ALL INDIA NATIONALISED BANKS OFFICERS' FEDERATION

(Registered under Trade Unions Act 1926)

(Regn No: 25127/West Bengal)

C/o Canara Bank Officers' Association,
216, Royapettah High Road,
Royapettah, Chennai - 600014
Opposite to Hotel Deccan Plaza
Tel. Nos. 044- 28112454 Fax:28113151
e-mail id: ainbof@gmail.com

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To

All Affiliates

Dear friends,

Sub : Prompt Corrective Action - A new Astra to finish PSBs

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No longer WE, the Bankers are chanting Deposits, Advances, customer service, Priority sector, Poverty alleviation and Nation building and on the contra, we are now driven to spend our energy to follow the defaulters, challenging them in courts, blabbering on NPA, write off, haircut, OTS, Provisions, charge sheet, arrest and punishment.

Now a new missile is fired on the Bankers **"PCA" Prompt corrective action.**

The way this word is now used has sent a fear of getting unseated from the industry, instead of ushering a new hope among the Bankers to get rid of present crisis by setting right few evils in the Industry.

The PSBs' dedication to Nation building through Social lending is no longer a respectable jargon as PCA gauges your contribution through **three indicators - capital ratios, the net NPA ratio and RoA.**

In short, profits and profitability which are already eroded through faulty prudential & provisioning norms and the last nail placed by RBI through its last minute game changer "Revised asset recognition norms" will be deciding your existence and not your presence and performance.

A small attempt is made to present the PCA norms for every banker to understand which may facilitate us to consolidate to counter the designs of both internal and external factors effectively.

Thanking you.

Manimaran G V
27th March 2018

Prompt Corrective Action

What is Prompt Corrective Action Framework?

- Prompt Corrective Action (PCA) refers to the imposition of appropriate regulatory sanctions on troubled financial institutions as and when they begin to exhibit symptoms of stress. The fundamental premise behind the PCA framework is based on the 'to act before it's too late' principle.
- A set of criteria is used to determine the severity of a bank's stress and restrictions are placed on its management and activities accordingly. PCA's core lies in a sequence of increasingly harsh restrictions as the problem worsens so that banks have little incentive to delay corrective actions.
- It reduces the moral hazard associated with the Lender-of-Last-Resort (LOLR) and makes banks liable to improve their overall financial health

- To adhere to international best practices, the Reserve Bank started the PCA scheme in December 2012. It worked out a schedule of corrective actions based on **three indicators - capital ratios, the net NPA ratio and RoA.**

- RBI has issued a policy action guideline (first in May 2014 and revised effective from April 1, 2017, based on the financials of the banks for the year ended March 31, 2017) in the form of Prompt Corrective Action (PCA) Framework if a commercial bank's financial condition worsens below a mark.

The PCA Framework

No. of stages	Three
Names of stages	Three thresholds defined for each indicator
Key parameters	1. Capital 2. Asset Quality 3. Profitability
Indicators used	1. CRAR/CET 1 ratio 2. Net NPA ratio 3. Return on assets 4. Leverage ratio is tracked additionally as a part of the framework
Method of categorization	Thresholds are defined for each indicator
Rule-based	Rule-based regime with specified mandatory actions for each phase and a common menu of discretionary actions

- On the directions of the Financial Stability and Development Council (FSDC) sub-committee, the framework was reviewed recently and a revised PCA framework was implemented with effect from April 2017. The indicators to be tracked for **capital, asset quality and profitability are capital to risk-weighted assets ratio (CRAR); the common equity Tier 1 ratio; net NPA ratio; and RoA.** New risk thresholds have also been defined and a breach of these will lead to the invocation of PCA and **mandatory and discretionary action.**

- The PCA framework specifies the ***trigger points*** or the level in which the RBI will intervene with corrective action. This trigger points are expressed in terms of parameters for the banks. Breach of any risk threshold would result in invocation of PCA.

- The PCA framework **would apply without exception to all banks operating in India including small banks and foreign banks operating through branches** or subsidiaries based on breach of risk thresholds of identified indicators.

- A bank will be placed under PCA framework based on the audited Annual Financial Results and the Supervisory Assessment made by RBI. However, **RBI may impose PCA on any bank during the course of a year** (including migration from one threshold to another) in case the circumstances so warrant.

- Some of the structured and discretionary actions that could be taken by the RBI are:

  1. **Recapitalization**

  2. **Restrictions on borrowing from inter-bank market to steps to**
     a. **merge/amalgamate/liquidate the bank**
     b. **impose moratorium on the bank if its CRAR does not improve beyond the required level**

  The corrective actions are tough with worsening of the financials.

Definitions of the Indicators

1. **<u>CRAR</u>**

The capital adequacy ratio (CAR) is a measure of a bank's capital. It is expressed as a percentage of a bank's risk weighted credit exposures. Also known as capital-to-risk weighted assets ratio (CRAR), it is used to protect depositors and promote the stability and efficiency of financial systems around the world.

