Discussion Paper on Prompt Corrective Action

Department of Banking Supervision
Central Office
Policy Planning Division

1. **Introduction**

1.1 The 1980s and early 1990s were a period of great stress and turmoil for banks and financial institutions all over the globe, viz. Brazil, Chile, Indonesia, Mexico, several Nordic countries, Venezuela and USA, etc. In USA, more than 1600 commercial and savings banks insured by the Federal Deposit Insurance Corporation (FDIC) were either closed or given FDIC financial assistance during this period. More than 900 Savings and Loan Associations were closed or merged with assistance from Federal Savings and Loan Insurance Corporation (FSLIC) during 1983 to 1990. The cumulative losses incurred by the failed institutions exceeded US $ 100 billion. These losses resulted in the insolvency and closure of FSLIC and its replacement by the Resolution Trust Corporation (RTC) and the Savings Association Insurance Fund (SAIF).

1.2 These events led to the search for appropriate supervisory strategies to avoid bank failures as they can have a destabilising effect on the economy. For this reason, medium sized or large banks are rarely closed and the governments try to keep them afloat. **In both industrial and emerging market economies, bank rescues and mergers are far more common than outright closure of the banks.** If banks are not to be allowed to fail, it is essential that corrective action is taken well in time when the bank still has adequate cushion of capital so as to minimise the cost to the insurance fund / public exchequer in the event of a forced liquidation of the bank. In this context, supervisory action can be at two levels:

- early stage recognition of problems and corrective actions
- supervision and monitoring of troubled banks

Identifying problem banks early is one of the responsibilities of bank supervisors. The other responsibility is to monitor the behaviour of troubled banks in an attempt either to prevent failure or to limit losses.

1.3 These objectives are sought to be achieved by establishing various trigger points and graded mandatory responses by the supervisors. This represents partial replacement of regulatory discretion by rules, as the prescribed actions are generally likely to be a mix of mandatory and discretionary actions. The case for automatic rules is that it will contain regulatory forbearance (i.e. hoping that problems will solve themselves) - which has been a very common complaint against the supervisors - and will lead to prompter action. Prompt actions are important as the cost of restructuring / liquidation of a bank is likely to rise, the longer that action is delayed.

1.4 The structured, predetermined capital or asset ratios that trigger actions by the regulatory authorities have two purposes: one is to reduce a bank's moral hazard behaviour. The several trigger points serve as **speed breakers** or **trip wires** to slow deterioration of weak banks and reduce incentives and opportunities for banks to increase their risky assets. Banks are encouraged to perform better by enticements (i.e. lesser restrictions on moving to higher zones). Such Structured Early Intervention and Resolution (SEIR) include **carrots** as well as **sticks**. The second purpose is to reduce the regulators' agency problem. The regulators first have the opportunity of using their discretion to get banks to restore depleted capital. But if the banks do not respond and their capital ratios continue to fall, appropriate sanctions including resolution ***at least cost*** to the Insurance Corporation become mandatory.

1.5 Since both the discretionary and the mandatory actions and other rules are explicit and known ***a priori*** to banks, they help shape the future behaviour of the banks so that the regulators have stronger ***ex-ante*** influence and are not faced as often with unexpected ***fait accompli***.

1.6 The Core Principles for Effective Banking Supervision (Principle 22) of Basel Committee on Banking Supervision mandate that banking supervisors must have at their disposal adequate

supervisory measures, backed by legal sanctions, to bring about timely corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations or where their depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking licence or recommend its revocation. The penal actions range from restricting the current activities of the bank, withholding approval of new activities or acquisitions, restricting or suspending payment to shareholders, restricting asset transfers, restrictions on discretionary powers of managers, directors or controlling owners, arranging a take-over by or merger with healthier institutions.

1.7 The Financial Stability Assessment Programme (FSAP), jointly made by International Monetary Fund and the World Bank team on India's compliance with the Basel Committee's Core Principles highlighted that lack of explicit rules mitigating against supervisory forbearance is a major weakness and that the time limit set by the Reserve Bank for taking remedial measures are too long.

