Partial Credit Guarantee Scheme 2.0

Why in News

The government has **extended the scope of the Partial Credit Guarantee Scheme (PCGS) 2.0** to provide greater flexibility to state-owned banks in purchasing bonds and Commercial Papers (CPs) of **Non-Banking Financial Companies (NBFCs)**.

Key Points

- **Background:**
  - The **PCGS** was announced in July **2019,** allowing **public sector banks** to **purchase** high-rated **(BBB+ or above) pooled assets from** financially sound **NBFCs** and **Housing Finance Companies (HFCs).**
    - A **pool of assets** is basically a **securitisation of loan portfolio** i.e. conversion of a loan into a marketable security, typically for the purpose of raising cash by selling them to other investors.
    - These are sold by NBFCs/HFCs to banks in return for an advance payment. **NBFCs/HFCs get the much needed money** and **banks get the interest paying assets.**
    - **Credit ratings** is an analysis of the credit risk associated with a financial instrument or a financial entity. These range from AAA to C and D.
  - As a part of the **Aatmanirbhar** initiative, the **scheme was extended in May 2020 (PCGS 2.0)** to cover **primary market issuance of bonds/CPs by NBFCs, HFCs** and **Micro Finance Institutions (MFIs)** with **low credit ratings.**
    - The Centre provided **20% first loss sovereign guarantee to public sector banks** for purchase of bonds/CPs, resulting in liquidity infusion of **Rs. 45,000 crore** into the system.
    - The scheme covered papers with ratings of **AA and below,** including **unrated papers,** aimed at providing access to fresh liquidity support to non-bank lenders.

- **Latest Extension:**
  - The Scheme has been **extended for three months,** giving public sector banks time till **19th November 2020** to build their portfolios of bonds and CPs from non-banking financial institutions.
  - Further, the government has **allowed banks to invest upto 50% of total investments under the Scheme in AA and AA- rated bonds.**
    - This decision was taken as the earlier limit for such investments at 25% was almost met.
- **Criticism:**
  - The latest announcement is a step towards **increased funding for bigger NBFCs which have higher ratings,** while the actual objective was to provide greater funding to **small and medium NBFCs.**
  - **Less than 100 NBFCs have been covered under the scheme** as a majority of small and medium NBFCs turn to **term loans,** instead of raising funds via bonds or CPs.

Note:

- **Bonds:** Borrowers issue bonds to raise money from investors willing to lend them money.
- **Commercial Paper:** It is a commonly used type of **unsecured, short-term debt instrument** issued by corporations, typically used for meeting the short-term liabilities.
- **Primary Market:** The primary market is where **companies issue a new security, not previously traded on any stock exchange.** Securities issued through a primary market can include stocks, corporate or government bonds, notes and bills.
  - The **secondary market** is where investors buy and sell securities they already own.

Way Forward

- NBFCs play a crucial role in sustaining consumption demand as well as capital formation in the small and medium segment, thus it is essential that they continue to get funding without disruption, and the extended PCGS is expected to systematically enable the same.
- The government can further expand the scope of the Scheme so as to extend the guarantee cover to term loans of banks and financial institutions given to NBFCs.

Source: PIB