Report of the

Comptroller and Auditor General of India

on

Recapitalisation of Public Sector Banks

Union Government
Ministry of Finance
Report No. 28 of 2017
(Performance Audit)

Contents

Preface

This Report of the Comptroller and Auditor General of India has been prepared for submission to the President of India under Article 151 of the Constitution of India for being laid before the Parliament.

This report contains the result of the Audit on 'Recapitalisation of Public Sector Banks' and covers the period from 2008-09 to 2016-17.

This report results from the scrutiny of the files and documents pertaining to Recapitalisation of Public Sector Banks in the Department of Financial Services, Ministry of Finance.

Executive Summary

Executive Summary

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. GNPAs 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 GNPAs 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.*

Chapter I
Introduction

1.1 Banking System in India

1.1.1 Banks work within the financial system to provide loans, accept deposits and provide other services to customers. A strong and resilient banking system is the foundation for sustainable economic growth, banks being the centre of the credit intermediation process. Banks provide critical services to consumers, small and medium-sized enterprises, large corporate firms and governments who rely on them to conduct their daily business, both at a domestic and international level. On account of their criticality to the economy, banks are often extensively regulated, regulations being designed to protect public interest.

1.1.2 The banking system in India comprises commercial and cooperative banks with commercial banks accounting for the bulk of banking assets. The commercial banks comprise 21 Public Sector Banks, 26 private sector banks, 43 foreign banks and 56 regional rural banks. There are 1,574 urban cooperative banks and 93,913 rural cooperative banks, in addition to cooperative credit institutions. The commercial banking structure primarily comprises scheduled commercial banks (SCBs), which are included in the second schedule of the Reserve Bank of India Act, 1934. SCBs primarily include the following:

- Public sector banks (PSBs) including State Bank of India and its associates[1] and other nationalised banks
- Private sector banks
- Foreign banks
- Regional Rural Banks

1.2 Significance of Public Sector Banks in Indian Banking System

Public Sector Banks (PSBs) are banks where the majority stake is held by the Government. PSBs constitute the single largest component of the Indian banking system, accounting for over 70 *per cent* of the deposits received in and advances made by SCBs. PSBs have consistently held the bulk of the assets in the Indian banking system as can be seen from table 1.1.

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[1] **SBI had five associates, - State Bank of Mysore, State Bank of Travancore, State Bank of Bikaner and Jaipur, State Bank of Patiala, State Bank of Hyderabad which were merged with it, with effect from 1 April 2017**

Table 1.1: Trends in share of Business of Public Sector Banks in India

(in per cent)

Year	2011-12	2012-13	2013-14	2014-15	2015-16
Share of PSBs in Total Advances of SCBs	76.4	76.1	75.7	74.1	70.8
Share of PSBs in Total Assets of SCBs	72.6	72.6	72.6	72.1	69.9
Share of PSBs in Total Deposits of SCBs	77.5	77.3	77.2	76.3	74.2

(Source: RBI Statistical Tables Relating to Banks in India)

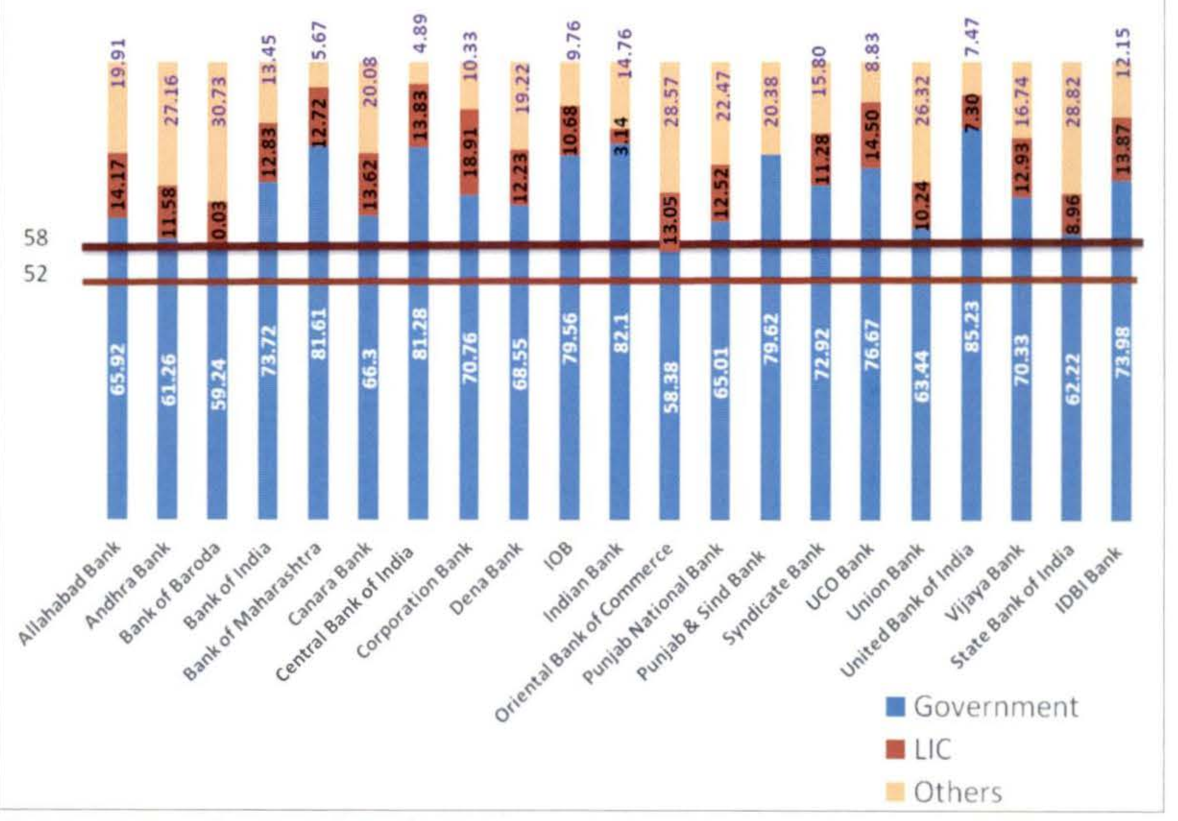
Besides, PSBs, as part of their mandate, extend credit to diverse sectors of the economy including the priority sector comprising the agriculture sector, Medium, Small and Micro Enterprises sector (MSME sector), weaker sections, self-help groups, government sponsored programmes etc. PSBs, thus, are significant not only in the volume of credit extended by them but also in extending credit to all segments of the economy including those that are credit starved.

1.3 Shareholding Pattern in PSBs

1.3.1 The statutory requirement in the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/1980 and State Bank of India Act, 1955, provides that the Central Government shall, at all times, hold not less than 51 *per cent* of the paid up capital consisting of voting equity shares of each PSB. To provide a headroom and enable PSBs to raise capital from the market at a future date without compromising their public character, the Cabinet Committee on Economic Affairs (CCEA) decided (December 2010) to raise the GOI holding in all PSBs to 58 *per cent*. Subsequently, the CCEA decided (December 2014) to allow PSBs to raise capital from public markets through Follow-on Public Offer (FPO) or Qualified Institutional Placement (QIP) by diluting GOI holding up to 52 *per cent* in a phased manner based on their capital requirement, stock performance, liquidity, market appetite and subject to such other conditions that may be prescribed for efficient use of capital and resources, on case to case basis, with specific approval of the Finance Minister for each PSB.

1.3.2 The GOI shareholding in PSBs has, however, been consistently well above these limits (52 or 58 *per cent*). Besides, Life Insurance Corporation (LIC) has significant stakes in different PSBs. The shareholding pattern in the 21 PSBs over 2010-11 to 2016-17 is at **Annexure-I**. The shareholding pattern of the PSBs as on 31 March 2017 is shown in the chart on the next page:

Shareholding in Public Sector Banks in percentage as on 31 March 2017



(Source : BSE and NSE websites)

1.4 Capital Structure of PSBs and Requirement of Additional Capital

1.4.1 The capital structure of a PSB comprises different types of liabilities which are incurred to fund the lending and investment activity of the bank on the asset side of the balance sheet:

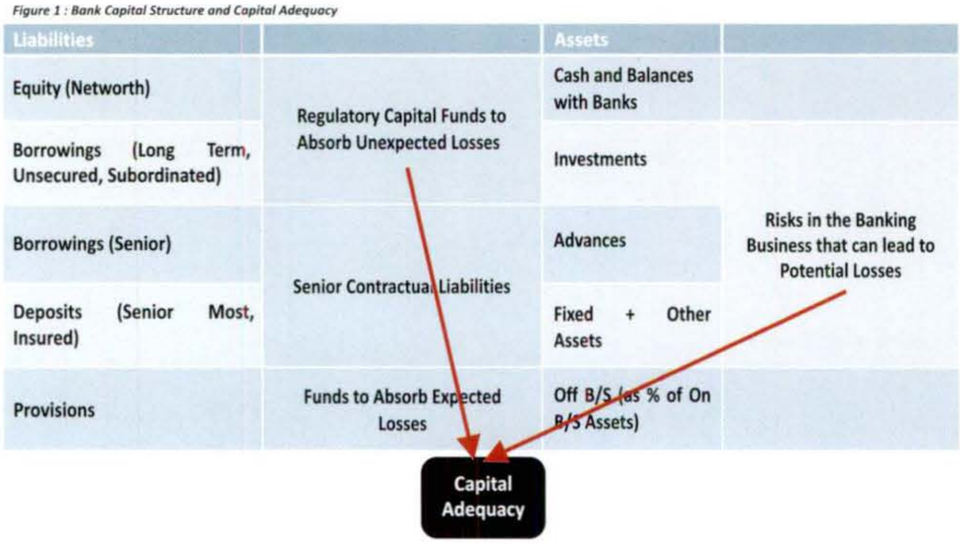
- **Shareholders' funds** include equity capital of the PSB (both common equity and preference shares), accumulated reserves and surplus, retained earnings from previous periods. These are the bank's "own" source of funds for financing investments depicted on the asset side. The amount of equity capital of the bank from an accounting perspective is the net worth, representing the margin by which assets outweigh outside liabilities, that is, the margin by which deposit funds and long term borrowings are covered if the bank were to liquidate its assets. The cost of equity funds is high, the return to the equity shareholder being through dividends and capital appreciation.

- **Borrowings** from the market are made through inter-bank lending, re-purchase agreements, money market borrowings and the issuance of bonds. These managed liabilities are subordinated to deposit funds, more volatile and rate-sensitive and their access is subject to market liquidity and the bank's own credit-worthiness. Borrowings could be secured or un-secured.

- **Deposits** from customers comprise the major funding source for the bank which are the senior most contractual liabilities of the bank, available at the lowest cost.

1.4.2 The bank liabilities are used to finance its investments and advances which constitute its assets. The bank assets are exposed to multiple risks (credit risk on fund-based[2] and non-fund-based[3] credit, market risk on investments and off balance sheet derivatives, liquidity risk in the banking and trading books and operational risks) which may lead to future losses. Poor quality of assets (advances which have poor probability of recovery) may require provisions to be created burdening the balance sheet of the bank. On the other hand, deposits and market borrowings of the bank are contractual liabilities, which if not paid when due, can cause the bank to "fail" (become insolvent). It is in this context, that the bank's own capital (the equity capital and subordinated debt) becomes crucial which can absorb the losses without leading to bank failure. The primary function of bank capital is to support the bank's operations, act as a cushion to absorb unanticipated losses and declines in asset values that could otherwise cause a bank to fail, and provide protection to uninsured depositors and debt holders in the event of liquidation[4]. Capital is thus critical to banks which employ high leverage, or gearing, compared to other businesses. From a regulatory perspective, PSBs should have adequate

Figure 1 : Bank Capital Structure and Capital Adequacy



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[2] **fund based credit - loans and advances**

[3] **Non fund based credit – bank guarantees, letters of credit etc.**

[4] **Functions of bank's capital as per the US Federal Reserve**

capital funds to absorb large losses, so that depositor funds are not adversely impacted. The higher the quantum of bank capital, the higher the degree of protection to depositor's funds. Thus, banking regulations therefore require banks to meet stringent minimum capital requirements so as to maintain bank solvency, safety and soundness of the banking system.

1.5 Some Drivers for Additional Capitalisation of PSBs

PSBs, being the largest segment in the Indian banking system, need to be infused with capital to drive higher credit capacity while meeting the prudential regulatory requirements. The regulatory requirements of capital adequacy and credit growth needs of the economy are two of the significant drivers for additional capitalisation of PSBs, keeping in view the business plans of the PSBs and their risk tolerance.

1.5.1 Capital Adequacy Requirements

1.5.1.1 Regulatory framework for banks is globally framed by the Basel Committee on Banking Supervision (BCBS) which is a committee of bank supervisors consisting of members from representative[5] countries. The Basel Committee is the primary global standard setter for the prudential regulation of banks and provides a forum for cooperation on banking supervisory matters. Its mandate is to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability. The RBI follows the Basel norms, though the RBI norms are often more stringent than the Basel norms.

1.5.1.2 So far, three sets of Basel norms have been issued. The BCBS issued Basel I norms in 1988 to provide, for the first time, a global standard on the regulatory capital requirements for banks. This was imposed through a minimum Capital Adequacy Ratio (CAR), expressed as the ratio of regulatory capital funds to risk-weighted assets (RWA), which internationally active banks would be required to maintain. The CAR is also called Capital to Risk-Weighted Assets Ratio (CRAR).

$$CAR = \frac{\textit{Regulatory Capital Funds}}{\textit{Risk Weighted Assets (RWA)}}$$

Subsequently, Basel II norms were introduced in 2004 which further strengthened the guidelines for capital adequacy, risk management and disclosure requirements. The norms were further revised to Basel III norms in 2010.

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[5] **Representative – the number of countries represented in BCBS has changed over time. During the formulation of Basel I and II, RBI was not part of BCBS. However, RBI was represented in BCBS during the design of Basel III as part of the G-20 countries**

1.5.1.3 The regulatory capital funds of banks as defined under the Basel norms include Tier I and Tier II capital.

- **Tier I capital** consists mainly of share capital and disclosed reserves (minus goodwill, if any). It is deemed to be of the highest quality because it is fully available to cover losses. Hence, it is also termed as core capital.
- **Tier II capital**, also known as supplementary capital, consists of certain reserves and specific types of subordinated debt. Tier II items qualify as regulatory capital to the extent that they can be used to absorb losses arising from a bank's activities. Tier II's capital loss absorption capacity is lower than that of Tier I capital.

Tier I Capital (going-concern capital)
(a) Common Equity Tier I
(i) Paid-up equity capital
(ii) share premium resulting from the issue of equity capital;
(iii) Statutory reserves;
(iv) Capital reserves i.e. surplus arising out of sale proceeds of assets;
(v) Other disclosed free reserves, if any;
(vi) Balance in Profit & Loss Account at the end of the previous financial year;
(b) Additional Tier I
(i) Perpetual Non-Cumulative Preference Shares and share premium on this
(ii) Perpetual Debt Instruments that may be issued as bonds or debentures,
(iii) Any other type of instrument generally notified by the RBI
Tier II Capital (gone-concern capital)
(i) General Provisions and Loss Reserves
(ii) Debt Capital Instruments issued by the banks
(iii) Preference Share Capital and share premium thereon, if any
(iv) Revaluation reserves at a discount of 55 *per cent*
(v) Any other type of instrument generally notified by the RBI

1.5.1.4 Bank assets carry a degree of risk with them. This includes credit risk[6], market risk[7] as well as operational risk. Based on the riskiness of the asset, a specific risk weight is assigned to it and the asset value is adjusted as per the risk weight; more risky the asset, higher the risk weightage and lower its asset value. In India, RBI prescribes risk weights for different assets. Risk weight for different assets vary e.g. 0 *per cent* on a Government Dated Security and 20 *per cent* on a AAA rated foreign bank etc. The notional amount of the asset is multiplied by the risk weight assigned to the asset to arrive at the risk weighted asset.

CET-I ratio is the ratio between common equity tier I capital and risk weighted assets.
CRAR includes all tier I capital and hence CET-I is more restrictive than CRAR

1.5.1.5 Based on the regulatory capital and risk weighted assets, the CRAR of a bank is worked out. The guidelines for CRAR under the Basel regime have evolved over time in terms of quantum of capital, definition of regulatory capital funds, risk coverage and risk weight estimation methodologies. This evolution has been triggered by various lessons learnt by global supervisory authorities from the financial crises that have occurred in the course of time. The

[6] **Credit risk : the risk that a party to a contractual agreement or transaction will be unable to meet its obligations or will default on commitments**
[7] **Market risk : the risk of loss arising from movements in market prices or rates away from the rates or prices set out in a transaction or agreement**

evolution of Basel III norms was a fallout of the global financial crisis of 2007-08. Basel III is a comprehensive set of reform measures, developed by BCBS, to strengthen the regulation, supervision and risk management of the banking sector. These measures aim to (i) improve the banking sector's ability to absorb shocks arising from financial and economic stress (ii) improve risk management and governance (iii)strengthen banks' transparency and disclosures. The reforms target bank-level regulation, which will help raise the resilience of individual banking institutions to periods of stress and macro-prudential, system wide risks that can build up across the banking sector as well as the pro-cyclical amplification of these risks over time. In fact, Basel III has separately emphasized on the adequacy of Common Equity Tier I (CET1) ratio, over and above Tier I capital ratio and CRAR.

1.5.1.6 The evolution of the Basel capital adequacy norms are summarized in the table below:

Table 1.2: Evolution of the Basel Capital Accord

	Basel I	Basel II	Basel III
Application (BCBS)	1988	2004	2010
Regulatory Capital – Definition	**Tier I**: Common Equity, Reserves and Surplus, Retained Earnings **Tier II**: Subordinated Debt	**Tier I**: Core Capital– Common Equity, Reserves and Surplus, Retained Earnings **Lower Tier I**: Preference Shares (PNCPS), Innovative Perpetual Debt Instruments (IPDI) **Tier II:** Upper Tier II Bonds, Preference Shares, Subordinated Debt	**Going Concern Capital** • **CETI**: Common Equity, Reserves and Surplus, Retained Earnings • **AT1**: Preference Shares (PNCPS) and Perpetual Debt Instruments (PDI) with loss absorption and PONV triggers[8] **Gone Concern Capital** Long dated subordinated Bonds and Preference shares with PONV triggers

[8] **PONV trigger – Point of Non Viability trigger. This is a condition imposed by Reserve Bank of India under Basel III under which if RBI identifies a Bank as non-viable, the non-equity bonds of the bank will have to be written down.**

RWA Coverage	Credit Risk Weighted Assets for on and off balance sheet positions	Credit, Market and Operational Risk Weighted Assets for on and off balance sheet positions	Credit, Market and Operational Risk Weighted Assets for on and off balance sheet positions, greater risk coverage
RWA Methodology	Standardized, ***not risk sensitive***	Standardized and Advanced Model Based Methodologies, ***more risk sensitive***	Standardized and Advanced Model Based Methodologies, ***more risk sensitive***
Minimum CRAR (BCBS)	eight *per cent*	eight *per cent*	8 *per cent* plus 2.5 *per cent* Capital Conservation Buffer

[Source: Master Circular – Basel III Capital Regulations (July 2015), RBI and Master Circular – Prudential Guidelines on Capital Adequacy and Market Discipline – New Capital Adequacy Framework (NCAF), RBI (July 2015)]

The Basel II norms were based on three pillars, - minimum capital requirement, supervisory review and market discipline which were further strengthened in Basel III norms.