2. **Prompt Corrective Action Framework in other countries**

2.1 The best-known example of such a regime is in USA. Federal Deposit Insurance Corporation Improvement Act (FDICIA) was passed in 1991 to limit regulatory forbearance by requiring (i) a more timely closure of failing institutions and (ii) early intervention in problem banks. These are known as **Prompt Corrective Action (PCA)**. The FDIC Improvement Act, 1991, requires each appropriate federal banking agency to take prompt corrective action to resolve the problems of insured depository institutions at the least possible long-term loss to the deposit insurance fund. PCA is a framework of supervisory actions for insured depository institutions that are not adequately capitalised. For this purpose, banks are placed in one of the five zones (i.e. Well Capitalised, Adequately Capitalised, Undercapitalised, Significantly Undercapitalised and Critically Undercapitalised) based on three capital ratios (CRAR, Tier I to Risk Weighted Assets and Tier I to Total Assets). Every Zone, other than the Well Capitalised Zone, has a set of mandatory and discretionary provisions with increasing severity. The basic structure of the scheme is given in Annexure I. The prescribed actions include establishing a capital restoration plan, restrictions on deposit taking, interest payable on deposits, new activities, acquisitions, officers' pay, asset growth, payment of dividends, and management fees, etc. Banks, which are critically undercapitalised for a prescribed period, face closure.

2.2 In the US, the FDIC is required to compute and document the costs of resolving a troubled institution in alternative ways and justify its option used as ***the least cost one***. However, an exemption from least cost resolution is provided for banks that regulators judge as *too-big-to-fail* and where not protecting their uninsured depositors or creditors from loss would have serious adverse effects on economic conditions or financial stability. The Act prescribes a stringent methodology for exercise of such discretion. It requires a determination of threat of **systemic risk** by the Secretary of Treasury upon the written recommendation of two thirds of FDIC Board of Directors and the Board of Governors of the Federal Reserve System and after consultation with the President.

2.3 USA was not the only country to experience serious banking problems in recent years. A study by the IMF reported that over 130 of the 181 member countries reported banking crises since 1980. Banks' regulatory system, as a consequence, came under intense scrutiny, and fundamental questions were raised about its effectiveness in anticipating and limiting the number of bank failures and losses to the deposit insurance fund. Consequently, a system of PCA regime operates in many other countries too, designed to address the problems developing in banking system in a prompt manner. Rules based on compulsory quantitative triggers (in relation to capital levels) for action by supervisors patterned on the rules set in the FDIC Improvement Act, 1991 have been devised in some industrial economies and in a number of emerging market economies (e.g. Korea, Argentina, Chile, Colombia, Czech Republic, Hong Kong). Some of the countries have rule-based system to initiate actions against banks which, apart from non compliance of CRAR, are unable to meet the obligations, doing business detrimental to the

interests of depositors or creditors, which suffer from illiquidity, insolvency, large losses, serious violation of laws and regulations, imminent loss, etc. (e.g. Singapore, Brazil, Mexico, Peru, Hungary, Poland and Saudi Arabia). A summary of such regimes is given in Annexure II.

2.4 The financial crisis that began in Asia has once again brought the importance of the PCA to the fore. The crisis clearly demonstrated the importance of robust and efficient domestic financial systems. Weak banking systems and poorly developed capital markets contributed to misallocation of resources that led to the crisis. Key to the strengthening of domestic financial system is the implementation of sound practices for regulation, supervision, settlement, and accounting and disclosure standards. The implementation of sound practices depends on incentives to do so. These can be in the form of market-based incentives, either alone or in combination with official or regulatory incentives. These have been emphasised in the Report of the **Working Group on Strengthening Financial Systems** *(of BIS / IMF / OECD / World Bank)*. The Working Group recommends adopting, implementing and enforcing a method of ***structured early intervention in the banking sector*** which includes a well considered set of mechanisms to ensure a consistent, timely and graduated response by supervisors.

