

# The Basel Effect: Changes in Asset Composition and Investment Strategies of Indian Public Sector Banks

Somen Mitra<sup>1</sup>, Dr. Javaid Akhter<sup>2</sup>, Dr. Ravi Changle<sup>3</sup>

<sup>1</sup>-Research Scholar, Faculty of Management Studies and Research (FMSR), Aligarh Muslim University, Aligarh (U.P.)

<sup>2</sup>-Former Professor, Faculty of Management Studies and Research (FMSR), Aligarh Muslim University, Aligarh (U.P.)

<sup>3</sup>- Director, AI & Emerging Technologies, Compunnel, Inc., Noida (U.P.)

**Abstract:** This study examines the impact of Basel regulatory norms on the asset allocation and investment composition of Indian Public Sector Banks (PSBs) from 1999 to 2021, covering Basel I, Basel II, and Basel III regimes. By analysing key investment and asset composition ratios, such as the Ratio of Investments in Government Securities to Total Investments (GSTI), Ratio of Advances to Government Undertakings to Total Advances (AGTA), Ratio of Advances Secured by Tangible Assets to Total Advances (ASTTA), Ratio of Unsecured Advances to Total Advances (UATA), and Ratio of Priority Sector Advances to Total Advances (PSATA), the study identifies significant shifts aligned with the phased implementation of Basel norms. Statistical analysis through independent t-tests highlights trends and shifts in portfolio metrics, demonstrating how regulatory changes influence the strategic asset and investment decisions of PSBs. The findings offer critical insights for policymakers and stakeholders on the effectiveness of Basel norms in strengthening financial stability within the Indian banking sector, thereby informing future regulatory policies and strategic decisions.

**Keywords:** *Asset Composition, Basel Norms, Financial Regulation, Indian Public Sector Banks, Investment Portfolio.*

## I. Introduction

The evolution of the Basel regulatory framework – spanning Basel I, II, and III – has fundamentally shaped the banking sector worldwide, especially in emerging markets like India. Basel I, introduced in 1988, primarily focused on credit risk by setting minimum capital requirements for banks. This initial framework established the foundation for risk management in global banking but was seen as limited in scope, particularly as it did not adequately address operational and market risks. In the Indian context, the Basel norms have played a crucial and practical role in shaping the risk management and operational strategies of banks, especially the Public Sector Banks (PSBs), which are the backbone of the country's banking system. This study focuses on the specific impact of Basel norms on the asset allocation and investment composition of Indian PSBs, providing valuable insights for regulatory policies and future research directions.

Indian Public Sector Banks (PSBs), which hold a dominant share in the country's banking assets, faced unique and significant challenges under Basel II and III. These challenges included the need to adopt more sophisticated risk assessment techniques and allocate capital in alignment with international standards, all while continuing to fulfil social and developmental mandates. The Basel III reforms, introduced in response to the global financial crisis of 2008, significantly raised the regulatory bar by emphasising higher capital buffers, liquidity requirements, and the introduction of a leverage ratio (Lyu et al., 2021). For Indian PSBs, the need for additional capital under Basel III posed challenges in terms of maintaining profitability and growth as capital infusion from the government and capital markets became essential to meet the new regulatory demands. These unique challenges make the study of asset allocation and investment composition in Indian PSBs under the Basel norms particularly relevant and important.

As Basel III further stresses on financial stability, Indian PSBs have had to reevaluate their asset allocation and investment compositions, balancing compliance with Basel norms against profitability. This research aims to analyse

how the Basel regime, encompassing Basel I, II, and III, has influenced asset allocation and investment composition in Indian PSBs. It particularly focuses on the need for these banks to adapt to evolving regulatory standards while managing their unique financial responsibilities, highlighting the crucial role of balanced lending strategies in this complex regulatory environment. The need for such strategies emphasises the importance of strategic decision-making in the banking sector, where every move must be carefully weighed against regulatory requirements and financial goals.

