International Journal for Multidisciplinary Research (IJFMR)

E-ISSN: 2582–2160, Volume 4, Issue 3, May-June 2022

Prompt Corrective Action (PCA) Scheme avoiding failure of Bank & NBFC

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Abstract

In all countries the banking system is under monitoring and control of one regulator along with central government of that country. All autonomy of the banks is regulated by Central bank of the country, Reserve Bank of India in case of India. The health of the banks is very sensitive and micro parameter but few parameters to assess the health of a bank are Capital adequacy (CRAR), Return on Assets (RoA) and NPA level, when we talk about GNPA it is ratio of gross nonperforming assets with total outstanding loans if provision against NPA assets is subtracted the figure will come out NNPA (Net NPA). After long considerations, deliberations, comments of bank and other stake holders RBI applied the trigger level of these parameters as PCA application. RBI decided the mandatory and discretionary actions against banks at various trigger levels of three parameters CRAR, NPA and RoA. All trigger levels for separate categories like PSBs, old private banks, new generation private Banks and foreign bank, all actions mandatory and discretionary are applied in PCA by RBI. As the RRBs are also systemically important financial system later on PCA was applied to RRBs also. RBI also applied PCA to NBFC (with certain Exceptions) on the inspection of balance sheet as at 31.03.2022 with effect from 1 October 2022.

Study described the PCA norms and trigger points for all type of financial Institutions (Banks, RRBs and NBFCs) the outcome of the study mentioned in the conclusion of the study.

Keywords: PCA, Prompt Corrective Action, FSAP, Financial Stability Assessment Programme, FDIC, Federal Deposit Insurance Corporation, RTC, Resolution Trust Corporation, SAIF, Savings Association Insurance Fund, FSLIC, Federal Savings and Loan Insurance Corporation, SSMM, Special Supervisory Monitoring Meetings, NBFCs-D, Non-banking Finance Company Deposit Taking, NBFCs-ND, Non-banking Finance Company Not Deposit Taking, NPIs, Non-erforming Investment

1. Introduction

The 1980s and early 1990s were a period of great stress and turmoil for banks and financial institutions all over the globe, viz. Brazil, Chile, Indonesia, Mexico, several Nordic countries, Venezuela and USA, etc. In USA, more than 1600 commercial and savings banks insured by the Federal Deposit Insurance Corporation (FDIC) were either closed or given FDIC financial assistance during this period. FIDC's counterpart in India is DICGC. More than 900 Savings and Loan Associations were closed or merged. The cumulative losses incurred by the failed institutions exceeded US $ 100 billion. These losses resulted in the insolvency and closure of FSLIC and its replacement by the Resolution Trust Corporation (RTC) and the Savings Association Insurance Fund (SAIF).

These events led to the search for appropriate supervisory strategies to avoid bank failures as they can have a destabilizing effect on the economy. For this reason, medium or large banks are rarely closed and the governments try to keep them afloat. In both industrial and emerging market economies, bank rescues and mergers are more common than outright closure of the banks. Corrective action, well in time, is to be taken to avoid banks' failure, corrective action well in time when the bank still has adequate cushion of capital so as to minimize the loss to the economy public exchequer , Public deposits and to the insurance fund as in case of forced liquidation of the bank.

In this context, supervisory action can be at two levels:

- Early recognition of problems and corrective actions.
- Supervision and monitoring of troubled bank.

Such Structured Early Intervention and Resolution (SEIR) is a carrots as well as sticks exercise.

If Banks do not respond and their capital ratios continue to fall, appropriate sanctions including resolution is required. The Financial Stability Assessment Programme (FSAP), Basel Committee's Core Principles highlighted that lack of explicit rules mitigating against supervisory forbearance is a major weakness and that the time limit set by the Reserve Bank for taking remedial measures.

Prompt Corrective Action (PCA), imposed by RBI, in the year 2001. Under the powers conferred under RBI Act, 1934 and Banking Regulation Act, 1949, Reserve Bank has been taking bank-specific supervisory corrective actions where the financial position warrants such measures are applicable on all commercial banks excluding RRBs. The PCA scheme was based on pre-determined rule-based structured early intervention.

