CRISIL
An S&P Global Company

RBI hastens clean-up of bank balance sheets

16 out of 21 public sector banks could breach new PCA risk thresholds

May 2017

Analytical contacts

Krishnan Sitaraman
Senior Director - CRISIL Ratings
CRISIL Limited
Phone:+91 22 3342 8070
krishnan.sitaraman@crisil.com

Rama Patel
Director - CRISIL Ratings
CRISIL Limited
Phone:+91 22 4254 1919
rama.patel@crisil.com

Vydianathan Ramaswamy
Associate Director – CRISIL Ratings
CRISIL Limited
Phone:+91 22 3342 3255
vydianathan.ramaswamy@crisil.com

Dinesh Shukla
Team Leader – CRISIL Ratings
CRISIL Limited
Phone:+91 22 3342 8311
dinesh.shukla@crisil.com

RBI hastens clean-up of bank balance sheets

16 out of 21 public sector banks could breach new PCA risk thresholds

The Reserve Bank of India (RBI) has, in April 2017, announced a series of measures that should structurally improve India's banking system by hastening a clean-up of balance sheets, strengthening credit discipline, and catalysing consolidation.

Mandatory public disclosure of deviation between reported non-performing assets (NPAs) and provisions compared with the RBI's assessment, increase in standard asset provisioning on exposures to vulnerable sectors, and revision in the prompt corrective action (PCA) framework for banks are aimed at enhancing transparency and ensuring adequate recognition of stress in the loan books of banks.

Additionally, tightening of risk thresholds under PCA based on capitalization, asset quality, profitability and leverage levels will help in devising effective resolutions for banks to address systemic issues. Banks breaching the risk thresholds 1 and 2 will be subject to mandatory and discretionary corrective actions. For breach of risk threshold 1 and 2, actions can include mandatory capital infusion, restriction on dividend payouts and branch expansions and increased provisioning requirements. However banks that breach threshold 3 with regards to common equity capital, could face more severe implications including their merger/winding-up/reconstruction. These measures will help in early resolution of issues within banks and hence are positive from a long-term sustainability perspective.

Our analysis shows 16 out of 21 public sector banks are likely to breach the risk threshold 1 or 2, triggered by weak asset quality and profitability parameters with only one bank breaching the risk threshold 3 on asset quality. Hence for most banks we do not foresee any severe corrective action being taken in the near term.

The RBI's move to increase standard asset provision beyond the regulatory minimum (currently 1% for real estate loans and 0.4% for other loans) will improve risk cover for vulnerable exposures. In the near term, however, there will be impact on bank profitability due to the increased provisioning.

We believe the increase in standard asset provisioning for the telecom sector, which accounts for ~1.5% of total banking sector advances, could just be the beginning, and may be followed with higher provisioning requirements for other stressed sectors such as infrastructure, iron & steel, and real estate, which account for ~20% of banks advances.

CRISIL estimates total weak assets[1] in the banking system at Rs.8.7 lakh crore (March 2017), mainly contributed by infrastructure, metal, real estate and construction sectors. However, the pace of fresh addition to non-performing loans (NPAs) will reduce in fiscal 2018 with improvement in credit quality of India Inc driven by firm commodity prices, stable macros, improving capital structures and low interest rates.

Since concerns relating to unrecognised NPAs persist, CRISIL believes the additional disclosures and provisioning will increase transparency and enhance investor confidence in the reported financials of banks.

[1] Weak assets is CRISIL's measure for assessing banks' asset quality. Weak assets = Gross NPAs + 40% of outstanding restructured standard advances (excluding state power utilities) + 75% of security receipts + 15% of loans structured under 5/25 (flexible structuring of long-term project loans).

About CRISIL Limited

CRISIL is a global, agile and innovative analytics company driven by its mission of making markets function better. We are India's foremost provider of ratings, data, research, analytics and solutions. A strong track record of growth, culture of innovation and global footprint sets us apart. We have delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers.

We are majority owned by S&P Global Inc., a leading provider of transparent and independent ratings, benchmarks, analytics and data to the capital and commodity markets worldwide.

About CRISIL Ratings

CRISIL Ratings is part of CRISIL Limited ("CRISIL"). We pioneered the concept of credit rating in India in 1987. CRISIL is registered in India as a credit rating agency with the Securities and Exchange Board of India ("SEBI"). With a tradition of independence, analytical rigour and innovation, CRISIL sets the standards in the credit rating business. We rate the entire range of debt instruments, such as, bank loans, certificates of deposit, commercial paper, non-convertible / convertible / partially convertible bonds and debentures, perpetual bonds, bank hybrid capital instruments, asset-backed and mortgage-backed securities, partial guarantees and other structured debt instruments. We have rated over 24,500 large and mid-scale corporates and financial institutions. CRISIL has also instituted several innovations in India in the rating business, including rating municipal bonds, partially guaranteed instruments and microfinance institutions. We also pioneered a globally unique rating service for Micro, Small and Medium Enterprises (MSMEs) and significantly extended the accessibility to rating services to a wider market. Over 95,000 MSMEs have been rated by us.

CRISIL Limited: CRISIL House, Central Avenue, Hiranandani Business Park, Powai, Mumbai – 400076. India
Phone: + 91 22 3342 3000 | Fax: + 91 22 3342 3001 | www.crisil.com
/company/crisil @CRISILLimited /CRISILLimited /user/CRISILLimited