RBI’s Decision on Economic Capital

What is the issue?

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RBI leadership must ensure that the institution preserves its autonomy while delivering its mandate of growth.

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What are the recent issues with RBI’s action?

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- In recent times there are difference of opinion between RBI governor and Finance Ministry over certain issues, which has resulted in a public spat. Click here to know more about tussle between RBI and Government.
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- Never before in the more than 80 years of RBI history has there been such a public debate on economic capital.
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- There are two aspects of the RBI accounts under debate.
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1. Surplus transfer to the government in the income-expenditure statement.
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2. Transfer to the funds such as Contingency Fund (CF), Asset Development Fund (ADF), Currency and Gold Revaluation Account (CGRA), and Foreign Exchange Revaluation Account (FCVA).
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- Over the years, these four have aggregated Rs.9.498 lakh crore and form 26.25 per cent of the total assets.
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- Critics say such capital buffer is unwarranted and a part of this should be

transferred to government, which, after all, is the owner.
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- Besides, the demand is that there should not be any provisioning made for the CF and ADF.
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What are the concerns with RBI’s fund transfer mechanism?

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- In 2017-18, as much as Rs.14,180 crore was transferred from the RBI’s gross income to the CF.
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- The RBI made this provisioning to the CF after a gap of consecutive four financial years (2016-17, 2015-16, 2014-15 and 2013-14), during which time there was nil transfer, indicating that the entire surplus went to the government in these years.
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- Indications are that this was based on the recommendations of the Malegam Committee II, which surprisingly is not in the public domain.
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- The RBI annual report for 1994-95 recognised that “an adequate Contingency Reserve balance is necessary such as to meet any unforeseen liability…”
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- In subsequent years, provisioning was done to make the CF a percentage of total assets to reach the target of 12 per cent from an abysmally low rate of 0.5 per cent as on end-June 1993.
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- Currently, the ratio is 7.05 per cent, never has this ratio reached 12 per cent.
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- Since the Malegam Committee II report is not public, there is no clarity on why provisioning to the CF stopped, or why it returned.
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- Apart from this it must be made clear that if the discontinuation of transfers to the CF was done (apparently) through a committee report, the return of provisioning should also be guided by a committee.
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What are the recent decisions taken by RBI to address concerns?

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- Recent RBI meeting discussed four points of the dispute such as
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- **The Basel regulatory capital framework -** The board concurred that CRAR (Capital to Risk Asset Ratio) of banks will remain at 9 per cent, putting an end to the clamor for a reduction to 8 per cent.
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- The extension of the transition period of the Capital Conservation Buffer (CCB) by one year (up to March 31, 2020) could broadly be in line with the Basel regulatory framework guidelines.
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- **Liquidity for stressed MSMEs -** With regard to MSMEs, the board advised the RBI to consider a scheme for restructuring of stressed assets of MSME borrowers with aggregate credit facilities of up to Rs.25 crore, subject to conditions that are necessary for financial stability.
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- **Economic Capital Framework (ECF) -** The board has shown its maturity and wisdom with the decision to constitute a committee in respect of ECF and examination of PCA by the Board for Financial Supervision (BFS).
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- **Bank health under Prompt Corrective Action (PCA) -** Let the BFS re-examine the PCA framework and suggest an appropriate remedy to prevent further erosion of capital of PCA banks.
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Click here for RBI board meeting Highlights.

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Source: Business Line

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