Basel Committee in year 1997 proposed to put in place as part of RBIs' constant efforts to enhance supervisory framework under the "Core Principles for Effective Banking Supervision". which were in the nature of minimum requirements intended to guide supervisory authorities in strengthening their current supervisory regime and stressed upon the necessity of their disposal adequate supervisory measures, backed by legal sanctions, to bring about timely corrective action when banks fail to meet prudential requirements like minimum capital adequacy ratios. PCA is one of the supervisory intervention of RBI when there are regulatory violations or there is any threat to depositors' interest.

As usual system and practice of RBI long discussions were made with stake holders over draft scheme of PCA, made available at RBI website. As regulator RBI has power for certain actions but certain policy decisions are taken with the consultation of central government, PCA is one of those decisions. The PCA scheme is proposed to be introduced as a supervisory tool in addition to the existing measures.

2. Abbreviations

PCA	Prompt Corrective Action.
FSAP	The Financial Stability Assessment Programme.
FDIC	Federal Deposit Insurance Corporation.
RTC	Resolution Trust Corporation.

SAIF	Savings Association Insurance Fund.
FSLIC	Federal Savings and Loan Insurance Corporation.
SSMM	Special Supervisory Monitoring Meetings.
NBFCs-D	Non-banking Finance Company Deposit Taking
NBFCs-ND	Non-banking Finance Company Not Deposit Taking.
NPIs	Non-berforming Investment

3. Methodology and Literature Review

As study relates with a very specific banking are, action by regulator and Government of India, the draft policy, RBI master circulars, Government GOs and Banking regulation Act along with RBI act referred very deeply. The detailed understanding of Basel committee which is at the helms of banking monitoring, control and reforms got studied. To enhance the knowledge about RBI functioning and way of consultation with GoI discussed with one of the RBI Regional director, name cannot be disclosed. The Banking parameters like RoA, Net Interest income, Net interest margin, GNPA, NNPA and capital adequacy got studied by text books of banking. Balance sheets of PSBs (PNB), private bank (ICICI) and one RRB (PUPGB) got down loaded and referred.

4. What is Prompt Corrective Action Scheme in India?

Under PCA (Prompt Corrective Action) a schedule of corrective actions has been worked out based on three parameters CRAR**,** Net NPAs and Return on Assets (RoA), which represent capital adequacy, asset quality and profitability respectively. Trigger point a level of all three parameters, are decided and a set of mandatory and discretionary PCAs has been laid down, based on trigger point.

The PCA, therefore, encompasses certain actions, which should bring immediate improvements, while some action points would be initiated in alignment with the severity of the problem. Thus, a set of Mandatory and Discretionary action points, in conformity with the magnitude of problems, is proposed to be in place to bring about improvement in the functioning of banks.

Where banks do not show improvement, despite taking mandatory actions, some of the discretionary actions will get converted into mandatory actions. In exceptional cases, RBI will have the right to waive mandatory provisions.

The total PCA framework for a bank will have to be determined by aggregating the PCAs under the various parameters.

In India, banks are at present required to maintain 9% CRAR as the regulatory minimum capital. Bank-specific capital adequacy requirements have not yet been prescribed in India. Under the circumstances, trigger points for initiating prompt corrective actions have been proposed when banks' CRAR falls below the regulatory minimum. While a marginal slip-back in the prescribed CRAR could be the first trigger point of supervisory action, further erosion, in the bands of 3% for a bank, in CRAR, could be the trigger points for subsequent stages. The trigger points based on capital adequacy requirements will be suitably modified when RBI adopts the proposal of bank-specific varying CRAR, as articulated in the second pillar of the New Capital Adequacy Framework.

5. What were the Trigger Points for a Bank under PCA Scheme?

The trigger points for NPAs and ROA may have to be set afresh every third year depending upon the performance parameters of the banks. Trigger Points for CRAR:

(1) CRAR less than 9%, but equal or more than 6%.
(2) CRAR less than 6%, but equal or more than 3%.
(3) CRAR less than 3%.

