Recently, the Centre has approved a ₹1,340-crore recapitalisation plan for Regional Rural Banks (RRBs). The move is crucial to ensure liquidity in rural areas during the lockdown due to the COVID-19 crisis.

Key Points

- This recapitalisation (a strategy of enhancing the financial base of an entity to overcome a rough financial situation) would improve their capital-to-risk weighted assets ratio (CRAR) and strengthen these institutions for providing credit in rural areas.
  - The step will help those RRBs which are unable to maintain a minimum CRAR of 9%, as per the regulatory norms prescribed by the RBI.
- The release of the Rs. 670 crore as the central share funds will be contingent upon the release of the proportionate share by the sponsor banks.
- The recapitalisation process of RRBs was approved by the cabinet in 2011 based on the recommendations of a committee set up under the Chairmanship of K C Chakrabarty.
  - The National Bank for Agriculture and Rural Development (NABARD) identifies those RRBs, which require recapitalisation assistance to maintain the mandatory CRAR of 9% based on the CRAR position of RRBs, as on 31st March of every year.
  - The scheme for recapitalization of RRBs was extended up to 2019-20 in a phased manner post 2011.

Capital-to-risk Weighted Assets Ratio

- CRAR or Capital Adequacy Ratio (CAR) is the ratio of a bank’s capital in relation to its risk weighted assets and current liabilities.
- It is decided by central banks and bank regulators to prevent commercial banks from taking excess leverage and becoming insolvent in the process.
- The Basel III norms stipulated a capital to risk weighted assets of 8%.
- However, as per RBI norms, Indian scheduled commercial banks are required to maintain a CRAR of 9%.

Regional Rural Banks

RRBs are financial institutions which ensure adequate credit for agriculture and other rural sectors. Regional Rural Banks were set up on the basis of the recommendations of the Narasimham Working Group of the Regional Rural Banks Act, 1976.

The first Regional Rural Bank “Prathama Grameen Bank” was set up on 2nd October, 1975.

Stakeholders: The equity of a regional rural bank is held by the Central Government, concerned State Government, and Sponsor Bank in the proportion of 50:15:35 (PT SHOT).

The RRBs combine the characteristics of a cooperative in terms of the familiarity of the rural problems and a commercial bank in terms of its professionalism and ability to mobilise financial resources.
Each RRB operates within the local limits as notified by the Government.

The main objectives of RRBs are

1. To provide credit and other facilities to the small and marginal farmers, agricultural labourers, artisans and small entrepreneurs in rural areas.
2. To check the outflow of rural deposits to urban areas and reduce regional imbalances and increase rural employment generation.
3. The RRBs are required to provide 75% of their total credit as priority sector lending.

Reforms

Recapitalization and amalgamation of RRBs

RRBs became financially weak with many having high NPAs because of the difficult loans they are giving. A committee chaired by Dr. K.C. Chakrabarty reviewed the financial position of all RRBs in 2010 and recommended for recapitalization of 40 out of 82 RRBs.

According to the Committee, the remaining RRBs are in a position to achieve the desired level of capital adequacy ratio (CRAR) on their own. Accepting the recommendations of the committee, the central government along with other shareholders started to recapitalize the RRBs by injecting funds into them. In the same manner the process of amalgamation continued.

Amalgamation of RRBs were made in two phases and the number of RRBs were brought down during the second phase of amalgamation and restructuring, which is ongoing from 2012, geographically extensive RRBs were amalgamated to have just one RRB in medium-sized states and two or three RRBs into sponsoring banks and their merger brought down the number from 196 in late 1990s to 56 by 2016.

Most of the reform measures enabled the RRBs to make a smart recovery without being a burden on the government. Their activities need additional capital in the context of advanced capital requirements and regulatory standards. Hence, to enable them to acquire more capital the government has enacted RRB Amendment Act (2015). The amendment is aimed to help them to mobilize additional capital by keeping a combined government holding of at least 51%.

RRBs Amendment Act 2015

The Regional Rural Banks (Amendment) Act, 2015, came into effect from 4th February 2016. The Act raised the amount of authorized capital to Rs 2,000 crore and states that it cannot be reduced below Rs One crore. The Act allows RRBs to raise capital from sources other than the existing shareholders - central and state governments, and sponsor banks. Here, the combined shareholding of the central government and the sponsor bank cannot be less than 51%.

For the sponsoring banks, they can provide various initiating assistance to the RRBs beyond the initial five years (previously, the sponsoring bank’s responsibility will be over in five years). The Act states that the central government may by notification raise or reduce the limit of shareholding of the central government, state government or the sponsoring bank in the RRB. For this, the central government may consult the state government and the sponsor bank.