Chapter III

Infusion of Capital Funds by GOI in PSBs

3.1 Process of Recapitalisation of PSBs

PSBs have been recapitalised on an annual basis during the period 2008-09 to 2016-17 reviewed in Audit. The process for recapitalisation of PSBs, as explained by DFS (April 2017), is summarized below:

- Every year, the PSBs project their capital requirements for the year to DFS. PSBs take into account the credit growth, risk profile of the assets to project the risk weighted assets of the bank. The internal accruals of the bank and other sources of capital generation are also assessed and the balance capital requirements are sought.
- DFS verifies the data submitted by the PSBs and undertakes an assessment of each PSB to arrive at its actual requirement for additional capital.
- These projections are then discussed with the senior management of the PSBs to understand the variances and refine the calculations.
- Post discussions, DFS decides capital allocations to banks on a 'need based' approach. DFS stated (April 2017) that need based approach is to be understood in a broader perspective, viz., to help the PSBs achieve minimum capital requirements as per the regulatory framework, maintain some buffer, plan and strategize for future growth and meet capital requirements for the same.

3.2 GOI Capital Infusion in PSBs

GOI infused ₹1,18,724 crore in PSBs during 2008-09 to 2016-17. For the period, 2008-09 to 2014-15, the amount of GOI capital to be infused in a year was decided through the annual budgetary process. In August 2015, the Indradhanush Plan was announced which provided for GOI capital infusion of ₹70,000 crore in PSBs over 2015-16 to 2018-19. The inter-se distribution of capital among the PSBs is carried out by DFS following the procedure detailed at Paragraph 3.1 above. The following table indicates the quantum of GOI capital infusion, PSB-wise, during the FYs 2008-09 to 2016-17:

Table 3.1: Year wise and Bank wise Capital Infusion

(₹in crore)

Name of PSBs	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	Total
Allahabad Bank	-	-	670	-	-	400	320	973	451	**2814**
Andhra Bank	-	-	1173	-	-	200	120	378	1100	**2971**
Bank of Baroda	-	-	2461	-	850	550	1260	1786	-	**6907**
Bank of India	-	-	1010	-	809	1000	-	3605	2838	**9262**
Bank of Maharashtra	-	-	940	470	406	800	-	394	300	**3310**
Canara Bank	-	-	-	-	-	500	570	947	748	**2765**
Central Bank of India	700	450	2253	676	2406	1800	-	535	1397	**10217**
Corporation Bank	-	-	309	-	204	450	-	857	508	**2328**
Dena Bank	-	-	539	-	-	700	140	407	1046	**2832**
Indian Overseas Bank	-	-	1054	1441	1000	1200	-	2009	2651	**9355**
Indian Bank	-	-	-	-	-	-	280	-	-	**280**
Oriental Bank of Commerce	-	-	1740	-	-	150	-	300	-	**2190**
Punjab National Bank	-	-	184	655	1248	500	870	1732	2112	**7301**
Punjab & Sind Bank	-	-	-	-	140	100	-	-	-	**240**
Syndicate Bank	-	-	633	-	-	200	460	740	776	**2809**
UCO Bank	450	450	1613	48	681	200	-	935	1925	**6302**
Union Bank of India	-	-	793	-	1114	500	-	1080	541	**4028**
United Bank of India	250	300	558	-	100	700	-	480	1026	**3414**
Vijaya Bank	500	-	1068	-	-	250	-	220	-	**2038**
State Bank of India[12]	-	-	-	7900	3004	2000	2970	5393	5681	**26948**
IDBI Bank Ltd.	-	-	3119	810	555	1800	-	2229	1900	**10413**
Total	**1900**	**1200**	**20117**	**12000**	**12517**	**14000**	**6990**	**25000**	**25000**	**118724**

(Source: Records of DFS)

It is seen from the table that:

- State Bank of India received the maximum capital infusion of ₹ 26,948 crore, i.e. nearly 22.7 *per cent* of the total capital infusion. IDBI Bank, Central Bank of India, Indian Overseas Bank and Bank of India were also significant beneficiaries with 8.77 *per cent*, 8.61 *per cent*, 7.88 *per cent* and 7.80 *per cent* of the total capital infusion of ₹1,18,724 crore respectively.
- Punjab & Sind Bank and Indian Bank received the lowest capital infusion, at 0.20 *per cent* and 0.24 *per cent* of the total funds infused.

