PCA Framework for UCBs

Why in News?

Recently, the Reserve Bank of India releases Prompt Corrective Action (PCA) framework for Primary (Urban) Co-operative Banks (UCBs).

What is Prompt Corrective Action (PCA) Framework?

- **Introduction** – RBI initiated the Scheme of Prompt Corrective Action (PCA) in 2002.
- **PCA** – A system that the RBI imposes on banks showing signs of financial stress.
- The regulator considers banks as unsafe if they fail to meet the standards on certain financial metrics or parameters.
- **Applicability** – It is applicable to *both banks and NBFCs*.
- It will apply to
  - All deposit-taking NBFCs, excluding government companies,
  - All non-deposit taking NBFCs in the middle, upper and top layers.
- **Significance** – It will stop bad lenders from going worse rather than brushing the issue aside.
- Safer NBFCs will translate to a safer overall financial system.

What are the features of the PCA framework on UCBs?

> *Urban Cooperative Banks (UCBs), though not formally defined, refers to primary cooperative banks located in urban and semi-urban areas.*

- **PCA framework for UCBs** – It will replace the existing Supervisory Action Framework (SAF) and come into effect from April 1, 2025.
- It is largely *principle-based* with *fewer number of parameters* as compared to the SAF, without any dilution in the supervisory rigour.
- **Aim** – To provide flexibility to design entity specific supervisory action plans based on the assessment of risks on a case-by-case basis.
- **Criteria's** - The norms to invoke framework for weak UCB are
  - Capital adequacy ratio (CAR) up to 250 bps below the required CAR
  - Net NPAs above 6.0% but below 9.0%
  - Incurring losses during two consecutive years.

- The breach of any risk threshold may result in invocation of PCA.
- **Coverage** - It will be applicable to UCBs with deposits above 100 crores.

Categories of UCBs

• UCBs have been categorized into four tiers
• **Tier 1** – It consists of UCBs with deposits *up to Rs 100 crore*.
• **Tier 2** – It is those with deposits *above Rs 100 crore and less than Rs 1,000 crore*.
• **Tier 3** – It will consist of UCBs with deposits *above Rs 1,000 crore and less than Rs 10,000 crore*.
• **Tier 4** – It would have UCBs with deposits *above Rs 10,000 crore*.

- **Exemption** - *Tier 1 UCBs have been excluded* from the PCA framework for the present.
- However, they shall continue to be subjected to enhanced monitoring under the existing supervisory framework.
- **Invocation** - A bank will generally be placed under PCA Framework based on the *Reported and Audited Annual Financial Results* and the ongoing *Supervisory Assessment*.
- However, RBI may impose PCA on any bank during a year in case the circumstances warrant.
- **Withdrawal of PCA** – It will be considered if no breaches in risk thresholds in any parameters are observed as per four successive quarterly financial statements.
- **Other features -** The fixed limit of Rs 25,000 for capital expenditure restrictions on UCBs under SAF has been removed.
- The revised framework enables the Supervisors to decide the limit depending upon their assessment of each entity.

What are the significance of RBI's PCA?

- **Early intervention-** PCA acts as an early warning system, allowing the RBI to identify and address potential issues in a bank before they become severe.
- **Financial stability-** It helps maintain the overall health of the banking sector, ensuring financial stability and protecting depositors' interests.
- **Risk management-** Banks under PCA are required to improve their risk management practices, reduce non-performing assets (NPAs), and enhance their capital adequacy.
- **Regulatory oversight-** PCA imposes restrictions and mandates corrective actions on banks, such as limiting dividend distribution, branch expansion, and high-risk lending, to prevent further deterioration.
- **Restoring confidence-** By monitoring and enforcing corrective measures, PCA helps restore confidence in the banking system among investors, depositors, and the public.

Quick Facts

• **NPA –** An asset becomes non-performing when it ceases to generate income for the bank.
• It is a loan or advance for which the principal or interest payment remained overdue for a period of 90 days.
• It can be classified depending on the length of time overdue and probability of repayment
- Substandard asset
- Doubtful asset
- Loss asset,

• **Capital Adequacy Ratio –** It is also known as capital-to-risk weighted assets ratio (CRAR), a measurement of a bank's available capital expressed as a percentage of a bank's risk-weighted credit exposures.
• Two types of capital are measured
- **Tier-1 Capital,** which can absorb losses without a bank being required to cease trading.
- **Tier-2 Capital,** which can absorb losses in the event of a winding-up and so provides less protection to depositors.

• It is used to protect depositors and promote the stability and efficiency of financial systems.

References

1. The Hindu | PCA for urban co-operative banks
2. Business Standard | PCA framework for urban cooperative banks