

Executive Summary

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I Introduction

Public Sector Banks (PSBs) account for over 70 per cent of the deposits received in and advances made by Scheduled Commercial Bank (SCBs). The capital requirement of PSBs is driven by credit growth in the economy and prudential regulatory requirements. The regulatory framework for banks is globally framed by the Basel Committee on Banking Supervision which is adopted by RBI for Indian banks. Over 2008-16, the advances of PSBs have more than doubled, from ₹ 22,59,212 crore to ₹ 55,93,577 crore, though the rate of increase in advances has decreased from 19.56 per cent in 2009-10 to 2.14 per cent in 2015-16. The return on assets (ROA) of PSBs which is a measure of their profitability has been consistently lower than that of SCBs (2011-16). PSBs account for nearly 88 per cent of Gross Non-Performing Assets (GNPAs) of the banking sector in 2015-16. There is a significant gap between book value and market value of PSB shares, with most PSBs having a lower market value which may come in the way of PSBs approaching the market for additional capital funds.

II Infusion of Capital Funds by GOI in PSBs

GOI infused ₹ 1,18,724 crore in PSBs during 2008-09 to 2016-17. Audit noticed that for the second phase of fund infusion in FY 2010-11, ₹ 6,423 crore was infused in PSBs, solely on the basis of information received from the PSBs, without any independent verification by DFS. Audit could not verify whether the assessments regarding capital requirement in PSBs made by DFS were in line with the ICAAP and AFI reports of the banks.

PSBs signed (February/ March 2012) MoUs with DFS for performance linked capital infusion in PSBs during 2011-12 to 2014-15. However achievement against MoU targets was not linked to actual capital infusion. The basis for working out parameters for capital infusion changed between actual and estimated values from year to year and often within different tranches in the same year (2010-11, 2015-16 and 2016-17). For FY 2014-15, there was a shift from 'need based' to 'performance based' capital infusion, with ROA being employed as the basic criteria for capital infusion.

(Para 3.3, 3.4.2, 3.4.3 and 3.4.4.1)

As per Indradhanush plan, for FY 2015-16, 20 per cent of the earmarked capital infusion was to be allocated to PSBs based on their performance during three quarters in FY 2015-16, which was not adhered to on account of the Asset Quality Review by RBI. Even in FY 2016-17, DFS decided (March 2016) that 25 per cent of the capital to be infused in 2016-17 would be disbursed upfront and the balance 75 per cent would be disbursed based on achievement of

quantitative targets by PSBs. This decision was reversed in July 2016. Eventually, as most of the PSBs fell short of the targets set, performance was not considered as the basis for capital infusion in 2016-17.

(Para 3.4.4.2 and 3.4.4.3)

In FY 2011-12, SBI was the only PSB which was infused with ₹ 7,900 crore, over and above the regulatory requirement being ₹ 5,874 crore, on grounds that with impending norms of Basel III, SBI would be required to maintain a 11 per cent Tier I CRAR target. The 11 per cent norm for SBI was not followed in future years. During 2013-14, four PSBs which had a GOI shareholding above 58 per cent and did not require capital to meet the Tier I CRAR target, were infused with capital to the tune of ₹ 2,900 crore. This was done even as the requirement of 11 PSBs to meet the Tier I CRAR target, was not fully met.

Against a target under Indradhanush for raising capital from the market by PSBs to the tune of ₹ 1,10,000 crore between 2015-16 and 2018-19, during January 2015 – March 2017, only ₹ 7,726 crore could be raised.

(Para 3.5.1, 3.5.2 and 3.6)

III Monitoring Capital Infusion in PSBs

Statement of Intent (SOI) was introduced to monitor the performance of PSBs, containing targets against parameters. Out of the nine years reviewed, in only one year were conditions stipulated in the sanctions that were issued to five PSBs for infusion of capital. Audit noticed that these conditions were significantly different from targets set for the same parameters in SOIs for the same period.