- **Pillar II- Supervisory review**: Basel II norms provided for stress tests for CRAR and additional internal capital buffers for risks not captured in the minimum capital requirements. These have been also emphasized in Basel III norms.
- **Pillar III- Market discipline**: Basel II norms provided for market discipline through more rigorous disclosures by banks. Basel III norms added reconciliation requirement of regulatory disclosures with accounting data of bank and disclosure of leverage ratio (the ratio of Tier-I capital to bank's average total consolidated assets; i.e. sum of the exposures of all assets and non-balance sheet items without risk weights and credit conversion).

1.5.1.7 The application of Basel norms to the Indian banking sector is determined by the regulator, RBI. There has been a gap in adoption of the Basel norms; - Basel I norms (1988) were adopted in 1996, Basel II norms (2004) were adopted in 2008 and the transition to Basel III norms (2010) commenced in September 2013 and is expected to be complete by 31 March 2019. The RBI norms have, however, been more stringent than the Basel norms. As against the Basel norms of minimum CRAR of eight *per cent*, RBI prescribed a CRAR of nine *per cent* for Indian banks. At present, the minimum CRAR prescribed by RBI is 9 *per cent* plus 2.5 *per cent* Capital Conservation Buffer (CCB).

1.5.1.8 To implement the Basel III norms in India, RBI has prescribed the following schedule of transitional arrangements to achieve minimum capital adequacy by FY 19 (Table 1.3):

Table 1.3: Transition Schedule for Basel III Implementation in India

	Percentage of Risk Weighted Assets (as on 31 March)					
	2013-14	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**
Minimum Common Equity Tier I (CET I)	5	5.50	5.50	5.50	5.50	5.50
Additional Tier I (AT I)	1.50	1.50	1.50	1.50	1.50	1.50
Minimum Tier I (CET I + AT I)	6.50	7	7	7	7	7
Capital Conservation buffer	0	0	0.63	1.25	1.88	2.50
Minimum Tier 1 + CCB	6.50	7	7.63	8.25	8.88	9.50
Minimum CET (including CCB)	5	5.50	6.13	6.75	7.38	8
Tier 2	2.50	2	2	2	2	2
Minimum Total Capital*	9	9	9	9	9	9
Minimum Total Capital + CCB	9	9	9.63	10.25	10.88	11.50
Phase in of all deduction from CET 1#	40	60	80	100	100	100

* The difference between the minimum total capital requirement of 9 *per cent* and the Tier I requirement can be met with Tier II and higher forms of capital.

The same transitional approach will apply to deduction from Additional Tier I and Tier II capital.

(Source: *Note for the CCEA dated 24 November 2014, approved on 10 December 2014*)

1.5.1.9 The implementation of Basel III norms has been coincident with subdued economic growth in Indian markets as shown in the table below:

Table 1.4: Indian Economic Growth

Financial Year	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17 (PE)**
GDP Growth Rate (*per cent*) at constant prices (2011-12 series)	5.5	6.4	7.5	8.0	7.1

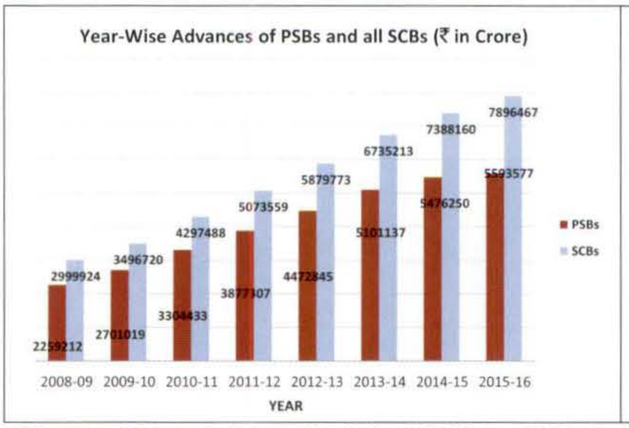
(Source: Ministry of Statistics and Programme Implementation, GOI)

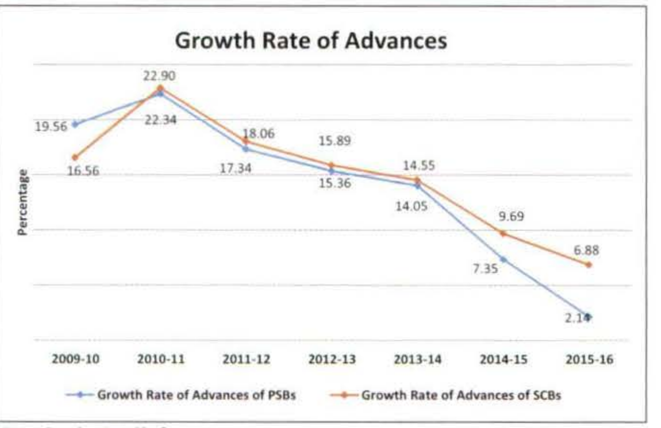
The implementation of Basel III norms has also been coincident with increasing NPA related losses for Indian banks, leading to higher provisions and write-offs and lower recovery rates leading to faster erosion of banks' available capital.

1.5.2 Credit Growth

As economies grow, requirements of credit multiply. Depending on the pace of economic growth coupled with the business expansion plans of the banks, fresh capital infusion is necessary so that the bank maintains adequate capital to meet the prudential regulatory norms.

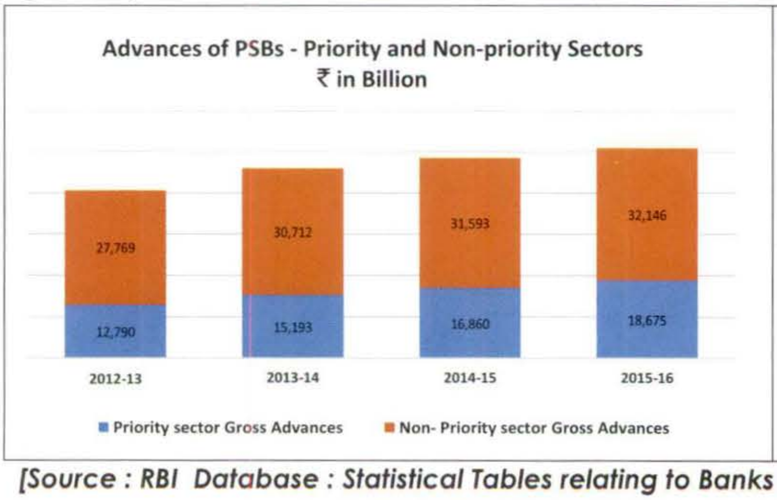
Over the period of study (2008-16), the advances of public sector banks have more than doubled, from ₹ 22,59,212 crore to ₹ 55,93,577 crore, though the rate of increase in advances has tapered in recent years (rate of increase in 2015-16 being 2.14 *per cent* as against 19.56 *per cent* in 2009-10). The year-wise quantum of advances by all PSBs vs all SCBs and the growth rate in advances is summarized in the charts below:





(Source: *RBI Database : Statistical Tables relating to Banks in India*)

As can be seen from the charts above, PSBs have been responsible for the bulk of credit in the economy. The bank-wise position of advances is at **Annexure – II**. The advances provided by PSBs is segregated into priority and non-priority sector advances. Over 2012-16, the priority sector advances have been in the range of 31.96 *per cent* to 35.72 *per cent* of total advances. The composition of advances given by PSBs over 2012-2016 is indicated in the chart below.



Priority sector mainly includes:

(i)agriculture

(ii)micro, small and medium enterprises

(iii)export credit

(iv)education

(v)housing

(vi)social infrastructure

(vii)renewable energy

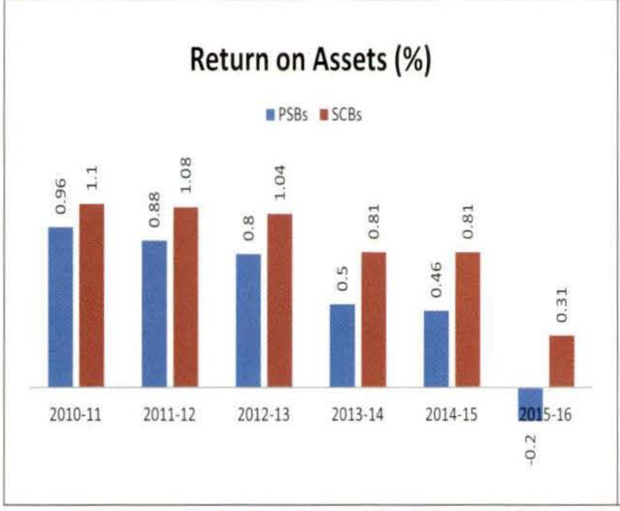
[Source : RBI Database : Statistical Tables relating to Banks in India: Domestic Operations]

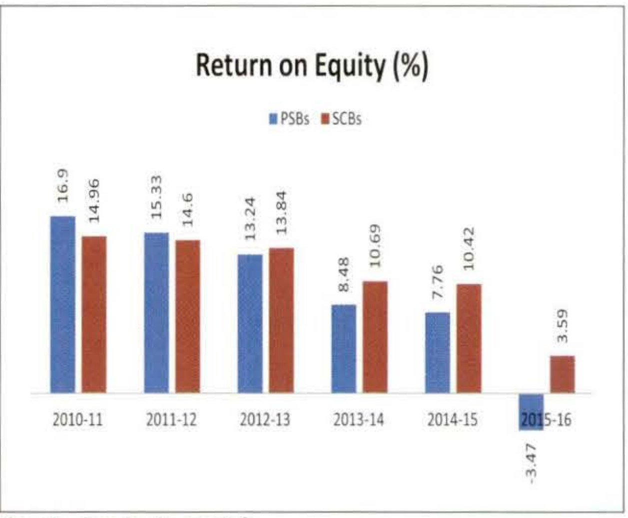
1.5.3 Operational Performance of PSBs and Their Effect on Capital Requirements

1.5.3.1 Bank performance is principally reflected in the return on assets (ROA) and return on equity (ROE).

- ROA indicates how profitable a bank is, relative to its total assets. ROA measures the efficiency of utilizing the bank assets to generate profit. It is worked out by dividing net income by average total assets. A higher ROA indicates a better managed bank. Besides the profit adding to capital, it also improves the bank's ability to access the markets for additional funds.
- ROE reflects the bank efficiency to utilize its shareholder's funds. A higher return on equity would also add to the capital of the bank through reserves and surpluses. A higher ratio indicates better management of shareholder capital. Low or negative ROE reduces the ability of the bank in tapping capital markets to raise additional funds to meet its regulatory capital needs.

1.5.3.2 The ROA and ROE of PSBs along with all SCBs, over 2010-11 to 2015-16 are shown in the graphs below.





(Source : RBI Database : Statistical Tables relating to Banks in India)

As can be seen from the graphs, the ROA of PSBs has been consistently lower compared to all SCBs, while ROE of PSBs has been lower since 2012-13. In 2015-16, the ROA and ROE for PSBs has been negative, indicating a loss to the banks. In comparison, however, the overall results for all SCBs have been positive indicating the gap in performance of PSBs vis-à-vis private sector and foreign banks.

1.5.3.3 The asset quality of the bank is also a significant indicator of the bank's performance. Worsening asset quality of the bank (greater

> Non performing assets (NPA) of banks are assets (including leased asset) which have ceased to generate income for the bank.

defaults, lower ratings of borrowers etc.) will lead to faster erosion of available capital due to provisions and write-offs as well as higher risk weighted assets. A bank with poor asset quality will need to raise higher incremental capital to maintain the regulatory requirement of capital adequacy. The status of non-performing assets of SCBs in general and PSBs in particular is indicated at table 1.5 below.

Table 1.5: Gross NPAs of Indian Banks by Banking Group

(₹in crore)

Gross NPA of SCBs	2011-12	2012-13	2013-14	2014-15	2015-16
SBI and Associates	48,214	62,779	79,817	73,509	121,969
Other Nationalised Banks	69,048	101,683	147,447	204,960	417,988
Private Banks	18,768	21,071	24,542	34,106	56,186
Foreign Banks	6,297	7,977	11,565	10,761	15,805
Total Gross NPA	**142,327**	**193,510**	**263,371**	**323,336**	**611,948**
Share of PSBs (*per cent*) in Total Gross NPAs	**82**	**85**	**86**	**86**	**88**

(Source: RBI Database : Statistical Tables Relating to Banks in India)

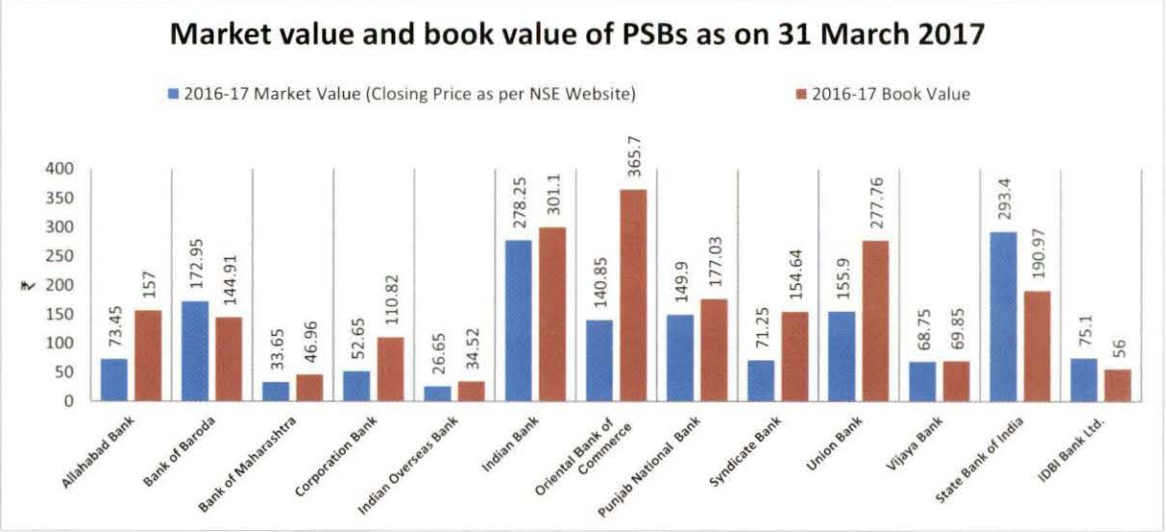
As can be seen from the table above, PSBs account for the largest share of NPAs in the banking sector which have consistently been on the rise over the past five years. The outcome of the rapidly deteriorating asset quality of PSBs on the banks' earnings is two-fold. First, with increasing NPA levels, the interest income of the bank is adversely affected since NPA accounts may not be servicing interest. Second, banks have to maintain higher provisions (from their reduced earnings), hence their net profits would be adversely affected, and could even turn negative, leading to faster erosion of banks' available capital.

1.6 Possible Modes to Recapitalise PSBs

1.6.1 The more than two-fold increase in advances extended by PSBs during 2008-09 and 2015-16, coupled with the stringent capital adequacy requirements imposed by RBI in the wake of the Basel III norms and the poor performance of the PSBs have led to significant capital requirements. The recapitalisation needs of PSBs could be met either through capital infusion by the shareholders (primarily GOI) or the PSBs could obtain the required funds from the market.

1.6.2 The primary responsibility of recapitalisation of PSBs often devolves on the Government, being the majority shareholder in these banks. Government may also infuse capital to address the broader objectives of distributional growth and equity in PSB operations. Besides, to ensure that the PSB character of the bank remains unaltered, dilution of Government stake below a fixed benchmark (58 *per cent* later lowered to 52 *per cent* in December 2014) may not be possible. However, as seen from chart in paragraph 1.3.2, the PSBs, at present have a high shareholding of GOI, well beyond the mandated benchmark of 52 *per cent.*

1.6.3 A reason why PSBs may not be able to access funds from the market is their underperformance, particularly in cases where recapitalisation is necessary, to offset losses and erosion of capital arising from high NPAs. A comparison of market value and book value of PSB shares as on 31 March 2017 is indicated in the chart below (for 13 PSBs where information was available as on 25 May 2017).



(Source : Annual Reports of PSBs, PSB websites and NSE website)

There is a significant gap between book value and market value of PSB shares, with most PSBs having a lower market value compared to their book values. The poor market valuations of PSB shares would hinder the bank from approaching the market for additional capital funds. Besides, the lower share values would imply that the quantum of funds that could be raised from the market would be low and may not meet the requirements of recapitalisation of the PSBs while eroding the Government stake in them.

1.6.4 Over the period 2008-09 to 2016-17, GOI has been infusing need based capital in the PSBs so that they maintain Tier-I capital adequacy while meeting the credit growth expectations. The capital infusion has generally been through preferential allotment of equity shares by the recipient bank to GOI. PSBs can also raise capital from domestic markets through Follow-on Public Offer (FPO), Rights Issue, Qualified Institution Placement (QIP), Exchange Traded Funds and preferential allotment to Investors (for example, to LIC, GIC and other private investors). A High Level Committee (HLC) on capital requirement of financial institutions was constituted[9] (September 2011) to assess possible options for raising resources to capitalise PSBs. The Committee had, inter-alia recommended creation of a holding company for PSBs which could then raise necessary extra budgetary resources (EBR).

[9] **Composition: Finance Secretary as Chairman, with Secretary Department of Expenditure, Secretary, Department of Economic Affairs, Secretary, Department of Financial Services and Chief Economic Advisor as members.**

1.7 Recapitalisation of PSBs during 2008-09 to 2016-17

Given their large share in the overall banking sector, the stability and solvency of Indian PSBs, is of paramount importance. In order to build up the capital adequacy of the PSBs, the Government of India, as the majority shareholder, infused ₹1,18,724 crore from 2008-09 to 2016-17 in PSBs.