NPAs as per the data in the Report on Trend and Progress of Banking in India (1999-2000), more than 80% of the public sector banks, 75% of old private sector banks and more than 73% of foreign banks and all the new private sector banks had net NPAs of less than 10%. Thus, the 10% level could be the trigger level for PCA. This is an appropriate level considering the fact that 9% of NPA is the ceiling for granting autonomy to Public Sector Banks.

Two trigger points have been set for NPA as under:

- Net NPAs over 10% but less than 15%
- Net NPAs 15% and above

ROA Internationally 1% ROA is considered as a benchmark. However, the results of banks for the last three years show very variations in ROA among all the bank groups as may be seen from the data given below:

Table 1: Showing the ROA of Different Type of Banks for Three Years, Taken in Consideration for PCA

Sr. No.	Public sector Bank		Old Private Sector banks		New Generation Private Banks		Foreign Banks	
	Year	ROA	Year	ROA	Year	ROA	Year	ROA
1	1997-98	0.77	1997-98	0.81	1997-98	1.55	1997-98	0.97
2	1998-99	0.62	1998-99	0.48	1998-99	1.03	1998-99	0.69
3	1999-2000	0.42	1999-2000	0.84	1999-2000	0.97	1999-2000	1.17

In view of such sharp variations in ROA, it is difficult to set a trigger ROA at a level close to the desired level i.e. 1%. Considering the Indian reality, a trigger point of ROA below 0.25% has been proposed.

5A. Mandatory and Discretionary Actions

Actions based on CRAR

Capital to Risk-weighted Assets Ratio is one of the significant indicators of the financial soundness of banks. CRAR normally comes down either due to unrestricted growth in assets, especially risk-weighted assets without concomitant increase in capital or inadequate internal generation because of low earnings or high expenditure or poor asset quality resulting in heavy provisioning requirement. Such banks have little cushion to absorb any shocks, triggered by credit / market risk or other external developments.

E-ISSN: 2582–2160, Volume 4, Issue 3, May-June 2022

The mandatory and discretionary actions proposed are aimed at augmenting capital, restricting asset growth, especially risk weighted assets, enhancing the internal generation through cost containment, and moderating risks in operations.

In more severe cases of capital shortfall, change in management or ownership may also have to be resorted to. Finally, in extreme cases, banks may have to be merged if the capital adequacy does not improve from the threshold level of 3% within a reasonable time or if the management / promoters do not show any inclination to restore capital to the desired level.

The underlying idea is that a bank which is hovering at a very critical level does not show any improvement despite reasonable opportunities ought to be closed down while it has some capital so as to minimize the damage.

The mandatory and discretionary actions for the three zones are given below. These have been designed to increase in severity as the capital shortage becomes more critical.

(1) CRAR Less than 9% but Equal to or More than 6%

The situation implies that the bank fails to comply with the minimum regulatory CRAR of 9%, which exhibits its inability to absorb future shocks. The poor capital base is exacerbated by low earnings, heavy provisioning requirements due to high level of NPAs, high intermediation costs, asset-liability mismatches and bank's high level of risky assets. It also exhibits bank's inability to access the capital market. In such cases, the bank is not in a position to gainfully expand its asset base for improving profitability. The bank's flexibility to operate in interbank and overseas markets would be severely restricted, forcing the bank to adopt narrow banking.

Mandatory Actions

- Submission and implementation of capital restoration plan by the bank.
- Restriction on expansion of risk-weighted assets by the bank.
- Restriction on entry into new lines of business by the bank.
- Paying off costly deposits and CDs by the bank.
- Reduction / suspension of dividend payments by the bank.
- CRAR less than 6%, but equal or more than 3% by the bank.

It showed further deterioration in capital base due to combination of factors, such as continuous losses, heavy provisioning requirements due to precarious asset quality, failure to adjust risk-weighted assets due to illiquidity, promoters' inability to bring in additional capital, etc. indicating higher possibility of bank failure

Discretionary Actions

- Discussion with the bank's Board on corrective plan of action.
- Ordering of recapitalisation by the bank.
- Reduction in stake in subsidiaries by the bank.
- Shedding of risky business by the bank.

