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PSU banks at most risk from bad loans, must be judicious on payouts: Financial stability report

By ET Bureau | Dec 24, 2015, 05:53 AM IST [Post a Comment](#)

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MUMBAI: The Reserve Bank singled out state-run banks in a survey of the financial sector's woes and told them to ensure they didn't overpay dividends since they are at risk from bad loans surging further in the event of a deterioration in the economy.

Worsening asset quality and sluggish profitability show that risks to banking stability have increased in the past six months, RBI said in its Financial Stability Report on Wednesday.

The risk to the banking system from the domestic economy, meanwhile, has dropped to medium from high, the central bank said in its Financial Stability Report.

Banks have been lax in credit assessment and in many cases loaned money to projects where the equity contribution of entrepreneurs was minuscule, exacerbating their poor health, it said. All the more reason to keep a watch on dividends.

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What The RBI Report Says

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PSBs have paid as dividend in past 4 years

₹20,000 CR

8% PSBs' gross bad loans by March 2017 in worst case scenario (figure was 6.2% in Sept)

"PSBs (public sector banks) pay out significant amounts as dividend to the government and other shareholders which have no relevance to their balance sheet strengths and capital planning," said the report. "This pattern of dividend payouts is not consistent with the dividend irrelevance theory. Thus, it is imperative that PSBs approach their dividend decisions as strategic business decisions which are in keeping with their objective of shareholder wealth maximisation."

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RBI assesses banks and various financial sector intermediaries such as [insurance](#) companies and [mutual funds](#) to gauge the health of the Indian markets. The findings are disclosed in the bi-annual stability report without naming specific institutions.

State-run banks have been at the receiving end of the regulator as bad loans have piled up. While they have declared more than Rs 20,000 crore as dividend in the past four years, banks have taken in more than twice that as capital from the government.

RBI said that if macroeconomic conditions deteriorate, in the worst case scenario, bad loans could jump to 6.9 per cent of total credit by March 2017 from 5.1 per cent in September. But public sector banks are the most vulnerable to a deteriorating economy — in the worst case, their gross bad loans could jump to 8 per cent by March 2017 from 6.2 per cent in September.

BANKERS FAULTED

The report also blamed bankers for poor credit evaluation, which has made it difficult to recover money from defaulters. Banks are laden with debt doled out to such companies that haven't been able to get going on their projects for various reasons.

"While adverse economic conditions and other factors related to certain specific sectors played a key role in asset quality deterioration, one of the possible inferences from the observations in this context could be that banks extended disproportionately high levels of credit to corporate entities/promoters who had much less 'skin in the game' during the boom period," said the report.

With regard to the external [environment](#), India's stable financial system and relatively stronger macroeconomic fundamentals give domestic institutions the strength to face uncertainty and emerging risks from the [global economy](#) and financial markets. But the report warned that policy-makers need to remain watchful about possibilities such as a sharp increase in oil and commodity prices, [financial market](#) volatility and a further slowdown in global trade.

At home, risks could stem from erratic climatic conditions, limited policy space, poor corporate performance, the asset quality of financial institutions and low investment growth.

While banks need capital, any funds raised would be wasted if they do not come up with ways to resolve the bad loan burden, it said.

"Banks need further capital cushion to tide over the current situation due to the impact of asset quality stress," the report said. "However, as the path of 'distance to default' is not linear and since a marginal deterioration in asset quality accelerates the 'default probability', devising appropriate strategies for resolution of bad assets is of crucial importance to derive the benefits from any additional capital infusion."

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