The table below indicates the Budget Estimates (BE), Revised Estimates (RE) and the Actual Outgo on account of re-capitalisation of Public Sector Banks.

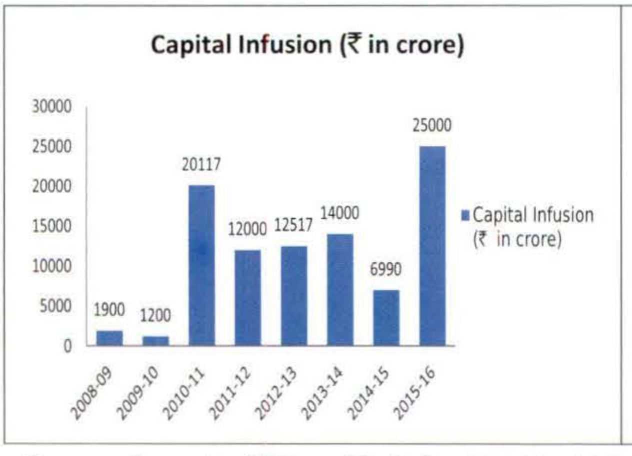
Table 1.6: Recapitalisation of PSBs- BE, RE and Actuals

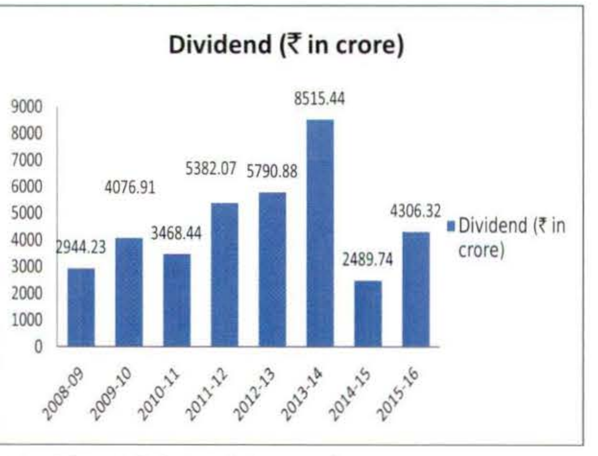
(₹in crore)

Financial Year	Budget Estimates	Revised Estimates	Actual Outgo
2008-09	N.A.	N.A.	1900
2009-10	N.A.	1200	1200
2010-11	16500	20157	20117
2011-12	6000	12000	12000
2012-13	14588	12517	12517
2013-14	14000	14000	14000
2014-15	11200	6990	6990
2015-16	7940	25000	25000
2016-17	25000	25000	25000
Total	**-**	**-**	**118724**

[Source : Detailed Demands for Grants (2009-10 to 2016-17 and records of DFS)]

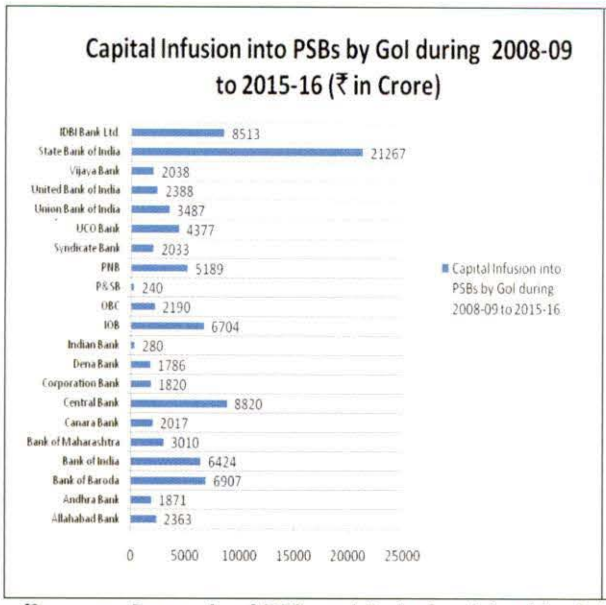
Over the period 2008-09 to 2016-17, GOI has infused capital of ₹1,18,724 crore in PSBs. The charts below show bank-wise capital infusion by GOI in PSBs vis-à-vis dividend paid by the PSBs to GOI over the period 2008-09 to 2015-16.

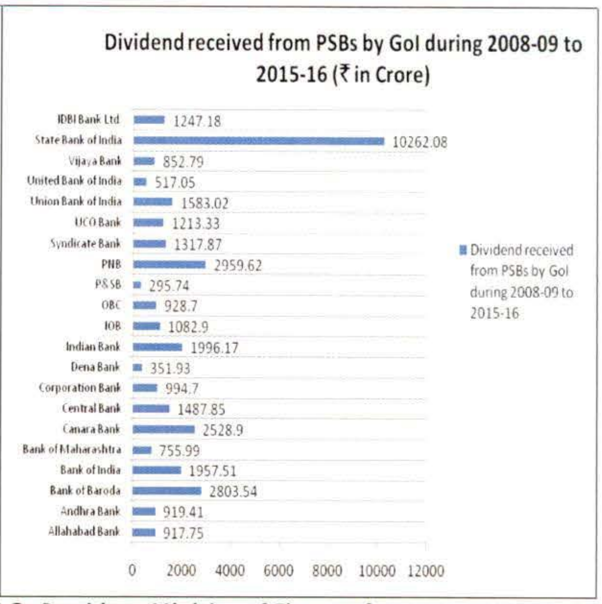




(Source : Records of DFS and Data furnished by PAO, Banking, Ministry of Finance)

The bank-wise position of dividends paid out to and capital infusions received from GOI is indicated in the charts on the next page:





(Source : Records of DFS and Data furnished by PAO, Banking, Ministry of Finance)

1.8 Recent Developments

1.8.1 A High Level Committee (HLC) on capital requirement of financial institutions was constituted (September 2011) under chairmanship of the Finance Secretary. The mandate of HLC included assessment of :

- the need of various financial institutions including banks under DFS for next 10 years
- various possible options to raise resources to capitalise these financial institutions
- Global Experience of various Governments and in particular in developing countries to meet such capitalisation requirements and
- suggested preferred mode for capitalisation.

The HLC recommended creation of a Holding Company, to which all equity holding by GOI would be transferred and which would also be given some budgetary support each year, so that it could raise through domestic and international market and then capitalise the PSBs. Subsequently, it was decided by DFS not to act further on the proposal to create a financial holding company (September 2016).

1.8.2 A Committee under the chairmanship of Sh P. J. Nayak was constituted by RBI in January 2014 to review governance of boards of banks in India. The committee gave its report in May 2014 and recommended, *inter alia,* that :

- the Government should set up a Bank Investment Company (BIC) to hold equity stakes in PSBs, with transfer of GOI holding to the BIC needing to be implemented in Phases – I, II and III
- the selection of the top management of public sector banks during Phase 1 be entrusted to a newly constituted Bank Boards Bureau (BBB)
- a minimum five-year tenure for bank Chairmen and a minimum three year tenure for Executive Directors.

Thereafter, a conclave of PSBs and Financial Institutions, 'Gyan Sangam' was organized in January 2015. The discussions culminated in a reform agenda which included adoption of Nayak Committee report, establishment of BBB comprising professionals and eminent bankers, empowerment of bank boards, establishment of Bank Investment Committee and strengthening legal framework for recovery from wilful defaulters. In March 2016, in line with the recommendations of the P J Nayak Committee and Gyan Sangam, the Banks Board Bureau was established by GOI for evolving a sound managerial policy for PSBs. One of the designated responsibilities of the Bank Board Bureau was to help PSBs in developing business strategies and capital raising plan.

Chapter II
Audit Methodology

2.1 Audit Objectives

The audit was taken up with the following objectives:

i. To assess whether objective parameters were adopted for recapitalisation of PSBs and to check consistency of their application across all PSBs;

ii. To assess whether the release of capital funds was monitored and check whether conditions attached to recapitalisation were complied with and objectives of recapitalisation were achieved.

2.2 Audit Criteria

The sources of audit criteria are the following:

- Approvals by the Cabinet Committee on Economic Affairs / Policy Announcements
- Circulars/Directives issued by DFS
- Circulars / Guidelines issued by RBI
- Memoranda of Understanding (MoU) between DFS and PSBs
- Statement of Intent (SOI) parameters as finalised between DFS and PSBs
- Sanction letters for release of funds to PSBs
- Minutes of Quarterly Review meetings chaired by Finance Minister / Secretary, Department of Financial Services (DFS)
- Reports of Parliamentary Standing Committee on Finance on 'NPA of financial institutions'

2.3 Audit Scope and Scope Limitation

2.3.1 Audit focused on recapitalisation of PSBs by Government through DFS during 2008-09 to 2016-17. For this purpose, Audit examined the records available in DFS. DFS had advised Audit that it might not be advisable to seek the internal records of individual banks due to the legalities involved. Audit had requisitioned some bank documents, namely Internal Capital Adequacy Assessment Process

(ICAAP[10]) reports and the Annual Financial Inspection (AFI[11]) reports. DFS could not make available these documents and clarified that they did not access the records of PSBs as the commercial decisions of banks 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.

2.3.2 Audit engaged National Institute of Bank Management (NIBM), Pune as a consultant to assist the audit exercise.

2.4 Audit Process

The audit commenced with an Entry Conference on 31 October 2016. Audit relied on review of reports and documents in DFS for the audit. After completion of the audit, the draft audit report was issued to DFS on 17 May 2017. The reply of DFS was received on 9 June 2017 and has been suitably incorporated. An exit conference was held on 14 June 2017.

2.5 Acknowledgements

Audit wishes to acknowledge the co-operation received from the Ministry of Finance, Department of Financial Services during the audit process. Audit is thankful to the Reserve Bank of India, for furnishing essential bank-wise data. Audit would like to place on record its appreciation for the assistance extended by National Institute of Bank Management.

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[10] ICAAP: In terms of the guidelines on Basel II, the banks are required to have a board-approved policy on internal capital adequacy assessment process (ICAAP). ICAAP clearly demarcates the quantifiable and qualitatively assessed risks and includes stress tests and scenario analyses, to be conducted periodically, particularly in respect of the bank's material risk exposures, in order to evaluate the potential vulnerability of the bank to some unlikely but plausible events or movements in the market conditions that could have an adverse impact on the bank's capital.

[11] AFI : AFI evaluates performance of banks on the following parameters:

(i) Banks' financial condition and performance highlighting Asset Quality, Solvency and Capital Adequacy, Earnings Performance and Liquidity
(ii) Management and operating conditions focusing on Management (board and senior management), Systems and Internal controls, including risk management strategies;
(iii) Compliance with Regulations including integrity of reporting and compliance to guidelines.

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.

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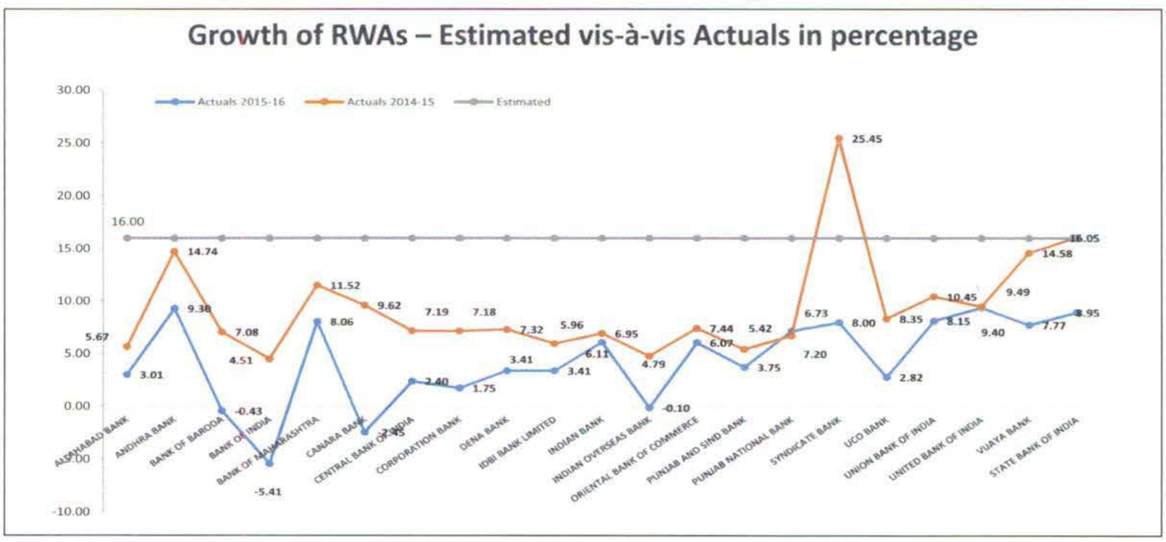
[13] **Cabinet Committee on Economic Affairs (CCEA) approvals to recapitalisation proposals in February/March 2009, April 2010, December 2010, January 2013 and December 2014**

- Capital adequacy – 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
- Credit requirement of the economy
- Maintaining GOI stake in PSBs 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 bases. While the actual Tier I CRAR as on 31 March 2010 was considered in the

[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**

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.

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

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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.

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.
- 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

[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**

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.

Chapter IV
Monitoring Capital Infusion in PSBs

Significant capital has been infused in the PSBs in the past decade by DFS (amounting to ₹ 1,18,724 crore over 2008-17). Audit reviewed the mechanisms available to DFS for monitoring the effect of capital infusion in PSBs over the same period. It was noticed that DFS communicated targets to PSBs essentially through Statements of Intent (SOI) and Memorandum of Understanding (MoU). Audit reviewed these documents (to the extent they were made available to Audit[20]) and the processes in DFS for monitoring capital infusion in PSBs.

4.1 Statement of Intent

The mechanism of SOI on Annual Goals to monitor the performance of PSBs, was introduced on the directions (June 2005) of the Ministry of Finance. A set of performance parameters were defined and targets were set for the PSBs against these parameters. SOI parameters have been revisited and redrafted from time to time, with amendments on 23 April 2010, 21 October 2011 and 20 May 2012. Post the amendment of May 2012, there were 44 SOI parameters which were to be monitored by DFS. Besides being a tool for monitoring performance of PSBs, the SOIs are also used to incentivize their top management when the SOI targets are achieved.

4.1.1 Mismatch of SOI targets vis-à-vis targets set for sanction of additional capital

Audit noticed that in one year (2010-11) out of the nine years (2008-17) reviewed, conditions were stipulated in the sanctions that were issued for infusion of capital in PSBs. No such conditions were on record for the other years. Based on the documents made available, Audit noticed that the targets stipulated against specific parameters at the time of sanction of capital in 2010-11 were significantly different from the targets set for the same parameters in the SOI for the same period in case of five PSBs. The mis-match in the two sets of targets and the actual achievements in these PSBs is tabulated on the next page:

[20] **SOI documents for 2011-12, 2012-13, 2013-14 and 2014-15 were made available to Audit. MoUs signed in February/ March 2012 were also provided**

Table 4.1: Mis-match in the Two Sets of Targets and the Actual Achievements in These PSBs

Parameter	2010-11			2011-12			2012-13		
	Target along with Sanction (*per cent*)	SOI Target (*per cent*)	Achievement (*per cent*)	Target along with Sanction (*per cent*)	SOI Target (*per cent*)	Achievement (*per cent*)	Target along with Sanction (*per cent*)	SOI Target (*per cent*)	Achievement (*per cent*)
Bank of Maharashtra									
ROA	0.80	0.70	0.47	1.00	0.55	0.55		0.70	0.74
Direct Agri. Adv	11	10.50	9.93	12.5	10.27	10.43	13.50	11.00	11.22
Adv. To Weaker Sections	7.50	7.00	6.49	9.00	6.72	6.72	10.00	8.00	8.31
Gross NPA (*per cent*)	2.40	2.60	2.47	2.00	2.36	2.28		2.48	1.49
Net NPA (*per cent*)	1.30	1.50	1.32	1.00	1.30	0.84		1.22	0.52
Net Profit (₹ in crore)	Min growth of 20 *per cent* p.a	485	330		400	430.83		650	759.52
Cost Income Ratio	Improve 200 bps p.a till 40 *per cent*	56	65.79		59	52.02		52	45.54
UCO Bank									
CASA Deposits	Improve 5 *per cent* p.a till 30 *per cent*	N.A	23.20		30	23.85		24.50	34.96
Net NPA(*per cent*)	1.00	0.80	1.84		1.6	1.96		1.69	3.17
ROA	1.00	0.85	0.66		0.74	0.69		0.75	0.33
Cost Income Ratio	Reduce 2 *per cent* p.a till 40 *per cent*	46	43.51		43	42.24		41.00	39.33
Union Bank of India									
Adv. To Weaker Sections	10	10	10.12		10	6.59		7.46	9.18
Gross NPA (*per cent*)	Below 2	2.4	2.37		2.65	3.01		2.95	2.98
Cost to Income ratio	40	43	47.85		47	43.15		44	44.70

IDBI Bank									
CASA Deposits	Improve 5 *per cent* p.a till 30 *per cent*		21		24	24.10		27.50	25.12
Priority Sector Adv.	40	40	30.44		33	31.51		37	22.30
Direct Agri. Adv.	13.5	13.55	5.70		9.00	4.99		10	2.80
Adv. To weaker sections	Improve 2 *per cent* p.a till 10 *per cent*	10.01	2.64		4	3.26		4	3.12
ROA	Improve min by 0.20 *per cent* p.a till 1 *per cent*	0.70	0.73		0.80	0.81		0.9	0.69
Central Bank of India									
ROA	0.8	0.8	0.70	1	0.55	0.26		0.55	0.44
Gross NPA (*per cent*)	Below 2	2	1.82		3.34	4.83		3.70	4.80
Cost Income Ratio	Reduce 2 *per cent* p.a till 40 *per cent*	49	60.68		54.64	57.11		53	57.16

(Source : Records of DFS)

The table indicates that the SOI targets were less stringent than the targets associated with the sanction orders. The table also indicates that the actual achievements were poor compared to the SOI targets. Thus, even the targets set in the sanction orders for 2010-11 were not actually achieved.

Audit did not find evidence that incorporation of the conditions set in the sanction orders was actually monitored by DFS. SOI, however, is reviewed regularly by the banks themselves as well as by DFS and as such, the SOI targets ought to have been set in line with the targets associated with infusion of additional capital.

In its reply (April 2017) DFS did not provide any justification for the mismatch between conditions in the sanctions and SOI targets.

