

Why government must not lean on RBI to relax norms for PCA banks

By: [The Financial Express](#) | Published: October 23, 2018 4:30 AM



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After a couple of announcements by State Bank of India (SBI) and other lenders that they would buy assets from Non Banking Financial Companies (NBFCs)—a move seen as a bailout of sorts—there is some discussion the finance ministry may ask other banks to step in. That

is unfortunate. The government should desist from asking banks to help alleviate the stress at NBFCs and Housing Finance Companies (HFCs) and leave it to lenders to decide whether they want to buy these. The fact is that several HFCs and NBFCs have borrowed short and lent long and find themselves with an asset-liability mismatch. They, alone, are to blame for this and banks, or for that matter mutual funds or other lenders, cannot be expected to fix the problem.

There is also some discussion to the effect that the inability of around a dozen banks to lend beyond a point—thanks to restrictions placed on them by Reserve Bank of India (RBI) under the Prompt Corrective Action (PCA) framework—has been the cause of a liquidity shortage. The fact is that overall loan growth at banks has been ruling in double digits—the non-PCA banks stepped up their lending—and been supplemented by lenders in the corporate bond market and, at the shorter end, in the commercial paper market. Even if the loan growth hadn't been at the levels that it is, the PCA was needed. The balance sheets of the banks concerned were found to be so weak post the AQR—asset quality review—initiated by RBI in Q4FY16, they would surely have become insolvent had the necessary steps not been taken.

As Viral Acharya, deputy governor of RBI, has rightly pointed out, had these banks not been re-capitalised, they might have become unstable and jeopardised the rest of the banking system. Within PCA banks, almost half of the total infusion of Rs 63,500 crore has taken place during 2017-18 and 2018-19. Given how the lending practices of these banks were poor—else they would not have been in the mess they were—it was imperative their operations were curtailed for sometime till their balance sheets stopped haemorrhaging.

In fact, as Acharya found, despite being more poorly capitalised and possessing a higher stressed assets ratio than other lenders, PCA lenders were actually growing their loan books at a pace that was similar to others until 2014. This reflects how poorly the operations of banks were being monitored. Indeed, had it not been for the AQR exercise, the true quality of banks's balance sheets would not have been known. To be sure, the loan growth at PCA lenders has slowed sharply, and even contracted in some instances since the AQR, but that is the price they need to pay for having been reckless. Even today, the provision coverage of these banks, at around 50%, remains much lower than the desired levels of 70% which shows there is some way to go before they are out of the woods. In the current tricky economic environment, where most companies remain over-leveraged and the recovery is slow, even the best of banks need to cherry pick their assets. At this time,

the government would do well to allocate more capital to the stronger and better-run banks rather than weaker banks which, when they are in better shape, could be merged with the bigger ones.

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