Revitalising Public Sector Banks

What is the issue?

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Making troubled public sector banks into narrow banks (these can't lend big) could be considered, with recent crises in PSBs.

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What is the need?

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- The RBI has put restrictions on all fresh lending by Dena Bank.
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- It has restricted lending to risky assets and raising high-cost deposits for Allahabad Bank.
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- This comes after further deterioration in their performance in 2017-18.
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- Besides, many other banks under *prompt corrective action* (PCA) are witnessing a downfall.
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- This became evident with recent declaration of their financial results for 2017-18.
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What is the government's response?

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- The government may ask the RBI to revise the PCA framework.
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- This is to ensure that such specific lending restrictions are not put in place.
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- This comes in the backdrop of the fears that more banks under PCA may face lending curbs.
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What was the earlier approach?

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- The idea of turning troubled public sector banks into narrow banks was not welcomed some time back.
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- It was felt that it would squeeze the flow of fresh credit.
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- This in turn was perceived to be dangerous for growth.
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- But with the latest financial results, RBI has made lending restrictions on some banks.
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- This effectively makes all of them narrow banks.
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What is the changing scenario with banks?

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- **Cash dispensing** - Banks no longer need to be primary dispensers of cash.
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- There are “white label” ATMs which are owned not by banks but independent companies.
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- Commercial establishments would dispense cash with the help of point of sale machines.
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- This will be particularly useful in villages.
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- The local all-purpose kirana shop can be the cash dispenser.
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- **Payments system** - Banks no longer need to be the mainstay of the country’s payments system.
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- With digital payments, old big banks carry a far smaller part of the payments load.

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- The National Payments Corporation of India (NPCI) is in place.

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- They greatly facilitate the adoption of an electronic payments system.

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- It has also introduced the RuPay card.

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- Even cooperative and regional rural banks have issued these for their customers who normally do not use cards.

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- Moreover, the “unified payments interface” is run by the NPCI.

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- It has enabled instant payments across banks with the use of mobile phones.

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- **Deposit taking** - One key role that PSBs have so far performed well is deposit taking.

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- It offers a safe place for people to keep their deposits.

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- PSBs were able to raise the national savings rate after bank nationalisation.

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- This has in turn helped raise the rate of economic growth.

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- But to continue this, government will have to sharply raise the level of deposit insurance.

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- Periodic episodes of cash crunch following demonetisation point to an underlying fear about security of bank deposits.

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- **Dealing with deposits** - What banks do with these deposits is an important task.

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- They can continue to dispense personal loans.

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- But their earlier major activity of lending to micro, small and medium businesses is being taken over.

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- This is done far more efficiently by microfinance organisations and the new small finance banks.

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- PSBs can participate in this sector by buying the securitised assets of small finance banks and MFIs.

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- **Lending for corporates** - Non-banking finance companies with the ability to manage risk and lend in individual sectors are emerging.

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- They are also hiring top banking talent.
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- The NBFCs will seek to refinance themselves by securitising these loans.
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- PSBs can invest in these NBFC issued securities with underlying loan assets which will be rated.
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- This will enable PSBs to earn a higher return than offered by government bonds.
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- This can also be taken up at a lower risk than lending directly.
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What lies ahead?

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- Public sector banks have considerably lost their public confidence.
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- This necessitates a fundamental change in the country's banking scenario.
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- To survive, PSBs can pare their lending and cash dispensing roles.
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- Deposits can be invested in securitised assets of small banks.
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Source: The Hindu

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Quick Fact

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Prompt Corrective Action (PCA)

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- PCA is primarily to take appropriate corrective action on weak and troubled banks.
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- The RBI has put in place some trigger points to assess, monitor and control banks.
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- The trigger points are on the basis of CRAR (a metric to measure balance sheet strength), NPA and ROA (return on assets).
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- Based on each trigger point, the banks have to follow a mandatory action plan.
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- It prohibits them from undertaking fresh business activities such as opening branches, recruiting talent or lending to risky companies.
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- RBI could take discretionary action plans too apart from these.
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