4.2 Memorandum of Understanding

In February/ March 2012, DFS introduced the mechanism of Memorandum of Understanding (MoU) with PSBs to ensure that they lay down a firm plan for long term business development and performance enhancement and relate the same to their capital requirement. The MoU, signed by the PSB and DFS, consists of a set of agreed targets that the PSB is expected to achieve which would form the basis for future capital infusion by GOI. The objective of the MoU was to achieve optimum utilization of scarce capital funds, with PSBs focusing on improving their efficiency simultaneously with the infusion of capital.

Audit noticed infirmities in preparation, finalisation and monitoring of MoUs. It was also noticed that MoUs had not been the basis for GOI capital infusion in PSBs during 2011-17.

4.2.1 Targets set for PSBs and efficiency

Audit noticed that the targets set against some of these parameters were decreasing, year-on-year, indicating that a lower efficiency was being targeted, as tabulated *below* :

Table 4.2: Targets Set for PSBs and Efficiency

Parameter	Targets vis-à-vis Achievements
CASA	For State Bank of India, the actual CASA was 48.66 *per cent* in 2010-11, whereas the year-wise target was set at a lower 45 *per cent* for all the years from 2011-12 to 2014-15. For United Bank of India, the CASA targets reduced progressively each year from 39 *per cent* in 2011-12 to 37 *per cent* in 2014-15
Cost to Income Ratio	For IDBI Bank Ltd, while the actual Cost to Income Ratio for 2010-11 was 35.15 *per cent*, the target for 2011-12 was pegged at 39.4 *per cent* indicating that the target set for future was lower than the current achievement. The targeted Cost to Income ratio was set at progressively higher rates in case of PNB over 2011-12 to 2014-15.

(Source : Records of DFS)

In its reply (April 2017) DFS did not comment on the reasons for setting lower targets for successive years.

4.2.2 No specific targets set for some parameters in the MoU

For certain PSBs (e.g., Andhra Bank and Allahabad Bank), specific targets were set for all components of RBI ratings. In case of other PSBs (e.g, Bank of Maharashtra, Bank of Baroda, Bank of India and Indian Bank) the targets were non-specific; - "shall improve upon existing rating on all parameters, particularly on Asset Quality, Management, Systems and Control".

4.2.3 Delay in fixing MoU targets

The MoUs were to be finalised by 30 November, 2011 as per directions of DFS. However, the MoUs were signed in February / March 2012, indicating a delay of nearly three months from the stipulated date. Further, the signed MoUs included targets to be achieved by 31 March, 2012. With MoUs signed as late as March 2012, the status of achievement on targets for 2011-12 were a foregone conclusion. In fact, the MoUs between SBI and its Associate Banks (State Bank of Bikaner & Jaipur, State Bank of Travancore, State Bank of Mysore, State Bank of Hyderabad and State Bank of Patiala) including targets for 2011-12, were signed in the 1st week of April 2012.

DFS replied (June 2017) that DFS had started discussions with the Banks immediately after the draft MoUs were sent to them and the numbers were indicated to them, so while signing might have been delayed the targets were known to them.

The reply of DFS has to be considered in light of the fact that only draft MoUs were circulated to all PSBs in October 2011, which were significantly different from the actual MoUs that were signed (February / March 2012).

4.2.4 Validity of MoU and targets fixed

The MoUs were to be valid for a period of five years. Audit observed that, with the exception of Central Bank (for which targets were fixed from 2012-13 to 2016-17), for all other PSBs, the signed MoUs contained targets to be achieved only till 31 March 2015. This indicated that targets were not fixed for the full period of MoU validity.

DFS replied (June 2017) that DFS entered into MoUs initially for period of three years and the targets were given till 2015, adding that all these targets were parts of the final targets and laid a roadmap towards achievement of the final or ultimate targets by 2017. DFS also replied that the targets given to the Banks to be achieved by 2015 were interim targets preparing the banks for achieving the ultimate or final target in 2017.

The reply of DFS was not acceptable on the following grounds;

(i) The forwarding letters from DFS to the individual PSBs enclosing the signed MoUs, mentioned that the PSBs had signed MoUs wherein certain long term targets were to be achieved by the bank upto 31 March, 2015, with no reference to March 2017.

(ii) The last column in the annexure to the signed MoUs contained targets to be achieved by FY 2014-15 only. These targets were not designated as 'interim targets' in the signed MoUs.

4.2.5 Mismatch between MoU and SOI targets

The targets for the years 2011-12 to 2014-15 were fixed in the MoUs which were signed in February/March 2012, while the SOI targets are fixed annually. Out of the 44 parameters under SOI, there were five parameters which were common with those in the MoU, [CASA, ROA, Cost to Income Ratio, Net Profit Per Employee (₹ in lakh) and Ratio of Staff in Branches to Total Staff]. **Annexures III to VI** contain a comparison between the targets in SOIs and MoUs across the five common parameters. Audit observed that there was significant variation between targets in SOIs and MoUs for the same parameter, with the maximum variation being the following:

Table 4.3 : Mismatch Between MoU and SOI Targets

Parameter	Maximum Difference
CASA *(per cent)*	18
ROA *(per cent)*	1.37
Cost to Income Ratio *(per cent)*	21.3
Net Profit per Employee *(₹ in lakh)*	10.15
Ratio of Staff in Branches to Total Staff *(per cent)*	10.23

(Source : Records of DFS)

DFS admitted (April 2017) that normally the targets for MoU and SOI should have been similar but due to changing assumptions, targets were not harmonized which should have been taken care of.

4.2.6 Progress reports on MoUs not monitored

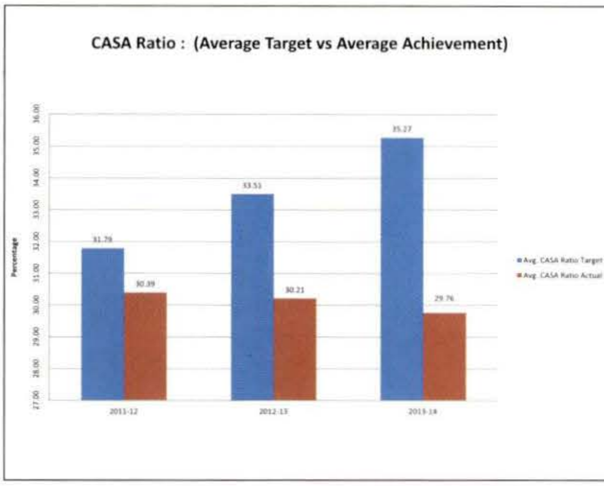
DFS had forwarded a copy of the signed MoUs to PSBs, stipulating that the bank would submit a progress report every quarter on the performance of the parameters stipulated in the said MoU. 273 progress reports were to be received from 21 PSBs (one from each PSB for Q4 of 2011-12, four from each PSB for each FY from 2012-13 to 2014-15). However, only 21 (for 4th Quarter of 2011-12 only) progress reports were received from PSBs indicating deficient monitoring of the performance of PSBs against agreed targets through progress reports.

In its reply (June 2017), DFS stated that the performance of the PSBs was done on a regular basis and DFS' senior officials have regular meetings with senior management of Banks to assess the performance of PSBs, with clarifications for non performance also sought and detailed structured study was undertaken by DFS for all PSBs on a quarterly basis. DFS also stated that the Finance Minister also did a review on a quarterly basis and GNDs as GOI representatives took active participation in the Board and also discussed the same with senior management of the PSBs. DFS further stated that they did not follow up for progress reports as they were able to monitor performance through the mechanisms mentioned above.

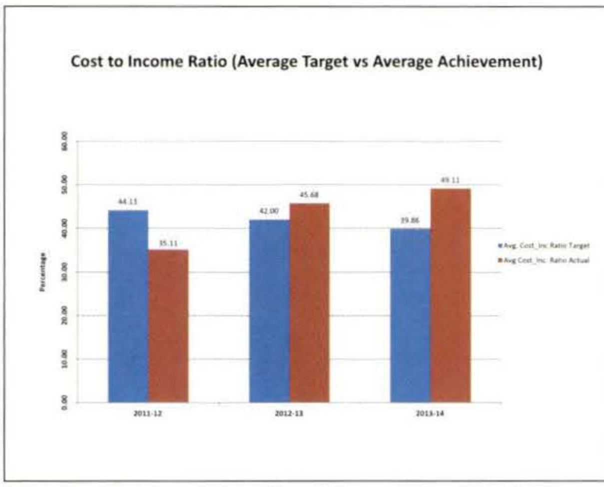
The fact remains that there was poor compliance by PSBs with regard to submission of quarterly progress reports. Further, there was no evidence to suggest that DFS had analyzed the achievement / non-achievement against targets in signed MoUs and linked the same to capital infusion.

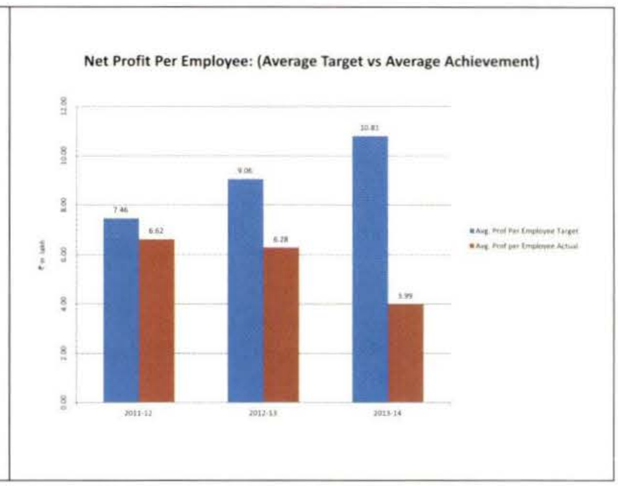
4.2.7 Non-achievement of MoU targets

From records made available, Audit observed that there was under-achievement of targets, in respect of the five parameters [CASA, ROA, Cost to Income Ratio, Net Profit Per Employee (₹ in lakh) and Ratio of Staff in Branches to Total Staff] for the FY 2011-12 to 2013-14, as shown in **Annexures VII to IX.** The charts on the next page show the under-achievement in targets during 2011-12 to 2013-14, measured through the average value of four parameters [CASA, ROA, Cost to Income Ratio, Net Profit per Employee (₹ in lakh)] for PSBs:



(Source : Records of DFS)





(Source : Records of DFS)

The widening gap between targets in MoUs and achievements with every passing year is an indication that the performance of the PSBs was not in sync with the targets.

In its reply (April 2017), DFS stated that the performance of all PSBs was analyzed at DFS on a quarterly basis on various parameters including those included in MoU and was discussed with individual banks at the highest level.

The fact remains that the targets stipulated in the signed MoUs were not achieved.

Chapter V
Analysis of Recapitalisation of PSBs

5.1 Rationale for Capitalisation of PSBs

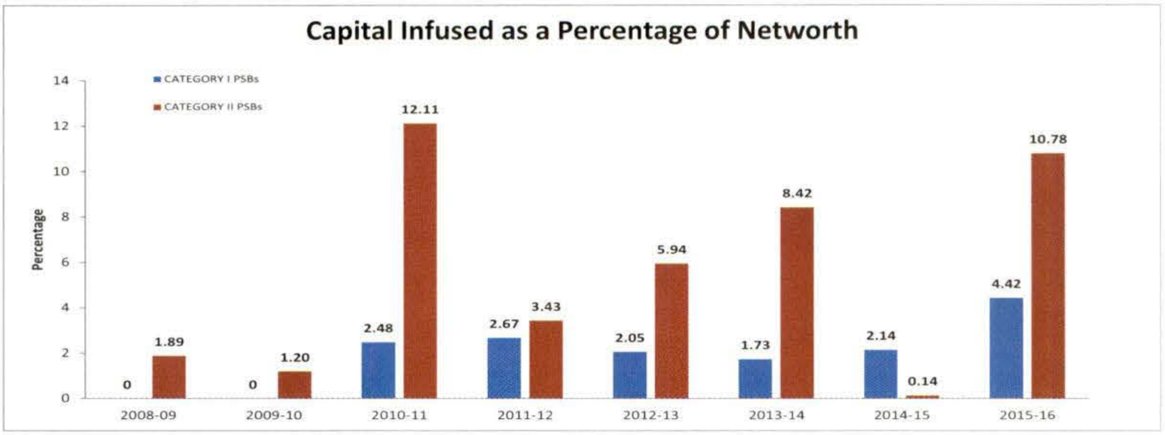
GOI infused capital in PSBs during the period 2008-09 and 2016-17 with the expectation that the PSBs would have an enhanced capability to extend credit, while maintaining regulatory capital requirements as per the Basel/RBI norms. Maintenance of pre-determined benchmark level of GOI shareholding (@58 *per cent* in December 2010 and @52 *per cent* in December 2014) was also envisaged for enabling PSBs to tap markets for additional capital requirements. For the year 2014-15, capital was infused to reward performance of PSBs.

5.2 Segregating PSBs into Two Categories

DFS had conducted (July 2016) an analysis of the performance of PSBs for determining their efficacy vis-à-vis capital infused, by segregating PSBs into three categories based on GOI capital infusion over 2008-16 as a percentage of their then net-worth; - Category I being PSBs which received capital less than 25 *per cent* of their then net worth over 2008-16; Category II being PSBs which received capital between 25 and 50 *per cent* of their present net worth and Category III being PSBs which received capital more than 50 *per cent* of their net worth.
Audit adopted this categorization segregating the PSBs into two categories by merging categories II and III to generate the two following categories of PSBs, -

- **Category I**: PSBs which received capital infusion during 2008-16 below 25 *per cent* of their net worth (as on 31 March 2016). Twelve PSBs, - Allahabad Bank, Andhra Bank, Bank of Baroda, Canara Bank, Corporation Bank, Indian Bank, Oriental Bank of Commerce, Punjab & Sind Bank, Punjab National Bank, State Bank of India, Syndicate Bank and Union Bank of India, fell into this category.
- **Category II**: PSBs which received capital infusion during 2008-16, 25 *per cent* or above 25 *per cent* of their net worth (as on 31 March 2016). Nine PSBs, - Bank of India, Bank of Maharashtra, Central Bank of India, Dena Bank, IDBI Bank, Indian Overseas Bank, UCO Bank, United Bank of India and Vijaya Bank, fell into this category.

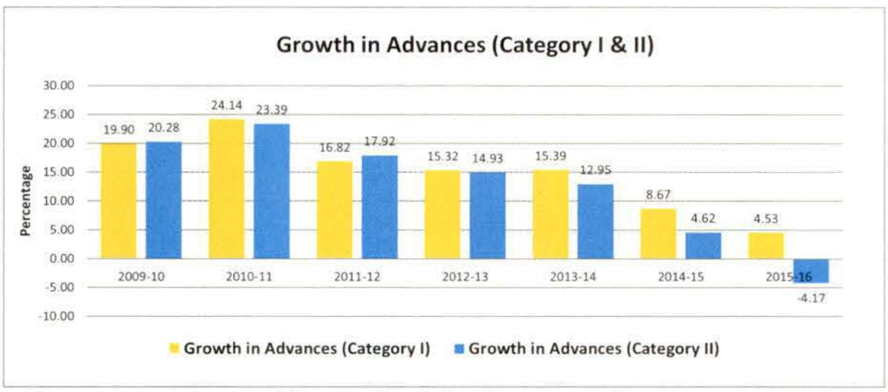
  The chart on the next page shows that for each year of the analysis, with the exception of 2014-15 (when capital infusion was done based on profitability of the PSBs), Category I PSBs received a lower share of capital (as a proportion of net worth) as compared to Category II PSBs.



[Source : Data from the RBI (Domestic Operations) and records of DFS]

5.3 Capital Infusion and Credit Growth

As already discussed in Chapter 1, the period from 2008-09 to 2015-16 had seen a deceleration in credit growth (growth of advances) across all PSBs, even as GOI capital was being infused in them. Audit compared the credit growth rate of PSBs across the two categories (category I with GOI capital infusion less than 25 *per cent* and *category* II banks with GOI capital infusion 25 *per cent* or more than 25 *per cent*). It is seen that the rate of growth of advances has, in general, been lower in case of category II PSBs compared to category I PSBs (except two years 2009-10 and 2011-12) as seen from the chart below:



(Source: Database of the RBI: Statistical Table relating to Banks in India)

The credit growth had sharply fallen in 2014-15 and 2015-16, turning negative for category II PSBs in 2015-16.

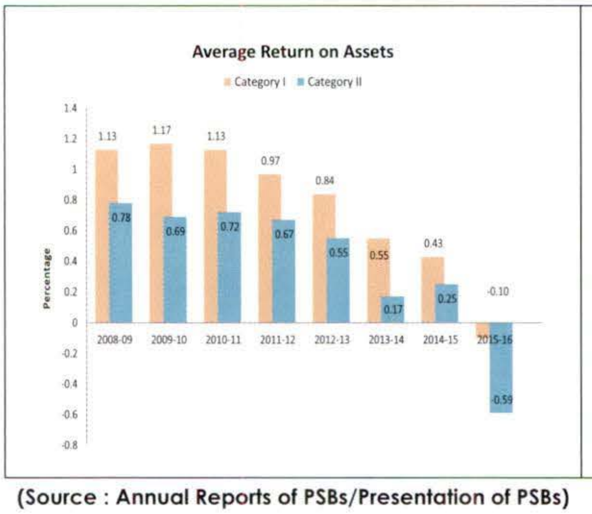
5.4 Capital Infusion and Performance of PSBs

5.4.1 Profitability is a measure of performance of a bank. Two of the commonly used parameters for measuring profitability of a bank are the Return on Assets (ROA) and the Return on Equity (ROE).

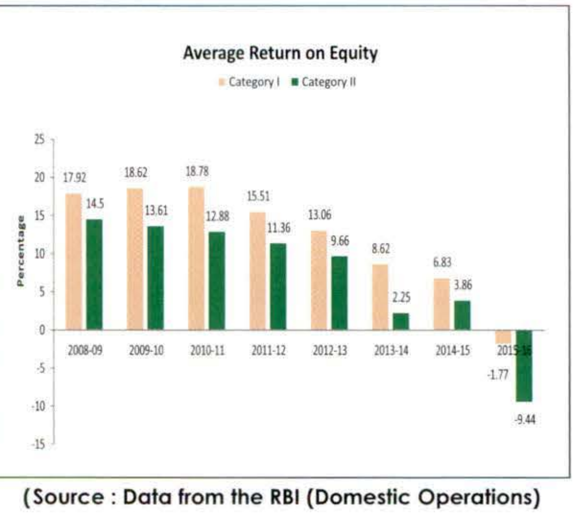
- ROA of a PSB is a financial ratio which measures net income as a percentage of average total assets of the bank. It indicates how efficient the management of the bank is, at employing its assets to generate profits.
- ROE of a PSB is the ratio of net profit to shareholders' equity. This ratio is monitored by the market as shareholders of the bank track ROE which is an indicator for the bank's performance.

