PCA Framework

For Prelims: RBI, NPA, Financial Stability and Development Council, Scheduled Commercial Banks, Return of Assets.

For Mains: Prompt Corrective Action Framework.

Why in News?

Recently, The **Reserve Bank of India (RBI)** has removed the **Central Bank of India (CBI)** from its **Prompt Corrective Action Framework (PCAF)** after CBI showed improvement in various financial ratios, including minimum regulatory capital and Net **Non-Performing Assets (NNPAs).**

- The RBI had imposed the PCA norms on CBI in June 2017 due to its **high net NPA and Negative Return of Assets (RoA).**

What is PCAF?

- **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.
- **Parameters:**
  - The RBI has specified certain regulatory trigger points, as a part of PCA Framework, in terms of three parameters, i.e., **Capital to Risk Weighted Assets Ratio (CRAR),** net **Non-Performing Assets (NPA) and Return on Assets (RoA)**
- **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.**
- **Recent Development:**
  - In 2021, the RBI revised the PCA Framework for **scheduled commercial banks**, round

capital, asset quality and leverage will be key areas, earlier asset quality and profitability were the key areas for monitoring under framework.

What is a 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.

What is Capital Adequacy Ratio?

- The CAR is a measure of **a bank's available capital expressed as a percentage** of a bank's risk-weighted credit exposures.
  - CAR is the measurement ratio that assesses **the ability of banks to absorb losses.**
- 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.

What is Return of Asset (RoE)?

- Return on assets is a profitability ratio that provides how **much profit a company is able to generate from its assets.**
- ROA is shown as a **percentage, and the higher the number, the more efficient a company's management is** at managing its balance sheet to generate profits.
- Companies with a low ROA usually have **more assets involved in generating profit,** while companies with a high ROA have fewer assets.
- ROA is best when comparing similar companies; an asset-intensive company's lower ROA might appear alarming compared to an **unrelated company's higher ROA with fewer assets and similar profit.**

UPSC Civil Services Examination Previous Year Question (PYQ)

Q. With reference to the governance of public sector banking in India, consider the following statements: (2018)

1. Capital infusion into public sector banks by the Government of India has steadily increased in the last decade.
2. To put the public sector banks in order, the merger of associate banks with the parent State Bank of India has been affected.

Which of the statements given above is/are correct?

(a) 1 only
(b) 2 only
(c) Both 1 and 2
(d) Neither 1 nor 2

Ans: (b)

Exp:

- The government has done capital infusion in stateowned banks to support credit expansion and to help them tide over losses resulting from the provisions that are to be made for **non-performing assets (NPAs).** But the capital infusion trend in state-owned banks has not been specific in a direction, like increasing or decreasing trend. While it has increased in some years, it has also decreased in a few years. **Hence, statement 1 is not correct.**

- Union Government in February 2017 had approved the merger of five associate banks along with the Bharatiya Mahila Bank with SBI. The purposes of the merger were rationalisation of public bank resources, reduction of costs, better profitability, and lower cost of funds leading to a better rate of interest to the public at large and improve productivity and customer service of the public sector banks. Parliament passed the State Banks (Repeal and Amendment) Bill, 2017 to merge six subsidiary banks with State Bank of India to affect rationalisation of public bank. **Hence, statement 2 is correct.**
- **Therefore, option (b) is the correct answer.**

Source: IE