3. **Existing Framework for Supervisory Action**

3.1 Under the powers conferred under RBI Act, 1934 and Banking Regulation Act, 1949, Reserve Bank has been taking bank-specific supervisory corrective actions where the financial position warrants such measures. These included directing banks to submit quarterly Monitorable Action Plans and progress reports on various targets set by the Reserve Bank, such as augmentation of capital, improvement in profitability, reduction of NPAs, reconciliation of entries in inter-branch, inter-bank and nostro accounts, review / renewal of borrowal accounts, etc. In extreme cases, Reserve Bank had also put caps on credit-deposit ratio, restrictions on payment of dividend, call money borrowings and refinancing with high cost deposits including Certificate of Deposit, ban on recruitment and opening of branches, etc. Where the financial position so warrants, Reserve Bank effects changes in the management of banks by removal of the Chief Executive Officer or Directors of the Board. In addition, RBI appoints additional Directors / Observers to oversee the functioning of the bank so as to prevent the affairs of the bank being conducted in a manner detrimental to the interest of present or future depositors. RBI also exercises powers in extreme cases to place banks under moratorium or initiate winding up proceedings.

3.2 Though there are explicit provisions (Sections 35A, 36AA, 36AB, 37, 46 to 48 of Banking Regulations Act, 1949) empowering Reserve Bank to initiate appropriate corrective actions against banks which are showing signs of distress, these are not properly structured and no time limit is set for response to such actions in the case of definite weaknesses in banks. It is, therefore, necessary that we should evolve rule-based corrective actions, which are transparent for addressing early warning signals.

4. **Proposed Prompt Corrective Action**

4.1 In the light of the discussions above, there is a need to put in place a rule-based PCA regime in India too, as a part of our commitment to adopt the international best practices and comply fully with the Core Principles.

4.2 The PCA or the rule-based framework prevalent in USA and other countries focuses on the need to prevent insolvency of banks by taking corrective actions well in time. It is, however, considered desirable to build a broader PCA regime in India so as to delineate rule-based actions not only for shortfall in capital but also for other indicators of deficiency so that a seamless paradigm for corrective actions can be put in place for major deficiencies in banks' functioning.

4.3 Accordingly, a schedule of corrective actions has been worked out based on three parameters i.e. **CRAR**, **Net NPAs** and **Return on Assets (RoA)** which represent the three important parameters, viz. capital adequacy, asset quality and profitability. Certain trigger points have been determined for the PCA framework under the three parameters taking into the practicability of

implementation of certain measures in the Indian context. These have also been discussed with select banks. The modified proposals taking into account bankers' views are given below:

5. **Framework for PCA**

5.1 Trigger points have been set up under all the three parameters, i.e. **CRAR, Net NPAs** and **Return on Assets (RoA)**. Composite Rating, being the supervisor's assessment of the overall condition of a bank, has not been taken as a trigger point. Composite Rating is a combined assessment based on the rating given on each component of CAMELS, viz. capital adequacy, asset quality, management, earnings, liquidity and systems and controls. Presently, supervisory ratings and actions taken based on such ratings are not made public. The triggers based on CRAR, Net NPAs and ROA take care of a bank's performance in three critical areas which are quantifiable and forming integral part of the rating framework.

5.2 For every trigger point a set of mandatory and discretionary PCAs have been laid down. The PCAs are designed to pre-empt any deterioration in the soundness of banks. Any actions, without duly recognising the diverse profile and factors contributing to the problems in banks, however, may not achieve the desired effect. The PCA should, therefore, encompass certain actions, which should bring immediate improvements, while some action points would be initiated in alignment with the severity of the problem. Thus, a set of **Mandatory** and **Discretionary** action points, in conformity with the magnitude of problems should be in place to bring about improvement in the functioning of banks. The rationale for classifying the rule based action points into **Mandatory** and **Discretionary** is that some of the actions are essential to restore the financial health of banks while other actions will be taken at the discretion of RBI depending upon the profile of each bank. In cases where banks do not show improvement, despite taking mandatory actions, some of the discretionary actions will get converted into mandatory actions. **However, in exceptional cases, RBI will have the right to waive mandatory provisions.**

5.3 The total PCA framework for a bank will have to be determined by aggregating the PCAs under the various parameters.

5.4 While there are mandatory provisions proposed for the liquidation / merger of banks under certain conditions, discretion would still be with RBI in enforcing liquidation where such a step can cause systemic problems. However, a rigorous methodology for such discretionary treatment will be put in place.

