Banking on good faith: on efforts to recapitalise PSBs

About 1 lakh crore is expected to be pumped into India's 21 public sector banks by March, which the Centre hopes will enable them to extend fresh credit lines worth over 5 lakh crore to spur economic activity. Of the capital injection — the first half of an ambitious 2.11-lakh crore recapitalisation programme for ailing public sector banks announced last October — about 8,100 crore is from the government's budgetary resources. Banks are expected to tap the markets for 10,300 crore, while recapitalisation bonds worth 80,000 crore are to be issued to finance the rest. Leaving aside the market-raising efforts by banks, over half the fresh capital of over 52,000 crore is being directed to the 11 public sector banks that the Reserve Bank of India has placed under the prompt corrective action, or PCA, framework. The RBI deploys the PCA to monitor the operation of weaker banks more closely to encourage them to conserve capital and avoid risks. For these entities, this capital offers a fresh lease of life as it will help meet regulatory requirements under the Basel-III regime as well as cushion them to an extent from possible haircuts on stressed loans that are going through the insolvency resolution process. State Bank of India, the country's largest, and the nine others that are out of the RBI's PCA net will receive nearly 36,000 crore in order to strengthen their lending capacity.

While announcing this package, the government has described each of the banks as "an article of faith". Its assertion that no public sector bank will fail and that depositors' money will remain safe should allay customers' worry about the safety of their savings under the proposed Financial Resolution and Deposit Insurance legislation. Rating agencies have given the move the thumbs up, but remain unimpressed about governance reforms packaged with it. These include tweaks to existing systems for closer monitoring of big-ticket loans, identifying niche areas where a bank has strengths, restricting corporate exposure to 25%, and a new performance management system. Actual capital inflows will depend on their performance on these fronts and their ability to meet the government's service priorities, including smoother credit flows to small businesses. More structural reforms may well be on the anvil in the second half of this recap plan, which RBI Governor Urjit Patel had described as providing a real chance to meet the banking sector's challenges for the first time in a decade. Yet, the absence of any reference to consolidation through mergers is glaring. Moreover, while the government has repeatedly ruled out privatisation of these banks, the only one where it intended to offload its majority stake, IDBI Bank, has got the largest allocation of 10,610 crore. At best, this sends out mixed signals.