As the bank under-performs, its ROA and ROE go down. A low or negative ROA/ROE of a bank indicated its reduced ability to generate profits internally. As a part of the profits go to enhance the bank reserves (post pay-out of dividends) and hence capital, this implies lower/ non-enhancement of reserves/ capital. Besides, a falling ROA/ ROE reduces market confidence and makes it more difficult for the bank to raise capital from the market.

5.4.2 As already noted in chapter 1, ROA and ROE measures for all PSBs declined over the period 2008-09 to 2015-16. The charts below indicate that PSBs which received a relatively higher share of GOI capital infusion (category II PSBs) had, in fact, performed worse than Category I PSBs:



(Source : Annual Reports of PSBs/Presentation of PSBs)



(Source : Data from the RBI (Domestic Operations)

While, the ROA and ROE of both categories progressively decreased, the average ROA and ROE of category II banks were lower than category I; - the average ROA of category II banks was -0.59 *per cent* vis-à-vis -0.10 *per cent* of category I banks in FY-2016 while the average ROE of category II banks was -9.44 *per cent* vis-à-vis -1.77 *per cent* of category I banks in the same year. Thus, a higher proportion of capital infusion (compared to the networth of the bank) has not translated into better profitability of the bank.

5.5 Capital Infusion and GOI Shareholding

As can be seen from the chart in Para 1.3.2 in chapter I, GOI holding in all PSBs was consistently above the benchmark (52 *per cent* decided in December 2014). As on 31 March 2017, United Bank of India had maximum GOI holding at 85.23 *per cent* while Oriental Bank of Commerce had the lowest percentage of GOI holding at 58.38 *per cent*. The following table categorizes PSBs by GOI share in them:

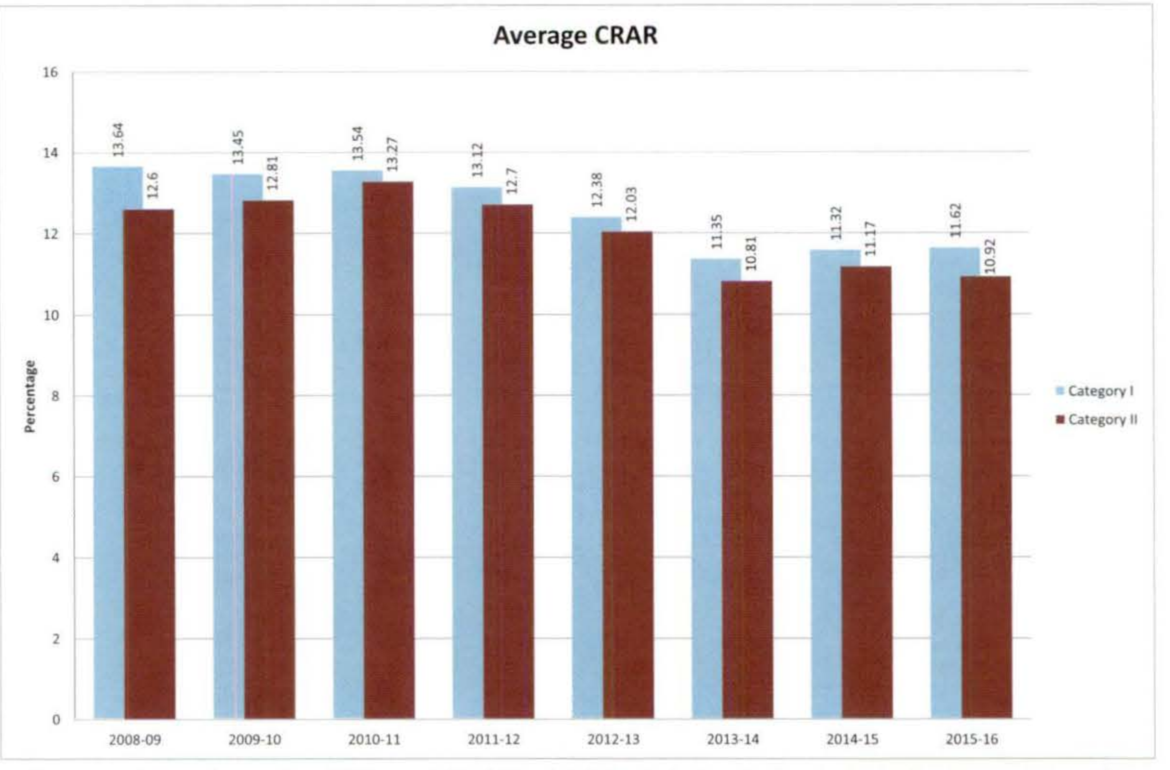
Table 5.1 : Categorization of PSBs by Range of GOI Shareholding

Range of GOI shareholding (in *per cent*)	PSBs
<58	None
>58 & <65	Andhra Bank, Bank of Baroda, Oriental Bank of Commerce, State Bank of India, Union Bank
>65 & <75	Allahabad Bank, Bank of India, Canara Bank, Corporation Bank, Dena Bank, Punjab National Bank, Syndicate Bank, Vijaya Bank, IDBI Bank Ltd
>75 & <85	Bank of Maharashtra, Central Bank, Indian Overseas Bank, Indian Bank, Punjab and Sind Bank, UCO Bank
>85	United Bank of India

(Source : BSE and NSE websites)

5.6 Capital Adequacy of PSBs

One of the primary objectives of GOI capital infusion in the PSBs was maintenance of the capital adequacy as per regulatory requirements (Basel norms/ RBI norms). Audit compared the Capital to Risk Weighted Assets Ratio (CRAR) or Capital Adequacy Ratio (CAR) of both categories of PSBs as shown in the chart on the next page:



[Source: Annual reports of PSBs and Statistical Tables Relating to Banks in India (RBI Database)]

The chart indicates that the average CRAR of category II banks was consistently lower than that of category I banks even after relatively higher proportion of GOI capital infusion. It was noticed that category II banks required frequent infusion of GOI capital to meet the regulatory capital adequacy requirements. Six out of the nine banks in category II had been infused with capital in six or more years out of the nine years that have been reviewed by Audit, as shown in the table below :

Table 5.2 : Category II PSBs and Frequency of Fund Infusion

Category II PSBs	Frequency of fund infusion	No. of PSBs
Central Bank, UCO Bank	8 out of 9 years reviewed	2
United Bank of India	7 out of 9 years reviewed	1
Bank of Maharashtra, IDBI, IOB	6 out of 9 years reviewed	3

(Source : Records of DFS)

This points to the continued dependence on GOI capital infusion for these banks.

Chapter VI
Asset Quality Position of PSBs

6.1 Classification of Assets in Banks

In 1985, a system of classifying assets was introduced in the Indian banking system on the recommendations of the Ghosh Committee on Final Accounts. The system, (Health Code System) involved classification of bank advances into eight categories ranging from one (satisfactory) to eight (bad and doubtful debt). In 1991, the Narasimhan Committee on the financial system aligned the classification of bank assets to international standards and introduced four broad asset groups, viz. (i) standard assets; (ii) substandard assets; (iii) doubtful assets; (iv) loss assets. Following this, prudential norms relating to income recognition, asset classification and provisioning were introduced in 1992. In 1998, the Narasimhan Committee on Banking Sector Reforms recommended a further tightening of prudential standards in order to strengthen the prevailing norms and bring them at par with evolving international best practices. Subsequently, in 2001, the non-performing asset (NPA) guidelines were brought at par with international standards with the introduction of 90-days norm for classification of NPAs. NPAs can broadly be classified into Gross NPAs[21] and Net NPAs[22].

An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank.

NPA is a loan or an advance where;

i. interest and/ or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan,
ii. the account remains 'out of order' in respect of an Overdraft/Cash Credit (OD/CC),
iii. the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
iv. the instalment of principal or interest thereon remains overdue for two crop seasons for short duration crops,
v. the instalment of principal or interest thereon remains overdue for one crop season for long duration crops,
vi. the amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitisation transaction undertaken in terms of guidelines on securitisation dated February 1, 2006.
vii. in respect of derivative transactions, the overdue receivables representing positive mark-to-market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment.

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[21] **Gross NPAs: Gross NPAs are the sum total of all loan assets that are classified as NPAs as per RBI guidelines as on balance sheet date. It reflects the quality of loans made by banks.**

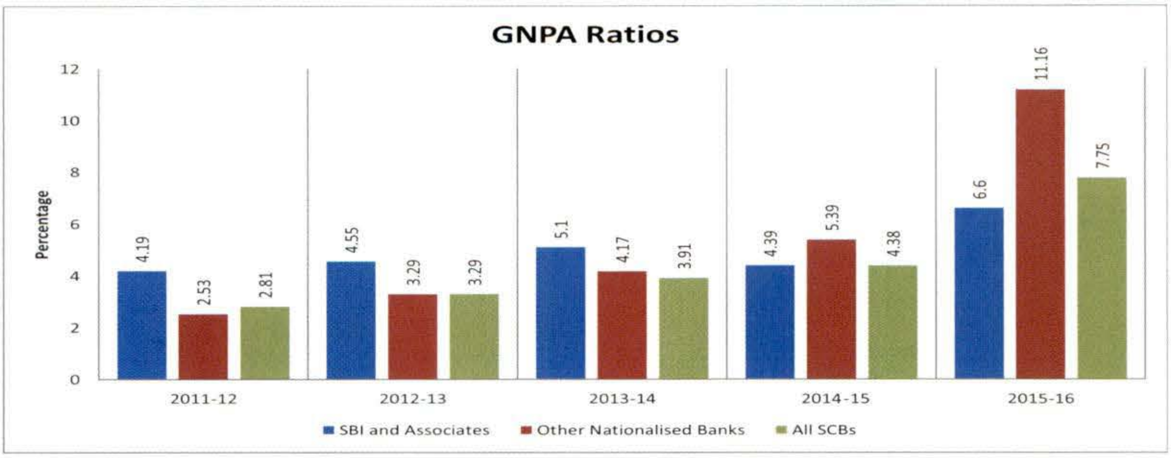
[22] **Net NPAs: Net NPAs are Gross NPAs less Provisions. It shows the actual burden of banks after deducting provisions**

6.2 Implications of NPAs

High levels of NPAs in banks affect the economy as bank credit is a catalyst for economic growth. When loans are not repaid, funds go out of the financial system and the cycle of lending- repaying-borrowing is affected. The banks have an obligation to repay their depositors and other lenders to the bank. In absence of loan repayment, the banks have to borrow additional funds to repay the depositors and creditors. This leads to a situation where banks are reluctant to lend fresh funds to new projects or the on-going projects. Once the credit to various sectors of the economy slows down, the economy is adversely affected. NPAs also lead to credit risk management assuming priority over other aspects of bank's functioning. A bank with high levels of NPA would be forced to incur carrying costs on non-income yielding assets. Other consequences would be reduction in interest income, high level of provisioning (with higher NPAs the banks would need to provide for them which will reduce their net profits), stress on profitability and capital adequacy, gradual decline in ability to meet steady increase in cost, increased pressure on Net Interest Margin (NIM) thereby reducing competitiveness, steady erosion of capital resources and increased difficulty in augmenting capital resources. NPAs in Indian banks in general and PSBs in particular, have been increasing and stood at ₹6.83 lakh crore [gross NPAs of PSBs as of March 2017 (provisional)] necessitating a higher degree of provisioning which affected the profitability of the PSBs adversely and contributed to the additional requirement of capital.

6.3 Non-performing Assets in PSBs

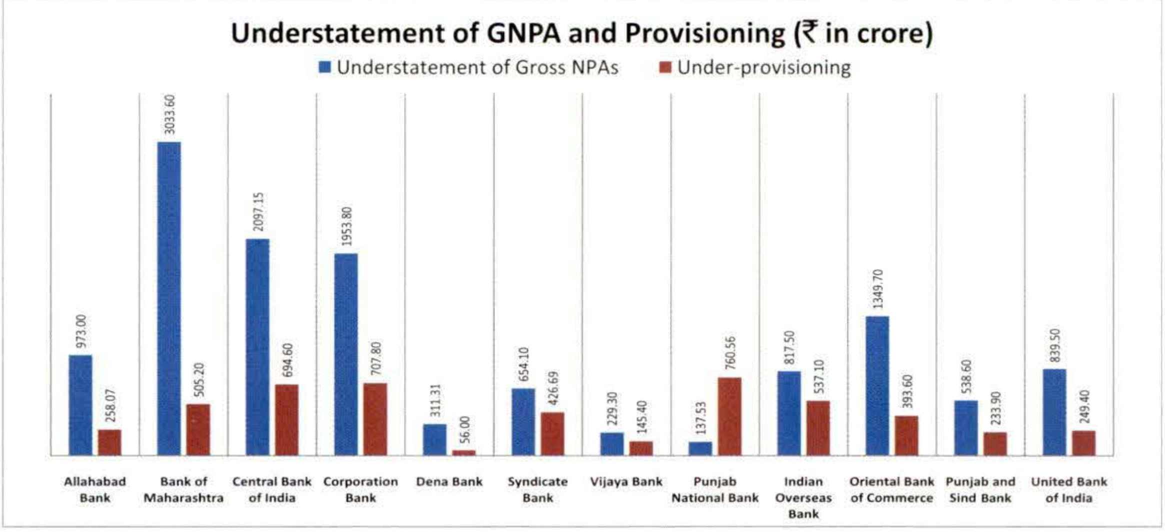
6.3.1 For SCBs, the Gross NPA ratio to advances was at 6.60 *per cent* in March 2016. Gross NPAs of PSBs surged from ₹ 2.27 lakh crore (31 March, 2014) to approximately ₹ 5.40 lakh crore (31 March, 2016), representing an increase of 138 *per cent*. They rose further to ₹ 6.83 lakh crore (provisional) at the end of March 2017. Paragraph 1.5.3.3 of Chapter I shows that PSBs account for the largest share of GNPAs in the banking sector. In fact, the gross NPA ratios of PSBs have risen sharply in the last few years though their ratios have, in general, remained higher than that of all SCBs, as shown in the chart on the next page:



(Source: RBI Database Statistical Tables Relating to Banks in India)

6.3.2 The above chart has been prepared from the database of the RBI. NPAs when recognized have to be provided for as per RBI norms. Instances of material differences between the NPAs recognized by banks and RBI and the provisioning made against them have been noticed. In April 2017, RBI directed[23] that banks make suitable disclosures wherever either (a)the additional provisioning requirements assessed by RBI exceed 15 *per cent* of the published net profits after tax for the reference period or (b)the additional Gross NPAs identified by RBI exceed 15 *per cent* of the published incremental Gross NPAs for the reference period, or both.

Audit reviewed the annual reports of PSBs for the year 2016-17 and noticed that NPAs have been recognized at a lower quantum in some PSBs[24]. This has also led to under-provisioning by these banks and a consequent over-projection of net profits, as shown in the charts below:



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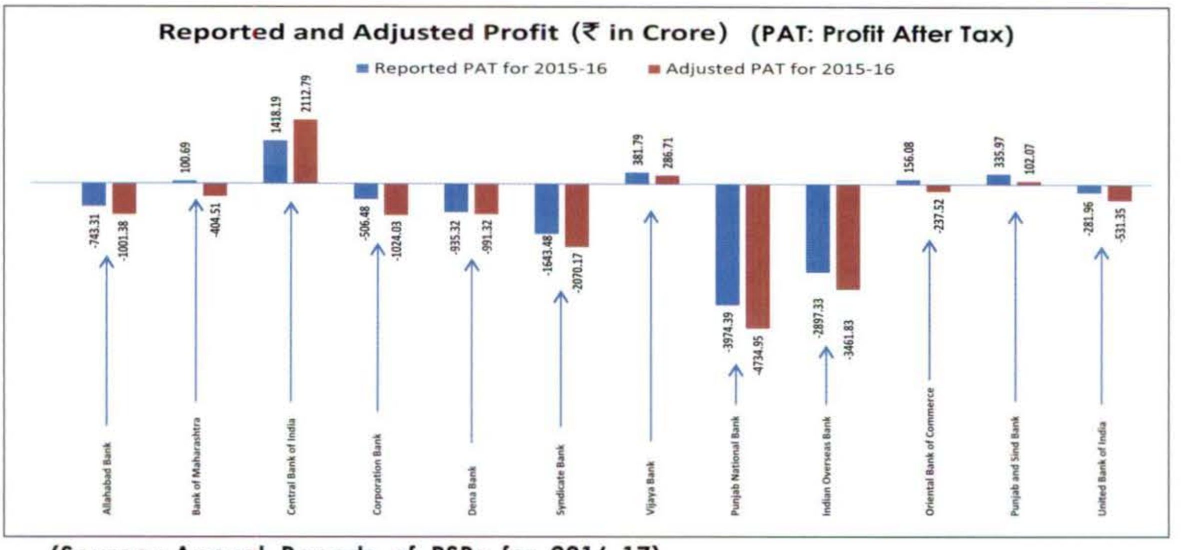
[23] **RBI instruction no. RBI/2016-17/283 DBR.BP.BC.no.63/21.04.018/2016-17 dated 18 April 2017**

[24] **In case of five PSBs, there were differences in the classification of and provisioning for assets, as stated by the PSBs in their annual reports. However as the divergence did not fall within the criteria fixed by RBI, it has not been disclosed by these PSBs.**

