Office of Comptroller and Auditor General of India

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PRESS RELEASE

CAG audit report on Recapitalisation of Public Sector Banks tabled in Parliament; Gross NPAs of PSBs rose to ₹ 6.83 lakh crore (prov.) at the end of March 2017

Comptroller and Auditor General of India audit report no 28 0f 2017 on Recapitalisation of public sector banks was tabled in parliament today**.**

The banking system in India comprises commercial and co-operative banks with commercial banks accounting for the bulk of banking assets. Public Sector Banks (PSBs) account for over 70 *per cent* of the deposits received in and advances made by Scheduled Commercial Banks (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 growth in advances has decreased from 19.56 *percent* in 2009-10 to 2.14 *percent* 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 *percent* 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. 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 reviewed capital infusion by Government of India over 2008-09 to 2016-17. Records available in DFS were examined for this purpose. DFS had advised Audit that it might not be advisable to seek the internal records of individual banks due to the legalities involved and that commercial decisions were taken by the banks themselves. Audit did not have access to individual bank records. The audit exercise, therefore, was limited to records of DFS.

2. Audit Findings

- The basis for working out parameters for capital infusion changed between actual and estimated values from year to year and often within different tranches of the same year (2010-11, 2015-16 and 2016-17).

- The rationale for distribution of GOI capital among different PSBs was not found on record in all cases. 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.
- While CCEA approval had been taken for 'need based' capital infusion, there was a shift in 2014-15 to performance/ profitability based capital infusion.
- Department of Financial Services 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.
- Statement of Intent (SOI) which set targets against a set of parameters, was introduced to monitor the performance of PSBs. Out of the nine years reviewed, in only one year, conditions were 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.
- 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 which was not adhered to on account of the Asset Quality Review by RBI during 2015-16 and the failure of most PSBs in meeting their targets during 2016-17.
- 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 which raises doubts on the possibility of raising the balance, amounting to over a lakh crore, from the market by 2019.
- To analyse re-capitalisation 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 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. It was also observed that the average capital adequacy ratio of Category II PSBs was consistently lower than that of Category I PSBs.
- 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.
- 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.
- The average provision coverage ratio of PSBs has generally been on the decline over 2011-12 to 2016-17.
- The ratio of Gross NPAs to Advances by PSBs has been higher than that of SCBs since 2011-12 and in general, write-offs have been higher than recoveries for PSBs.

3. Recommendations by Audit

- ✓ Criteria for fund infusion, once finalized, may be consistently applied across all PSBs, however in case of variation, reasons should be well documented.
- ✓ Bank-specific ICAAP documents may be considered by DFS while assessing the quantum of fund infusion yearly.
- ✓ 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.
- ✓ There should be an effective monitoring system in place and this system should ensure fulfillment of the intended objectives of fund infusion.
- ✓ Efforts should be made by the Department of Financial Services to ensure that PSBs increase the quantum of recovery vis-à-vis write-offs.