- Restrictions on borrowings from interbank market by the bank.
- Revision of credit / investment strategy and controls by the bank.

(2) CRAR Less than 3%

This indicates all-round deterioration in capital adequacy, which may have arisen out of very poor asset quality and earnings of the bank. It also shows the inability of the existing management to infuse fresh capital, which point to the fact that induction of new management with adequate resources is the only solution to restore the position. Given the asset quality problem and poor earnings, the possibility of a quick turnaround is ruled out. Immediate injection of capital is only alternative to avert the failure.

Mandatory Actions

Same as discretionary actions above and appointment of observers to monitor the functioning of the bank, Merger or amalgamation / liquidation / moratorium if the bank's CRAR does not improve beyond 3% within one year or within such extended period as granted by RBI.

Discretionary Actions

Since the financial position of a bank with CRAR less than 3% will be a matter of serious concern for the supervisor, there is no scope for taking discretionary actions against the bank and in such cases mandatory actions alone will be more appropriate.

5B. Actions based on Net NPAs

Poor asset quality is due to deficiencies in credit administration like sub-standard credit appraisal, follow-up and recovery of loan assets and weaknesses in credit risk management. Lack of adequate income inhibits the banks from making provisions as per regulatory requirements. As such, to reduce the net NPAs, the steps needed are: a clear cut loan as well as recovery policy, drive for recovery of NPAs, up gradation of skills, revamping of credit administration and risk management systems and entertaining only high quality proposals. A sound loan review mechanism needs to be in place to protect the quality of loan portfolio. Expanding avenues to generate fee-based income and measures for containment of costs would also be desirable to ensure that banks make adequate provisions. The set of mandatory and discretionary actions for the two zones are as under:

- Net NPAs over 10% but less than 15%
- Net NPAs in excess of 10% clearly demonstrates the poor asset quality of banks, which will have serious implications not only for current earnings but also its future income. Such banks' charge on Net Interest Income for loan provisioning / write off will be substantial. Further, the situation may also lead to serious provisioning implications in future due to migration of such NPAs into higher categories. The huge stock of NPAs forces the banks place their entire credit administration machinery in dealing with problem loans with little time for follow-up of other assets. This may also prevent the bank from undertaking profitable loan business.

In few cases, banks may be tempted to take on risky loans for generating more income, leading to adverse selection. High NPAs will also restrict the banks' flexibility in assuming interest rate and exchange rate risks, even under favorable environment. The coverage ratio of such banks will be at a very unsustainable level.

Mandatory Actions

- Special drive to reduce the stock of NPAs and contain generation of fresh NPAs.
- Review of loan policy by the bank.
- Upgradation of credit appraisal skills and systems of the bank through various levels of trainings.
- Strengthening of follow up of advances including loan review mechanism for large loans by the bank.
- Effective follow-up of suit filed / decreed debts accounts by the bank.
- Putting in place proper credit-risk management polices / process / procedures / prudential limits.
- Reduction of loan concentration - individual, group, sector, industry, etc.

Discretionary Actions

- Restriction on entry into new lines of business.
- Reduction / suspension of dividend payments.
- Reduction in stake in subsidiaries
- In case of banks having net NPAs of 15% and above, mandatory action alone will be applicable.

5C. Action based on Return on Assets (ROA)

Return on Assets is one of the important indicators of the overall efficiency of banks. ROA comes down due to various factors such as high nonperforming assets, low fee- based income, high intermediation costs due to overstaffing, etc. Proposed actions aim at improving the income and containing expenses, reduction of high cost deposits, possible reduction in high level of provisioning / write off and tapping of avenues to increase fee based income

ROA Less than 0.25%

ROA at less than 0.25% indicates abysmal productivity of assets. The lower ROA may also be due to unsustainable level of NPAs, high cost-income ratio due to heavy non-operating expenditure including staff expenditure and inability of the bank to tap off-balance sheet business opportunities. It could be possible that the bank suffered losses on account of interest rate and currency mismatches. Imprudent pricing of assets and liabilities without reckoning cost -yield relationship also leads to lower ROA. Raising the ROA requires restructuring of asset- liability profile, scientific pricing, undertaking fee-based activities, control over non-operating expenditure and reduction of NPAs to contain provisioning level within reasonable range.

