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RBI removes Central Bank of India from Prompt Corrective Action framework

Published On: 21-09-2022

What's in News?

The Reserve Bank of India (RBI) removed Central Bank of India from its Prompt Corrective Action Framework (PCAF) after the lender showed improvement in various financial ratios, including minimum regulatory capital and net non-performing assets (NNPAs).

Prompt Corrective Action Framework:

Reserve Bank of India had introduced a Prompt Corrective Action Framework (PCA**) for Scheduled Commercial Banks in 2002.**

The objective of the PCA Framework is to enable **Supervisory intervention** at appropriate time and require the Supervised Entity to **initiate and implement remedial measures in a timely manner**, so as to restore its financial health.

The PCA Framework is also intended to act as a tool for **effective market discipline**.

The PCA framework deems banks as risky if they slip below certain norms on **three parameters — capital ratios, asset quality and profitability.**

It has three risk threshold levels (1 being the lowest and 3 the highest) based on where a bank stands on these ratios.

Trigger Points

CRAR (capital to risk-weighted assets ratio) (The ratio measures a bank's financial stability by measuring its available capital as a percentage of its risk-weighted credit exposure.)

(i) CRAR less than 9%, but equal or more than 6%

(ii) CRAR less than 6%, but equal or more than 3%

(iii) CRAR less than 3%

NPAs (Non Performing Assets)

(i) Net NPAs over 10% but less than 15%

(ii) Net NPAs 15% and above

ROA (return on assets) (It is usually calculated by dividing a company's net income by the average total assets) below 0.25%

Depending on the threshold levels, the RBI can place **restrictions on dividend distribution, branch expansion, and management compensation.**

Only in an **extreme situation**, breach of the third threshold, would identify a bank as a likely candidate for resolution through **amalgamation, reconstruction or winding up.**

PCA **does not really limit the normal lending operations of banks**.

While the RBI has placed restrictions on credit by PCA banks to unrated borrowers or those with high risks, it hasn't invoked a complete ban on their lending.

PCA for NBFCs:

- The PCA Framework for NBFCs, **comes into effect from October 1, 2022**, based on the financial position of NBFCs on or after March 31, 2022.
- The PCA Framework will be reviewed after three years of being in operation.
- Under the framework, NBFCs will face restrictions when certain parameters like non-performing assets, capital adequacy ratio and Tier 1 capital fall below the stipulated levels.
- It will be applicable for **all deposit-taking NBFCs — excluding government NBFCs, primary dealers and housing finance companies — and other non-deposit taking NBFCs in the middle, upper and top layers**.
- There are three risk thresholds in the PCA framework for NBFCs.
- An NBFC under PCA framework, caused by triggering the first threshold, will be **restricted on dividend distribution, promoters will be asked to infuse capital and reduce leverage.**
- The RBI will also **restrict issuance of guarantees or taking other contingent liabilities** on behalf of group companies, in case of core investment companies.
- After hitting risk threshold 2, the NBFC will be **prohibited from opening branches**, while on risk threshold 3, **capital expenditure will be stopped, other than for technological upgradation**.
- PCA will be imposed if the net non-performing assets is between 6-9 per cent (risk threshold 1), 9-12 per cent (risk threshold 2) and greater than 12 per cent (risk threshold 3).
- If the capital adequacy ratio falls 300 basis points from the current level of 15-12 per cent (risk threshold 1), 300-600 bps from 12-9 per cent (risk threshold 2) and by 600 bps from 9 per cent (risk threshold 3), PCA will be imposed.

News Highlights:

- The RBI had imposed the PCA norms on the bank in June 2017 due to its high net NPA and negative return of assets (RoA).
- This is the last bank which has been removed from the PCA norms by the RBI.
- The **decision to lift the business restrictions** from the bank was taken after a review by **the Board for Financial Supervision**
- RBI had placed 11 state-run banks – Allahabad Bank, United Bank, Corporation Bank, IDBI Bank, Uco Bank, Bank of India, Central Bank of India, Indian Overseas Bank, Oriental Bank of Commerce, Dena Bank and Bank of Maharashtra – under PCA framework after they breached the risk thresholds.