

RBI SHOULD BE ALLOWED TO TAKE THE PCA MECHANISM TO ITS LOGICAL END

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

It's hard to find a silver lining in Indian banking, with headlines dominated by statistics of bad loans, frauds being perpetrated on banks, even scandals involving chief executives. Yet, as pointed out by Reserve Bank of India deputy governor Viral Acharya recently, the banking regulator's prompt corrective action (PCA) on 12 banks, 11 of which are state-owned, is one. The 11 state-owned banks under Prompt Corrective Action (PCA) are Dena Bank, Allahabad Bank, United Bank of India, Corporation Bank, IDBI Bank, UCO Bank, Bank of India, Central Bank of India, Indian Overseas Bank, Oriental Bank of Commerce, and Bank of Maharashtra. The only private bank under PCA is Dhanalaxmi Bank. It is only over the past year, since revising guidelines for PCA, that RBI has become aggressive about placing banks under PCA — nine of the 12 cases have happened since. When a bank is placed under PCA, is a function of the quantum of its bad loans, profitability and capital adequacy. And once it is placed under it, a bank cannot pay dividends, set up new branches, hire , or issue fresh loans. With almost half the state-owned banking universe under PCA, there was apprehension that credit growth could suffer. That doesn't seem to be the case; the latest available credit growth(non-food), for August, is a respectable 12.4%. Indeed, it has been over 10% for the past few months.

The banks themselves aren't happy with PCA, though. In September, in a meeting with the finance ministry (effectively their biggest shareholder), the state-owned banks sought a relaxation. There have been reports that the ministry agrees with them. That would be premature. As Acharya pointed out, the fact that overall credit growth hasn't suffered suggests that the bigger and stronger banks have stepped in to meet credit needs. More than anything else, PCA ensures that future non- performing assets (NPAs) are not being created. The importance of that, in the context of a banking system struggling with NPAs, cannot be overstated.

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