Mandatory Actions

- Paying off costly deposits and CDs by the bank.
- Increasing fee based income by the bank and containing administrative expenses.
- Special drive to reduce the stock of NPAs and contain generation of fresh NPAs of the bank.
- Restriction on entry into new lines of business by the bank.
- Reduction / suspension of dividend payments by the bank and
- Restrictions on borrowings from interbank market by the bank.

Discretionary Actions

- Capital expenditure only for technological upgradation and for day-to-day operations within Board approved limits.
- Staff expansion / filling up of vacancies only with prior approval of RBI, except recruitment of specialists.

6. Institutional Mechanism

The published balance sheets, off-site returns and on-site inspection reports will be the primary sources for identifying the banks, which could be placed under the PCA framework. If a bank's performance under any of the three broad parameters has crossed the trigger point, the bank will be placed under corrective action programme. Such corrective action will consist specific mandatory action and those of discretionary actions, which in the opinion of Reserve Bank, may be applied to the concerned bank. Once a bank is under corrective action programme, BFS will be informed of the same.

7. Application of Mandatory and Discretionary Actions

While some of the actions under PCA can be initiated by the Reserve Bank of India on its own, in certain cases prior approval of the Government of India will be obtained by the RBI.

8. Legal Protection to Supervisors:

As regards legal protection to supervisors RBI will be authorizing prompt Corrective Action under Section 54 of Banking Regulation Act, 1949 provides for the following:

(1) No suit or other legal proceeding shall lie against the Central Government, the Reserve Bank or any officer for anything which is in good faith done or intended to be done in pursuance of this Act.

(2) Save as otherwise expressly provided by or under this Act, no suit or other legal proceeding shall lie against the Central Government, the Reserve Bank or any officer for any damage caused or likely to be caused by anything in good faith done or intended to be done in pursuance of this Act.

9. Mandatory / Discretionary Actions under the Scheme of Prompt Corrective Action (PCA)

9A. Public Sector Banks

Part A: Actions which require the prior approval of / consultation with the Government of India:

(1) Submission and implementation of capital restoration plan
(2) Ordering of recapitalisation
(3) Reduction in stake in subsidiaries
(4) Bringing in new Management / Board
(5) Change of promoters / change in ownership
(6) Merger if the bank fails to submit / induce capital plan or fails to recapitalize in pursuant to order, within such period as RBI may stipulate
(7) Merger or amalgamation / Liquidation if the bank's CRAR does not improve beyond 3% within one year or within such extended period as granted by RBI
(8) Appointment of observers to monitor the functioning of the bank

Part B: Actions which RBI can initiate on its own (in terms of Section 35A of Banking Regulation Act, 1949):

(1) Discussion with bank's Board on corrective plan of action
(2) Restriction on expansion of risk-weighted assets
(3) Restriction on entry into new lines of business
(4) Shedding of risky business
(5) Paying off costly deposits and CDs
(6) Reduction / suspension of dividend payments
(7) Restrictions on borrowings from inter-bank market
(8) Revision of credit / investment strategy and controls
(9) Reduction in advances / capital expenditure / overheads
(10) Special drive to reduce the stock of NPAs and contain generation of fresh NPAs
(11) Review of loan policy
(12) Upgrading credit appraisal skills and systems
(13) Strengthening of follow-up of advances including loan review mechanism for large loans
(14) Effective follow-up of suit-filed and decreed debts
(15) Putting in place proper credit-risk management policies / process / procedures / prudential limits
(16) Reduction of loan concentration – individual, group, sector, industry, etc
(17) Appointment of consultants for business / organisational restructuring
(18) Increasing fee-based income
(19) Containing administrative expenses
(20) Capital expenditure only for technological upgradation and for day today operations within Board approved limits
(21) Staff expansion / filling up of vacancies only with prior approval of RBI, except recruitment of specialist

9 B. Private Sector Banks

Part A: Actions which require prior approval of the Government of India:

(1) Merger if the bank fails to submit / implement re capitalization plan or fails to re capitalize pursuant to order, within such period as RBI may stipulate.
(2) Merger or amalgamation / Moratorium if the bank's CRAR does not improve beyond 3% within one year or within such extended period as granted by RBI.

