Revision Series 50 Important Topics

Economy (Part-2)

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26. Revised PCA Framework For Banks

- The **Prompt Corrective Action (PCA)** framework is aimed at nursing a lender facing issues on the asset quality, profitability and capital fronts back to health.

- PCA seeks to put a bank, whose **financial parameters are out of kilter**, back on the rails.

- The framework is intended to encourage banks to eschew certain riskier activities and focus on conserving capital so that their **balance sheets can become stronger**.

- RBI puts a Bank under PCA if the breach any one of the three risk thresholds under the three indicators that it tracks -- **capital, asset quality and leverage**.

26. Revised PCA Framework For Banks

PCA matrix – Parameters, indicators and risk thresholds				
Parameter	**Indicator**	**Risk Threshold 1**	**Risk Threshold 2**	**Risk Threshold 3**
(1)	(2)	(3)	(4)	(5)
Capital (Breach of either CRAR or CET 1 ratio)	CRAR - Minimum regulatory prescription for Capital to Risk Assets Ratio + applicable Capital Conservation Buffer (CCB) **and/or** Regulatory Pre-Specified Trigger of Common Equity Tier 1 Ratio (CET 1 PST) + applicable Capital Conservation Buffer (CCB)	Upto 250 bps below the Indicator prescribed at column (2) Upto 162.50 bps below the Indicator prescribed at column (2)	More than 250 bps but not exceeding 400 bps below the Indicator prescribed at column (2) More than 162.50 bps below but not exceeding 312.50 bps below the Indicator prescribed at column (2)	In excess of 400 bps below the Indicator prescribed at column (2) In excess of 312.50 bps below the Indicator prescribed at column (2)
	Breach of either CRAR or CET 1 ratio to trigger PCA			
Asset Quality	Net Non-Performing Advances (NNPA) ratio	>=6.0% but <9.0%	>=9.0% but < 12.0%	>=12.0%
Leverage	Regulatory minimum Tier 1 Leverage Ratio	Upto 50 bps below the regulatory minimum	More than 50 bps but not exceeding 100 bps below the regulatory minimum	More than 100 bps below the regulatory minimum

27. PCA Framework For NBFCs

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- PCA is the **regulator's action on weaker entities** if the financial performance falls below certain thresholds.
- The regulator then **imposes certain restrictions on the business operations** till the entities get back to satisfactory performance levels.
- The PCA system was already in place for banks.
- With NBFCs growing in size and having substantial inter-connectedness with other segments of the financial system, it was imperative that a PCA framework be put in place.
- **The PCA Framework for NBFCs comes into effect from October 1, 2022, based on their financial position on or after March 31, 2022**.

27. PCA Framework For NBFCs

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For NBFCs-D and NBFCs-ND (excluding CICs):

Indicator	Risk Threshold-1	Risk Threshold-2	Risk Threshold-3
CRAR	Upto 300 bps below the regulatory minimum CRAR [currently, CRAR <15% but ≥12%]	More than 300 bps but upto 600 bps below regulatory minimum CRAR [currently, CRAR <12% but ≥9%]	More than 600 bps below regulatory minimum CRAR [currently, CRAR <9%]
Tier I Capital Ratio	Upto 200 bps below the regulatory minimum Tier I Capital Ratio [currently, Tier I Capital Ratio <10% but ≥8%]	More than 200 bps but upto 400 bps below the regulatory minimum Tier I Capital Ratio [currently, Tier I Capital Ratio <8% but ≥6%]	More than 400 bps below the regulatory minimum Tier I Capital Ratio [currently, Tier I Capital Ratio <6%]
NNPA Ratio (including NPIs)	>6% but ≤ 9%	>9% but ≤12%	>12%

For CICs:

Indicator	Risk Threshold-1	Risk Threshold-2	Risk Threshold-3
Adjusted Net Worth / Aggregate Risk Weighted Assets	Upto 600 bps below the regulatory minimum ANW/RWA [currently, ANW/RWA <30% but ≥24%]	More than 600 bps but upto 1200bps below regulatory minimum ANW/RWA [currently, ANW/RWA <24% but ≥18%]	More than 1200 bps below regulatory minimum ANW/RWA [currently, ANW/RWA <18%]
Leverage Ratio	≥2.5 times but <3 times	≥ 3 times but <3.5 times	≥3.5 times
NNPA Ratio (including NPIs)	>6% but ≤ 9%	>9% but ≤12%	>12%

28. Red Herring Prospectus

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- A Red Herring Prospectus, or **offer document**, is **filed by a company to SEBI** when it intends to raise money from the public by selling shares of the company to investors.
- The document is very **useful to investors** because it **provides detailed information about the company's business operations**, financials, promoters and the **company's objective for raising funds by filing an IPOs**.
- It also elaborates on how the **company intends to use the money that will be raised**, the possible risks for investors.
- It does not contain details of either price or number of shares being offered or the amount of issue.
- As an investor, here are a few things to look at in a draft red herring prospectus:
  - **Business Description, Financial information, Risk Factors, Use of Proceeds, Industry overview and Management**

29. Inverted Duty Structure

- An inverted duty structure comes up in a situation where **import duties on input goods are higher than on finished goods**.
- In other words, the GST rate paid on purchases is more than the GST rate payable on sales.

