RBI Board Meeting – Highlights II

What is the issue?

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The issue of banks’ capital norms and PCA framework between centre and the RBI appears to have been resolved at the recent meeting.

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Click here to know more on the issue

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What are the existing issues?

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- **Capital adequacy** - Public sector banks have been losing capital over the past two to three years.
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- This is despite the Centre’s announcement of re-capitalisation of PSB’s at the tune of Rs. 88,000 crores last year.
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- Tier I capital ratios for weaker PSBs (placed under PCA) have fallen sharply.
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- This happened despite a near 8% fall in risk-weighted assets during this period, which should have eased up banks’ capital.
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- Nearly half of the PSBs do not meet the current total capital requirement (including capital conservation buffer or CCB).
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- Hence, there was a need for a stringent capital norm.
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- **Under-capitalisation** - A 2017 RBI paper on risk-weighting under Basel framework has well-argued the need for higher capital adequacy norms for Indian banks.

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- It found that Indian credit rating agencies' cumulative default rates (CDRs) and the resultant notional risk-weights were higher than the risk-weights currently prescribed by Basel.
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- This implied that banks ran the risk of being under-capitalised as the risk-weights laid down by Basel (adopted by the RBI) may not reflect the true default risk in loans of Indian banks.
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- **Centre's demand** - As per banks' FY17 net NPA, capital and profitability metrics, 16 or 17 PSBs should have fallen under PCA, based on the RBI's stated thresholds alone.
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- But only 11 banks were placed under PCA, suggesting that the RBI has reviewed the matter on a case-to-case basis.
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- Also, the PCA framework has been in operation since 2002 and net NPA and profitability (return on asset) have been a criterion under PCA since then.
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- Hence demands by the Centre to do away with these thresholds as they are not in sync with global practices may not hold true, as they have been in existence for over 15 years now.
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- Even if one were to revert to the old threshold levels of net NPA and ROA (prior to 2017), about half of the PSBs could be under PCA.
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- Thus, lowering the thresholds may not make much of difference, unless the deteriorated financials of PSBs improve.
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What are the outcomes of the meeting?

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- The RBI retained the 9% capital adequacy requirement for Indian banks, higher than the Basel mandated 8%.
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- It has only extended the transition period for banks to comply with the capital to risk-weighted assets ratio of 9%.
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- By mandating a higher capital ratio for Indian banks, the RBI also hopes to mitigate the risk of under-capitalisation.
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- The board meeting alsoputs out that the PCA framework will be reviewed by the RBI’s Board for Financial Supervision.
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- Here, the focus is likely to be on getting banks out of the PCA.
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- This could be doneby relaxing the ROA criteria, by which the criteria of two consecutive years of positive earnings to stay out of PCA be reduced to one year.
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- But given that nearly half the PSBs have reported loss in FY18, changing the criteria would not make much difference.
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What should be done?

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- Both the Centre and the RBI seemed to have found common ground on contentious issues —
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1. Setting of an expert committee to examine the Economic Capital Framework of the RBI
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2. The Board for Financial Supervision of the RBI looking into banks’ PCA (prompt corrective action) framework
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3. Respite on capital norms
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- The RBI would do well to not entirely dilute the prudential norms and hold its ground.
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- The RBI’s relief on the CCB component of capital will ease up about Rs. 14,000 crores for the Centre by way of recapitalisation plan.
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- There will be another Rs. 15,000-20,000-crore left with the public sector banks, with the possible revision on PCA norms.
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- However, reviving credit growth is the most critical part that RBI should take care of to resolve the festering issues in the banking sector.
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Source: Business Line

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