Part B: Actions which RBI can initiate on its own:

(1) Ordering recapitalization
(2) Bringing in new Management / Board
(3) Change of promoters / change in ownership
(4) Submission and implementation of capital restoration plan (under Section 35 A of Banking Regulation Act, 1949)
(5) Reduction in stake in subsidiaries
(6) Restriction on expansion of risk-weighted assets
(7) Restriction on entry into new lines of business
(8) Shedding of risky business and

(9) Paying off costly deposits and CDs
(10) Reduction / suspension of dividend payments
(11) Restrictions on borrowings from inter-bank market
(12) Revision of credit / investment strategy and controls
(13) Discussion with bank's Board on corrective plan of action
(14) Reduction in advances / capital expenditure / overheads
(15) Special drive to reduce the stock of NPAs and contain generation of fresh NPAs
(16) Review of loan policy
(17) Upgrading credit appraisal skills and systems
(18) Strengthening follow-up of advances including loan review mechanism for large loans
(19) Effective follow-up of suit-filed and decreed debts
(20) Putting in place proper credit-risk management policies / process / procedures / prudential limits
(21) Reduction of loan concentration – individual, group, sector, industry, etc.
(22) Appointment of consultants for business / organisational restructuring
(23) Increasing fee-based income
(24) Containing administrative expenses (under Section 35 A of Banking Regulation Act, 1949)
(25) Capital expenditure only for technological up gradation and for day to day operations within Board approved limits (under Section 35 A of Banking Regulation Act, 1949)
(26) Staff expansion / filling up of vacancies only with prior approval of RBI, except recruitment of specialists (under Section 35 A of Banking Regulation Act, 1949)
(27) Appointment of observers to monitor the functioning of the bank (Section 36(1)(d)(ii) and Section 38 respectively of BR Act, 1949)
(28) Liquidation if the bank's CRAR does not improve beyond 3% within one year or within such extended period as granted by RBI (Section 36(1)(d)(ii) and Section 38 respectively of BR Act, 1949).

10. Foreign Banks

The following actions will be initiated by the Reserve Bank of India on its own in respect of foreign banks under the mechanism of Prompt Corrective Action:

(1) Order replenishment of capital funds to the required level
(2) Reduction in stake in subsidiaries
(3) Special drive to reduce the stock of NPAs and contain generation of fresh NPAs
(4) Review of loan policy
(5) Putting in place proper credit-risk management policies / process / procedures / prudential limits
(6) Reduction of loan concentration – individual, group, sector, industry, etc.
(7) Restriction on loan portfolio growth

11. PCA Application on Regional Rural Banks (Is PCA Applicable to RRBs?):

The supervisory action framework will be implemented based on the findings of inspection conducted with reference to March 31, 2018.

In order to ensure financial soundness and functional efficiency of RRBs with statutory and regulatory compliance, the Board of Supervision (for State CBs, DCCBs and RRBs) board of supervision (BoS) has considered introducing the Supervisory Action Framework for Prompt Corrective Action (PCA) i.e. Self-corrective Action by RRBs and Supervisory.

The primary focus on introducing the above frame work for Prompt Corrective Actions is to ensure early rectification of the irregularities / deficiencies by Self-Corrective Action of RRBs. In case of absence of or despite self-corrective actions, the continuance of the incidence of prolonged / major irregularities and deficiencies in banks' functioning will warrant Supervisory Action by NABARD as it deems fit viz., recommending to RBI for issuing directions / caution advices / show cause notices, imposition of penalty, etc., in the interest of the bank concerned and in the interest of its depositors.