2. **<u>Common Equity Tier 1</u>**

Tier 1 common capital ratio is a measurement of a bank's core equity capital compared with its total risk-weighted assets that signifies a bank's financial strength. **The Tier 1 common capital ratio is utilized by regulators and investors because it shows how well a bank can withstand financial stress and remain solvent.** Tier 1 common capital excludes any preferred shares or non-controlling interests when determining the amount of Tier 1 common capital when calculating the ratio.

3. **<u>Net NPA</u>**

The Reserve Bank of India defines **Net NPA** as **Net NPA** = **Gross NPA –** (**Balance in Interest Suspense account + DICGC/ECGC claims received and held pending adjustment + Part payment received and kept in suspense account + Total provisions held).**

Non-performing asset (**NPA**) **ratio**: The **net NPA** to loans (advances) **ratio** is used as a measure of the overall quality of the bank's loan book. An **NPA** are those assets for which interest is overdue for more than 90 days (or 3 months).

4. **Return on Assets (ROA)**

ROA is a profitability ratio and shows how profitable a bank is relative to its total assets. ROA also gives an idea as to how efficient management is at using its assets to generate earnings. **The ROA ratio formula is calculated by dividing net income by average total assets during a financial year.**

For instance, if a bank has Rs.10,000 in total assets and generates Rs.2,000 in net income, its ROA would be Rs.2,000 / Rs.10,000 = 0.2 or 20%.

5. **Leverage ratio**

Basel III introduced a minimum "leverage ratio". This is a non-risk-based leverage ratio and is **calculated by dividing Tier 1 capital by the bank's average total consolidated assets** (sum of the exposures of all assets and non-balance sheet items). The banks are expected to maintain a leverage ratio in excess of 3% under Basel III

What will RBI do if PCA is triggered?

- RBI has formulated three risk thresholds for each indicator, breach of any would result in invocation of PCA.
- Breach of 'Risk Threshold 3' of CET 1 by a bank would identify a bank as a likely candidate for resolution through tools like amalgamation, reconstruction, winding up, etc.
- For every threshold level, RBI has stipulated specific 'Mandatory Actions' as under:

Specification	Mandatory Actions
Risk Threshold 1	• Restriction on dividend distribution/remittance of profits. • Promoters/owners/parent in the case of foreign banks to bring in capital
Risk Threshold 2	• In addition to mandatory actions of Threshold 1, • Restriction on branch expansion; domestic and/or overseas • Higher provisions as part of the coverage regime
Risk Threshold 3	• In addition to mandatory actions of Threshold 1, • Restriction on branch expansion; domestic and/or overseas • Restriction on management compensation and directors' fees, as applicable

- Besides Mandatory Actions, RBI has also specified "Discretionary Actions" under the following ten common menu:

1. **Special Supervisory Interactions**
2. **Strategy related**
3. **Governance related**
4. **Capital related**
5. **Credit risk related**
6. **Market risk related**
7. **HR related**
8. **Profitability related**
9. **Operations related**
10. **Any other**

- **Special Supervisory Interactions include :**
  - Monitoring Meetings, inspections, audit
- **Strategy related actions include advise by RBI to:**
  - Activate Recovery Plan, review of business model for business process reengineering, restructuring of operations.
- **Governance related actions include :**
  - Active engagement of RBI in Bank's Board, changes in the management / Board, supersede the Board, impose restrictions on Directors' or management compensation.
- **Capital related actions include all areas pertaining to :**
  - Capital, investment, subsidiaries, restriction on high risk-weighted assets to conserve capital, reduction in exposure to high risk sectors.
- **Credit risk related actions include :**
  - Commitment for NPA reduction, containing generation of fresh NPAS, loan review mechanism, reduction in risk assets, restriction on credit to unrated borrowers, sale of assets, action plan for recovery.
- **Market risk related actions include:**
  - Restrictions on borrowings from inter-bank market, restriction on accepting / renewing wholesale deposit / costly deposits / certificates of deposits, restrictions on derivative activities, restrictions on excess maintenance of collateral held that could contractually be called any time by the counter-party.
- **HR related actions include:**
  - Restriction on staff expansion i.e., recruitment and review of specialized training needs of existing staff.
- **Profitability related actions include:**
  - Restrictions on capital expenditure, other than for technological upgradation.
- **Operations relations actions include:**
  - Restrictions on branch expansion, reduction in business at overseas branches / subsidiaries, restriction on entering into new business, reduction in non-fund based business, reduction in risky assets, restrictions on non-credit asset creation,

- **Any other specific action RBI may deem fit considering circumstances of a bank.**

- The PCA framework does not preclude the Reserve Bank of India from taking any other action as it deems fit in addition to the corrective actions prescribed in the framework.

Implications on imposition of PCA

- ### Impact on Banking Industry

    - So far, PCA has been imposed on the following 11 banks:

        1) IDBI Bank
        2) Indian Overseas Bank
        3) Central Bank of India
        4) Bank of Maharashtra
        5) Dena Bank
        6) United Bank of India
        7) Corporation Bank
        8) Oriental Bank of Commerce
        9) Bank of India
        10) UCO Bank
        11) Allahabad Bank

    - Most of the PSBs that are falling under PCA are small and mid -sized banks with the exception of IDBI Bank. These banks are now a good candidate for merger as the government is very keen on pushing consolidation amongst the PSBs. There has been resistance in the past, but the present government looks more serious. The SBI merger with associate banks was a bold one as five banks of the size of private sector ICICI bank were merged with the parent.

