Chapter VII
Conclusion and Recommendations

Conclusion

A strong and resilient banking system is the foundation for sustainable economic growth. In India, Public Sector Banks (PSBs) comprise the largest component of the banking system, accounting for over 70 *per cent* of total lending. From a regulatory perspective, PSBs must manage their risks to control potential future losses and have sufficient capital funds to absorb large losses, before depositor funds are adversely impacted. Banking regulations, therefore, require PSBs to meet stringent minimum capital requirements.

GOI, as the majority shareholder, has infused capital of ₹ 1,18,724 crore from 2008-09 to 2016-17 in the PSBs for meeting their capital adequacy requirements or based on their performance. Audit noticed that the estimation of the parameters based on which capital was infused altered from year to year and often within different tranches of the same year. While CCEA approval had been taken for 'need based' capital infusion, there was a shift in 2014-15 to performance/ profitability based capital infusion. Audit also noticed that in some cases the rationale for distribution of GOI capital among different PSBs was not on record. Some banks which did not qualify for additional capital as per decided norms were infused with capital, a bank was infused with more capital than required while others did not receive the requisite capital to meet their capital adequacy requirements. In 2015-16 and 2016-17, it was decided that 20 and 25 *per cent* of the capital infusion, respectively, would be based on performance. However, the poor asset condition of the PSBs brought out in the Asset Quality Review of RBI (2015-16) and the failure of most PSBs in meeting their targets for both years led to release of capital without considering performance. In March 2017, DFS decided that achievement against quarterly benchmarks would be the yardstick for fund infusion from 2017-18 onwards.

A target had been set (August 2015) for PSBs to raise ₹ 1,10,000 crore from the markets by 2018-19. Against this target, ₹ 7,726 crore only has been raised during January 2015 and March 2017. Considering the commitment to the CCEA that the market would not be flooded by multiple banking equity issues at the same time, achievement of this target by March 2019 appears doubtful.

DFS had decided that achievement of performance parameters listed in the MoUs with individual PSBs (signed in February/ March 2012) would be the basis for future capital infusion. This, however, was not adhered to in practice. Audit noticed that for some parameters, the MoU targets decreased year-on-year while for others, specific targets were not fixed. Though MoUs were valid upto FY-17, only interim targets upto March 2015 were set. It was seen that the targets set in the MoUs varied substantially from the targets set in the SOIs of the PSBs. While 273 progress reports on MoUs were due from PSBs, only 21 were actually received, indicating deficient monitoring of the MoUs through progress reports. The achievements against the MoU targets (for the parameters[32] against which achievements were available to Audit) were also poor. Audit also noticed that the conditions that had been stipulated while sanctioning capital infusion in the PSBs (2010-11) were significantly different from the targets set in the SOIs for the same period.

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. Audit noticed that the average ROA, ROE and rate of growth of advances has, in general, been lower in case of category II PSBs compared to category I PSBs. Audit also noticed that the average capital adequacy ratio of category II PSBs was consistently lower than that of category I PSBs even after higher and more frequent GOI capital infusion.

Meanwhile, the quality of assets in PSBs have deteriorated sharply, particularly in recent times. Gross NPAs of PSBs surged from ₹ 2.27 lakh crore (31 March 2014) to approximately ₹ 5.40 lakh crore (31 March 2016), representing an increase of 138 *per cent*. GNPAs of PSBs rose further to ₹ 6.83 lakh crore (provisional) at the end of March 2017. Audit noticed that there were material differences (beyond 15 *per cent*) between NPAs recognized by 12 PSBs and RBI leading to lower recognition of provisions and hence over-projection of net profits. It was also seen that the average PCR of PSBs has generally been on the decline over 2011-12 to 2016-17. It was seen that the ratio of Gross NPAs to Advances by PSBs have been higher than that of SCBs since 2011-12 and in general, write-offs have been higher than recoveries for PSBs. Various steps have been/ are being taken for resolution of stressed assets by GOI and RBI and it is expected that the situation may improve in future.

[32] **ROA, CASA, Net profit per employee, Cost to Income ratio and Ratio of Staff in Branches to Total Staff**

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.*

Dated: 03 July 2017
Place : New Delhi

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Countersigned

Dated: 03 July 2017
Place : New Delhi

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Comptroller and Auditor General of India