

Understanding Provision Coverage Ratio in Banking

The **Provision Coverage Ratio (PCR)** is a crucial indicator of a bank's financial strength and risk management practices. It measures the proportion of a bank's bad loans, also known as non-performing assets (NPAs), that are covered by the provisions the bank has set aside from its profits. In simple terms, provisions are reserves created by the bank to absorb potential losses that may arise if borrowers fail to repay their loans.

PCR is calculated by dividing the total provisions made for NPAs by the gross NPAs, and then multiplying the result by 100 to express it as a percentage. For example, if a bank has gross NPAs worth ₹100 crore and has created provisions of ₹60 crore, the PCR would be 60%. This indicates that 60% of the bad loans are already covered through reserves, and the bank would only be exposed to potential losses on the remaining 40%.

A higher PCR reflects a more conservative and financially stable position, as it shows that the bank has safeguarded itself against the risk of loan defaults. Regulators such as the Reserve Bank of India (RBI) often prescribe a minimum PCR to ensure that banks remain resilient during times of stress and to protect depositors' interests. On the other hand, a low PCR suggests that the bank may not be adequately prepared to deal with defaults, making it more vulnerable to financial shocks.

Overall, the Provision Coverage Ratio is an important measure of prudence in banking, signaling the extent to which a bank has anticipated and prepared for potential losses from its loan portfolio. It is closely watched by regulators, investors, and analysts as a key indicator of a bank's health and risk management practices.