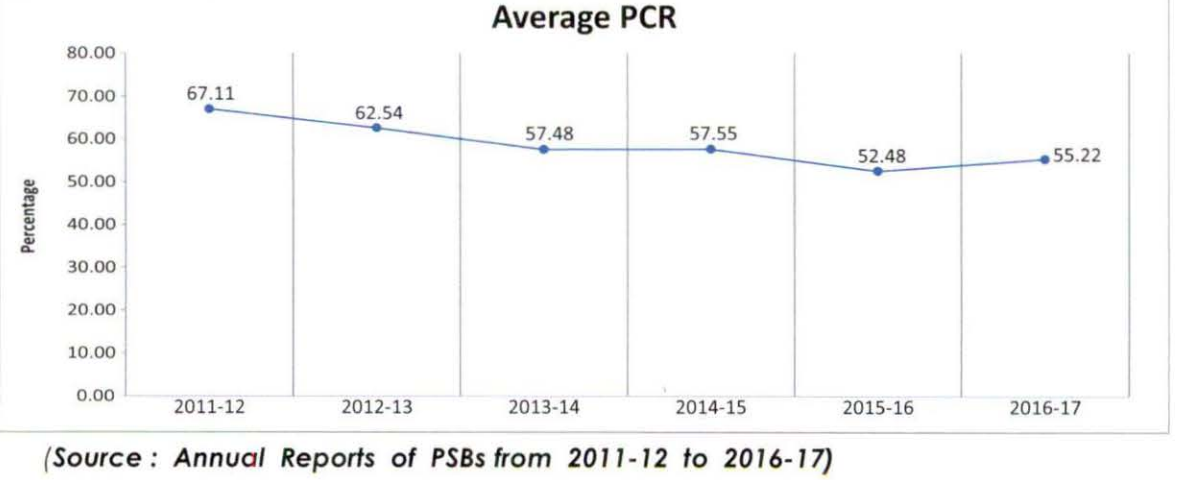


(Source : Annual Reports of PSBs for 2016-17)

6.4 Providing for NPAs

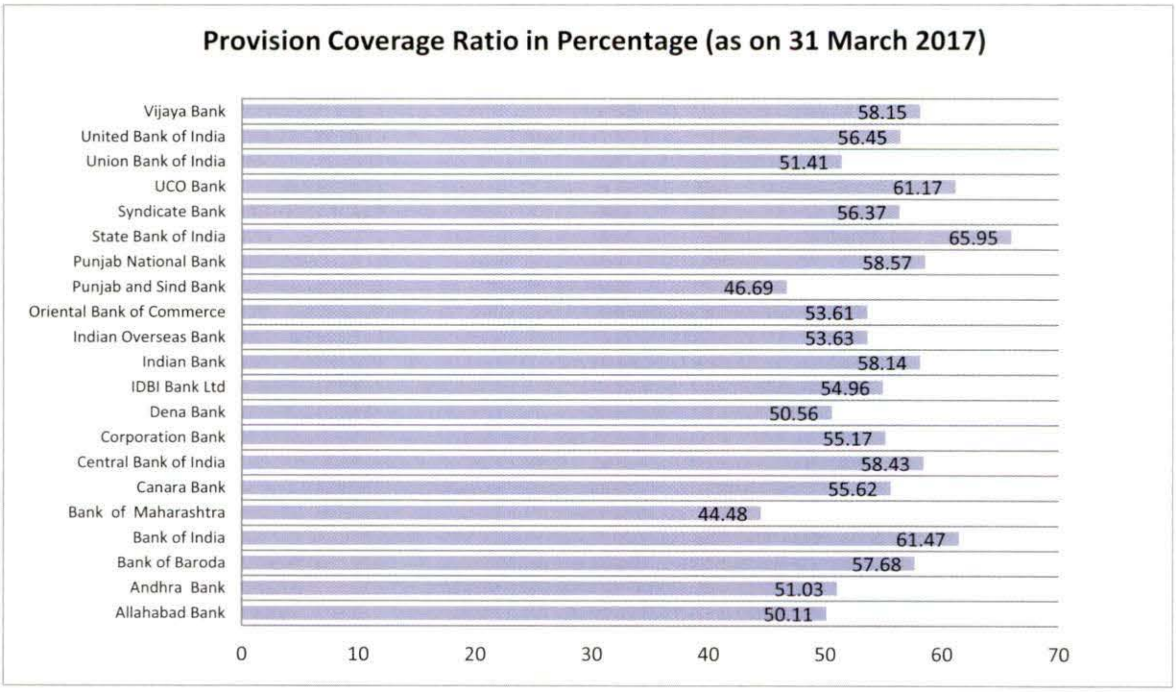
6.4.1 The primary responsibility for making adequate provisions for any diminution in the value of loan assets, investment or other assets is that of the bank managements and the statutory auditors. The assessment made by the inspecting officer of the RBI is furnished to the bank to assist the bank management and the statutory auditors in taking a decision in regard to making adequate and necessary provisions in terms of prudential guidelines. In conformity with the prudential norms, provisions should be made on the non-performing assets on the basis of classification of assets into prescribed categories.

6.4.2 Provision Coverage Ratio (PCR) is essentially the ratio of provisioning to gross non-performing assets and indicates the quantum of funds the bank has kept aside to cover losses on NPAs. The degree of provisioning required for NPAs is mandated by RBI. The PCR of the Bank should be disclosed in Notes to the Accounts to the Balance Sheet.



(Source : Annual Reports of PSBs from 2011-12 to 2016-17)

The chart above indicates that the average PCR of PSBs during 2011-12 to 2016-17 has been successively reducing, with the exception of 2014-15 and 2016-17. The PCR for the PSBs, as on 31 March 2017 is indicated in the chart below:



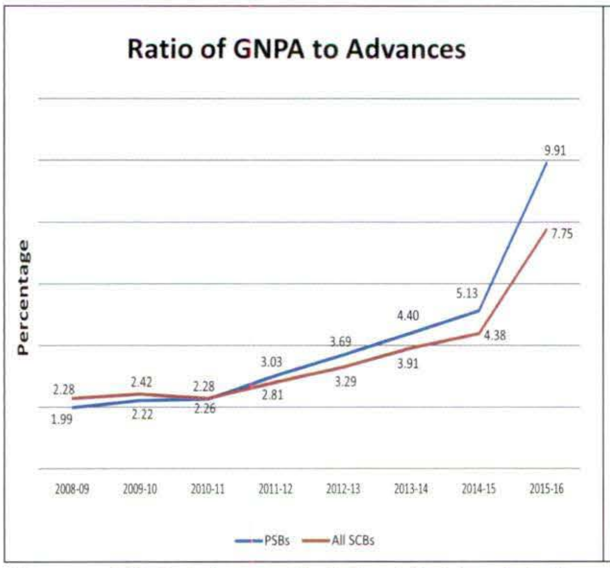
(Source : Annual Reports of PSBs for 2016-17)

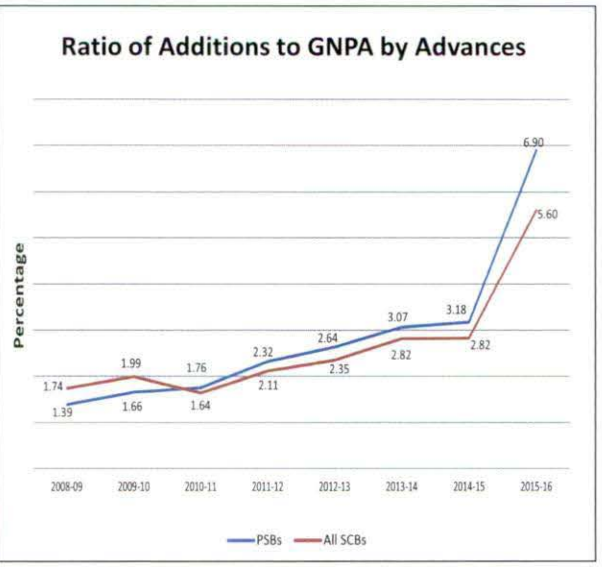
State Bank of India had the highest PCR at 65.95 *per cent* while Bank of Maharashtra had the lowest at 44.48 *per cent.*

6.5 Deteriorating Asset Quality in PSBs over 2008-16

6.5.1 The asset quality of commercial banks in general and PSBs in particular has been deteriorating significantly since 2012-13 onwards. The GNPA ratio in PSBs increased from 1.99 *per cent* (2008-09) to 9.91 *per cent* (2015-16). It is noticed that while the GNPA ratio of PSBs has been lower than that of all SCBs, indicating better performance by PSBs, by 2011-12, GNPA ratio has been higher for PSBs and has remained so. The trend of fresh slippage ratio[25] for PSBs also indicates an increase in fresh slippage (from 1.39 *per cent* in 2008-09 to 6.90 *per cent* in 2015-16) and consequent increase of NPAs in PSBs. The charts on the next page depict the same:

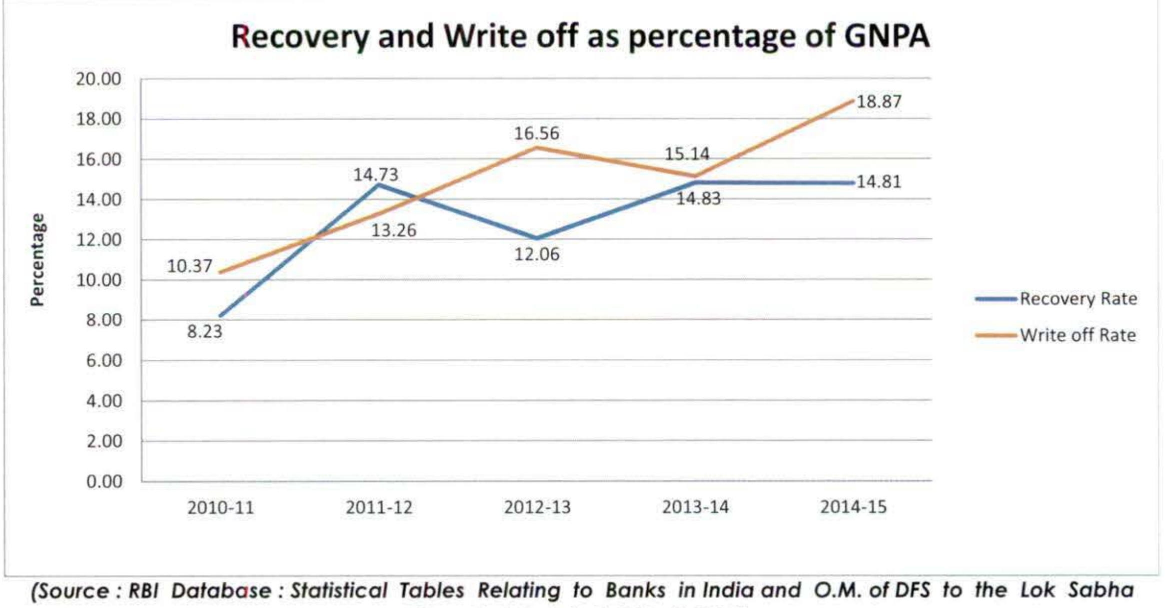
[25] **Fresh Slippage ratio: ratio between additions to Gross NPA in a financial year and Advances in that year, expressed as a percentage**





(Source: RBI Database : Statistical Tables Relating to Banks in India)

To appreciate the efforts made by PSBs to recover the NPAs, Audit reviewed the gross NPA recovery rates[26] and the write off rates[27] of PSBs over 2010-11 to 2014-15 as can be seen in the chart below:



(Source : RBI Database : Statistical Tables Relating to Banks in India and O.M. of DFS to the Lok Sabha Secretariat, dated 21April 2016)

As can be seen from the chart above, the GNPA recovery rate has, in general, been lower than the write-off rate (except for 2011-12) which implies that a larger component of the gross NPAs have been written off compared to being recovered.

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26 Recovery rate = recoveries made/ Gross NPAs

27 Write off rates = write offs done / Gross NPAs

6.6 Quality of Assets in Stressed Sectors

6.6.1 The Financial Stability Report (December 2016) of RBI points to a high concentration of GNPAs in large borrower accounts. The Report indicates that nearly 88.4 *per cent* of GNPAs of SCBs relate to large borrowers. As of 30 June, 2016, while the GNPA ratio (GNPA divided by Gross Advances, expressed as a percentage) in the Corporate Sector was 8.78 *per cent*, it was 7.70 *per cent* in the Infrastructure Sector[28] and 7.03 *per cent* in the Agriculture Sector.

DFS agreed (May 2017) that Corporate lending had contributed the maximum in GNPAs.

6.6.2 For PSBs, a significant component of the GNPAs are advances made to the infrastructure, iron and steel and textile sectors, as can be seen in the table below :

Table 6.1: Sectors under Stress

Industry		31 March 2016	31 March 2017
Mining and Quarrying	Share in Gross Advances	0.59	0.54
	Stressed Adv Ratio	16.52	23.45
Coal	Share in Gross Advances	0.08	0.06
	Stressed Adv Ratio	40.13	43.14
Basic Metal and Metal Products – Iron and Steel	Share in Gross Advances	5.12	5.42
	Stressed Adv Ratio	53.19	60.03
Textiles	Share in Gross Advances	2.92	3.18
	Stressed Adv Ratio	25.39	33.16
Infrastructure	Share in Gross Advances	15.5	14.61
	Stressed Adv Ratio	18.91	21.17
Energy	Share in Gross Advances	9.06	8.98
	Stressed Adv Ratio	17.21	18.21
Aviation	Share in Gross Advances	0.33	0.48
	Stressed Adv Ratio	16.86	5.59

(Source : Data from the RBI) Figures for 2016-17 are provisional

In its reply (May 2017), DFS accepted that Iron & Steel, Power and Textile had been the most stressed sectors.

[28] **Infrastructure sector includes educational institution, power, roads, real estate, ports, shipping, etc.**

6.7 Industry-wise Asset Quality in Systemically Large PSBs

The industry-wise asset quality and credit growth positions of systemically large PSBs in India as on 31 December 2016, provides insights into the performance of 18 specific industries. The industry portfolio risk information has been compiled using data of six systemically large PSBs (SBI, BOB, BOI, Canara Bank, PNB and Union Bank of India) and is placed in the table below.

Table 6.2: Asset Quality and Credit Growth Positions of Systemically large PSBs

Industry Name	Total Credit (₹ in crore)	Industry[29] Credit Growth (*Per cent*)	Exposure Share[30]	Closing GNPAs (₹ in crore)	GNPA Ratio (*Per cent*)
Mining and Quarrying	18677.10	4.42	1.23	1699.11	9.10
Food Processing	69731.79	-21.67	4.60	10218.92	14.65
Beverages (excluding Tea & Coffee) and Tobacco	8135.84	14.65	0.54	1260.38	15.49
Textiles	113066.14	-6.03	7.46	19709.08	17.43
Leather and Leather products	5798.96	-3.75	0.38	232.58	4.01
Wood and Wood Products	4348.33	-1.26	0.29	663.85	15.27
Paper and Paper Products	14729.48	-63.77	0.97	2690.38	18.27
Petroleum, Coal (non-mining) & Nuclear Fuels	40949.46	-10.36	2.70	3769.15	9.20
Chemicals and Chemical Products	82514.23	-17.35	5.45	8480.29	10.28
Rubber, Plastic and their Products	46229.19	95.90	3.05	1700.31	3.68
Glass & Glassware	4927.63	-13.75	0.33	1446.25	29.35
Cement & Cement Products	17134.32	8.79	1.13	3363.46	19.63
Basic Metal and Metal Products	249371.31	1.17	16.46	81417.81	32.65
All Engineering	94615.70	-5.05	6.25	7967.69	8.42
Vehicles, Vehicle Parts & Transport Equipments	27027.72	2.52	1.78	4850.93	17.95
Gems and Jewellery	42436.02	-33.63	2.80	5089.25	11.99
Construction	51511.65	2.04	3.40	6183.08	12.00
Infrastructure	494492.10	6.09	32.64	31097.53	6.29
Other Industries	129230.16	-12.42	8.53	20474.17	15.84
Total	**1514927.1**		**100.00**	**212314.22**	**14.01**

(Source: Data from the RBI : Domestic Operations)

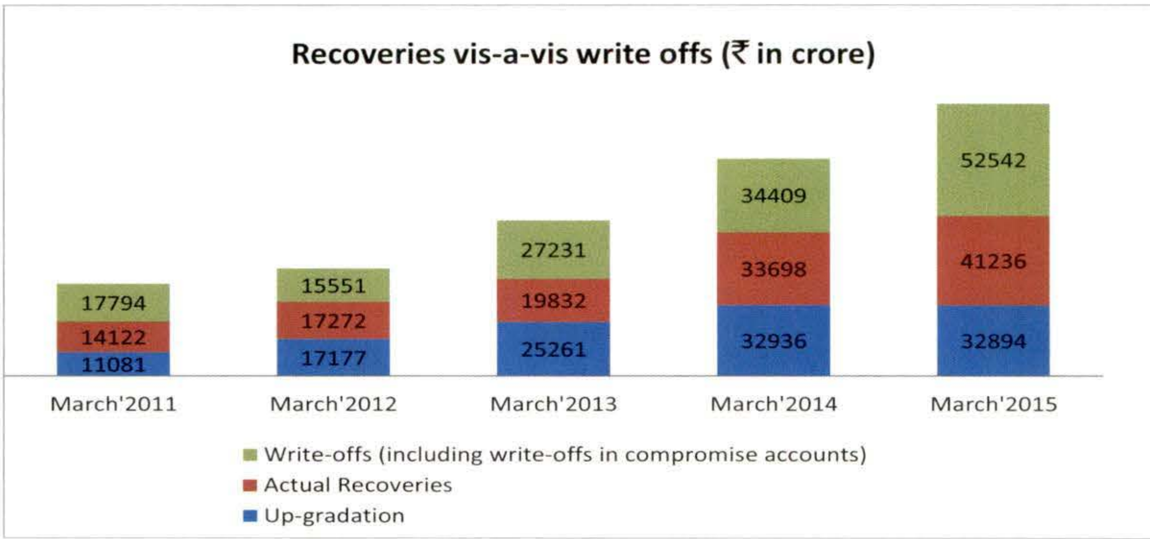
6.8 Recoveries and Write-Offs

6.8.1 Management of the NPAs include their recoveries and write-offs. An account classified as NPA may also be up-graded when the arrears of interest and principal are paid by the borrower. The following chart shows the break-up

[29] **Industry credit growth for 9 months from April to December 2016**

[30] **Exposure share reflects exposure of systemically large PSBs in the particular industry to total industry credit in respect of these PSBs**

of GNPA reduction across three categories (i)up-gradation (ii)actual recoveries and (iii)write offs (including write-offs in compromise accounts) during 2010-15.



(Source : O.M. of DFS to the Lok Sabha Secretariat, dated 21 April 2016)

It is noticed that the actual recoveries were lower than the write-offs in all years except 2011-12. The quantum of write-off in 2014-15 was in fact ₹ 52,542 crore, significantly higher than the recovery of ₹ 41,236 crore which goes against the principle of DFS to ensure that recoveries match amounts written off.

DFS stated (May 2017) that they were in agreement with the principle that written off amount should match with the recovery in accounts but the stressed asset situation in PSBs had become grim during the last few years and while special measures had been taken, it might take some time for normalcy to be restored in terms of asset quality.