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[12] **Includes the SBI associates**

- Indian Bank received capital only once, in FY 2014-15. Central Bank and UCO Bank were given capital in eight out of nine years under audit scrutiny.

3.3 Capital Infusion by DFS

The process of deciding on the capital infusion in PSBs entailed independent assessment by DFS. Audit, however noticed that in one year. i.e. FY 2010-11 (out of the nine years reviewed in Audit), decision on capital infusion was taken by DFS solely on the basis of information received from and assessment of the PSBs themselves, without any independent verification. Capital of ₹ 20,117 crore was infused in FY-2010-11 in three phases (₹ 7,694 crore in first phase, ₹ 6,423 crore in second phase and ₹ 6,000 crore in the third phase). For the second phase of fund infusion in FY-2010-11, the PSBs had furnished data as on 1 January 2011 with projections of shortfall in Tier I capital (vis-à-vis a target of 8 *per cent* CRAR as on 31 March, 2011). Accordingly, the requirement of capital for the second phase was worked out by DFS at ₹ 6,423 crore, which was infused.

Besides, 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 as Audit was not allowed access to ICAAP and AFI reports.

DFS replied (June 2017) that while inputs from each and every Bank were taken for deciding the quantum and mode of capital infusion, they noted to take the ICAAP of each and every Bank before finalising the capital allocation. DFS also replied that the requirements shown under ICAAP would however be subject to scrutiny, which was currently done indirectly through Government Nominee Directors (GNDs) and might change post discussions with banks to make them more realistic.

The reply of DFS needs to be considered in line with the functions of DFS which include scrutiny of the annual financial reviews of PSBs conducted by RBI under Section 35 of the Banking Regulation Act, 1949 and follow up action.

3.4 Basis for Capital Infusion

3.4.1 Basis for capital infusion in PSBs

3.4.1.1 Capital infusion in PSBs had been approved for the period 2008-09 to 2014-15[13] based on the following considerations:

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[13] Cabinet Committee on Economic Affairs (CCEA) approvals to recapitalization proposals in February/March 2009, April 2010, December 2010, January 2013 and December 2014

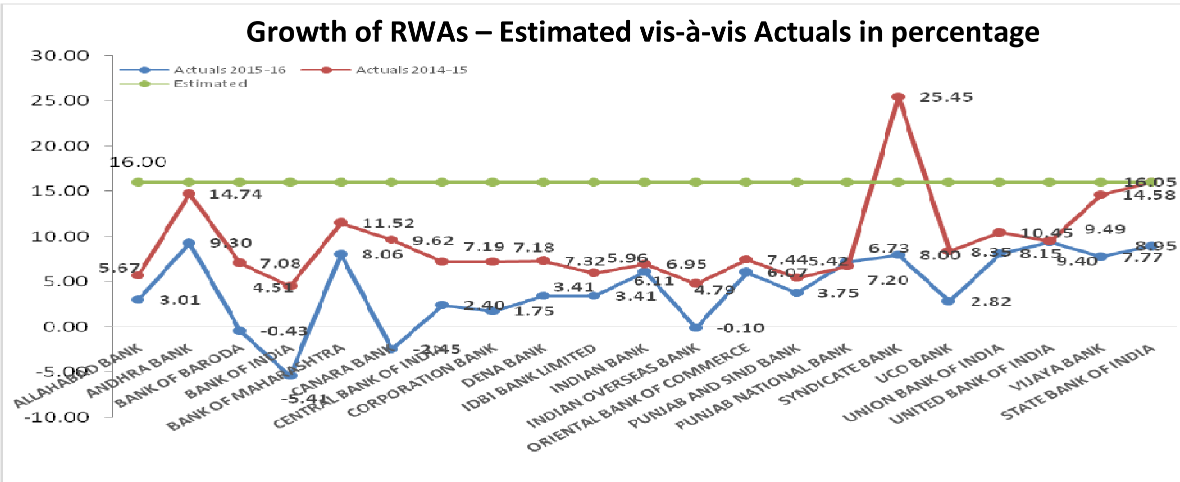
- <u>Capital adequacy</u> – for maintaining Tier I CRAR at six *per cent* (FY 2008-09 and FY 2009-10), eight *per cent* (2010-11 and 2011-12) and at comfortable levels (2012-13). For 2013-14 to 2018-19, the intent was to ensure compliance with capital adequacy norms under Basel III