## **II. Literature Review**

The impact of Basel norms on asset composition and investment strategies in banking has been widely examined, with a focus on regulatory influences and adaptive strategies in response to capital requirements. Banerjee (2012) provides an early insight into Indian banks' compliance with Basel I and II, highlighting factors such as the credit deposit ratio, capital, and Return on Assets (ROA) in public banks under Basel I, as well as a focus on operational risk management across different bank types under Basel II. This study points to the importance of buffer capital for managing risk under Basel III, particularly in the context of profitability.

Internationally, Haubrich and Wachtel (1993) investigated a shift in U.S. commercial bank portfolios, noting a move from commercial loans to government securities driven by risk-based capital requirements. They argue that regulatory frameworks have a substantial impact on portfolio composition, which has implications for market dynamics. Similarly, Wall and Peterson (1995) examine how regulatory pressure influences bank holding companies' capital ratios, suggesting that regulatory intensity increased during periods of economic strain, particularly for banks facing formal enforcement actions.

In the context of Basel's evolving framework, Hall (2006) critically examines Basel II, acknowledging concerns over its ability to ensure financial stability despite extensive stakeholder involvement and effective research. Hall's analysis justifies the need for continuous adaptation of regulatory norms to respond to dynamic market conditions. Echoing similar concerns, Lindquist (2004) explores buffer capital as insurance against regulatory shortfalls, finding evidence that banks in Norway responded to Basel II's more risk-sensitive requirements by holding buffer capital as protection against market uncertainties.

Chami and Cosimano (2010) shift the focus towards monetary policy, arguing that Basel norms, particularly capital requirements, are increasingly shaping monetary policy transmission rather than traditional reserve requirements. This "bank balance-sheet channel" perspective highlights the regulatory role in influencing financial intermediation and broader economic outcomes. Similarly, Van den Heuvel (2002) emphasises the role of bank capital in monetary transmission, arguing that capital requirements have nuanced effects on policy effectiveness, particularly under evolving Basel norms.

In the Indian context, Nag and Das (2002) analyse how uniform capital requirements under Basel influence credit flow in the business sector. Their findings suggest that Indian public sector banks strategically adjusted their portfolios to align with regulatory requirements, while risk management practices led to more conservative lending. Nitsure (2005) expands on this, discussing Basel II's importance as a tool for internal improvement in Indian banks and raising concerns about the potential restriction of credit to underserved sectors due to stringent regulatory norms. Sen and Ghosh (2005) further emphasise the need for inclusive financing within the Basel framework, particularly for SMEs and low-income demographics in India.

Lastly, Arrawatia et al. (2019) focus on asset quality deterioration in Indian banks, noting that macroeconomic factors, industry conditions, and ownership structures influence non-performing loans (NPLs). This study underlines how Basel norms, especially under Basel III, may prompt public sector banks to adopt more diversified portfolios to mitigate risk, albeit with challenges related to market competition and political factors. This dynamic regulatory landscape, as highlighted by Kishore (2019), also affects investment patterns, with private banks showing a higher propensity for non-SLR investments compared to public sector banks, underlining the strategic adaptations banks make within Basel's evolving framework.

Overall, these studies suggest that Basel norms have been instrumental in reshaping asset allocation and investment strategies in Indian public sector banks, driving risk-aware capital adjustments, and prompting shifts toward diversified asset holdings to enhance resilience.

### **III. Methodology**

In this study, a comprehensive examination of the trends in asset and investment composition among 26 Indian Public Sector Banks (PSBs) is conducted over the period from 1999 to 2021, segmented into four key Basel regimes: the pre-Basel phase (1999–2002), Basel I (2003–2008), Basel II (2009–2013), and Basel III (2014–2021). This division aligns with the progressive implementation of Basel Norms in India, allowing for an in-depth comparative analysis of asset and investment composition trends before and after the Basel regulatory frameworks were enforced. The pre-Basel period (1999–2002) enriches the study by providing a baseline, which enables a more precise assessment of regulatory impacts across different phases. Data was sourced from authoritative secondary sources, including the Reserve Bank of India (RBI) database, the annual reports of PSBs, and other relevant financial publications. These sources ensure access to reliable and granular data on portfolio metrics crucial to this study's objectives. The data analysis was conducted using EViews 10 software, which was selected for its robustness in handling time-series econometric analysis.