Why is it a problem?

- Taxpayers who face an inverted duty structure will always have **Input Tax Credit (ITC)** in their GST electronic credit ledger even after paying off the output tax liability.
- This creates **working capital issues** for the taxpayers, as crucial resources remain blocked in the form of ITC.
- While the GST law provides the option to claim the unutilized ITC as a refund, there are other complications.

29. Inverted Duty Structure

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- From the government's standpoint, because of the current anomaly, many administrative-level issues have cropped up.
- A **complicated refund process** under GST creates additional compliance requirements and finally leads to more cost of compliance.
- This way, the inverted duty structure has caused **refund-related issues under the GST regime**.
- The disadvantage of the inverted duty structure increases with the increased use of imported raw materials.
- Manufactured **goods by the domestic industry becomes uncompetitive** against imported finished goods.

29. Inverted Duty Structure

What is Inverted Duty Structure?

It's created when inputs attract a higher tax rate than final product

How Does it Impact Industry?

- It hurts manufacturers of that product
- They have to pay higher tax on inputs
- Has led to pile up of input tax credit
- It has created cash flow issues for Cos

Which Sectors are Impacted Under GST ?

Product	GST on inputs	GST on finished goods
Mobile phones	18%	12%
Fertilizers	12%	05%
Footwear	18%	05%
Man-made yarn	18%	05%
Fabric	18%	05% or 12%

BCCL

30. Credit-deposit Ratio

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- The CD ratio refers to the **credit-deposit ratio in banking parlance**. It tells us how much of the **money banks have raised in the form of deposits has been deployed as loans**.
- So if the CD ratio for a single bank or the whole banking system stands at 75%, it means that three-fourths of the deposits with that bank or with the system has been given out as loans.
- A **low CD ratio suggests relatively poor credit growth** compared with deposit growth.
- A high CD ratio would mean strong demand for credit in an environment of relatively slower deposit growth.
- The CD ratio had slipped to historic lows of **under 70%** in late 2016, when demonetisation kept bankers busy exchanging banknotes and few new loans were given.

31. Monetary Policy Tools

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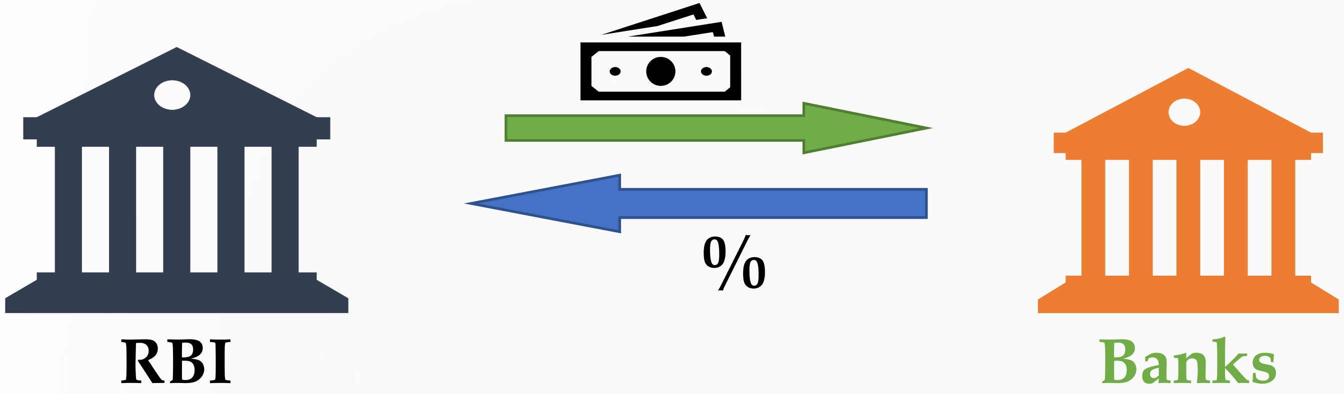
- **Cash Reserve Ratio (CRR)**: The average daily balance that a bank is required to maintain with the Reserve Bank as a share of such per cent of its Net demand and time liabilities (NDTL).
  - Current: 4%
  - From 21st May 2022: 4.5%

