RBI Governor explains what banks should do to mitigate risks arising out of Covid-19

By: PTI
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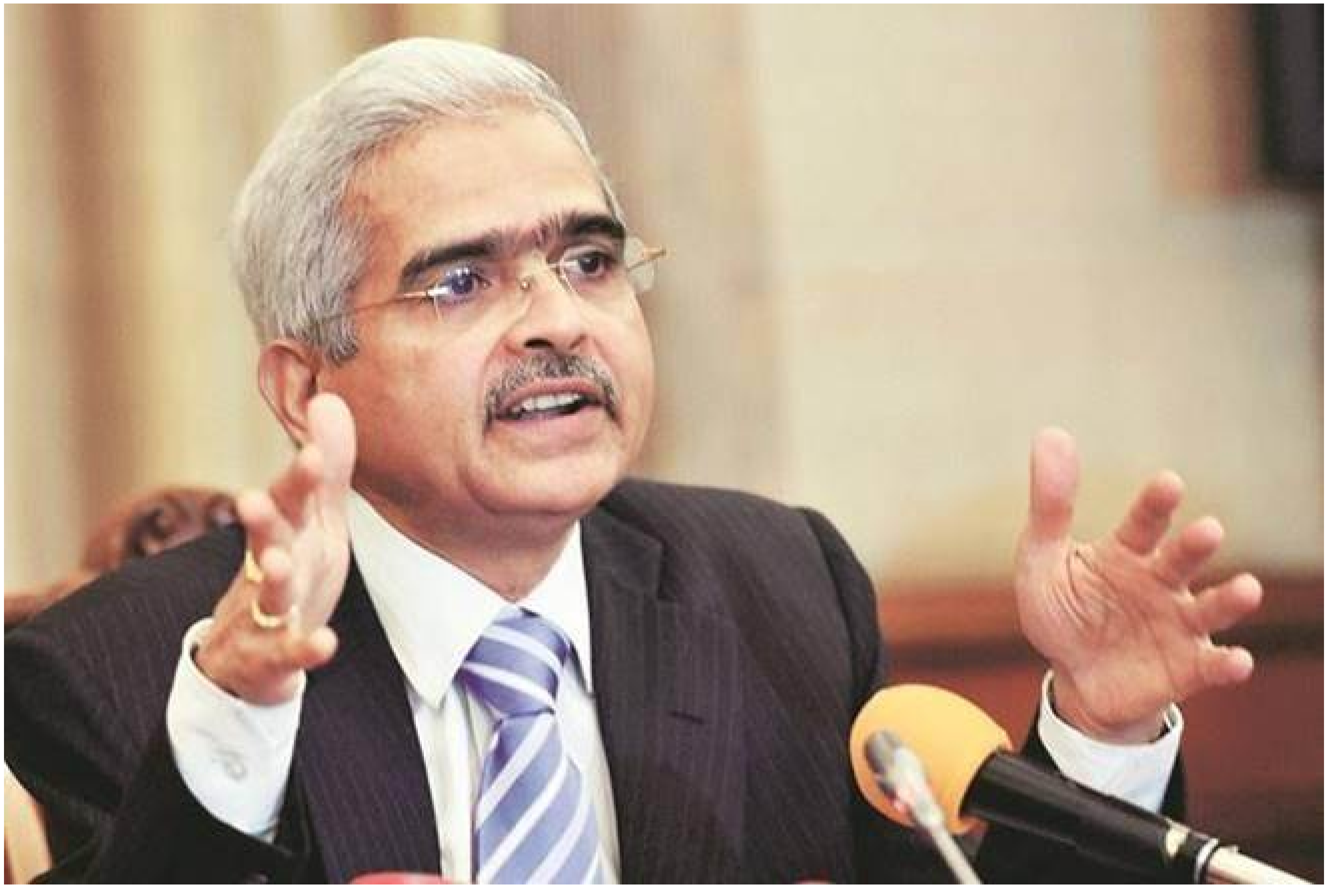

RBI Governor Shaktikanta Das.

Banks need to raise capital on anticipatory basis to build up adequate capital buffers to mitigate risks arising out of coronavirus outbreak, RBI Governor Shaktikanta Das said on Saturday. He said building buffers and raising capital will be crucial not only to ensure credit flow but also to build resilience in the financial system. "In such a situation, it has become a lot more important that the banks have to improve their governance, sharpen their risk management skills and banks have to raise capital on an anticipatory basis instead of waiting for a situation to arise. "Proactively, it is necessary for both public and private sector banks to build up adequate capital buffers," Das said at SBI's banking and economic conclave.

The economic impact of the pandemic – due to lock-down and anticipated post lock-down compression in economic growth – may result in higher non-performing assets and capital erosion of banks, he said. A recapitalisation plan for public sector and private banks has, therefore, become necessary, he added.

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For the five years – between 2015-16 and 2019-20 – the government had infused a total of Rs 3.08 lakh crore in public sector banks. However, the government refrained from committing any capital in the Budget 2020-21 for the PSBs, hoping that the lenders will raise funds from the market depending on the requirement.

Many private and public sectors such as State Bank of India, PNB, HDFC Bank, ICICI Bank, and Canara Bank are looking to raise capital through various means this fiscal. The governor also asked banks and non-banking finance companies (NBFCs) to conduct stress test to analyse the impact of COVID-19 on their balance sheets and prepare a plan for any possible risk.

The RBI has recently (June 19 and July 1, 2020) advised all banks, non-deposit taking NBFCs (with an asset size of Rs 5,000 crore) and all deposit-taking NBFCs to assess the impact of COVID-19 on their balance sheet, asset quality, liquidity, profitability and capital adequacy for the financial year 2020-21, Das said. "Based on the outcome of such stress testing, banks and non-banking financial companies have been advised to work out possible mitigating measures, including capital planning, capital raising, and contingency liquidity planning, among others," he added.

The idea is to ensure continued credit supply to different sectors of the economy and maintain financial stability, the governor noted. The global financial crisis of 2008-09 and the COVID-19 pandemic have dispelled the notion that tail risks to the financial system will materialise only rarely, Das added. "Shocks to the financial system dubbed as 'once in a lifetime events' seem to be more frequent than even 'once in a decade'," he said.

Accordingly, the minimum capital requirements of banks, which are calibrated based on historical loss events, may no longer be considered sufficient enough to absorb the losses, he noted.

Meeting the minimum capital requirement is necessary, but not a sufficient condition for financial stability, he said, adding "hence, it is imperative that the approach to risk management in banks should be in tune with the realisation of more frequent, varied and bigger risk events than in the past". Das said banks and financial intermediaries have to be ever vigilant and substantially upgrade their capabilities with respect to governance, assurance functions and risk culture.