To evaluate the asset and investment compositions, ratio analysis was performed, concentrating on five key metrics indicative of asset allocation and portfolio quality. These metrics included:

The Ratio of Investments in Government Securities to Total Investments (GSTI); The Ratio of Advances to Government Undertakings to Total Advances (AGTA); The Ratio of Advances Secured by Tangible Assets to Total Advances (ASTTA); The Ratio of Unsecured Advances to Total Advances (UATA) and The Ratio of Priority Sector Advances to Total Advances (PSATA). These ratios were specifically chosen because they represent a bank's asset structure, risk exposure, and overall financial resilience, thus enabling a deeper understanding of asset allocation under different Basel standards. For each Basel regime, the study computed the mean values of these variables, allowing clear observation of shifts in banking practices across regulatory transitions.

To assess the impact of Basel norms on the investment and asset composition metrics of PSBs, t-tests were applied to the full dataset, encompassing year-wise and bank-specific observations for each ratio. These t-tests facilitated comparisons between consecutive Basel regimes—specifically, Basel I versus Basel II and Basel II versus Basel III. This statistical approach tested for significant changes in mean values of the metrics across different regimes, providing empirical insights into the extent of Basel norms' influence on the financial strategies of Indian PSBs.

### **IV. Data Analysis and Results**

The analysis of asset composition across Basel regimes highlights the evolving strategies of Indian Public Sector Banks (PSBs) in response to regulatory shifts, specifically in terms of investment allocation, risk mitigation, and sectoral lending priorities. Each stage of Basel implementation brought distinct changes in PSBs' asset composition, with independent t-tests providing statistical insights into the significance of these shifts.

Starting with the ratio of government securities to total investments (GSTI), the data reveals an upward trend across Basel regimes, moving from 0.73 in the pre-Basel period to 0.84 in Basel III. The t-tests comparing Basel I to Basel II and Basel II to Basel III indicate no statistically significant difference in GSTI ( $p = 0.1287$  and  $p = 0.6222$ , respectively), suggesting a steady rather than sharp increase. This consistency aligns with Basel's capital adequacy requirements, which encourage investments in government securities as lower-risk assets.

The advances to government and public sector undertakings (AGTA) ratio exhibit a steady decline from 0.09 in the pre-Basel period to 0.04 in Basel III. While the t-test between Basel I and Basel II indicates no significant change ( $p = 0.1265$ ), the difference between Basel II and Basel III is statistically significant ( $p = 0.0406$ ), reflecting a regulatory impact that influenced banks to reduce exposure to government-related advances. This shift may be attributed to Basel III's emphasis on diversifying lending portfolios and reducing risk concentration.

In terms of advances secured by tangible assets (ASTTA), the findings show relative stability in Basel I and Basel II, with a substantial increase in Basel III, where ASTTA rose from 0.77 to 0.84. The t-tests reveal that while there is no statistically significant difference between Basel I and Basel II ( $p = 0.1492$ ), there is a highly significant increase between Basel II and Basel III ( $p < 0.0001$ ). This shift likely results from Basel III's stringent capital and asset quality requirements, which may have encouraged PSBs to favour secured lending over unsecured advances.

The unsecured advances to total assets (UATA) ratio demonstrates a marked transformation across Basel regimes. Initially rising from 0.09 in the pre-Basel period to 0.17 in Basel II, UATA declines significantly to 0.12 in Basel III. The t-test results emphasise this change, with a significant increase from Basel I to Basel II ( $p = 0.0105$ ) and an even stronger

reduction from Basel II to Basel III ( $p < 0.0001$ ). These shifts reflect regulatory preferences for secured lending practices to bolster financial stability and limit exposure to credit risk.