12. PCA Application on NBFCS

The PCA frame work for NBFC shall come into effect from October 1, 2022, based on the financial position of NBFCs on or after 31 March 2022. The frame work is applicable to NBFC-D except government companies and NBFC–ND (middle layer, Upper layer and Top layer (including Investment and Credit Companies, Core Investment Companies (CICs), Infrastructure Debt Funds, Infrastructure Finance Companies, Micro Finance Institutions and Factors but Excluding:

(1) NBFCs not accepting/not intending to accept public funds.
(2) (Government Companies,
(3) Primary Dealers and
(4) Housing Finance Companies

For NBFCs-D and NBFCs-ND, Capital and Asset Quality would be the key areas for monitoring in PCA Framework. For CICs, Capital, Leverage and Asset Quality would be the key areas for monitoring in PCA Framework.

12A. For NBFCs-D and NBFCs-ND, indicators to be tracked would be Capital to Risk Weighted Assets Ratio (CRAR), Tier I Capital Ratio and Net NPA Ratio (NNPA). For CICs, indicators to be tracked would be Adjusted Net Worth/Aggregate Risk Weighted Assets, Leverage Ratio and NNPA.

12B. NBFC will generally be placed under PCA Framework based on the audited Annual Financial Results and/or the Supervisory Assessment made by the RBI. However, the RBI may impose PCA on any NBFC during the course of a year (including migration from one threshold to another) in case the circumstances so warrant.

- The Reserve Bank may issue a press release when a NBFC is placed under PCA as well as when PCA is withdrawn vis-à-vis a NBFC.
- Breach of any risk threshold (as detailed under) may result in invocation of PCA.

Table 2: For NBFCs-D (deposit Taking NBFC) and NBFCs-ND (Not deposit taking NBFC) (excluding CICs)

Indicator	Risk Threshold-1	Risk Threshold-2	Risk Threshold-3
CRAR	Upto 300 bps below the regulatory minimum	More than 300 bps but up to 600 bps below	More than 600 bps below regulatory

E-ISSN: 2582–2160, Volume 4, Issue 3, May-June 2022

	CRAR (currently, CRAR < 15% but ≥ 12%)	regulatory minimum CRAR(NBFC) [currently, CRAR (12% but ≥ 9%)	minimum CRAR currently, CRAR(NBFC) < 9%
Tier I Capital Ratio	Up to 200 bps below the regulatory minimum Tier I Capital Ratio [currently, Tier I Capital Ratio < 10% but ≥ 8%]	More than 200 bps but upto 400 bps below the regulatory minimum Tier I Capital Ratio [currently, Tier I Capital Ratio < 8% but ≥ 6%]	More than 400 bps below the regulatory minimum Tier I Capital Ratio [currently, Tier I Capital Ratio < 6%]
NNPA Ratio (including NPIs)	> 6% but ≤ 9%	> 9% but ≤ 12%	> 12%

Table 3: For CICs (Core Investment Companies)

Indicator	**Risk Threshold 1**	**Risk Threshold 2**	**Risk Threshold 3**
Adjusted Net Worth / Aggregate Risk Weighted Assets	Up to 600 bps below the regulatory minimum ANW/RWA (currently, ANW/RWA < 30% but ≥ 24%)	More than 600 bps but up to 1200 bps below regulatory minimum ANW/RWA (currently, ANW/RWA < 24% but ≥ 18%)	More than 1200 bps below regulatory minimum ANW/RWA (Currently, ANW/RWA < 18%)
Leverage Ratio	≥ 2.5 times but < 3 times	≥ 3 times but < 3.5 times	≥ 3.5 times
NNPA Ratio (including NPIs)	> 6% but ≤ 9%	> 9% but ≤ 12%	> 12%

The menu of corrective actions is as below:

Table 4: Mandatory and Discretionary Actions

Specifications	**Mandatory Actions**	**Discretionary Actions**
Risk Threshold 1	• Restriction on dividend distribution/remittance of profits; • Promoters/shareholders to infuse equity and reduction in leverage; • Restriction on issue of guarantees or taking on other contingent liabilities on behalf of group companies (only for CICs)	**Common Menu** • Special Supervisory Actions • Strategy related • Governance related • Capital related • Credit risk related • Market risk related • HR related • Profitability related
Risk Threshold 2	In addition to mandatory actions of Threshold 1, • Restriction on branch expansion	
Risk Threshold 3	In addition to mandatory actions of Threshold 1 & 2	
	• Appropriate restrictions on capital expenditure, other than for technological upgradation within	• Operations/Business related • Any other

