicator

A bank's impairment or failure might have a stronger impact on the domestic economy if it accounts for a major portion of domestic banking operations.

A larger bank's impairment or failure may have a stronger impact on the financial sector and the domestic economy. Large bank failures can harm overall public trust in the financial system. Size is the most significant indicator of systemic importance; hence it will always be given precedence over other indicators. The size indicator includes both on- and off-balance-sheet elements. To align with the BCBS methodology, banks' size will be calculated using the same total exposure metric as the Basel III capital framework's leverage ratio calculation. Each bank's score is computed by dividing its overall exposure by the entire exposure of the sample banks.

Interconnectedness Indicator

The concept of interconnectedness itself explains that there is some interconnection between different banks, which can be from both side of the balance sheet, i.e., from both asset and funding side. As a result, the greater the interconnection or linkage between different banks, the greater the systemic risk will be, because collapse of one bank will trigger a domino effect and cause other banks to fail.

Interconnectedness assesses how much a bank depends on other financial organizations and how much those institutions rely on it. To assess this, we look at three factors:

- How much the bank lends and borrows from other banks.
- The amount that the bank invests in other financial institutions.
- How much money the bank earns by selling its own securities (such as bonds) to investors.

The more a bank relies on other financial organization to lend or borrow, the more interconnected it becomes. Similarly, if a bank relies extensively on selling securities to raise funds, it becomes increasingly reliant on the wholesale funding market.

In essence, connectivity indicates how a bank is linked to the larger financial system.

Substitutability Indicator

The failure of a banking institution can cause significant damage to the banking industry and economy, especially if vital services cannot be quickly substituted by other banks. Banks that play a larger role in market infrastructure, such as payment systems, are more prone to cause disruptions in service availability, range, and accessibility in the event of collapse. Customers of a failing bank may face higher charges when seeking the exact same service from a different bank if the collapsed bank had a greater share of the market in delivering that service.

Complexity Indicator

A bank's complexity also indicates its systemic relevance. Banks with complicated operations incur higher costs and take longer to resolve issues.

To assess a bank's complexity, three indicators were used: (i) the quantity of OTC (over-the-counter) derivatives, (ii) cross-jurisdictional liabilities, and (iii) traded and available-for-sale instruments.

The numerous indicator-based methods outline a framework for evaluating the systemic significance of banks. The decision to designate a bank as D-SIB is based on subjective regulatory and supervisory decisions, as it is not a precise quantitative instrument.

Yearly Evaluation

The Systemic significance score is computed using the end-March data of all sample banks, from August to October. The banks selected as D-SIB will be announced in November annually. Banks are required to provide the necessary data to the RBI by August 15th of every year.

5.3 Allocation of Banks into Buckets

The systemic significance score will be derived using data from the bank samples for the above indicators.

Formula used for calculation of systemic significance score is:

Score for a certain indicator = [(Individual bank amount / Cumulative amount for the indicator) * 1000]

Where:

- Single bank amount is the value of the indicator for a specific bank.
- Cumulative amount for the indicator is the total of the indicator's value for all banks in the sample.
- 1000 is a constant applied to adjust the result into basis points.

A bank's overall systemic relevance will be determined by taking the weighted average of all indicators. A banks systemic importance score reveals its relative importance to other banks in the sample. Banks with scores above a threshold are classed as D-SIB.

The Reserve Bank of India (RBI) first designated SBI and ICICI Bank as D-SIBs in 2015 and 2016, respectively. However, based on a detailed analysis of data from the year 2017, HDFC Bank was also designated as a D-SIB. This classification indicated HDFC Bank's growing systemic relevance in the Indian financial environment. Notably, HDFC Bank's systemic importance increased after it merged with HDFC Limited on July 1, 2023. The RBI's most recent update, based on data from March 31, 2023, reaffirmed HDFC Bank's status as a D-SIB and highlighted its increased systemic significance.

The Reserve Bank of India (RBI) reinstated SBI, HDFC Bank, and ICICI Bank as DSIBs. While ICICI Bank remains in bucket 1, SBI and HDFC Bank have been moved to higher buckets. SBI has moved from bucket 3 to bucket 4, while HDFC Bank has switched from bucket 1 to bucket 2. These changes reflect the banks' growing systemic role in the Indian financial scene.

6.0 CONCLUSION

The rise of "too big to fail" banks poses serious risks to financial stability. This study looked at the Indian context, specifically the RBI's framework for recognizing D-SIBs. While the RBI's strategy meets worldwide standards, more research is needed to determine its effectiveness in addressing systemic risks.
The findings indicate that, while size is an important element in defining systemic importance, interconnection, substitutability, and complexity are equally important. The RBI's emphasis on size is appropriate given its potential economic impact, but a balanced assessment of all indicators is required for a thorough understanding of systemic risk.
To strengthen the regulatory framework, the RBI might explore improving data collecting and analytic capabilities, adjusting indicator weighting, and investigating new measures to address the unique challenges encountered by D-SIBs. Furthermore, on-going monitoring and review of the framework are critical for ensuring its efficiency in changing financial landscapes.

By proactively addressing the risks associated with D-SIBs, India may strengthen its financial system while also protecting stakeholders' interests.

References

1. Ryssdal, K., & Hollenhorst, M. (2023, April 13). *The history of "too big to fail."* Marketplace. https://www.marketplace.org/2023/04/13/the-history-of-too-big-to-fail/
2. Narain, A., Ötker, M., & Pazarbasioglu, C. (2012b). *Building a More Resilient Financial Sector: Reforms in the Wake of the Global Crisis*.
3. Ahlawat, S. a. a. I. (2024, March 16). Reigning in "too-big-to-fail" – Toward Incentive-Based Regulation. *NLS BLR*. https://www.nlsblr.com/post/reigning-in-too-big-to-fail-toward-incentive-based-regulation
4. Flannery, M. J. (2010, May). What to do about TBTF. In *Federal Reserve Bank of Atlanta 2010 Financial Markets Conference—Up From the Ashes: The Financial System After the Crisis, Atlanta, May* (Vol. 12).
5. Strahan, P. E. (2013). Too big to fail: Causes, consequences, and policy responses. *Annu. Rev. Financ. Econ.*, *5*(1), 43-61.
6. Sorin-George, T., & CĂTĂLIN, G. (2018). Too big to fail banks in the age of globalization. *Annals-Economy Series*, 131-136.
7. Moore, K., & Zhou, C. (2014). The determinants of systemic importance.
8. Mohan, R. (2008). Global financial crisis and key risks: impact on India and Asia. *RBI Bulletin. https://rbidocs. rbi. org. in/rdocs/Speeches/PDFs/87784. pdf*.
9. Reserve Bank of India. (2023, July). RBI releases 2023 list of Domestic Systemically Important Banks (D-SIBs). [LexSite.com] https://www.lexsite.com/eDocs/1556.pdf