- **Statistical Liquidity Ratio (SLR)**: The share of NDTL that a bank is required to maintain in safe and liquid assets, such as, unencumbered government securities, cash and gold.
  - Changes in SLR often influence the availability of resources in the banking system for lending to the private sector.
  - Current: 18%

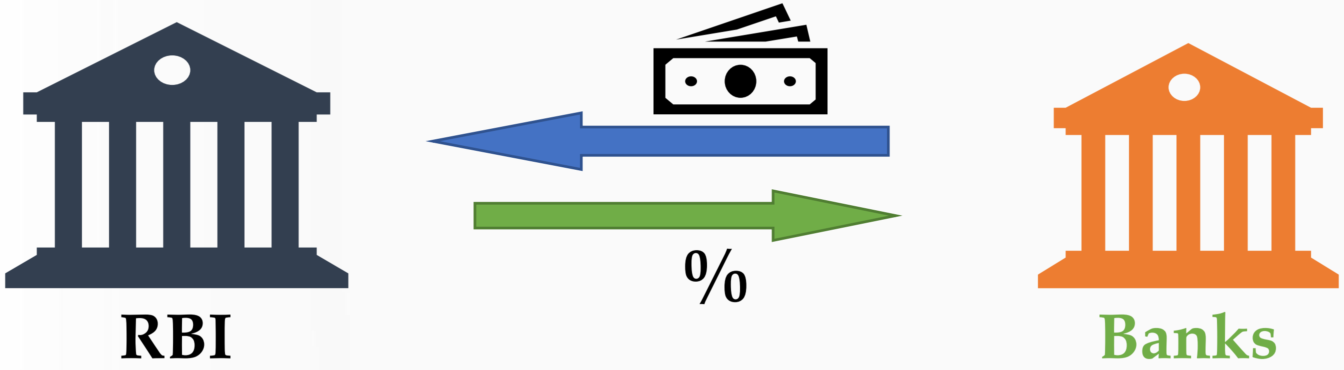
NDTL include current deposits, demand drafts, balances in overdue fixed deposits, and demand liabilities portion of savings bank deposits.

31. Monetary Policy Tools

Repo Rate



Reverse Repo Rate

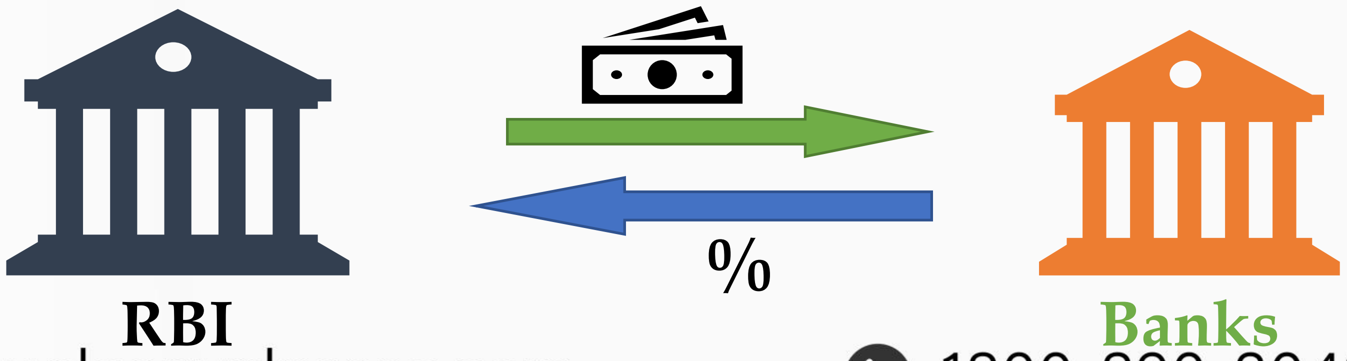


Since RBI is also a bank and has to earn more than it pays, the repo rate is higher than the reverse repo rate.

At present, the repo rate is 4.4%, and the reverse repo rate is 3.35%.

