General Studies-3; Topic: Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment

Recapitalisation of PSBs

1) Introduction

- The government recently detailed the Rs 2.11 lakh crore recapitalisation plans for Public Sector Banks (PSBs) announced last year including a reforms package.

2) Details of Recapitalisation Plan

- Rs 80,000 crore will be through recapitalisation bonds.
- In exchange for bonds, the government will get shares of banks, a transaction that will not have an impact on the fiscal deficit.
- The bonds will have a maturity of 10 to15 years and priced at around 8 per cent.
- The bonds will not have a statutory liquidity ratio (SLR) requirement and would be non-tradeable.
- Rs 8,139 crore as budgetary support.
- Banks will raise Rs 10,312 crore from the market.

3) Other Major Reforms

- An 'annual report card' for each of the PSBs.
- Providing banking facility at all corners of the country within a radius of 5 kilometres.
- The government also listed a six-fold roadmap for banking reforms which will facilitate ease of banking and encourage clean business.
- **The reform agenda is aimed at EASE — Enhanced Access and Service Excellence. It focuses on six themes of:**
  1) Customer responsiveness
  2) Responsible banking
  3) Credit offtake
  4) PSBs as Udyami Mitra
  5) Deepening financial inclusion
  6) Digitalisation and developing personnel for brand PSB
- Banks will need to set up specialised monitoring agencies for loans above Rs 250 crore and a separate vertical for NPAs.
- Banks need to have a minimum 10% exposure in consortium loans.

4) Need for Recapitalisation

- Government has the prime responsibility of keeping the public sector banks in good health.
- To help PSBs deal with bad debts and revive credit growth.
- Bank recapitalisation is "critical" for the economic recovery of the country.
- For enabling the banks to meet higher regulatory capital burdens under Basel III.
- Gross NPAs of PSBs rose to 12.47% at the end of March 2017 from 4.72% at the end of March 2014.

5) Impact

- It will step up lending and, therefore, growth, step up tax collections and partly bring down the fiscal deficit.

- The capital infusion in PSBs will pull down lending rates, spur aggregate demand, put idle factories to work, and spark investment in 2-3 years.
- Once growth recovers, the government can gradually convert these recap bonds into normal G-secs and sell them to the market.
- It will enhance the banks' ability to raise equity capital.
- Capital infusion will stem the downward pressure on Viability Ratings (VRs), which have been downgraded several times over the last three to four years.
- It will improve the financial risk profile of the banks and help them meet Basel-III regulatory capital norms.
- It also provides a cushion against an expected rise in provisioning for non-performing assets (NPAs).

6) <u>Concerns / Challenges</u>

- Recapitalisation will be difficult for the government due to the compulsion to adhere to the stringent budgetary deficit benchmarks.
- Recapitalisation is not going to result in the recovery of bad loans.
- Banks may not take adequate precautions while lending when they know that the government will step in to help if the loans turn sour.

7) <u>Way Forward</u>

- Increased financial strength via bank recapitalisation is necessary but not sufficient for credit expansion.
- Capital mobilization from the market in the post-recapitalisation period.
- Steps need to be taken to ensure governance of banks follows highest standards.
- Need for institutional mechanism to ensure past is not repeated.
- The banks will have to monitor loans, keep a close eye on bad debt and sell non-core assets.
- Need for Bank Consolidation. The banking structure outlined by the Narasimham Committee was 3 or 4 large “international” banks and 8 to 10 “national” banks.
- If some PSBs cannot mobilize the required resources for their profitable growth, they should be either privatized or merged.
- PSBs must be given adequate functional autonomy and operational flexibility. Bureaucratic and political interference must be minimized.
- Re-skilling the existing staff, along with direct recruitment of specialists, is needed to address the talent issue in banks.
- PSBs must create or purchase the expertise for excellent project evaluation.

8) <u>Conclusion</u>

- Recapitalisation alone cannot be the panacea. It is extremely crucial that the banking reforms are properly sequenced and executed in time.