(Para 4.1 and 4.1.1)

PSBs signed (February / March 2012) MoUs with DFS (for performance linked capital infusion) containing targets against nine parameters. For United Bank of India and Punjab National Bank, the CASA targets and Cost to Income Ratio targets were decreasing year-on-year. For certain PSBs (Bank of Maharashtra, Bank of Baroda, Bank of India and Indian Bank) targets set for components of RBI ratings were not specific. Targets for 2011-12 were fixed in February / March 2012, around the close of the year, while for SBI and its associate PSBs, targets for 2011-12 were fixed in April 2012. MoUs were valid for a period of five years, however, with the exception of Central Bank of India, in respect of other PSBs, signed MoUs contained targets to be achieved till 2014-15 only. Out of 44 parameters under SOI, there were five parameters (CASA, ROA, Net profit per employee, Cost to Income Ratio and Ratio of Staff in Branches to Total Staff) common between MoUs and SOIs. There were significant variations between targets in SOIs and MoUs for the same parameter. 273 progress reports were

to be received from 21 PSBs over 2011-12 to 2014-15, however, only 21 were received. There was under-achievement against targets fixed in respect of the five parameters from 2011-12 to 2013-14.

(Para 4.2, 4.2.1, 4.2.2, 4.2.3, 4.2.4, 4.2.5, 4.2.6 and 4.2.7)

IV Analysis of Recapitalisation of PSBs

To appreciate the effect of recapitalisation of PSBs, they were segregated into two categories, - category I which received a lower share (less than 25 per cent) of GOI capital as a proportion of their net worth and category II which received a higher share (25 per cent or more than 25 per cent) of GOI capital as a proportion of their net worth. The rate of growth of advances has in general, been lower for category II PSBs compared to category I PSBs. The average ROA and ROE of category II PSBs was lower than that of category I PSBs. The average CRAR of category II PSBs was consistently lower than that of category I PSBs.

(Para 5.2, 5.3, 5.4.2 and 5.6)

V Asset Quality Position of PSBs

High levels of NPAs in banks affect the economy as bank credit is a catalyst for economic growth. GNPA of PSBs surged from ₹ 2.27 lakh crore (31 March 2014) to ₹ 6.83 lakh crore (provisional) as on 31 March 2017. Instances of material differences exceeding 15 per cent, between the NPAs recognized by PSBs and RBI and the provisioning made against them were noticed in case of 12 PSBs out of 17 reviewed. Consequently, there was over-projection of net profits. The average Provision Coverage Ratio (PCR) during 2011-12 to 2016-17 had reduced from 67.11 per cent to 55.22 per cent. The GNPA ratio in PSBs has been higher than SCBs since 2011-12, reaching 9.91 per cent in 2015-16. The fresh slippage has increased from 1.39 per cent in 2008-09 to 6.90 per cent in 2015-16. For PSBs, the recovery rate has in general been lower than the write-off rate between 2010-11 and 2014-15. A significant component of the GNPA are advances made in the infrastructure, iron and steel and textile sectors. While the GOI and RBI have taken measures like Debt Recovery Tribunals, Lok Adalats, SARFAESI Act and Schemes for Restructuring Debt, to reduce address NPAs, the revised Prompt Corrective Action framework (April 2017) and the promulgation of the Banking Regulation (Amendment) Ordinance 2017, hopefully will further address the issue.

(Para 6.2, 6.3.1, 6.3.2, 6.4.2, 6.5.1, 6.8.1, 6.6.2 and 6.9)

VI Recommendations

1. *Criteria for fund infusion, once finalised, may be consistently applied across all PSBs, however in case of variation, reasons should be well documented.*
2. *Bank-specific ICAAP documents may be considered by DFS while assessing the quantum of fund infusion yearly.*
3. *The purpose of fund infusion, for which CCEA approval is taken, may be adhered to. Changes, if necessary, in the purpose of fund infusion may be approved by the CCEA before being implemented.*
4. *There should be an effective monitoring system in place and this system should ensure fulfillment of the intended objectives of fund infusion.*
5. *Efforts should be made by the Department of Financial Services to ensure that PSBs increase the quantum of recovery vis-à-vis write-offs.*