2. RBI introduces Prompt Corrective Action Framework for NBFCs

Prelims Syllabus: Banking

Mains Syllabus: GS-III Indian Economy and issues relating to Planning, Mobilization of Resources, Growth, Development and Employment.

Why in News?

- The Reserve Bank of India (RBI) has introduced the prompt corrective action (PCA) Framework for non-banking Financial Companies (NBFCs).

About the News:

- The PCA framework for NBFCs will come into effect on October 1,2022 on the basis of their Financial Position on or after March 31.

What is PCA Framework?

- The objective of the framework is to enable supervisory intervention at the appropriate time and require the supervised entity to initiate and implement remedial measures in a timely manner, to restore its Financial Health.

Applicability:

- The framework will be applicable to all deposit-taking non-banking financial companies (NBFCs), all non-deposit taking NBFCs in the middle, upper and top layers including investment and credit companies, core investment companies, infrastructure debt funds, infrastructure finance companies and microfinance institutions.
- However, it has excluded NBFCs not accepting/not intending to accept public funds, primary dealers and Housing Finance companies along with government-owned ones.

Indicators based on which PCA will be Invoked for NBFC:

- The central bank will track three indicators — capital to risk-weighted assets ratio (CRAR), Tier I ratio and net non-performing assets (NNPAs) including non-performing investments (NPIs).
- In the case of core investment companies (CICs), the RBI will track adjusted net worth/aggregate risk-weighted assets, leverage ratio and NNPAs, including NPIs.
- A breach in any of the three risk thresholds under the above-mentioned indicators could result in invocation of PCA.

Need for:

- The PCA Framework for NBFCs has been brought after four big finance firms — IL&FS, DHFL, SREI and Reliance Capital — which collected public funds through fixed deposits and non-convertible debentures collapsed in the last three years despite the tight monitoring in the financial sector. They collectively owe over Rs 1 lakh crore to investors.

What will happen once the PCA is invoked for an NBFC?

- Based on the risk threshold, the RBI may prescribe mandatory corrective actions such as restriction on dividend distribution/remittance of profits, requiring promoters /shareholders to infuse equity and reducing leverage.
- The RBI can also restrict the issuance of guarantees or take other contingent liabilities on behalf of group companies (only for CICs).
- Further, the central bank may also restrict branch expansion, impose curbs on capital expenditure other than for technological up-gradation within board-approved limits and restrict/ directly reduce variable operating costs.