

One in two public sector banks may require 'prompt corrective action': Fitch

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Rating agency says RBI may use new PCA framework to identify weak banks for mergers

Mumbai, April 20: More than half the country's state-owned banks would breach at least one of the four thresholds specified by the Reserve Bank of India under its revised "prompt corrective action" (PCA) framework, mainly owing to high non-performing loans (NPLs), according to Fitch Ratings.

The credit rating agency felt that the RBI may use the PCA framework to identify weak banks as candidates for mergers.

The RBI has tightened the thresholds — for capital ratios, NPLs, profitability and leverage — at which banks enter the PCA framework. Fitch underscored that this appears to be an acknowledgement of the significant asset-quality stress in the system and that more banks are in need of regulatory intervention.

"PCA was previously viewed as an extraordinary step, which the RBI urged banks to make great efforts to avoid. That now looks likely to change. More than half of state-owned banks would breach at least one of the new thresholds, mainly owing to high NPLs, based on their latest financial reports," said the agency.

The new PCA framework will be invoked on the basis of the banks' FY17 financials.

Fitch observed that the RBI has also given itself greater discretion in terms of the measures it can use to intervene in banks once they fall under the PCA framework, which suggests it has recognised a need to take corrective action at an earlier stage when banks run into difficulties.

The previous PCA, in contrast, explicitly reserved the most interventionist actions for banks that had breached more extreme thresholds.

"It is possible that intervention could involve forcing banks to conserve capital, if other actions do not address problems. The risk of non-performance on bank capital instruments may therefore have risen," said Fitch.

Flagging the possibility of the RBI using the PCA framework to identify weak banks as candidates for mergers, the agency said State Bank of India took over five smaller lenders earlier this month, and further consolidation could be part of the overall strategy to clean up the banking system.

However, such mergers would also require the support of the government, it added.

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