    - The current stalemate at the PSBs is offering a big opportunity for private sector to gain market share in retail as well as corporate lending. The private sector banks have a very comfortable capital adequacy ratio, which offers a big opportunity to them to lend. In fact, the market share of private banks remained at 14-15 per cent in the advances and deposits for a long time, but now many of these banks have scale and also the products to expand in both retail and corporate lending.

- Imposition of PCA has wide range of ramifications on business, operations, brand, and HR.

    - ### Business & Brand Implications

        - "Asset Quality Review" conducted by RBI notified many accounts as NPA and forced banks to increase provisioning, which greatly affected the profitability. Such special supervisory actions may affect the normal functioning of the bank.

        - Reduced profit or loss may result in non-declaration of dividend to investors and shareholders. Besides affecting the Bank's image this may create panic amongst the investors and also prevent the bank from raising required capital through IPOs / Rights issues, etc.

        - A situation may arise wherein the depositors may lose confidence on the bank and if they withdraw their deposits, the bank may undergo challenging situation and may face difficult times.

        - Restriction on granting fresh advances / extending credit facilities which will have an impact on interest income.

- The Bank under PCA will be viewed as a weaker bank by the public at large which will affect the goodwill and reputation of the bank to a large extent.

- **HR implications**

  - The bank will not be permitted to open new branches. This, besides affecting business prospects, will also have a deep impact on recruitment.

  - Much against the Government's promise of creating employment opportunities, embargo on branch expansion will curtail recruitment.

  - Static branch network may curb career progression and the axe will fall on promotional opportunities.

  - In the name of reduction of operational cost, existing benefits, allowances, perks, etc., may be restricted or stopped.

  - Merger and consolidation will result, in the name of rationalization, closure of branches. As a consequence of this manpower resources may be in surplus and banks may devise their own strategies to downsize the resources.

  - In such an eventuality, private banks are likely to seize the opportunity and make inroads into the PSB clients. Possible loss of customers and business and thereby the profits, may force banks to withdraw monetary benefits, other than salary, to staff members.

  - Benefits extended under Staff Welfare Measures, which were borne out of Net Profit may no longer be made available.

In order to avoid such circumstances, it is the primary duty of each and every one of us

- ✓ To ensure that the assets quality of the Banking sector is maintained well to ensure maximum profitability.
- ✓ To be more vigilant and comply with the existing policy guidelines while sanctioning of loans starting from identification of borrowers, understanding their businesses, assessing their actual requirements of credit facilities, extending the same in appropriate time, educating the customers in complying with the Bank's requirements, monitoring the advances closely.
- ✓ To initiate recovery measures promptly wherever necessary.

- In sum,
  - Imposition of PCA is an affront on the organization.
  - The organization cannot by itself wriggle out of it.
  - We also have to understand that it is pernicious to the organization.
  - No good can be achieved by playing the blame game.
  - It is an extremely critical situation where no individual can be charged responsible for such a state of affairs.

- ➢ Onus lies on all the staff members to collectively raise the bar and contribute to come out of such a scenario.
- ➢ We have to exude confidence and positivity.
- ➢ Shouldering higher responsibility has to be the norm;
- ➢ Erasing the blot and bringing in quality clients and new business should be the voluntary focus of every bank employee.
- ➢ By reversing the blot in the quickest possible time, we have to regain the confidence of the general public, regulator, and the controller.

- All these efforts should be backed by solid and top notch customer service at the branch counters. ***Customer service is the provision of service to customers before, during and after a purchase. The perception of success of such interactions is dependent on employees "who can adjust themselves to the personality of the guest"***.
- The concept of 'walk-in' customers is a thing of the past. Every prospective customer 'sits-in' at the cozy comfort of the drawing room, enjoying quality time with the beloved ones and casually logs on to complete banking transactions / make utility bill payments, shop online, and completes scores of many such chores.
- If such people have to choose a bank to transact with, walk in to a brick and mortar location, the quality of customer service has to be affable, impressive, prompt, and delightful.
- This is the age of the digital revolution. Gone are the days one's **Intelligent quotient (IQ)** is measured; we have to keep abreast of all the technological advancements in banking and improve our **Digital Quotient (DQ)** to sustain and be in the reckoning.
- It is time we understand and appreciate all these dynamics of banking and enhance our skills to suit the changing times.

AINBOF ZINDABAD
AIBOC ZINDABAD

MANIMARAN G V
GENERAL SECRETARY
ALL INDIA NATIONALIZED BANKS OFFICERS' FEDERATION
CANARA BANK OFFICERS' ASSOCIATION
SENIOR VICE PRESIDENT, ALL INDIA BANK OFFICERS' CONFEDERATION