- <u>Credit</u> requirement of the economy

- <u>Maintaining GOI stake in PSBs</u> at 58 *per cent* (decided in December 2010). Subsequently, this was revised to 52 *per cent* in December 2014 when it was decided to allow the PSBs to raise capital from markets through FPO or QIP by diluting GOI holding.

3.4.1.2 To arrive at the capital infusion required to maintain a specific capital adequacy ratio of PSBs (regulatory requirement) DFS estimates the growth of risk weighted assets of the banks. As credit expands, the risk weighted assets also increase necessitating additional capital for the bank to maintain capital adequacy ratio (specified by Basel norms / RBI). If the RWAs grow at a high rate, there would be greater need for capital to meet CRAR norms. The growth of RWAs as estimated (16 *per cent*) by DFS in the Note approved (December 2014) by the CCEA, compared with the actual growth of RWAs over the period 2014-16 in PSBs, is in the chart given below :

$$\text{Tier I CRAR} = \frac{\text{Tier I capital}}{\text{Risk weighted assets}}$$



[Source : Note approved by the CCEA (December 2014) and Data from RBI]

The chart indicates that there was a considerable gap between the estimated and actual RWA growth in most PSBs; the actual RWA growth being much lower.

3.4.1.3 The Indradhanush Plan was introduced in August 2015 which envisaged GOI capital infusion of ₹ 70,000 crore in PSBs to adequately capitalise all the banks and keep a safe buffer over and above the minimum norms of Basel III. It assumed that the credit growth during this period would be of the order of 12 to 15 *per cent*. The year-wise capital infusion projected is on the next page:

Table 3.2: Year-wise capital infusion projected

Financial Year	Amount (₹ in crore)
2015-16	25,000
2016-17	25,000
2017-18	10,000
2018-19	10,000

(Source: Indradhanush Plan document)

The estimated need for the PSBs during this period was worked out as ₹ 1,80,000 crore (over 2015-19). The Plan estimated that the market valuations of PSBs would improve significantly due to far reaching governance reforms; tight NPA management and risk controls, significant operating improvements; and capital allocation from GOI. Improved valuations, coupled with unlocking value from non-core assets as well as improvements in capital productivity, will enable PSBs to raise the remaining ₹ 1,10,000 crore from the market.

3.4.2 Mismatch between MoU and basis for capital infusion

The PSBs signed MoUs with DFS in February/ March 2012 which were to form the basis for capital infusion in the PSBs during 2011-12 to 2014-15. The MoUs set out targets against performance parameters achievement of which were to trigger capital infusions. The parameters included Current Account Savings Account (CASA) percentage, Return on Assets (ROA) percentage, Net Profit per Employee, Employees Cost to Income Ratio (in percentage), Other cost to income ratio (percentage), Market share – deposits (percentage), RBI rating, ratio of staff in branches to total staff and Outstanding NPAs over two years as a percentage of total NPAs.

Audit noticed that instead of performance against MoU targets being the basis for capital infusion, the actual basis was regulatory requirements regarding capital adequacy and estimates of credit growth as listed as para 3.4.1.1 and 3.4.1.2 above. Some performance parameters formed the basis for capital infusion only during 2014-15.

DFS replied (June 2017) that the CCEA approval for need based capital infusion did over ride the earlier decision and hence the requirement for MoUs wasn't there. The purpose of MoUs was to have capital allocation based on certain parameters but post the CCEA approval the purpose for which MoUs were required extinguished.

