Business Standard
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Fri, 22 Feb-19; Business Standard - Mumbai; Size : 376 sq.cm.;
Circulation:14800; Page : 10

Lower growth capital remains key challenge for banks under PCA

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Mumbai, 21 February

In a move to take some more public sector banks (PSBs) out of the Reserve Bank of India's (RBI's) prompt corrective action (PCA) framework, over 59 per cent of the approved ₹48,239-crore capital infusion was allocated to a few PCA banks by the government on Wednesday.

Corporation Bank and Allahabad Bank, allocated the highest recap amount, are potential candidates that could come out of PCA. Not surprising that shares of these banks surged 5 per cent and 19 per cent, respectively, on Thursday.

Even the other PSB stocks traded in the green. What turned investors positive is the expected earnings improvement of PCA banks, with no operational restriction as they emerge out of PCA. Yet, the large bad loans or non-performing assets (NPAs) are the biggest hurdles for these banks.

"The capital infusion by the government will help Allahabad Bank and Corporation Bank to come out of the PCA framework, subject to RBI approval, as the fund allocation will help them meet capital position and also help bring down net NPA levels. But, it is unlikely to take care of growth," says Anil Gupta, head-financial sector ratings at Icra.

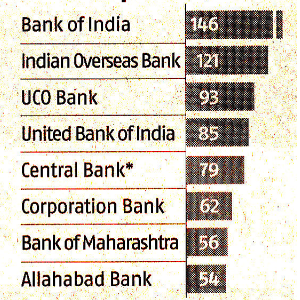
SHORING UP CAPITAL ADEQUACY

All figuresin %

	TIER-1 CAPITAL		TOTAL ADEQUACY	
	Dec '18	Post recap	Dec '18	Post recap
Bank of India	9.2	10.8	12.5	14.0
Central Bank*	7.4	9.0	9.3	10.9
Allahabad Bank	7.2	12.6	10.4	15.9
Indian Overseas Bank	6.7	9.8	8.9	11.9
Corporation Bank	9.1	17.0	11.1	19.0
UCO Bank	7.1	10.5	9.3	12.7
Bank of Maharashtra	9.0	9.3	11.0	11.3
United Bank of India	7.1	11.9	10.0	14.8

Regulatory requirement for Tier-1 capital by March 2019 is at 8.875, including capital conservation buffer
Sources: Banks, brokerage reports, BS Research

Net NPAs as % of revised capital



*Based on net worth as of December 2018
Figures are as of December 2018 under Basel-III after recapitalisation
Sources: Banks, BS Research

According to the RBI, banks are required to keep their Tier-1 capital ratio, including capital conservation buffer, of 8.875 per cent by March 2019. As shown in the table, a calculation shows that most PCA banks (including Bank of India and Bank of Maharashtra that were recently freed from PCA) will meet the requirement with this capital infusion.

The regulator puts banks under PCA if the latter do not comply with the regulatory threshold limits

The regulator puts banks under PCA if the latter do not comply with the regulatory threshold limits, mainly in terms of net NPAs, capital adequacy, and profit position. As a result, such banks bear operational restrictions, in terms of branch expansion, lending to risky sectors, etc. This is also visible from the loan book growth of these banks.

Most PCA banks getting recapitalised (including Bank of India and Bank of Maharashtra) recorded up to 9 per cent year-on-year fall in their respective loan books as of December 2018. This is in sharp contrast to around 15 per cent credit growth of the banking sector.

Issues at non-banking financial companies (NBFCs) are offering tremendous growth opportunities for banks. Further, there is scope for growth, given the focus of most housing finance companies on securitisation of loan portfolio, increase in sectoral lending limits to finance NBFCs. However, NPAs are likely to spoil the game. Even though some banks could come out of PCA, there will not be much room to improve their loan book.

"A major chunk of this recapitalisation will be utilised by PCA banks towards provisioning of NPAs. With no clarity on recovery, except for few accounts and expected fresh slippages (accounts turning bad), the NPA position will reduce to the extent of capital infusion," adds Gupta.

As of December 2018, net NPAs of the six PCA banks stood at 8-14 per cent. This shows the quantum of recap funds to be put in to bring net NPAs within the threshold.

The pain is aggravated with deposits, growing at a relatively very slower pace (around 9-9.5 per cent). Reduction in credit risk for loans given to NBFCs, open market operations could be a breather.

Overall, say experts, banks need more capital to improve their financial performance. Thus, investors are recommended to wait till growth capital concerns are taken care of.