

# Revisit the PCA policy for PSBs

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The newly appointed finance minister, as reported in the media, is requesting the Reserve Bank of India ([RBI](#)) to review and relax the triggers in invoking prompt corrective action (PCA) for banks that are in a difficult situation. The liberal approach of the minister is, in fact, correct for many reasons.

Public sector banks (PSBs), not without reason though, have been severely criticised over the last few years because of high-stressed and non-performing assets. This criticism never took into consideration the stresses and strains under which PSBs

were operating, and positively contributing to stabilising the national economy. PSBs were lending mainly to infrastructure and projects that required large investments, while private sector banks were generally operating with creamy clients and in urban areas, mainly extending low-risk and smaller-value retail loans. The high-value loans of PSBs were, in fact, proxy for large government deficits and virtually supporting industry, employment and growth in the economy. The fall in tide, implying slowdown in global economic growth, reached shores of India rather late, and suddenly the strategy adopted by PSBs was pronounced faulty. There is fair probability to believe that if India's savings rate had not declined, and growth of exports had not slackened, the stress level of assets in PSBs would not have been as high as recorded now. However, it can be argued that PSBs should have been more careful, agile and alert to move out in time, or should have had a more diversified portfolio to mitigate risks.

Consequently, RBI, as a regulator and supervisor, has invoked PCA on PSBs. The spirit of PCA is that if a commercial bank has been irresponsible in lending decisions, then RBI would step in to help the bank. Traditionally, RBI, only after due diligence and careful scrutiny, would place the bank under PCA. The trigger of PCA could be asset quality, profitability, leverage ratio or capital adequacy. PCA provides substantial power to RBI to examine the governance of the bank. RBI can then strategise an action plan to nurse the respective bank to recovery and, if need be, take recourse to unconventional corrective measures, including merger.

To place the bank under PCA is an exceptional action, which impacts the rating of the bank as well as consumer confidence. This is detrimental in the long run as it impacts the credit history of the bank, including its management. It also raises questions on the governance of the specific bank.

In the current case, nearly all PSBs are recording high-stress levels and 14 commercial banks, according to press reports, are already under PCA. This is not a routine case of PCA, but rather an epidemic and a symptom of a deeper malaise, which requires rigorous diagnostics before suggesting corrective action.

The initiation of PCA, in normal course, conveys to the general public that RBI is alert and is carefully monitoring the vital parameters of the respective sick bank, so that taxpayers' good money is not wasted on bad money in the troubled banks. It also inspires confidence in the existing depositors that their bank is attracting attention of the specialists and would soon recover completely.

In sharp contrast, in case of an epidemic, initiation of PCA on an ad hoc basis, regularly, would imply lack of investigation, analysis and preparation by the regulator. The extensive research department of RBI, and liberally-funded CAFRAL (research institution of RBI) with extensive programme for foreign visitors, probably would have already examined the ailment in depth by now, given that the stressed banks have been showing grim symptoms for nearly half a decade. It will be helpful for market analysts if such research is placed in public domain to inspire confidence in steps being initiated by RBI.

Further, there is a need to examine whether similar standards for invoking PCA and levels for capital adequacy and profitability should be applicable to all types of commercial banks when performance, illustratively, in terms of priority sector, loan portfolio and Pradhan Mantri Jan-Dhan Yojana differs. Also, in case one bank is placed under PCA, then only the credibility of that specific bank is impacted, but when more than half of PSBs are placed under PCA, not only the rating of the country, with impact on exchange rates and risk premium, but also the capability and capacities of the regulator itself get suspected.

There is a need to explore, through a survey-based study of bankers, to identify specific factors that led to this difficult situation, across the spectrum. Only then a credible action plan can be designed and implemented, rather than implementing a PCA plan meant for routine cases. In the absence of an experienced commercial banker in the top management of RBI, to prepare a successful recovery strategy the government may also need inputs from the Indian Banks' Association (IBA).

In the medium to long term, RBI may like to consider preparing a policy to examine and suggest a course of action when pandemic breaks and many banks suffer from stress concurrently, irrespective of diversified portfolio. Should PCA be invoked then and would it ever be productive when financial tide is low and many commercial banks are barely able to manage staying afloat amongst the rocks? Such an analysis is necessary because, by simultaneously placing many banks under PCA, the

general public is impacted with hardships in terms of restrictions in making deposits or borrowings from respective banks. Most importantly, in such a situation, financial inclusion suffers an irrevocable setback and massive public investment in financial literacy and opening of bank accounts goes waste.

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