The reply of DFS has to be viewed against the approach in adopting performance as the basis for capital infusion in PSBs. Though DFS has emphasized in the reply that the requirement for MoUs wasn't there, in 2014-15 capital infusion was primarily on the basis of return on assets (ROA), a performance parameter under the MoU, to reward better performing banks. DFS had also proposed to infuse 20 *per cent and* 25 *per cent* of earmarked capital on the basis of performance of the PSBs in 2015-16 and 2016-17 respectively. Besides, Audit noticed that DFS specified (March 2017) that '*only on signing MoUs and achieving quarterly benchmarks, PSBs shall be eligible to be considered for capital infusion*' and entered into MoUs with PSBs in March 2017.

3.4.3 Different basis adopted for estimating need for capital infusion

Capital of ₹ 1,18,724 crore was infused in PSBs over 2008-09 to 2016-17 with the primary objective of meeting capital adequacy needs (CRAR, Tier-I capital, CET-I) or based on performance (ROA). The basis for working out these parameters changed from year to year and often within different tranches in the same year (2010-11, 2015-16 and 2016-17), as can be seen from the table below:

Table 3.3: Basis adopted for estimating need for capital infusion

Financial Year	Capital Infused (₹ in crore)	Basis	
		Reference Date	Actual / Estimated
2010-11	7694[14]	31 March 2010	Actual Tier I CRAR
	6423	31 March 2011	Estimated Tier I CRAR
	6000	31 March 2011	Raising GOI holding to 58 *per cent*
2011-12	12000	31 December 2011	Actual Tier I CRAR
2012-13	12517	31 March 2013	Estimated Tier I CRAR
2013-14	14000	31 March 2014	Estimated Tier I CRAR & Raising GOI holding to 58 *per cent*
2014-15	6990	Last three years average return	Actual ROA
2015-16	9932	31 March 2016	Estimated CET-1
	10018	31 March 2016	Estimated RWA
	5050	31 March 2016	Estimated minimum regulatory capital
2016-17	16414	31 March 2017	Estimated Tier-1
		31 March 2017	Estimated RWA
	7750	31 March 2017	Estimated CET-1
	836	31 March 2018	Estimated CET-1

(Source : Records of DFS)

DFS explained (May 2017) the lack of consistency in working out capital requirement of PSBs by stating that the approach of ensuring that banks achieve minimum regulatory capital requirements had been done on future estimates but the balancing part where the approach was based on rewarding banks who had used capital judiciously could only be done on actuals.

While the reply of DFS explains the use of actual ROA for FY-2014-15, it does not address consideration of actual Tier I CRAR in 2010-11 and 2011-12. In fact, in 2010-11, capital infusion was made in two separate tranches adopting different

[14] **Includes ₹ 250 crore, ₹ 300 crore, ₹ 700 crore and ₹ 250 crore infused in United Bank, UCO Bank, Vijaya Bank and Central Bank of India, based on CCEA approval (February/March 2009) for infusion in 2009-10**

bases. While the actual Tier I CRAR as on 31 March 2010 was considered in the first phase, the estimated Tier I CRAR as on 31 March 2011 was considered in the second phase. Audit noticed that in respect of two PSB as tabulated below, capital was infused in both phases in 2010-11, on the basis of actual Tier – I CRAR as on 31 March 2010 and projected Tier – I CRAR as on 31 March 2011.

Table 3.4: Capital infusion in two banks in two separate tranches adopting different bases

Bank	Capital Infused (₹ in crore)	
Bank of Maharashtra	588	352
UCO Bank	373	940

(Source : Records of DFS)

3.4.4 Capital infusion on the basis of performance

3.4.4.1 DFS identified (January 2015) beneficiary banks and the amount of equity capital to be infused for the FY 2014-15 primarily on the basis of return on assets (ROA[15]). This indicated a shift from 'need based' to performance/ profitability based capital infusion. It is noticed that the CCEA approval taken for infusion of capital in 2014-15 (January 2013) had envisaged 'need based' capital infusion to comply with Basel III norms.

In its reply (June 2017), DFS stated that while there was no requirement of capital during 2014-15, capital infusion was done in the Banks to create a buffer for the coming years and at the same time ensuring that better performing Banks were rewarded and the parameter was the returns generated. This was to ensure that capital had been used judiciously by the Bank and it would continue to do so.