	Board approved limits • Restrictions/reduction in variable operating costs	

13. Common Menu for Selection of Discretionary Corrective Actions

1. Special Supervisory Actions

- Special Supervisory Monitoring Meetings (SSMMs) at quarterly or other identified frequency
- Special inspections/targeted scrutiny of the NBFC
- Cause a special audit/inspection of NBFC/Group entities by the extant supervisory mechanism and/or through external auditors
- Restricted and need based regulatory/supervisory approvals to be given by the Reserve Bank
- Resolution of NBFC by Amalgamation/ Reconstruction / Splitting (Section 45MBA of RBI Act, 1934)
- File insolvency application under IBC (As per the rules dated November 15, 2019, notified under section 239 of the Insolvency and Bankruptcy Code, 2016 (31 of 2016))
- Show Cause Notice for cancellation of CoR and winding up of the NBFC

2. Strategy Related Actions

- Activate the Recovery Plan that has been duly approved by the Supervisor
- Undertake a detailed review of business model in terms of sustainability of the business model, profitability of business lines and activities, medium and long term viability, etc.
- Review short-term strategy focusing on addressing immediate concerns
- Review medium-term business plans, identify achievable targets and set concrete milestones for progress and achievement
- Undertake business process reengineering as appropriate.
- Undertake restructuring of operations as appropriate

Exit from PCA and Withdrawal of Restrictions under PCA - Once a NBFC is placed under PCA, taking the NBFC out of PCA Framework and/or withdrawal of restrictions imposed under the PCA Framework will be considered: (a) if no breaches in risk thresholds in any of the parameters are observed as per four continuous quarterly financial statements, one of which should be Annual Audited Financial Statement (subject to assessment by RBI); and (b) based on Supervisory comfort of the RBI, including an assessment on sustainability of profitability of the NBFC.

14. Status of Banks under PCA

Between February 2014 and September 2019, 13 banks, 11 in the public sector and two in the private sector were under the PCA Framework. Now, barring one bank, all others have been taken out of PCA by RBI's Board for Financial Supervision (BFS) as their promoters infused capital and the banks upped loan loss provisions.

15. Conclusion

Allowing a bank to fail is the tragedy that a supervisor should to avoid at all cost. In order to ensure that banks are not allowed to fail, it is essential that corrective actions must be taken when banks have adequate cushion of capital and their financial position is still satisfactory. This is important since low or negative capital base and adverse financial conditions will induce banks to try desperate measures such as, offering very high interest rates on deposits to fund high risk borrowers. The Basel Committee had also endorsed the need for supervisors taking timely corrective action when banks fail to meet CRAR or other prudential requirements. It is accepted that intervention should be guided by rules rather than left to the discretion of supervisors.

The rule-based framework in most of the countries focuses on the need to prevent insolvency of banks. It is considered desirable to build a comprehensive PCA regime in India to delineate rule-based actions not only for shortfall in capital but also for other indicators of deficiency so that a seamless paradigm for corrective actions can be put in place for major deficiencies in banks' functioning. Accordingly, a schedule of corrective actions has been worked out based on three parameters, CRAR, Net NPAs and ROA. It is suggested to incorporate a blend of mandatory and discretionary prompt actions for every trigger point to deal comprehensively with different dimensions of problems. However, the discretion to enforce PCA will be vested with RBI.

When regulator observes that banks are going towards failure due to poor capital, poor management, over enthusiasm in credit sanction, poor quality of advances, low yield advances, timely intervention and action is necessary by RBI that is PCA (Prompt Corrective Action).

For NBFCs besides the parameter CRAR, ROA and NPA / NNPA trigger points are also applied on Adjusted Net Worth / Aggregate Risk Weighted Assets and Leverage ratio.

RBI took steps for strong enforcement of the PCA framework at the end of December 2017.

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