5.5 The Basel Committee proposes the existing regulatory capital requirement as minima and that banks should hold capital in excess of the minima on the basis of risk profile, track record in risk management, experience and quality of personnel, nature of the market, etc. In the UK, Financial Services Authority (FSA) prescribes different minimum capital ratios (**Triggers**) for different banks. The **'Trigger'** ratio is considered sacrosanct. Banks must meet their trigger ratios at all times and a breach of this is considered a serious violation which has the effect of putting the banks' customers at unacceptable risk. In order to avoid such a situation, FSA expects the banks to maintain capital at a level higher than the trigger ratio, which is the **'Target'** ratio. The **target ratio is normally ½% to 1% above the trigger ratio** and acts as a regulatory buffer. The banks are expected to inform FSA if the capital falls below either the target or trigger ratio at any time. The expectation is that the capital will normally be above the target ratio, and if it falls to the target level, then corrective action can be initiated in time to prevent breach of the trigger. Thus in UK, the target ratio acts as a proxy for the regulatory minimum capital requirement.

5.6 However, in India, banks are presently required to maintain 9% CRAR as the regulatory minimum capital. Bank-specific capital adequacy requirements have not yet been prescribed. Under the circumstances, trigger points for initiating prompt corrective actions have been proposed when banks' CRAR falls below the regulatory minimum. While a marginal slip-back in the prescribed CRAR could be the first trigger point of supervisory action, further erosion, in the bands of 3% each in CRAR, could be the trigger points for subsequent stages. The trigger points based on capital adequacy requirements will be suitably modified when RBI adopts the proposal

of bank-specific varying CRAR, as articulated in the second pillar of the New Capital Adequacy Framework.

5.7 The trigger points for NPAs and ROA may have to be set afresh every third year depending upon the performance parameters of the banks.

6. **Recommended Trigger Points**

6.1 **CRAR** Three trigger points have been proposed:

- **(i) CRAR less than 9%, but equal or more than 6%**
- **(ii) CRAR less than 6%, but equal or more than 3%**
- **(iii) CRAR less than 3%**

6.2 **NPAs**

6.2.1 As per the data in the Report on Trend and Progress of Banking in India (1998-99), nearly 2/3rd of the public sector banks, old private sector banks and foreign banks had net NPAs of 10% or less whereas the new private sector banks had an average net NPAs of 4.1%. Thus, the 10% level could be the trigger level for PCA. This is an appropriate level considering the fact that 9% of NPA is the ceiling for granting autonomy to Public Sector Banks.

6.2.2 Two trigger points have been proposed as under:

- **(i) Net NPAs over 10% but less than 15%**
- **(ii) Net NPAs 15% and above**

6.3 **ROA**

6.3.1 Internationally 1% ROA is considered as a benchmark. However, the 1998-99 results of banks show a very sharp decline in ROA in all the four groups of banks as may be seen from the data given below :-

	1997-98	**1998-99**
Public Sector banks	0.77	0.42
Old Private Sector banks	0.81	0.48
New Private Sector banks	1.55	1.03
Foreign banks	0.97	0.90

6.3.2 In view of such sharp variations in ROA, it is difficult to set a trigger ROA at a level close to the desirable level i.e. 1%. Keeping in view Indian reality, **a trigger point of below 0.25%** has been proposed.

7. **Mandatory and Discretionary Actions**

7.1 **Actions based on CRAR**

7.1.1 Capital to Risk-weighted Assets Ratio is one of the significant indicators of the financial soundness of banks. CRAR normally comes down either due to unrestricted growth in assets, especially risk-weighted assets without concomitant increase in capital or inadequate internal generation because of low earnings or high expenditure or poor asset quality resulting in heavy provisioning requirement. Such banks will have little cushion to absorb any shocks, triggered by credit / market risk or other external developments. Therefore, the mandatory and discretionary actions proposed are aimed at augmenting capital, restricting asset growth, especially risk-weighted assets, enhancing the internal generation through cost containment, and moderating risks in operations. In more severe cases of capital shortfall, change in management or ownership may also have to be resorted to. Finally, in extreme cases, banks may have to be merged / liquidated if the capital adequacy does not improve from the threshold level of 3% within a reasonable time or if the management / promoters do not show any inclination to restore capital to the desired level. The underlying idea is that a bank which is hovering at a very critical level does not show any improvement despite reasonable opportunities ought to be closed down while it has some capital so as to minimise the cost to the insurance fund / public exchequer.