The reply of DFS needs to be considered against the observation of DFS on the MoUs of the PSBs (October 2014) that achievements of all banks (including the banks which had been infused capital) had been below par and had directed all PSBs to strengthen their internal processes and generate additional capital savings in the near-to-medium term. DFS also stressed that each bank should do a thorough assessment of their opportunity in earmarked areas[16] (which did not include ROA) which would be monitored by DFS for further capital infusions. Audit noticed that while processing fund infusion in January 2015 for 2014-15, DFS did not refer to progress in the areas they had highlighted to banks in October 2014 and employed ROA as the basic criteria for capital infusion.

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15 **ROA - is a profitability ratio which is worked out by dividing net profit by total assets**

16 **Five areas- (a)capital release through RWA reduction (b)Deploying more stringent risk-based pricing for all new origination and implementing improved scoring models to enable this (c)strengthening performance management (d)Building capability for key bank staff on risk based pricing and understanding capital implications of their decisions (e)Review all subsidiaries / JVs for the bank.**

3.4.4.2 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 the three quarters in 2015-16, judged on the basis of certain performance. Audit noticed that this was not done and all funds were released on the basis of need following the Asset Quality Review by RBI. Even during FY 2016-17, DFS earmarked 25 *per cent* of fund infusion based on performance (July 2016). However, as most of the banks fell short of the targets set, performance was not considered as the basis for capital infusion during the year.

3.4.4.3 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 by the end of the financial year (2016-17). It was specifically stated that banks which do not achieve the targets would not receive further funds. In July 2016, however, DFS amended this decision, deciding upon 75 *per cent* upfront disbursement with the balance 25 *per cent* alone being based on benchmarks. The amendment was so that PSBs have enough liquidity to support credit and to enable them raise money from markets. The shift in upfront disbursement from the earlier intended 25 *per cent* to 75 *per cent* has impacted the DFS objective of ensuring accountability for efficient and optimal use of capital.

DFS replied (June 2017) that the proportion or ratio was later changed to 75:25 instead of 25:75 based on discussions with the Banks, which was a routine practice and might not have been referenced to in the Note. DFS also replied that since Banks needed to disclose CAR on a quarterly basis they represented that higher capital infusion upfront gave them some buffer, with the change in decision being influenced by discussions with Bankers.

The reply of DFS needs to be viewed against the fact that in 2016-17, the entire capital was released to PSBs without considering their achievement of any performance criteria which highlights the shift in approach by DFS.

3.5 Distribution of Capital Across PSBs

Capital has been infused on a regular (annual) basis to the PSBs over 2008-09 to 2016-17, so that they meet regulatory capital requirements mandated in Basel norms/ RBI norms, address the demands of credit fuelled by economic growth and maintain GOI stake in the PSBs at a benchmark level (set at 58 *per cent* in December 2010 subsequently lowered to 52 *per cent* in December 2014).

3.5.1 In FY 2011-12, the intent was to infuse capital in PSBs so that they reach Tier I CRAR of eight *per cent* (CCEA approval of April 2010). Audit noticed that SBI was infused (March 2012) with additional capital, over and above its requirement for meeting the Tier I CRAR target of eight *per cent*. While the regulatory requirement for SBI in 2011-12 was ₹ 5,874 crore, DFS infused capital of ₹ 7,900 crore in SBI during the year, in line with their demand for capital, stating that in the wake of impeding Basel III norms SBI would be required to maintain its Tier I CRAR at approximately 11 *per cent.* In fact, of the seven[17] PSBs which had received capital infusion during 2011-12, SBI was the only PSB which had received the full amount requested.

DFS replied (June 2017) that capital was infused in SBI to help maintain achieve Tier I ratio of eight *per cent* which was in line with the GOI policy for capitalisation, adding that the decision to infuse an amount slightly in excess of the requirement that year was done primarily to take care of the requirements for the future. DFS added that the requirement was huge for SBI and with nearly 25 *per cent* market share (including Associate Banks) it accounted for nearly one third of Public Sector Banks Business.

The reply of DFS is not tenable in view of the following:

(i) the approval of CCEA was for maintaining a Tier I CRAR of eight *per cent*.

(ii) the 11 *per cent* target for Tier I CRAR was not maintained uniformly for SBI in future years.