31. Monetary Policy Tools

- Marginal Standing Facility (MSF) is the rate at which RBI lends funds overnight to the banks, which are included in the Second Schedule of Reserve Bank of India Act, 1934, against government securities.
- The Reserve Bank of India has come up with this borrowing scheme **to regulate the mismatch in short-term asset liability** more effectively.
- MSF = Repo Rate + X
- Current MSF= 4.65 per cent



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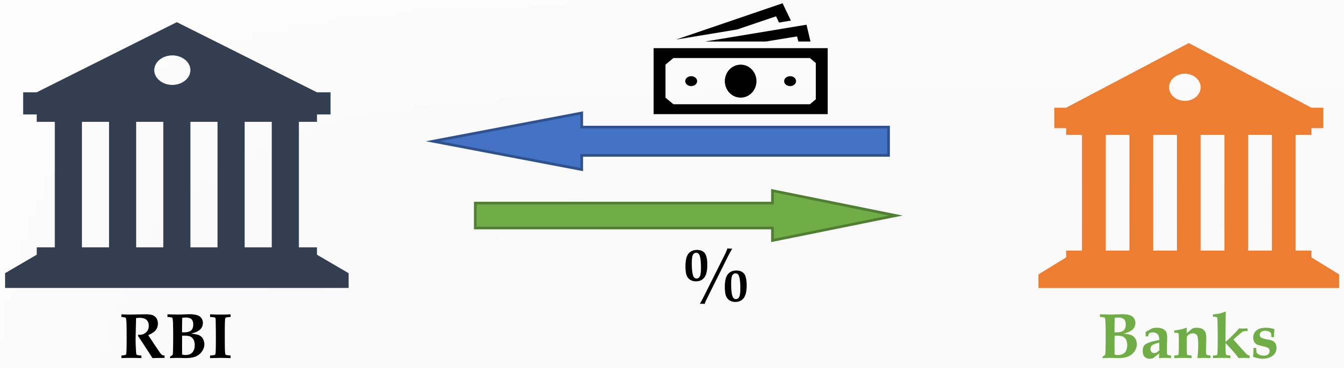
SCIENCE & TECH PYQ's MARATHON

Online+Offline Discussion

22 MAY 2022 10:00AM

Address: Sleepy Classes, E-42, Phase-8, Industrial Area, Mohali, Punjab, India.

31. Monetary Policy Tools



- The **Standing Deposit Facility** is a **liquidity window** through which the **RBI will give banks an option to park excess liquidity with it**.
- Interest rate for SDF has been fixed **at 4.15 per cent.**
- It is a ***win-win for both the central bank and commercial banks***, as it will be more attractive for the commercial banks to pump that liquidity back to the central bank due to higher returns, while for the central bank it would not need to offer any security to the commercial bank.

32. BHIM UPI

- Unified Payments Interface (UPI) has gained acceptance in **Singapore (March, 2020), Bhutan (July, 2021) and recently with partners in UAE and Nepal (February, 2022)**.

- Bharat Interface for Money (BHIM) is an app that lets you make simple, easy and quick payment transactions using Unified Payments Interface (UPI).

- You can make instant bank-to-bank payments and Pay and collect money using just Mobile number or Virtual Payment Address (UPI ID).

33. Beed Model

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- This model is related to **Pradhan Mantri Fasal Bhima Yojana (PMFBY)**.
- Beed — which was declared in 2020 as a single district cluster under the PM Fasal Bima Yojana (PMFBY) — had **failed to attract bids from insurance firms** to offer the crop insurance scheme.
- This was because the central Maharashtra district has been **witnessing high levels of claims ratio in the past** — due to almost three years (2017-20) of successive scanty monsoon rainfall and drought — prompting the firms to shun from offering services there.
- However, the Maharashtra government managed to rope in public sector **Agriculture Insurance Corporation of India Limited (AIC)** to provide crop insurance in Beed district.

33. Beed Model

- To attract the insurance companies, the state Agriculture Department decided to tweak the PMFBY guidelines for the district.
- Under the new guidelines, the insurance company provided a **cover of 110% of the premium collected**, with caveats.
  - If the **compensation exceeded** the cover provided, the state **government would pay the bridge amount**.
  - If the compensation was **less than the premium collected**, the insurance **company would keep 20%** of the amount as handling charges and **reimburse the rest to the state government**.

34. Nano Urea Liquid

- **Indian Farmers Fertiliser Cooperative Limited (IFFCO)** launched the **Nano Urea Liquid**, a nutrient to provide nitrogen to plants as an alternative to the conventional urea.
- It is a **patented technology of IFFCO** developed at its Nano Biotechnology Research Center, Gujarat.
- Nano Urea Liquid is **developed to replace conventional urea** and it can curtail the requirement of the same by at least 50%.
- It contains **40,000 ppm of nitrogen in a 500 ml bottle** which is equivalent to the impact of nitrogen nutrient provided by one bag of conventional urea.
- IFFCO has priced Nano Urea at Rs 240 per 500 ml bottle for the farmers, which is 10% cheaper than the cost of a bag of conventional Urea.

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