Prompt Corrective Action (PCA)

Why in News?

The Central government and the RBI are in conflict over the application of the Prompt Corrective Action (PCA).

What is Prompt Corrective Action (PCA)?

- 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.
- It aims to check the problem of Non-Performing Assets (NPAs) in the Indian banking sector.
- 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.
- PCA 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.
- Essentially PCA helps RBI monitor key performance indicators of banks, and taking corrective measures, to restore the financial health of a bank.
- The PCA framework deems banks as risky if they slip some trigger points - **capital to risk weighted assets ratio (CRAR), net NPA, Return on Assets (RoA) and Tier 1 Leverage ratio**.
- Certain structured and discretionary actions are initiated in respect of banks hitting such trigger points.
- The PCA framework is applicable only to commercial banks and not to co-operative banks and non-banking financial companies (NBFCs).
- It may be noted that of the 21 state-run banks, 11 are under the PCA framework.

Non Performing Asset

A non performing asset (NPA) is a loan or advance for which the principal or interest payment remained 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.

PCA Measures

- RBI can place restrictions on dividend distribution, branch expansion, and management compensation.
- Only in an extreme situation, would a bank be a likely candidate for resolution through amalgamation, reconstruction or winding up.
- RBI may place restrictions on credit by PCA banks to unrated borrowers or those with high risks, but it doesn’t invoke a complete ban on their lending.
- RBI may also impose restrictions on the bank on borrowings from interbank market.
- Banks may also not be allowed to enter into new lines of business.

Challenges and Issues

- PCA is an exceptional action and impacts the rating of the bank as well as consumer confidence. This is detrimental in the long run as it impacts the credit history of the bank and raises questions about its management.
- PCA can accelerate the loss of market share and cause further decline of the position of the public sector banks in the financial system in favour of private banks and foreign banks.
- PCA is seen by government as hindering economic growth therefore is arguing for easier lending policies by relaxing the PCA norms and aligning them to global norms.
- The tussle between RBI and government can negatively impact the image of India as an investment destination.

Way Forward

- Narasimham Committee (1998) on structural reforms recommended the merger of Indian banks; consolidated banking industry will be able to better deal with NPA crisis.
- Government should address the core issue of Governance impacting the Banking Sector.

- A formal agency such as Public Sector Asset Rehabilitation Agency (PARA), can be instituted to resolve the large bad debt cases; this step was taken by East Asian countries after they were hit by severe TBS problems in the 1990s.
- The Insolvency and Bankruptcy Code (IBC) mechanism needs to be strengthened to meet global standards with active involvement of the government, regulators, lenders, borrowers and the judiciary.