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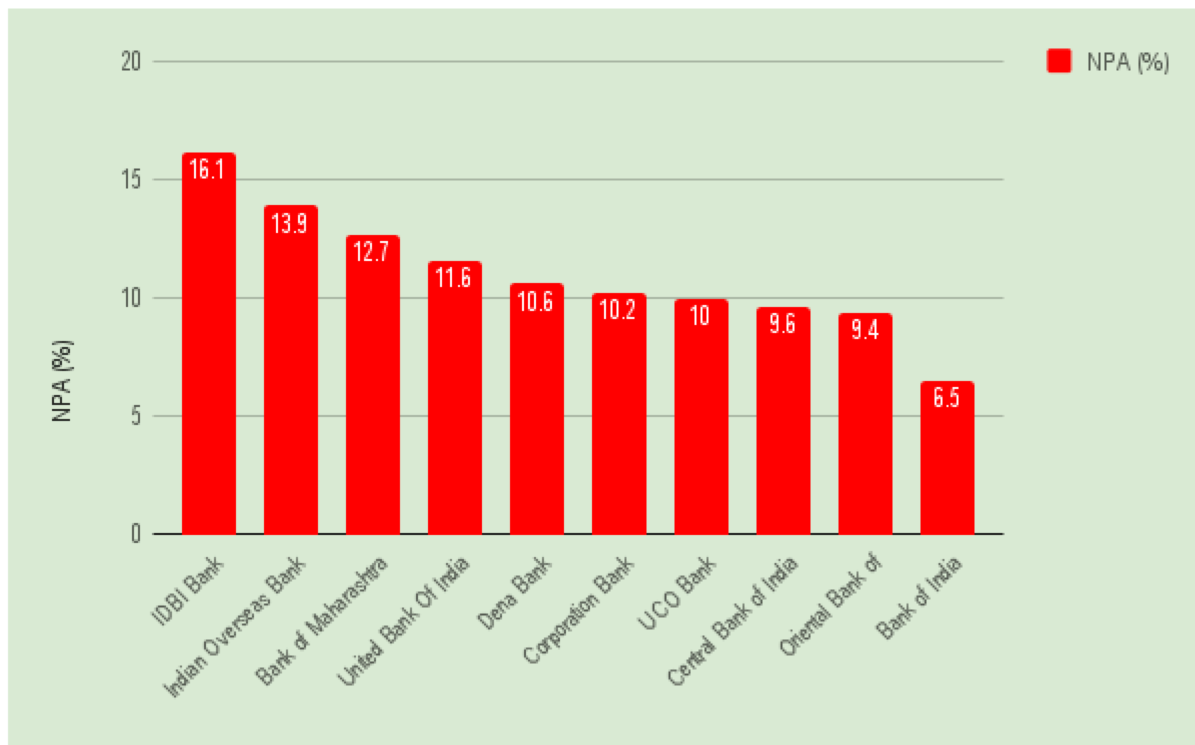
Removal of Banks from PCA framework

Why in news?

The Reserve Bank of India (RBI) recently removed three state-owned banks from the prompt corrective action (PCA) framework.

What is Prompt Corrective Action?

- Under the PCA norms, the performance of banks was determined on the basis of three criteria — capital, asset quality and profitability.
- It is a quick corrective measure taken in case a bank is found to be having low Capital Adequacy Ratio (CAR) or high NPAs.
- The capital adequacy ratio (CAR) is a measurement of a bank's available capital expressed as a percentage of a bank's risk-weighted credit exposures.
- RBI initiates PCA when CAR goes below 9% or NPA rises above 10%.
- When RBI initiates PCA against a bank, it puts restrictions on fresh loans and dividend distribution.
- The actions could include stricter norms for lending, branch expansion, management change and asset reduction depending on the financial health of the bank.
- The RBI tightened the PCA norms when bad loans situation in the country got worse, with many PSU banks showing high NPA ratio.
- The RBI had put 11 PSBs under PCA with different degree of restrictions.



- Rating agencies like Fitch have hailed the RBI's decision to put stricter norms, saying that it would address the problems of struggling banks.
- However, the government was of the opinion that the RBI should relax the PCA norms to enable more sanction of credit by PSU Banks.

What are the underlying reasons?

- The three banks which are removed from the PCA framework are Bank of India, Bank of Maharashtra and Oriental Bank of Commerce.
- The three banks were among 11 public sector lenders that were brought under the PCA framework by the apex bank.
- Subsequently, the government infused capital in PSU banks and some of the lenders reported better numbers for the third quarter ended December 31, 2018.

- Thus, there was an expectation that at least two banks will come out of the PCA framework.
- For instance, at least two banks — Bank of India and Bank of Maharashtra — had non-performing assets as a percentage of total assets that were lower than the threshold of 6% set by the RBI.
- Bank of India had a net NPA of 5.87%, while Bank of Maharashtra's NPA was 5.91%.
- In case of Oriental Bank of Commerce, the net NPA is 7.15% in the third quarter.
- The government had since infused sufficient capital and the bank had brought down the net NPA to less than 6%.

- Thus, the RBI decided to remove these banks, along with Oriental Bank of Commerce, after a review of the performance of these three banks.
- These banks have met the regulatory norms including Capital Conservation Buffer (CCB) norms.
- It pointed out that these lenders were not in breach of the PCA parameters on the basis of their results in the third quarter, except Return on Assets (RoA).
- According to rules, bank having negative RoA for at least two consecutive years will come under the PCA framework.
- However, the RBI said the lenders with weak ROA have given it in writing that they would comply with the norms of minimum regulatory capital, net NPA and leverage ratio on an ongoing basis.
- Further, they have told the RBI that they are making various structural and systemic improvements.
- Also, the government has also said the capital requirements of these banks will be duly factored in while making bank-wise capital allocations during the current financial year.
- Taking all the above into consideration, these banks are taken out of the PCA framework subject to certain conditions and continuous monitoring.

Source: Financial Express

Capital Conservation Buffer

- CCB is a relatively new concept, introduced under the international Basel III norms.
- The concept says that during good times, banks must build up a capital buffer that can be drawn from when there is stress.
- In India, the minimum capital requirement is 9%.
- The CCB would be 2.5 percentage points over and above the minimum capital requirement.

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