3.5.2 In FY-2013-14, the bases for capital infusion in PSBs (in line with the CCEA decision of December 2010, January 2013) were :

- To maintain Tier I CRAR at a level above eight *per cent* as on 31 March 2014
- To maintain the shareholding of GOI as close as possible to 58 *per cent.*

Audit noticed the following regarding actual capital infusion in PSBs during the year:

- Of the 20 PSBs whose assessment was done, four[18] PSBs did not qualify as per the given criteria (i.e. had a Tier I CRAR higher than eight *per cent* and a GOI shareholding above 58 *per cent*) and another three[19] met the CRAR target but had a lower GOI shareholding. 20 banks (including these four banks which did not qualify as per the given criteria) were infused with capital during the year.

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[17] **Bank of Maharashtra (₹ 470 crore), Central Bank (₹ 676 crore), IDBI Bank (₹ 810 crore), Indian Overseas Bank (₹ 1441 crore),Punjab National Bank (₹ 655 crore), State Bank of India (₹ 7900 crore) and UCO Bank (₹ 48 crore)**

[18] **SBI, Canara Bank, Syndicate Bank, UCO Bank**

[19] **Bank of Baroda, Punjab National Bank, Union Bank of India**

- DFS had assessed a requirement of ₹ 15,703 crore for PSBs to meet the Tier I CRAR in 2013-14 against an available budget of ₹ 14,000 crore. For meeting CRAR target in PSBs, however, only ₹ 9,550 crore was infused with the balance ₹ 4,450 crore being infused in the balance seven banks (of which ₹ 2,900 crore infused in the four banks which did not satisfy the criteria).

- No uniform criteria was on record for distributing the ₹ 9,550 crore capital between the 13 PSBs which did not satisfy the Tier I CRAR benchmark of 8 *per cent*. It was seen that 50.10 to 108.17 *per cent* of the requirement assessed by DFS for these banks was infused. In fact, in case of Corporation Bank, capital infused was ₹ 450 crore (more than the requirement assessed at ₹ 416 crore) and in case of Allahabad Bank, capital infused was ₹ 400 crore (equal to the assessed requirement).

DFS replied (April 2017) that the amount to be infused was rounded off, without giving reasons for the variation noticed. It was informed that capital allocation during FY 14 was first done to ensure that all PSBs achieved a minimum of eight *per cent* Tier I ratio. Post that, capital was allocated to those PSBs where GOI holding was below 58 *per cent*. In the banks where GOI shareholding was more than 58 *per cent*, a mix of preferential allotment in favour of GOI (60 *per cent*) and QIPs by PSBs (40 *per cent*) was considered to ensure minimum dilution of GOI shareholding in PSBs and create headroom for future capital raising from the markets. The unallocated amount after the above exercise was given to the remaining banks to ensure enough headroom for minimum capital requirements in the years to come. The capital allocation to SBI, Canara Bank, Syndicate Bank and UCO Bank was done accordingly.

The response of DFS indicates that the CRAR requirement of all PSBs were met before capital was infused in other banks (without specific CRAR needs). This, however, does not accurately reflect the fact that the full requirement of 11 PSBs, as assessed by DFS, was not met during the year 2013-14, even as other banks were capitalised.

3.6 Raising Capital from the Market by PSBs

In the Indradhanush plan (2015-19), it was envisaged that the PSBs would raise ₹ 1,10,000 crore over 2015-19 from the market along with capital infusion of ₹ 70,000 crore by GOI over the same period to meet their assessed capital requirement of ₹ 1,80,000 crore.

Audit noticed that so far (January 2015 – March 2017), PSBs could only raise ₹ 7,726 crore from the market which raises doubts on the possibility of raising the balance amounting to over a lakh crore from the market by 2019.

DFS replied (June 2017) that the market scenario was quite upbeat especially the Banking stocks, adding that stronger and bigger PSBs were nearing their 52 weeks high and were at their highest levels in the last few years. While the Bankex had gone down, the bigger few PSBs were doing well and their share prices were nearing 52 week high. DFS also replied that bigger banks, which would need nearly 60-70 *per cent* of the capital requirement, would be in a position to raise equity from the markets in next two years.