PCA Framework Revised

Why in News

Recently, the **Reserve Bank of India (RBI)** has announced a revised **Prompt Corrective Action (PCA) framework**.

- The PCA framework **enables supervisory intervention of RBI** over Banks at an appropriate time and ensures effective market discipline.

Key Points

- **Revised Framework:**
  - **Applicability:**
    - The framework applies to all banks operating in India, including foreign banks operating through branches or subsidiaries based on breach of risk thresholds of identified indicators.
    - However, **payments banks** and **small finance banks (SFBs)** have been removed from the list of lenders where prompt corrective action can be initiated.
      - The new provisions will be effective from **January, 2022.**
  - **Monitored Areas:**
    - **Capital, Asset Quality and** Capital-To-Risk Weighted Assets Ratio(CRAR)**, NPA ratio**, Tier I Leverage Ratio, will be the key areas for monitoring in the revised framework.
    - However, the revised framework **excludes** return on assets as a parameter that may trigger action under the framework.
  - **Invocation of PCA:**
    - The **breach of any risk threshold** may result in the invocation of the PCA. Stressed banks may not be allowed to expand credit/investment portfolios.
      - However, they are allowed to invest in government securities/other high-quality liquid investments.
    - In the **case of a default on the part of a bank** in meeting the obligations to its depositors, possible **resolution processes may be resorted to without reference to the PCA matrix.**
  - **RBI's Powers:**
    - In governance-related actions, the RBI can supersede the board under Section 36ACA of the **Banking Regulation Act, 1949.**
    - **Amendment to Section 45 of the BR Act** enables the Reserve Bank to reconstruct or amalgamate a bank, with or without implementing a moratorium, with the approval of the Central government.
    - The RBI, as part of its mandatory and discretionary actions, **may also impose**

- **appropriate restrictions on capital expenditure**, other than for technological upgradation within Board approved limits, under the revised PCA.
  - **Withdrawal of PCA Restrictions:**
    - Withdrawal of restrictions imposed will be considered **if no breaches in risk thresholds in any of the parameters are observed** as per **four** continuous **quarterly financial statements.**
- **Prompt Corrective Action:**
  - **Background:** PCA is a framework under which banks with weak financial metrics are put under watch by the RBI.
    - The RBI introduced the **PCA framework in 2002** as a structured early-intervention mechanism for banks that become undercapitalised due to poor asset quality, or vulnerable due to loss of profitability.
    - The framework was reviewed in 2017 based on the recommendations of the working group of the **Financial Stability and Development Council** on Resolution Regimes for Financial Institutions in India and the Financial Sector Legislative Reforms Commission.
  - **Objective:** The objective of the PCA framework is to **enable supervisory intervention at an appropriate time** and require the supervised entity to initiate and implement remedial measures in a timely manner, so as to restore its financial health.
    - It aims to **check** the problem of **Non-Performing Assets (NPAs)** in the Indian banking sector.
    - It is intended to **help alert the regulator as well as investors** and depositors if a bank is heading for trouble.
    - The idea is to head off problems before they attain crisis proportions.
  - **Audited Annual Financial Results:** A bank will generally be placed under the PCA framework based on the audited annual financial results and the ongoing supervisory assessment made by the RBI.

Non Performing Asset:

- It is a loan or advance for which the principal or interest payment remains overdue for a period of 90 days.
- Banks are required to classify NPAs further into Substandard, Doubtful and Loss assets.

Capital Adequacy Ratio (CAR):

- The CAR is a measure of a bank's available capital expressed as a percentage of a bank's risk-weighted credit exposures.
- The Capital Adequacy Ratio, also known as capital-to-risk weighted assets ratio (CRAR), is used to protect depositors and promote the stability and efficiency of financial systems around the world.

Tier 1 Leverage Ratio:

- It is the **relationship between a banking organization's core capital and its total assets.**
- The tier 1 leverage ratio is **calculated by dividing tier 1 capital by a bank's average total consolidated assets** and certain off-balance sheet exposures.
  - A leverage ratio is any one of several financial measurements that assesses the ability of a company to meet its financial obligations.Some of the examples are :
    - **Equity Ratio:** This ratio indicates total owner contribution in the company.
    - **Debt Ratio:** This ratio indicates total leverage used in the company.
    - **Debt To Equity Ratio:** This ratio indicates total debt used in the business in comparison to equity.

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