Priority sector advances to total advances (PSATA) provide insights into banks' alignment with sectoral mandates. Although PSATA declined from Basel I to Basel II (0.37 to 0.32), Basel III witnessed a resurgence in priority sector lending, returning to 0.37. The t-tests reveal statistically significant differences both in the decrease from Basel I to Basel II ( $p < 0.0001$ ) and the increase from Basel II to Basel III ( $p < 0.0001$ ). This pattern suggests an intensified focus on priority sector obligations under Basel III, which aligns with regulatory goals to support key economic areas such as agriculture, small industries, and exports, even as overall lending criteria became more risk-averse.

Overall, the results show that Basel regulations have systematically influenced Indian PSBs' asset allocation strategies by promoting safer, asset-backed, and priority sector lending practices. The t-test results provide robust evidence that Basel norms have contributed to a more secure and balanced lending environment, guiding Indian PSBs toward greater resilience and stability within the banking sector. These shifts reinforce Basel's effectiveness in shaping banking practices to achieve stronger capital adequacy, improved risk management, and alignment with economic priorities.

## **V. Discussion**

The findings reveal a clear shift in how Indian Public Sector Banks (PSBs) have managed their assets as they adapted to different Basel regulatory phases, each aimed at strengthening banks' stability, risk management, and lending practices. Basel norms appear to have guided these banks toward a safer, more balanced investment and lending approach over time.

A steady increase in banks' investments in government securities highlights a cautious approach, as these assets are generally low-risk. This trend suggests that even as regulations evolved, PSBs consistently prioritised holding government-backed investments to ensure financial stability. The lack of major variations across Basel phases shows a commitment to maintaining safe asset allocations, reinforcing Basel's goal of capital strength and resilience.

The data show a decline in lending to government and public sector undertakings, especially under Basel III. This may be linked to regulatory pressures to reduce exposure to public sector credit risk while still supporting public initiatives. As Basel III emphasised capital adequacy and risk mitigation, PSBs may have shifted toward more diversified lending, focusing on a balance between social goals and secure, profitable investments.

A notable change was the rise in secured loans backed by tangible assets under Basel III, indicating a strategic move toward lending practices that are less vulnerable to risk. This shift is likely a response to Basel III's focus on improved credit quality and the need for collateral. By increasing secured lending, PSBs aimed to reduce the risk of loans turning into non-performing assets, aligning with Basel III's emphasis on loan quality.

On the other hand, banks' unsecured lending initially rose under Basel II but then dropped sharply in the Basel III period, reflecting tighter controls on high-risk lending. This decline suggests that banks responded to Basel III's stricter norms by reducing exposure to loans lacking collateral, focusing instead on safer, more secure forms of credit.

Changes in priority sector lending also tell an interesting story. Basel III saw a renewed focus on lending to sectors that support economic development, such as agriculture and small enterprises. As shown by the increase in priority sector lending, PSBs are balancing their regulatory obligations with social responsibilities, providing vital support to key sectors while still maintaining financial soundness.

Overall, these results highlight Basel norms' impact on PSBs' lending and investment choices, pushing banks to balance growth and stability. Basel III, in particular, drove banks to improve loan quality, reduce high-risk exposures, and support essential economic areas. This evolution suggests that Basel regulations not only fortified Indian banks' capital and credit standards but also shaped prudent banking practices that align with broader economic priorities.

VI. Tables

Table 1: List of Indian Public Sector Banks (PSBs) under the Study

S.N.	Name of the Bank	S.N.	Name of the Bank	S.N.	Name of the Bank
1	Bank of India	10	Canara Bank	19	State Bank of Indore
2	Bank of Maharashtra	11	Corporation Bank	20	State Bank of Mysore
3	Central Bank of India	12	Dena Bank	21	State Bank of Patiala
4	Indian Overseas Bank	13	Indian Bank	22	State Bank of Travancore
5	Punjab And Sind Bank	14	Oriental Bank of Commerce	23	Syndicate Bank
6	Uco Bank	15	Punjab National Bank	24	Union Bank of India
7	Allahabad Bank	16	State Bank of Bikaner and Jaipur	25	United Bank of India
8	Andhra Bank	17	State Bank of Hyderabad	26	Vijaya Bank
9	Bank of Baroda	18	State Bank of India		