7.1.2 The mandatory and discretionary actions for the three zones are given below. These have been designed to increase in severity as the capital shortage becomes more critical.

CRAR less than 9%, but equal or more than 6%

7.1.3 The situation implies that the bank fails to comply with the minimum regulatory CRAR of 9%, which exhibits its inability to absorb future shocks. The poor capital base is exacerbated by low earnings, heavy provisioning requirements due to high level of NPAs, high intermediation costs, asset-liability mismatches and bank's strong appetite for risky assets. It also exhibits bank's inability to access the capital market. In such cases, the bank is not in a position to gainfully expand its asset base for improving profitability. The bank's flexibility to operate in inter bank and overseas markets would be severely restricted, forcing the bank to adopt narrow banking.

7.1.4 **Mandatory Actions**

- Submission and implementation of capital restoration plan
- Restriction on expansion of risk-weighted assets
- Prior approval of RBI for new branches and lines of business
- Paying off costly deposits and CDs
- Reduce / suspend dividend

7.1.5 **Discretionary Actions**

- Order recapitalisation
- Reduce stake in subsidiaries
- Shedding of risky business
- Cap on deposit interest rates
- Restriction on borrowings from inter bank market
- Revise credit / investment strategy and controls

CRAR less than 6%, but equal or more than 3%

7.1.6 It showed further deterioration in capital base due to combination of factors, such as continuous losses, heavy provisioning requirements due to precarious asset quality, failure to adjust risk-weighted assets due to illiquidity, promoters' inability to bring in additional capital, etc. indicating higher possibility of bank failure.

7.1.7 **Mandatory Actions**

- Same as for category (7.1.4) above
- Discussion with the bank's Board on corrective plan of action
- Order recapitalisation
- Reduce overseas presence / stake in subsidiaries
- Cap on deposit interest rates
- Revise credit / investment strategy and controls
- Bring in consultants for business / organisational restructuring
- Bring in new Management/Board
- Reduce advances / capital expenditure / overheads

7.1.8 **Discretionary Actions**

- Change of promoters / change in ownership
- Wage freeze/VRS
- Merger / liquidation if the bank fails to submit / implement recapitalisation plan or fails to recapitalise pursuant to order, within such period as RBI may stipulate.

CRAR less than 3%

7.1.9 This indicates all-round deterioration in capital adequacy, which may have arisen out of very poor asset quality and earnings of the bank. It also shows the inability of the existing management to infuse fresh capital, which point to the fact that induction of new management with adequate resources is the only solution to restore the position. Given the asset quality problem and poor earnings, the possibility of a quick turnaround is ruled out. Immediate injection of capital is only alternative to avert the failure.

7.1.10 **Mandatory Actions**

- Same as for category (7.1.7) above

- Wage freeze / VRS
- Appointment of Observers to monitor the functioning of the bank
- Merger / liquidation if the bank's CRAR does not improve beyond 3% within one year or within such extended period as granted by RBI

7.2 **Actions based on Net NPAs**

7.2.1 Poor asset quality is due to deficiencies in credit administration, i.e. sub-standard credit appraisal, follow-up and recovery of loan assets and weaknesses in credit risk management. Lack of adequate income inhibits the banks from making provisions as per regulatory requirements. As such, to reduce the net NPAs, the steps needed are: a clear cut loan as well as recovery policy, drive for recovery of NPAs, upgradation of skills, revamping of credit administration and risk management systems and entertaining only high quality proposals. A sound Loan Review Mechanism needs to be in place to protect the quality of loan portfolio. Expanding avenues to generate fee- based income and measures for containment of costs would also be desirable to ensure that banks make adequate provisions.

