Financial Stability Report: RBI

Why in News

Recently, the **Reserve Bank of India (RBI)** released the **23rd issue** of its **Financial Stability Report (FSR).**

- The FSR which is **published biannually** reflects the collective assessment of the Sub-Committee of the Financial Stability and Development Council **(FSDC - headed by the Governor of RBI)** on risks to **financial stability and the resilience of the financial system.**
- The Report also discusses **issues relating to development and regulation of the financial sector.**

Key Points

- **Impact of Covid-19 Second-Wave:**
    - The impact of the **Covid-19 Second-Wave** on the balance sheets of Indian banks has been **less than what was projected** before and **capital buffers are reasonably resilient** to withstand future shocks.
        - A **capital buffer** is required reserves held by financial institutions put in place by regulators. These are designed to provide banking organizations with the means to support the economy in adverse situations.
    - **Covid-19 Second-Wave** has dented economic activity, but monetary**, regulatory and** fiscal policy **measures have helped curtail the solvency risk** of financial entities, stabilise markets, and maintain financial stability.
        - **Solvency risk** is the risk of being unable to absorb losses, generated by all types of risks, with the available capital.
- **Global Recovery:**
    - Sustained **policy support, benign financial conditions and the gathering momentum of** vaccinations are nurturing an uneven global recovery.
    - **Policy support has helped** in shoring up financial positions of banks, containing non-performing loans and maintaining solvency and liquidity globally.
- **New Risks:**
    - While the recovery is underway, **new risks have emerged which are:**
        - **Nascent and mending state of the upturn** (Revival of Economy).
        - Economy Vulnerable to shocks and **future waves of the** pandemic**.**
        - International **commodity prices** and **inflationary pressures.**
        - Global spillovers amid high uncertainty.
        - Rising incidence of data breaches and **cyber attacks.**
- **Gross Non-Performing Asset Ratio:**
    - The **Gross Non-Performing Asset (GNPA)** ratio of India's Scheduled Commercial Banks

(SCBs) may climb by the **end of 2021-22** to as much as **11.2% under a severe stress scenario, from 7.48% in March 2021.**

        - The GNPA ratio of SCBs may increase to **9.8% by March 2022 under the baseline scenario.**
    - While **banks' exposures to better rated large borrowers are declining,** there are incipient signs of stress in the **Micro, Small and Medium Enterprises (MSMEs)** and retail segments.
    - The demand for consumer credit across banks and **Non-Banking Financial Companies (NBFCs)** has decreased, with some deterioration in the risk profile of retail borrowers becoming evident.
        - **Retail Loans** are provided to purchase property, vehicles or other assets such as essential electronics.
- **CRAR & PCR:**
    - Banks have managed to capitalise themselves well during 2020-21 aiding them in **maintaining adequate capital adequacy even under stress situations.**
    - The Capital to Risk-Weighted Assets Ratio (CRAR) **of SCBs increased to 16.03%** and the Provisioning Coverage Ratio (PCR) **stood at 68.86%** in March 2021.
- **Restructuring of Loans:**
    - During 2020-21 the RBI had introduced a **one-time restructuring scheme** to aid borrowers affected by the Covid-19 pandemic.
    - The scheme was to be **invoked by December 2020 and implemented within 90 days for retail borrowers and 180 days for corporate borrowers.**
    - By March 2021, **0.9% of total bank advances (loans) were under restructuring.**
        - MSMEs had the **highest restructure ratio at 1.7%.**
        - Corporate borrowers had a **restructured ratio of 0.9%** of total advances.
        - **0.7% of total retail advances** were restructured.
- **Suggestions:**
    - **Balance Sheet Stress:**
        - Banks need to **reinforce their capital and liquidity positions** to fortify themselves **against potential balance sheet stress.**
    - **Policy Support:**
        - Sustained **policy support and simultaneous increased fortification of capital and liquidity buffers** by financial entities is important.
    - **Financial Needs:**
        - Stronger **capital positions, good governance and efficiency in financial intermediation** can be the touchstones of this endeavour so that financing needs of productive sectors of the economy are met while the integrity and soundness of banks and financial institutions are secured on an enduring basis.

Non-Performing Asset

- NPA refers to a **classification for loans or advances that are in default** or are in arrears on scheduled payments of principal or interest.
- In most cases, **debt is classified as non-performing, when the loan payments have not been made for a minimum period of 90 days.**
- **Gross non-performing assets** are the sum of all the loans that have been defaulted by the individuals who have acquired loans from the financial institution.
- **Net non-performing assets** are the amount that is realized after provision amount has been deducted from the gross non-performing assets.

Capital Adequacy Ratio

- It is the **ratio of a bank's capital in relation to its risk weighted assets and current liabilities.** It is **also known as Capital-to-Risk Weighted Asset Ratio (CRAR).**
- It is **decided by central banks to prevent commercial banks** from taking excess leverage and becoming insolvent in the process.

Provisioning Coverage Ratio

- It refers to the prescribed **percentage of funds to be set aside by the banks for covering the prospective losses due to bad loans.**

Source: TH