Source: Compilation by Authors

Table 2: Basel Regimes (As per implementation in India and considered for the Study)

Period	Basel Regime
1999-2002	Pre-Basel
2003-2008	Basel I
2009-2013	Basel II
2014-2021	Basel III

Source: Compilation by Authors

Table 3: Shift in Asset Composition of Public Sector Banks in Basel Regime

Regime	GSTI	AGTA	ASTTA	UATA	PSATA
Pre Basel	0.73	0.09	0.81	0.09	0.34
Basel I	0.83	0.06	0.78	0.15	0.37
Basel II	0.84	0.06	0.77	0.17	0.32
Basel III	0.84	0.04	0.84	0.12	0.37

Source: Compilation by Authors from the Reserve Bank of India (RBI) Database

Table 4: Table showing the Result of Independent t-test for GSTI of Indian PSBs across Basel Regimes

Particulars of t-Test of GSTI (Based on Full Values-Year wise and Bank wise) across Basel I and Basel II Regimes		Particulars of t-Test of GSTI (Based on Full Values-Year wise and Bank wise) across Basel II and Basel III Regimes	
Parameters	Value/Remarks	Parameters	Value/Remarks
t value	-1.523890	t value	0.493283
No. of observations	283	No. of observations	297
df	281	df	295
p-value	0.1287	p-value	0.6222
H <sub>0</sub>	Not Rejected	H <sub>0</sub>	Not Rejected
Mean GSTI (Basel I)	0.830321	Mean GSTI (Basel II)	0.842283
Mean GSTI (Basel II)	0.842283	Mean GSTI (Basel III)	0.838471
Std. Deviation-GSTI (Basel I)	0.069165	Std. Deviation-GSTI (Basel II)	0.061129
Std. Deviation-GSTI (Basel II)	0.061129	Std. Deviation-GSTI (Basel III)	0.069248

Source: Compilation by Authors based on the output of Eviews 10

Table 5: Table showing the Result of Independent t-test for AGTA of Indian PSBs across Basel Regimes

<b>Particulars of t-Test of AGTA (Based on Full Values-Year wise and Bank wise) across Basel I and Basel II Regimes</b>		<b>Particulars of t-Test of AGTA (Based on Full Values-Year wise and Bank wise) across Basel II and Basel III Regimes</b>	
Parameters	Value/Remarks	Parameters	Value/Remarks
t value	1.532429	t value	2.056834
No. of observations	283	No. of observations	297
df	281	df	295
p-value	0.1265	p-value	0.0406
H <sub>0</sub>	Not Rejected	H <sub>0</sub>	Rejected
Mean AGTA (Basel I)	0.064423	Mean AGTA (Basel II)	0.056772
Mean AGTA (Basel II)	0.056772	Mean AGTA (Basel III)	0.045235
Std. Deviation-AGTA (Basel I)	0.039337	Std. Deviation-AGTA (Basel II)	0.044595
Std. Deviation-AGTA (Basel II)	0.044595	Std. Deviation-AGTA (Basel III)	0.050091

Source: Compilation by Authors based on the output of Eviews 10

Table 6: Table showing the Result of Independent t-test for ASTTA of Indian PSBs across Basel Regimes

<b>Particulars of t-Test of ASTTA (Based on Full Values-Year wise and Bank wise) across Basel I and Basel II Regimes</b>		<b>Particulars of t-Test of ASTTA (Based on Full Values-Year wise and Bank wise) across Basel II and Basel III Regimes</b>	
Parameters	Value/Remarks	Parameters	Value/Remarks
t value	1.446188	t value	-7.349827
No. of observations	283	No. of observations	297
df	281	df	295
p-value	0.1492	p-value	0.0000
H <sub>0</sub>	Not Rejected	H <sub>0</sub>	Rejected
Mean ASTTA (Basel I)	0.781795	Mean ASTTA (Basel II)	0.769055
Mean ASTTA (Basel II)	0.769055	Mean ASTTA (Basel III)	0.837059
Std. Deviation-ASTTA (Basel I)	0.064593	Std. Deviation-ASTTA (Basel II)	0.083566
Std. Deviation-ASTTA (Basel II)	0.083566	Std. Deviation-ASTTA (Basel III)	0.075209