7.2.2 The set of mandatory and discretionary actions for the two zones are as under:

Net NPAs over 10% but less than 15%

7.2.3 Net NPAs in excess of 10% clearly demonstrates the poor asset quality of banks, which will have serious implications not only for current earnings but also its future income. Such banks' charge on Net Interest Income for loan loss provisioning / write off will be substantial. Further, the situation may also lead to serious provisioning implications in future due to migration of such NPAs into higher categories. The huge stock of NPAs forces the banks place their entire credit administration machinery in dealing with problem loans with little time for follow-up of other assets. This may also prevent the bank from undertaking profitable loan business. In a few cases, banks may be tempted to take on risky loans for generating more income, leading to adverse selection. High NPAs will also restrict the banks' flexibility in assuming interest rate and exchange rate risks, even under favourable environment. The coverage ratio of such banks will be at a very unsustainable level.

7.2.4 **Mandatory Actions**

- Special drive to reduce the stock of NPAs and contain generation of fresh NPAs
- Review loan policy
- Upgrade credit appraisal skills and systems
- Strengthen follow-up of advances including loan review mechanism for large loans
- Effective follow-up of suit filed / decreed debts
- Put in place proper credit risk management polices / process / procedures/ prudential limits
- Reduce loan concentration - individual, group, sector, industry, etc.
- Restriction on loan portfolio growth

7.2.5 **Discretionary Actions**

- Prior approval of RBI for branch expansion / undertaking new lines of business.
- Reduce overseas presence
- Reduce /suspend dividends
- Engagement of consultants to revamp credit administration
- Reduce stake in subsidiaries

Net NPAs 15% and above

7.2.6 It shows structural weaknesses in loan policy / administration and inability of banks to adequately provide for loan impairment. Also, such banks have little or no scope or inclination to provide for more than the regulatory provisioning requirements. It could be possible that the sub-standard assets constitute a significant portion of the NPAs. In such an event, the bank may have to face the situation of making higher provisioning requirements in future due to migration of sub-standard advances to lower categories. Such banks will have limited flexibility in absorbing

future shocks and undertaking profitable business. The earning potential is severely restricted, with limited scope for internal generation of capital. In pursuit for higher income, such banks could be assuming low quality assets, which may lead to adverse selection.

7.2.7 **Mandatory Actions**

- Same as for category (7.2.4) above
- Discussion with bank's Board on corrective plan of action
- Prior approval of RBI required for branch expansion / undertaking new line of business
- Reduce overseas presence
- Reduce / suspend dividends
- Engagement of Consultants to revamp credit risk management process
- Reduce stake in subsidiaries

7.3 **Action based on Return on Assets (ROA)**

7.3.1 Return on Assets is one of the important indictors of the overall efficiency of banks. ROA comes down due to various factors such as high non performing assets, low fee- based income, high intermediation costs due to overstaffing, etc. Proposed actions aim at improving the income and containing expenses, reduction of high cost deposits, possible reduction in high level of provisioning / write off and tapping of avenues to increase fee based income.

ROA less than 0.25%

7.3.2 ROA at less than 0.25% indicates abysmal productivity of assets. The lower ROA may also be due to unsustainable level of NPAs, high cost-income ratio due to heavy non-operating expenditure including staff expenditure and inability of the bank to tap off-balance sheet business opportunities. It could be possible that the bank suffered losses on account of interest rate and currency mismatches. Imprudent pricing of assets and liabilities without reckoning cost - yield relationship also leads to lower ROA. Raising the ROA requires restructuring of asset-liability profile, scientific pricing, undertaking fee-based activities, control over non-operating expenditure and reduction of NPAs to contain provisioning level within reasonable range.