6.9 Measures Taken by GOI and RBI to Address NPAs

GOI and RBI have taken several initiatives to address the problem of burgeoning NPAs. Some of the significant measures are summarized below:

6.9.1 Debt Recovery Tribunals (DRT)

Debt Recovery Tribunals (DRTs) had been constituted under an Act of Parliament (1993) for recovering NPAs of banks. At present, there are 39 DRTs and 5 Debt Recovery Appellate Tribunals (DRATs) functioning in different states. The amount recovered[31] through DRTs (including compromise) was ₹ 3,484 crore and ₹ 5,590 crore in 2014-15 and 2015-16 respectively.

[31] **Recovery figures through DRTs, Lok Adalats and SARFEASI are taken from the RBI Report on Trend and Progress of Banking in India 2015-16**

6.9.2 Lok Adalat

The RBI had issued guidelines (May 2001) with a view to making increasing use of the forum of Lok Adalats to settle banking disputes involving smaller amounts. The amounts recovered through Lok Adalat were ₹ 931 crore and ₹ 3,134 crore in 2014-15 and 2015-16 respectively.

6.9.3 SARFAESI Act, 2002

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 empowers banks/financial institutions to recover their NPAs without the intervention of the Court. The Act provides three alternative methods for recovery of non-performing asset, namely securitization, asset reconstruction and enforcement of security without the intervention of the Court. The amounts recovered through implementation of SARFAESI Act were ₹ 23,434 crore and ₹ 11,033 crore in 2014-15 and 2015-16 respectively.

6.9.4 Schemes for Restructuring

Corporate Debt Restructuring (CDR) mechanism was introduced by RBI in August 2001 and is a voluntary non-statutory system based on Debtor-Creditor Agreement (DCA) and Inter-Creditor Agreement and the principle of approvals by super-majority of 75 *per cent* creditors (by value) which makes it binding on the remaining 25 *per cent* to fall in line with the majority decision.

The 5/25 Scheme was introduced (July 2014) to enable long term debt financing of projects in infrastructure and core industries and provides for longer amortization period for loans in these sectors of upto 25 years (based on the economic life or concession period of the project) with periodic refinancing every five years to ensure long term viability. **Strategic Debt Restructuring (SDR)** was introduced (June 2015) with a view to ensuring more stake of promoters in reviving stressed accounts and provide banks with enhanced capabilities to initiate change of ownership in accounts which fail to achieve the projected viability milestones, whereby RBI had directed (June 2015) that banks may, at their discretion undertake a Strategic Debt Restructuring (SDR) by converting loan dues to equity shares. **The scheme for Sustainable Structuring of Stressed Assets (S4A)** was formulated (June 2016) by the RBI as an optional framework for the resolution of large stressed accounts. The S4A envisages determination of the sustainable debt level for a stressed borrower, and bifurcation of the outstanding debt into sustainable debt and equity/quasi-equity instruments which are expected to provide upside to the lenders when the borrower turns around.

6.9.5 Prompt Corrective Action framework

The Reserve Bank of India has introduced a policy action guideline in the form of revised Prompt Corrective Action (PCA) framework for banks on April 13, 2017. Capital, asset quality, and profitability to be the key areas for monitoring the banks in the revised framework. RBI will track CRAR or CET1 ratio, Net NPA ratio and Return on Assets respectively. Leverage would also be monitored additionally as part of PCA. Certain trigger points have been specified and breach of any defined risk threshold would result in invocation of PCA. This has become effective from April 1, 2017. The RBI has initiated (May 2017 and June 2017) PCA on four PSBs, i.e. IDBI Bank Ltd, UCO Bank, Dena Bank and Central Bank of India in view of their high net NPA and negative ROA.

6.9.6 Ordinance

The Banking Regulation (Amendment) Ordinance, 2017 has been promulgated (May 2017), inserting two new Sections (viz. 35AA and 35AB) after Section 35A of the Banking Regulation Act, 1949, to enable the Union Government to authorize the Reserve Bank of India (RBI) to direct banking companies to resolve specific stressed assets by initiating insolvency resolution process, where required. The RBI has also been empowered to issue other directions for resolution, and appoint or approve for appointment, authorities or committees to advise banking companies for stressed asset resolution.

6.9.7 Other measures

Specific measures have been taken to address NPAs specific sectors, primarily in Infrastructure (Power, Roads etc.), Steel and Textiles. In the Steel Sector, Minimum Import Price (MIP) has been introduced on import of specific steel products in December 2016 while coal mines have been auctioned to manufacturers in the sector, which would boost domestic production and may help combat the mounting NPAs in that sector. In the power sector, the Ujwal Discom Assurance Yojna (UDAY) has been launched (September 2015) under which the State Governments would take over 75 *per cent* of the debt in the DISCOMs over 2015-17 which would improve the NPA, for unlocking capital in PSBs. Discoms have accumulated losses of approx. ₹ 3.8 lakh crore and outstanding debt of approximately ₹ 4.3 lakh crore as of March 2015.

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.

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[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

(MANISH KUMAR)
Director General of Audit
(Economic and Service Ministries)

Countersigned

Dated: 03 July 2017
Place : New Delhi

(SHASHI KANT SHARMA)
Comptroller and Auditor General of India

Annexures

Annexure I

Government of India and LIC's Shareholding in PSBs as on 31 March

(Referred to in Paragraph No. 1.3.2)

(figures in *per cent*)

Name of PSBs	2016-17		2015-16		2014-15		2013-14		2012-13		2011-12		2010-11	
	Govt	LIC	Govt	LIC	Govt	LIC	Govt	LIC	Govt	LIC	Govt	LIC	Govt	LIC
Allahabad Bank	65.92	14.17	61.38	14.50	60.83	11.46	58.90	8.26	55.24	10.61	55.24	12.93	58	7.61
Andhra Bank	61.26	11.58	61.26	11.58	61.02	6.51	60.14	7.28	58	8.07	58	8.65	58	8.47
Bank of Baroda	59.24	10.03	59.24	11.89	56.26	9.95	56.26	10.79	55.41	11.16	54.31	12.10	57.03	6.44
Bank of India	73.72	12.83	68.01	14.61	64.43	14.93	66.70	11.82	64.11	12.82	62.72	13.52	65.86	8.31
Bank of Maharashtra	81.61	12.72	81.61	12.72	79.80	13.80	85.21	5.31	81.24	7.82	78.95	8.94	79.24	6.57
Canara Bank	66.30	13.62	66.30	13.75	69.91	7.29	69	5.35	67.72	4.97	67.72	4.97	67.72	4.71
Central Bank of India	81.28	13.83	79.94	14.50	81.46	13.41	88.63	5.44	85.31	7.03	79.15	10	80.20	6.55
Corporation Bank	70.76	18.91	67.20	21.22	63.33	22.54	63.33	22.54	59.82	24.69	58.52	25.49	58.52	24.81
Dena Bank	68.55	12.23	62.89	14.50	59.75	12.66	58.01	13.42	55.24	6.35	55.24	10.30	58.01	6.34
Indian Overseas Bank	79.56	10.68	77.32	14.50	73.80	12.62	73.80	14.77	73.80	8.90	69.62	10.47	65.87	9.78
Indian Bank	82.10	3.14	82.10	3.14	82.10	2.64	81.51	2.21	80	2.42	80	2.42	80	1.87
Oriental Bank of Commerce	58.38	13.05	55.17	14.06	59.13	7.88	59.13	8.22	58	11.06	58	11.91	58	10.49
Punjab National Bank	65.01	12.52	62.08	13.85	59.86	11.19	58.87	12.70	57.87	12.79	56.10	14.15	58	6.37
Punjab & Sind Bank	79.62	0.00	79.62	10.49	79.62	10.49	81.42	4.21	79.86	4.56	78.16	4.94	82.07	-
Syndicate Bank	72.92	11.28	65.17	14.50	69.24	8.12	67.39	9.52	66.17	11.32	66.17	14.53	69.47	10.42
UCO Bank	76.67	14.50	72.83	14.36	72.83	14.36	77.20	7.56	69.26	10.20	65.19	10.47	68.13	7.33
Union Bank	63.44	10.24	63.44	10.24	60.47	10.73	60.13	10.28	57.89	10.88	54.35	12.36	57.07	4.14
United Bank of India	85.23	7.30	82	12.12	82	12.12	88	3.10	82.23	4.60	81.56	4.77	85.48	-
Vijaya Bank	70.33	12.93	68.23	14.50	74.06	7.13	74.06	6.92	55.02	12.34	55.02	10.17	57.69	6.35
State Bank of India	62.22	8.96	61.32	11.49	58.60	11.82	58.60	14.99	62.31	9.99	61.58	11.08	59.40	11.26
IDBI Bank Ltd.	73.98	13.87	73.98	14.37	76.50	7	76.50	7.04	71.72	8.63	70.52	9.21	65.13	10.18

(Source : BSE and NSE websites)

Annexure II

Statement of Year and Bank-wise Advances of PSBs

(Referred to in Paragraph No. 1.5.2)

(₹in million)

Banks	2015-16	2014-15	2013-14	2012-13	2011-12	2010-11	2009-10	2008-09
Allahabad Bank	1523721	1498768	1380066	1294897	1111451	936249	716049	588018
Andhara Bank	1307879	1259547	1076442	983733	832230	714354	561135	441393
Bank of Baroda	3837702	4280651	3970058	3281858	2873773	2286764	1750353	1432514
Bank of India	3591890	4020255	3707335	2893675	2488333	2130962	1684907	1429094
Bank of Maharashtra	1075627	985991	889204	754708	560598	468808	403147	342908
Canara Bank	3247148	3300355	3010675	2421766	2324898	2112683	1693346	1382194
Central Bank of India	1800096	1884775	1773152	1719358	1475129	1297254	1053835	854832
Corporation Bank	1403222	1450660	1370863	1187166	1004690	868504	632026	485122
Dena Bank	823283	789343	775538	657812	566925	448280	354624	288780
IDBI Bank Limited	2158934	2083769	1976860	1963064	1805723	1570981	1382019	1034445
Indian Bank	1290491	1258635	1222090	1056425	903236	752499	621461	513965
Indian Overseas Bank	1608607	1717560	1758816	1603641	1407244	1118330	789992	748853
Oriental Bank of Commerce	1488800	1452613	1390798	1289551	1119777	959082	834893	685004
Punjab and Sind Bank	639161	638702	572391	514308	461514	426378	326391	246153
Punjab National Bank	4123258	3805344	3492691	3087959	2937748	2421067	1866012	1547030
Syndicate Bank	2013685	2027198	1739124	1475690	1236202	1067819	904064	815323
UCO Bank	1259054	1473509	1495842	1282829	1155400	990708	825045	688039
Union Bank of India	2673540	2556546	2291044	2081022	1778821	1509861	1193153	965342
United Bank of India	680602	667630	657675	689087	630433	535024	423300	353935
Vijaya Bank	889870	866959	815040	697658	579037	487186	415067	354677
State Bank of India[33]	18499200	16743683	15645662	13792240	11519913	9941536	8579368	7394499
TOTAL	**55935768**	**54762496**	**51011367**	**44728447**	**38773075**	**33044329**	**27010187**	**22592117**

(Source : RBI Database : Statistical Tables Relating to Banks)

[33] State Bank of India figures include the figures of its associate banks and Bhartiya Mahila Bank

Annexure III

Mismatch Between SOI and MoU - (2011-12)

(Referred to in Paragraph No. 4.2.5)

Bank	CASA (in per cent)		ROA (in per cent)		Cost to Income Ratio (in per cent)		Net Profit per employee(₹ in lakh)		Ratio of Staff in Branches to Total Staff (in per cent)	
	SOI target	MOU target	SOI target	MOU target	SOI target	MOU target	SOI target	MOU target	SOI target	MOU target
Allahabad Bank	30	30.01	1.02	1.02	44	44	6.98	7	89	89
Andhra Bank	30	29.1	1.38	1.38	39.90	39.91	8.5	8.5	89.84	88
Bank of Baroda	33.5	33.5	1.15	1.15	40	40	11	11	86	86
Bank of India	30	31.01	0.82	0.7	44	44	6	6.5	90	89.74
Bank of Maharashtra	38	38	0.55	0.55	59	59	5	5	90	90
Canara Bank	28	28	1.1	1.1	42	42	10	10	80	80
Central Bank of India	32	32	0.55	0.5	54.64	54.64	4.17	3.5	89	86
Corporation Bank	30	26.34	1.15	1.15	40	40	11.18	11.18	85	85
Dena Bank	35.43	36.34	1	1.1	42.67	42.67	7	7.86	84.21	88
IDBI Bank Limited	24	24	0.8	0.8	39.4	39.4	12.1	12.5	80	80
Indian Bank	31	31	1.25	1.25	42	42	9	9	84	84
Indian Overseas Bank	30	31	0.56	0.62	45.50	46.27	5.02	5.02	88.5	88.3
Oriental Bank of Commerce	25	25	0.87	0.87	37.18	37.18	9.11	9.25	88	88
Punjab and Sind Bank	25.23	25	1	1	49.9	49.9	7.5	7.5	80	80
Punjab National Bank	35	35	1.1	1.1	42	43	8.25	8.25	89	89
State bank of Bikaner & Jaipur	30	38.95	0.92	1.15	51	47.37	4.3	7.3	80	80
State Bank of Hyderabad	26	32.41	0.9	1.3	44	38.27	7.84	9.42	88.65	88.65
State Bank of India	46	45	1.02	1.02	45	45	6	6	81	81
State Bank of Mysore	35.53	35.53	1.18	1.18	41.20	41.20	7.49	7.49	83.58	83.38
State Bank of Patiala	31.68	31.68	1.07	1.07	40.63	40.63	7.54	7.54	81.86	81.86
State Bank of Travancore	30.58	33.22	0.74	1.23	44.36	44.36	4.76	8.24	81	81
Syndicate Bank	30	33	0.85	0.85	44	44	5	5	80	80
UCO Bank	30	24.19	0.74	0.74	43	43	5	5	88	88
Union Bank of India	30	32.34	0.9	0.9	47	43.46	6.87	7	87	81
United Bank of India	39	39	0.8	0.8	42.50	42.5	4	4	85	85
Vijaya Bank	30	26	0.94	0.94	49	53.53	5	5	83	83

(Source : Records of DFS)

Annexure IV
Mismatch Between SOI and MoU- (2012-13)
(Referred to in Paragraph No. 4.2.5)

Bank	CASA (in per cent)		ROA (in per cent)		Cost to Income Ratio (in per cent)		Net Profit per employee(₹ in lakh)		Ratio of Staff in Branches to Total Staff (in per cent)	
	SOI target	MOU target	SOI target	MOU target	SOI target	MOU target	SOI target	MOU target	SOI target	MOU target
Allahabad Bank	31.87	31.87	1.08	1.2	42.75	41.75	9.7	9.69	88	88
Andhra Bank	27	30.88	1.2	1.4	39.23	39.23	9	9.62	88	88
Bank of Baroda	32	35	1.1	1.3	39	38	11.5	13	86	84
Bank of India	32.5	32.5	0.6	0.85	45	42	5.66	8.33	90	89.88
Bank of Maharashtra	38.6	38.6	0.7	0.85	52	52	4.14	5.5	87	87
Canara Bank	29	30	1.05	1.25	42.50	40	10	11	80	80
Central Bank of India	33.5	33	0.55	0.7	53	51	3.55	5	87.72	86
Corporation Bank	25	29.23	1.1	1.18	40	40	11.65	11.79	85	85
Dena Bank	35	37.25	1	1.2	42	40.54	8.15	9.17	85	86
IDBI Bank Limited	27.5	27	0.9	0.9	38.75	38.8	14.09	13.75	82	80
Indian Bank	31.5	31.5	1.05	1.3	41.74	41.74	9.26	9.2	85	82.5
Indian Overseas Bank	27	32	0.55	0.7	46	45.1	3.85	5.76	88.5	88.3
Oriental Bank of Commerce	25.20	27	0.75	1.02	41.50	40.52	7.50	10.73	88	88
Punjab and Sind Bank	30	27	0.75	1.08	50	45.1	5.27	9	85	80
Punjab National Bank	35	35.5	1.15	1.15	43.40	43.4	8.33	10	85	89
State bank of Bikaner & Jaipur	37.5	39.4	1	1.3	46	42.07	5.5	9.75	82.5	80
State Bank of Hyderabad	27	35.66	1.15	1.39	40	36.87	8	10.96	87.73	
State Bank of India	45	45	1	1.08	44	44	6.85	7.2	81.5	81.5
State Bank of Mysore	35	37.44	1.33	1.33	39.24	38.54	4	9.85	88	81.88
State Bank of Patiala	30	35.25	1	1.25	41	38.21	7.37	9.88	81.06	81.06
State Bank of Travancore	32	36.12	0.65	1.34	47.50	40.35	5.25	10.28	84	81
Syndicate Bank	32	33	0.83	0.95	44	41	5.76	6.33	85	80
UCO Bank	24.5	27	0.75	1	41	40.25	5.39	6.25	87	86
Union Bank of India	32.5	35	0.9	1.09	44	41.02	6.83	8.4	87	Above 81
United Bank of India	39	38	0.56	1	42	41.5	3.48	6	85	85
Vijaya Bank	26	31	0.7	1.19	48	49.02	5.11	9	82	82

(Source : Records of DFS)

Annexure V

Mismatch Between SOI and MoU- (2013-14)

(Referred to in Paragraph No.4.2.5)