Source: Compilation by Authors based on the output of Eviews 10

Table 7: Table showing the Result of Independent t-test for UATA of Indian PSBs across Basel Regimes

<b>Particulars of t-Test of UATA (Based on Full Values-Year wise and Bank wise) across Basel I and Basel II Regimes</b>		<b>Particulars of t-Test of UATA (Based on Full Values-Year wise and Bank wise) across Basel II and Basel III Regimes</b>	
Parameters	Value/Remarks	Parameters	Value/Remarks
t value	-2.575356	t value	8.142630
No. of observations	283	No. of observations	297
df	281	df	295
p-value	0.0105	p-value	0.0000
H <sub>0</sub>	Rejected	H <sub>0</sub>	Rejected
Mean UATA (Basel I)	0.153910	Mean UATA (Basel II)	0.173307
Mean UATA (Basel II)	0.173307	Mean UATA (Basel III)	0.117294
Std. Deviation-UATA (Basel I)	0.061188	Std. Deviation-UATA (Basel II)	0.065199
Std. Deviation-UATA (Basel II)	0.065199	Std. Deviation-UATA (Basel III)	0.053247

Source: Compilation by Authors based on the output of Eviews 10



Table 8: Table showing the Result of Independent t-test for PSATA of Indian PSBs across Basel Regimes

Particulars of t-Test of PSATA (Based on Full Values-Year wise and Bank wise) across Basel I and Basel II Regimes		Particulars of t-Test of PSATA (Based on Full Values-Year wise and Bank wise) across Basel II and Basel III Regimes	
Parameters	Value/Remarks	Parameters	Value/Remarks
t value	9.707867	t value	-7.032663
No. of observations	283	No. of observations	297
df	281	df	295
p-value	0.0000	p-value	0.0000
H <sub>0</sub>	Rejected	H <sub>0</sub>	Rejected
Mean PSATA (Basel I)	0.371218	Mean PSATA (Basel II)	0.318031
Mean PSATA (Basel II)	0.318031	Mean PSATA (Basel III)	0.367412
Std. Deviation-PSATA (Basel I)	0.050114	Std. Deviation-PSATA (Basel II)	0.039961
Std. Deviation-PSATA (Basel II)	0.039961	Std. Deviation-PSATA (Basel III)	0.071172

Source: Compilation by Authors based on the output of E views 10

## VII. Conclusion

This study concludes that Basel norms have significantly influenced asset management and lending strategies in Indian Public Sector Banks (PSBs). Over successive Basel phases, PSBs have demonstrated a cautious approach, with increased investments in secure government-backed assets and a gradual reduction in high-risk, unsecured loans. The shift in lending practices, particularly under Basel III, shows a focused strategy toward secured and priority sector lending, aligning with regulatory goals of enhanced stability and risk management. Basel III's stricter norms appear to have effectively reinforced the quality of loans and improved overall asset composition, promoting a resilient and socially responsible banking framework.

This study, while insightful, faces certain limitations. It primarily focuses on quantitative data from a limited period and may not fully capture the broader economic and policy factors influencing banks' asset choices outside of Basel mandates. The study is also restricted to Indian Public Sector Banks, potentially limiting the generalizability of findings to private banks or banks in other countries. Additionally, the analysis does not account for internal bank management policies or sector-specific economic factors that might have influenced lending and asset decisions.

Future research could broaden the scope by examining the impact of Basel norms on private and international banks to understand comparative responses to regulatory frameworks. It would also be valuable to explore the role of internal bank policies and specific sectoral economic conditions that influence asset allocation beyond regulatory requirements. Additionally, longitudinal studies capturing post-Basel III adjustments would offer deeper insights into the long-term effects of these norms on asset quality, risk management, and banks' roles in economic development.

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