7.3.3 **Mandatory Actions**

- Pay off costly deposits and CDs
- Mobilise low cost deposits
- Increase fee based income
- Contain administrative expenses
- Special drive to reduce the stock of NPAs and contain generation of fresh NPAs
- Prior approval of RBI required for opening new branches / starting new lines of business
- Staff expansion / filling up of vacancies only with prior approval of RBI except recruitment of specialists
- Capital expenditure only for technological upgradation and for day-to-day operations within Board approved limits
- Reduce / suspend dividends
- Restriction on borrowings in inter bank market

7.3.4 **Discretionary Actions**

- Cap on deposit interest rates
- Wage freeze / VRS

8. **Institutional Mechanism**

The published balance sheets, off-site returns and on-site inspection reports may be the primary sources for identifying the banks which could be placed under the PCA framework. If a bank's performance under any of the four broad parameters has crossed the trigger point, permission of the Board for Financial Supervision (BFS) will be taken for placing any bank under corrective action programme. Such permission will also include specific mandatory action and those of discretionary actions, which in the opinion of BFS, may be applied to the bank.

9. **Legal Protection to Supervisors**

As regards legal protection to supervisors / Members of the Board for Financial Supervision, who will be authorising Prompt Corrective Action, it has to be examined whether the existing provision contained in s.54 of Banking Regulation Act, 1949, viz.

S.54 (1) No suit or other legal proceeding shall lie against the Central Government, the Reserve Bank or any officer for anything which is in good faith done or intended to be done in pursuance of this Act.

(2) Save as otherwise expressly provided by or under this Act, no suit or other legal proceeding shall lie against the Central Government, the Reserve Bank or any officer for any damage caused or likely to be caused by anything in good faith done or intended to be done in pursuance of this Act.

will be adequate or a specific provision to this effect should be promoted in the B.R.Act.

10. **Conclusion**

10.1 Allowing a bank to fail is the tragedy that a supervisor should try to avoid. In order to ensure that banks are not allowed to fail, it is essential that corrective actions must be taken when banks have adequate cushion of capital and their financial position is still satisfactory. This is important since low or negative capital base and adverse financial conditions will induce banks to try desperate measures such as, offering very high interest rates on deposits to fund high risk borrowers. The Basel Committee had also endorsed the need for supervisors taking timely corrective action when banks fail to meet CRAR or other prudential requirements. It is accepted that intervention should be guided by rules rather than left to the discretion of supervisors.

10.2 The best known example of rule-based structured early intervention is the compulsory quantitative triggers for action by FDIC. Similar rules have been adopted in some developed economies and in a number of emerging market economies. While CRAR is generally accepted as a trigger point, a few emerging market economies have adopted multiple trigger points, viz. illiquidity, insolvency, serious violation of laws and regulations, non-compliance with prudential standards, etc.

10.3 The rule-based framework in most of the countries focuses on the need to prevent insolvency of banks. It is, however, considered desirable to build a broader PCA regime in India so as to delineate rule-based actions not only for shortfall in capital but also for other indicators of deficiency so that a seamless paradigm for corrective actions can be put in place for major deficiencies in banks' functioning. Accordingly, a schedule of corrective actions has been worked out based on three parameters, i.e. **CRAR, Net NPAs and ROA.** It is suggested to incorporate a blend of **mandatory** and **discretionary** prompt actions for every trigger point to deal comprehensively with different dimensions of problems. However, in exceptional cases, RBI will have right to waive mandatory provisions. While the published balance sheets, off-site returns and on-site inspection reports are the primary sources for identifying banks to be placed under PCA framework, the discretion to enforce PCA will be vested with BFS.

References

Reserve Bank of India – "Report of the Working Group on Restructuring Weak Public Sector Banks" (October 1999)

Reserve Bank of India – "Report on Trend and Progress of Banking in India -1998-99" (November 1999)

Benston, George J. and George G. Kaufman. "FDICIA after five years: A review and evaluation" - Federal Reserve Bank of Chicago Working Paper 1 (1997)

BIS Policy Paper No.6 - "Bank Restructuring in Practice" (August 1999)

BIS Economic Paper No.46 - "Banking crises in emerging economies: Origins and Policy Options" (October 1996)

Willard Group Reports on the International Financial Architecture – "Report of the Working Group on Strengthening Financial Systems" (October 1998)

Federal Deposit Insurance Corporation, USA – "History of the Eighties – Lessons for the Future"