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AN ANALYSIS OF CHALLENGES AND BARRIERS IN IMPLEMENTING BASEL III IN THE LICENSED COMMERCIAL BANKS OF SRI LANKA

By

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Master of Business Administration (MBA) 2016

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The work described in this research was carried out by me under the supervision of Professor Kennedy D. Gunawardana and a report on this has not been submitted in whole or in part to any university or any other institution for another Degree/Diploma

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"I certify that the above statement made by the candidate is true and that this research project is suitable for submission to the University for the purpose of evaluation."

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'AN ANALYSIS OF CHALLENGES AND BARRIERS IN IMPLEMENTING BASEL III IN THE LICENSED COMMERCIAL BANKS OF SRI LANKA '

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ABSTRACT

Since the early days of banking, it was identified that a uniform regulatory framework needs to be introduced to safeguard the global financial sector. With the exponential increase of international trade during the 2^{nd} half of the 20^{th} century, the need for international regulations for banking was more evident.

The Basel Accord has its origins in the financial turmoil of 1973. After the collapse of Bretton Woods's system of managed exchange rates, banks worldwide faced considerable foreign exchange losses which led to banking supervisors globally to formulate a regulatory framework for the banking sector.

As a result the Basel Committee of Banking Supervision formulated a minimum set of requirements for the operation of banks in 1988 and the G10 countries adopted this framework in 1992. This accord was heavily criticized in subsequent years for measuring risk only in terms of credit. This resulted in the introduction of Basel II which had a more wide angled approach to risks faced by the banking sector. However with the financial crisis that occurred in Western Countries in 2007; the need of putting forward a new accord to replace Basel II was identified. The Basel III was first

introduced in 2010/11 and was modified in 2013. This accord gives emphasis to areas like Capital Adequacy, Stress Testing and Liquidity Coverage.

As the March 2019 deadline for Basel III compliance looms ever closer, banks across the globe including Sri Lanka race against the clock to meet the requirements outlined by Basel III. In this research the main barriers and challenges faced by Licensed Commercial Banks in Sri Lanka and their relationship for the successful implementation of Basel III will be identified. Further methods to overcome these barriers and challenges will be briefly discussed.

Primary and Secondary data were collected and analyzed using statistical and other methods to prove/disprove the objectives of the research. SPSS software was used for the statistical analysis of data. The outcome of the data was used to test the 6 Hypotheses developed in Chapter 3 of this research and the steps that can be taken to overcome these were briefly identified.

Chapter 1 - Introduction

1.1 Background on the Research Topic

Business of Banking naturally entails assuming "Risks" in all business transactions. As a result, "Risk Management" remains to gain prominence as a key strategic focus in managing banks effectively in today's impulsive financial markets. The vision of Risk Management, as per Bertsch et al (2006), is to proactively assist the business in delivering superior shareholder value by ensuring an optimal trade-off between risks and rewards whilst upholding strong liquidity and adequate capital positions at all times combined with a robust asset quality.

The changing nature of today's business world is increasing the scope and potential impact of the risks faced. As per Schwerter (2011) ability of a bank to take strategic initiatives within pre-defined and consistent risk framework can be considered as a speciality that can make a distinction for a bank to ensure safety to all stakeholders in today's competitive market scenario. Hence, the Bank has recognised the risk management capabilities as a 'journey " rather than a destination and is committed to maintain and continuously improve its risk management framework and capabilities through a number of initiatives including substantial investments in IT, training and development of human resources.

As explained in NDB Bank PLC, Annual Report (2013) "Risk Management" can be divided into three major categorise as Credit, Market and Operational risk. Credit risk is the risk of financial loss if a customer or counterparty to a financial instrument fails to