Bank	CASA (in %)		ROA (in %)		Cost to Income Ratio (in %)		Net Profit per employee(₹ in lakh)		Ratio of Staff in Branches to Total Staff (in *percent*)	
	SOI target	MOU target	SOI target	MOU target	SOI target	MOU target	SOI target	MOU target	SOI target	MOU target
Allahabad Bank	32	33.57	0.75	1.3	45	39.25	6	12.26	90	87
Andhra Bank	26	33.03	0.5	1.42	45.50	37.72	3.94	11.23	90	88
Bank of Baroda	31	39	0.68	1.4	40.50	36.5	9.62	14.75	88	82
Bank of India	33	34.04	0.65	0.98	48	38.5	6.05	10.47	80	90.23
Bank of Maharashtra	35	39.25	0.74	1.2	47.05	44	5.73	8.75	86.5	84
Canara Bank	26	32	0.75	1.4	42	38	5.53	13	80	80
Central Bank of India	33.07	33	0.03	0.8	59.30	47.5	0.19	7.5	86	86
Corporation Bank	23	32.11	0.7	1.22	40	40	8.1	12.39	87	85
Dena Bank	29	38.17	0.67	1.3	44	38.49	4.7	10.87	85	85
IDBI Bank Limited	27	30	0.81	1	38.44	37.25	12.3	15.25	86	81
Indian Bank	27.5	32	0.83	1.35	52	42.51	4.75	9.5	85	81
Indian Overseas Bank	27	33	0.24	0.82	49	44.6	2	8.28	88	88.3
Oriental Bank of Commerce	24	28.5	0.6	1.05	44	39.36	5.94	12.1	90	88
Punjab and Sind Bank	23	29	0.48	1.14	57.70	42.3	3.45	10	85	80
Punjab National Bank	37	37.5	0.95	1.2	45	43.7	8.15	12	88	89
State bank of Bikaner & Jaipur	36.4	39.7	0.98	1.4	49.50	38.54	6.15	11.38	83	80
State Bank of Hyderabad	32	37.83	1.02	1.44	43.61	35.94	7.33	11.98	87.75	
State Bank of India	45	45	0.96	1.16	48.65	42	6.81	8.62	80	82
State Bank of Mysore	35	38.72	0.67	1.41	49	36.77	4	11.43	90	80.9
State Bank of Patiala	30	37.63	0.71	1.38	47.50	36.61	5.14	11.44	85	80.53
State Bank of Travancore	27.65	38.05	0.7	1.42	50	37.68	4.9	11.64	85	81
Syndicate Bank	31.25	34	0.8	1.03	47	37	5.5	7.84	84	80
UCO Bank	31	33	0.6	1.25	40	38.12	5.21	9.25	87	84
Union Bank of India	31.5	37.5	0.8	1.18	47.10	37.98	6.12	10.08	88.66	Above 81
United Bank of India	35	37.5	0.25	1.25	42.25	40	1.25	8	85	85
Vijaya Bank	22	34	0.35	1.34	55	46.01	5.51	11	82	81

(Source : Records of DFS)

Annexure VI

Mismatch Between SOI and MoU- (2014-15)

(Referred to in Paragraph No. 4.2.5)

Bank	CASA (in *per cent*)		ROA (in *per cent*)		Cost to Income Ratio (in *per cent*)		Net Profit per employee(₹ in lakh)		Ratio of Staff in Branches to Total Staff (in *per cent*)	
	SOI target	MOU target	SOI target	MOU target	SOI target	MOU target	SOI target	MOU target	SOI target	MOU target
Allahabad Bank	32.5	35	0.53	1.4	48.50	37	4.93	13	90	85
Andhra Bank	26	35	0.5	1.5	45	35	4.29	13	90	88
Bank of Baroda	32.5	45	0.65	1.5	45	35	9.32	16	88	80
Bank of India	33	35	0.65	1.1	46	35	6.65	13	90	90.78
Bank of Maharashtra	36.5	40	0.4	1.5	54	35	3.71	13	88	80
Canara Bank	28	35	0.5	1.5	48	35	5.1	15	80	80
Central Bank of India	34	35	0.15	1	60.30	39	1.21	10	86	86
Corporation Bank	23	35	0.33	1.25	44	40	3.85	14	87	85
Dena Bank	32	39.08	0.6	1.4	44	36.63	4.75	13.47	88.5	85
IDBI Bank Limited	26	32	0.43	1.1	41	35	6.75	16.25	88	82
Indian Bank	28.5	32.5	0.38	1.4	55	44	3.37	10	84	80
Indian Overseas Bank	27	35	0.3	0.97	49	43.67	2.8	12	88	88.3
Oriental Bank of Commerce	25.5	30	0.55	1.1	44	37	5.71	13.73	90	88
Punjab and Sind Bank	23	30	0.48	1.18	58	41	3.7	11	85	80
Punjab National Bank	37.25	38.3	0.6	1.25	47.50	44.4	5.65	15	88	89
State bank of Bikaner & Jaipur	38	40	0.9	1.5	50	35	5.81	13	82	80
State Bank of Hyderabad	32.5	40	0.75	1.5	46	35	6	13	86.52	
State Bank of India	46	45	0.7	1.23	50	40	5.92	10.34	83	83
State Bank of Mysore	35.25	40	0.5	1.5	49	35	3	13	90	80
State Bank of Patiala	33.5	40	0.6	1.5	55.50	35	4.66	13	87.5	80
State Bank of Travancore	30	40	0.5	1.5	52	35	2.92	13	87	81
Syndicate Bank	31.5	35	0.81	1.1	47.25	35	7.15	10	86.5	80
UCO Bank	33.5	40	0.75	1.5	37	35	7.1	13	88.5	80
Union Bank of India	31.5	40	0.55	1.25	52	35	4.89	12.1	90	81
United Bank of India	37.75	37	0.13	1.5	45	35.5	0.91	10	87	85
Vijaya Bank	22	40	0.55	1.5	51	40	3.57	13	88	80

(Source : Records of DFS)

Annexure VII
Targets with Respect to Parameters in MoU *vis a vis* Achievements (2011-12)
(Referred to in Paragraph No. 4.2.7)

Name of PSB/Parameter	CASA *(in per cent)*		ROA *(in per cent)*		Profit Per Employee *(₹in Lakh)*		Cost to Income Ratio *(in per cent)*		Ratio of Staff in Branches to Total Staff *(in per cent)*	
	Targets	Achievem-ents	Targets	Achievem-ents	Targets	Achiev-ements	Targets	Achiev-ements	Targets	Achiev-ements
Allahabad Bank	30.01	30.78	1.02	1.02	7	8.36	44	41.65	89	89.2
Andhra Bank	29.1	26.4	1.38	1.19	8.5	8.91	39.91	39.06	88	88.95
Bank of Baroda	33.5	33.18	1.15	1.24	11	11.87	40	37.55	86	87.54
Bank of India	31.01	34.25	0.7	0.72	6.5	6.37	44	42.47	89.74	88.76
Bank of Maharashtra	38	41.33	0.55	0.55	5	3.12	59	52.02	90	90
Canara Bank	28	25.16	1.1	0.95	10	8.21	42	44.02	80	80.8
Central Bank of India	32	33.27	0.5	0.26	3.5	1.48	54.64	38.18	86	86.78
Corporation Bank	26.34	22.12	1.15	1.06	11.18	10.9	40	38.44	85	85.43
Dena Bank	36.34	34.46	1.1	1.08	7.86	7.87	42.67	43.04	88	87.62
IDBI Bank Limited	24	24.1	0.8	0.81	12.5	13.16	39.4	39.13	80	84
Indian Bank	31	31	1.25	1.31	9	9.3	42	38.71	84	88.66
Indian Overseas Bank	31	26.42	0.62	0.52	5.02	3.84	46.27	47.23	88.3	88.07
Oriental Bank of Commerce	25	24.13	0.87	0.67	9.25	6.21	37.18	42.44	88	90.05
Punab and Sind Bank	25	23.95	1	0.65	7.5	5.61	49.9	60.39	80	82.98
Punjab National Bank	35	35.34	1.1	1.19	8.25	8.42	43	39.75	89	87
State bank of Bikaner & Jaipur	38.95	37.34	1.15	0.99	7.3	5.42	47.37	47.18	80	85
State Bank of Hyderabad	32.41	27.27	1.3	1.15	9.42	8.63	38.27	39.55	88.65	87.53
State Bank of India	45	46.86	1.02	0.88	6	5.31	45	45.23	81	80.6
State Bank of Mysore	35.53	31.7	1.18	0.67	7.49	3.60	41.20	49.55	83.38	88.59
State Bank of Patiala	31.68	24.39	1.07	0.93	7.54	5.87	40.63	43.06	81.86	82.55
State Bank of Travancore	33.22	27.34	1.23	0.65	8.24	4.20	44.36	49.62	81	84
Syndicate Bank	33	31.43	0.85	0.81	5	5.29	44	45.68	80	85.31
UCO Bank	24.19	23.85	0.74	0.69	5	5.09	43	42.24	88	88
Union Bank of India	32.34	31.28	0.9	0.79	7	5.8	43.46	43.15	Above 80	88.1
United Bank of India	39	40.76	0.8	0.7	4	4.08	42.5	43.06	85	88
Vijaya Bank	26	22.06	0.94	0.66	5	5.16	53.53	49.39	83	84.55

(Source : Records of DFS)

Annexure VIII
Targets with Respect to Parameters in MoU *vis a vis* Achievements (2012-13)

(Referred to in Paragraph No. 4.2.7)

Name of PSB/Parameter	CASA (*in per cent*)		ROA (*in per cent*)		Profit Per Employee (*₹in Lakh*)		Cost to Income Ratio (*in per cent*)		Ratio of Staff in Branches to Total Staff(*in per cent*)	
	Targets	Achievements	Targets	Achievements	Targets	Achievements	Targets	Achievements	Targets	Achievements
Allahabad Bank	31.87	31.05	1.2	0.64	9.69	5.25	41.75	46.63	88	89
Andhra Bank	30.88	25.65	1.4	0.99	9.62	7.8	39.23	42.40	88	90.1
Bank of Baroda	35	30.38	1.3	0.82	13	10.39	38	39.79	84	87.34
Bank of India	32.5	32.79	0.85	0.65	8.33	6.44	42	41.69	89.88	89.68
Bank of Maharashtra	38.6	40.79	0.85	0.74	5.5	5.59	52	45.54	87	86.49
Canara Bank	30	25.12	1.25	0.77	11	6.96	40	46.61	80	80
Central Bank of India	33	32.55	0.7	0.44	5	2.83	51	57.16	86	85.07
Corporation Bank	29.23	21.68	1.18	0.88	11.79	9.68	40	39.67	85	87.31
Dena Bank	37.25	28.84	1.2	0.86	9.17	7.31	40.54	42.77	86	87.96
IDBI Bank Limited	27	25.12	0.9	0.72	13.75	12.18	38.8	36.48	80	86
Indian Bank	31.5	28.68	1.3	1.02	9.2	8.38	41.74	47.33	82.5	89
Indian Overseas Bank	32	26.51	0.7	0.24	5.76	1.99	45.1	47.17	88.3	88.58
Oriental Bank of Commerce	27	24.55	1.02	0.71	10.73	7.03	40.52	41.49	88	91
Punab and Sind Bank	27	22.28	1.08	0.44	9	3.98	45.1	54.38	80	84
Punjab National Bank	35.5	39	1.15	1	10	8.06	43.4	42.8	89	86
State bank of Bikaner & Jaipur	39.4	35.88	1.3	0.96	9.75	5.91	42.07	47.97	80	82.92
State Bank of Hyderabad	35.66	27.88	1.39	0.99	10.96	8.29	36.87	43.02		87.85
State Bank of India	45	47	1.08	0.91	7.2	6.45	44	48.51	81.5	80.52
State Bank of Mysore	37.44	31.22	1.33	0.66	9.85	3.86	38.54	46.25	81.88	88.79
State Bank of Patiala	35.25	25.06	1.25	0.68	9.88	4.62	38.21	49.55	81.06	85
State Bank of Travancore	36.12	25.79	1.34	0.66	10.28	5.06	40.35	51.42	81	85
Syndicate Bank	33	31.08	0.95	1.07	6.33	8.11	41	47.96	80	83.61
UCO Bank	27	35	1	0.33	6.25	2.72	40.25	39.33	86	88
Union Bank of India	35	30.95	1.09	0.79	8.4	6.79	41.02	44.7	Above 80	88.28
United Bank of India	38	39.61	1	0.38	6	2.53	41.5	42.32	85	87.47
Vijaya Bank	31	20.97	1.19	0.35	9	5.05	49.02	54.85	82	89

(Source : Records of DFS)

Annexure IX

Targets with Respect to Parameters in MoU *vis a vis* Achievements (2013-14)

(Referred to in Paragraph No. 4.2.7)

Name of PSB/Parameter	CASA *(in per cent)*		ROA *(in per cent)*		Profit Per Employee (₹ *in Lakh)*		Cost to Income Ratio *(in per cent)*		Ratio of Staff in Branches to Total Staff *(in per cent)*	
	Targets	Achievements	Targets	Achieve ments	Targets	Achieve ments	Targets	Achieve ments	Targets	Achieve ments
Allahabad Bank	33.57	31.53	1.3	0.57	12.26	4.77	39.25	46.23	87	90.06
Andhra Bank	33.03	24.81	1.42	0.29	11.23	2.33	37.72	45.56	88	92.07
Bank of Baroda	39	31.76	1.4	0.69	14.75	9.87	36.5	43.44	82	87.53
Bank of India	34.04	29.97	0.98	0.51	10.47	6.28	38.5	44.3	90.23	90.58
Bank of Maharashtra	39.25	35.89	1.2	0.3	8.75	2.68	44	54.43	84	89.27
Canara Bank	32	25.9	1.4	0.54	13	5.01	38	47.22	80	80
Central Bank of India	33	33.33	0.8	-0.47	7.5	-3.11	47.5	61.53	86	85.99
Corporation Bank	32.11	20.33	1.22	0.29	12.39	3.29	40	44.04	85	86.9
Dena Bank	38.17	28.01	1.3	0.51	10.87	4.25	38.49	48.16	85	87.38
IDBI Bank Limited	30	22.63	1	0.38	15.25	6.82	37.25	36.88	81	87.16
Indian Bank	32	28.34	1.35	0.67	9.5	5.97	42.51	49.4	81	89.68
Indian Overseas Bank	33	25.34	0.82	0.23	8.28	2.01	44.6	48.4	88.3	88.54
Oriental Bank of Commerce	28.5	24.31	1.05	0.56	12.1	5.83	39.36	41.24	88	91.17
Punab and Sind Bank	29	20.88	1.14	0.35	10	3.39	42.3	60.91	80	84
Punjab National Bank	37.5	38	1.2	0.64	12	5.49	43.7	45	89	88.4
State bank of Bikaner & Jaipur	39.7	39.51	1.4	0.87	11.38	5.62	38.54	54.2	80	81.63
State Bank of Hyderabad	37.83	30.51	1.44	0.7	11.98	6.1	35.94	45.73		86.44
State Bank of India	45	44	1.16	0.65	8.62	4.85	42	52.67	82	81.27
State Bank of Mysore	38.72	33.25	1.41	0.4	11.43	2.53	36.77	53.4	80.9	89.38
State Bank of Patiala	37.63	31.37	1.38	0.42	11.44	2.98	36.61	58.23	80.53	87.5
State Bank of Travancore	38.05	27.65	1.42	0.29	11.64	2.2	37.68	57.66	81	84
Syndicate Bank	34	29.90	1.03	0.78	7.84	6.83	37	48.1	80	86.38
UCO Bank	33	32	1.25	0.7	9.25	6.55	38.12	33.05	84	89
Union Bank of India	37.5	29.5	1.18	0.52	10.08	5.02	37.98	51.24	Above 80	87.23
United Bank of India	37.5	37	1.25	-0.99	8	-7.35	40	45.31	85	86.59
Vijaya Bank	34	18	1.34	0.5	11	3.62	46.01	60.49	81	84

(Source : Records of DFS)

Glossary

Sl. No.	Term	Description
1.	**BASEL Committee on Banking Supervision**	The BASEL Committee is a committee of bank supervisors consisting of members from each of the G10 countries. The Committee is a forum for discussion on the handling of specific supervisory problems. It coordinates the sharing of supervisory responsibilities among national authorities in respect of banks' foreign establishments with the aim of ensuring effective supervision of banks' activities worldwide.
2.	**Capital Funds**	Equity contribution of owners. Capital is divided into different tiers according to the characteristics / qualities of each qualifying instrument. For supervisory purposes capital is split into two categories: Tier I and Tier II.
3.	**CASA Deposit**	Deposit in bank in current and Savings account.
4.	**Cost to Income Ratio (Efficiency Ratio)**	The cost to income ratio reflects the extent to which non-interest expenses of a bank make a charge on the net total income (total income - interest expense). The lower the ratio, the more efficient is the bank.
5.	**CRAR(Capital to Risk Weighted Assets Ratio)**	Capital to risk weighted assets ratio is arrived at by dividing the capital of the bank with aggregated risk weighted assets for credit risk, market risk and operational risk. The higher the CRAR of a bank the better capitalised it is.
6.	**Credit Risk**	The risk that a party to a contractual agreement or transaction will be unable to meet its obligations or will default on commitments.
7.	**Internal Capital Adequacy Assessment Process (ICAAP)**	In terms of the guidelines on BASEL II, the banks are required to have a board-approved policy on internal capital adequacy assessment process (ICAAP) to assess the capital requirement as per ICAAP at the solo as well as consolidated level. The ICAAP is required to form an integral part of the management and decision-making culture of a bank. ICAAP document is required to clearly demarcate the quantifiable and qualitatively assessed risks. The ICAAP is also required to include stress tests and scenario analyses, to be conducted periodically, particularly in respect of the bank's material risk exposures, in order to evaluate the potential vulnerability of the bank to some unlikely but plausible events or movements in the market conditions that could have an adverse impact on the bank's capital.
8.	**Market Risk**	Market risk is defined as the risk of loss arising from movements in market prices or rates away from the rates or prices set out in a transaction or agreement. The capital charge for market risk was introduced by the BASEL Committee on Banking Supervision through the Market Risk Amendment of January 1996 to the capital accord of 1988 (BASEL I Framework).
9.	**Non Performing Assets (NPA)**	An asset, including a leased asset, becomes non performing when it ceases to generate income for the bank.

10.	**Return on Assets (ROA)**	Return on Assets (ROA) is a profitability ratio which indicates the profit generated on total assets. It is computed by dividing net income by average total assets.
11.	**Return on Equity (ROE)**	Return on Equity (ROE) is a ratio relating net profit to shareholders' equity. Here the equity refers to share capital reserves and surplus of the bank.
12.	**Risk Weighted Asset**	The notional amount of the asset is multiplied by the risk weight assigned to the asset to arrive at the risk weighted asset number. Risk weight for different assets vary e.g. 0% on a Government Dated Security and 20% on a AAA rated foreign bank etc
13.	**Tier I Capital**	A term used to refer to one of the components of regulatory capital. It consists mainly of share capital and disclosed reserves (minus goodwill, if any). Tier I items are deemed to be of the highest quality because they are fully available to cover losses Hence it is also termed as core capital.
14.	**Tier II Capital**	Refers to one of the components of regulatory capital. Also known as supplementary capital, it consists of certain reserves and certain types of subordinated debt. Tier II items qualify as regulatory capital to the extent that they can be used to absorb losses arising from a bank's activities. Tier II's capital loss absorption capacity is lower than that of Tier I capital.