RBI Issues Revised PCA Framework

November 08, 2021

Overview

On November 02, 2021, RBI issued a revised Prompt Corrective Action (PCA) Framework for Scheduled Commercial Banks (SCBs) excluding Small Finance Banks, Payment Banks, and Regional Rural Banks to enable intervention at appropriate time and require the SCB initiate and implement remedial measures in a timely manner. The provisions of the revised PCA Framework will be effective from January 1, 2022.

The revised framework includes the following changes:

	Old Framework	New Framework
Key Monitoring areas	Capital, asset quality and **profitability**, while Leverage would be monitored additionally	Capital, Asset Quality and Leverage
Indicators to be tracked	Capital, asset quality and profitability would be CRAR/ Common Equity Tier I ratio, Net NPA ratio and **Return on Assets**, respectively	Capital, Asset Quality and Leverage would be CRAR/ Common Equity Tier I Ratio, Net NPA Ratio, and **Tier I Leverage** Ratio, respectively
Profitability - ROA	**Negative ROA for 2/3/4 consecutive years**	**Has been removed from the New Framework**
Capital – Risk Threshold 3	-	RBI has specifically included this level of **400 bps below CRAR** as a monitorable
Leverage	Tier 1 Leverage ratio: Threshold 1: <=4.0% but > = 3.5% (leverage is over 25 times Tier 1 capital) Threshold 2: < 3.5% (leverage is over 28.6 times Tier 1 capital)	**Monitoring of leverage has been made explicit and levels have been made explicit across thresholds** Threshold 1: Up to 50 bps below the regulatory minimum Threshold 2: More than 50 bps but not exceeding 100 bps below the regulatory minimum Threshold 3: More than 100 bps below the regulatory minimum
Expense monitoring	The **following points were mandatory**: Threshold 2: Higher provisions as part of the coverage regime Threshold 3: Restriction on management compensation and directors' fees, as applicable	**These actions have been included in discretionary activities and have been made applicable across all thresholds. They have been combined and made more stringent** by restriction/ reduction on variable operating costs, outsourcing activities, and restriction/reduction of outsourcing activities Further **restrictions on capital expenditure,** other than for technological upgradation within Board approved limits have been made mandatory in risk threshold 3.
Discretionary Corrective Actions - Special Supervisory Actions	RBI could amalgamate/ reconstruct a bank under extant regulations	The RBI has **specifically included** resolution of the bank by Amalgamation or Reconstruction (Ref. Section 45 of Banking Regulation Act 1949) under the revised framework.
Exit from PCA and Withdrawal of Restrictions under PCA	Exit of a bank from the PCA framework was based on RBI's assessment on multiple parameters based on the financials of the bank.	**The new framework has laid down an explicit framework for a bank to exit the PCA framework as follows:** Once a bank is placed under PCA, taking the bank out of PCA Framework and/or withdrawal of restrictions imposed under the PCA Framework will be considered: a) if no breaches in risk thresholds in any of the parameters are observed as per four continuous quarterly financial statements, one of which should be Audited Annual Financial Statement (subject to assessment by RBI); and b) based on Supervisory comfort of the RBI, including an assessment on sustainability of profitability of the bank.

CARE Rating's view

The prompt corrective action framework would apply to all banks operating in India including foreign banks operating through branches or subsidiaries from January 01, 2022. Currently, only the Central Bank of India remains under PCA framework. The PCA Framework's focus has shifted to Capital, Asset Quality and Leverage. Additionally, recently banks which had moved out of the PCA framework based on RBI's assessment were either not profitable when the restrictions were lifted or had higher than allowed NPA level. RBI has addressed this issue in the revised framework by introducing a structured exit policy and removing the profitability parameter. However, the exit of any bank from the PCA framework continues to depend on RBI's supervisory comfort and assessment on sustainability of profitability of the bank.

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