RBI’s plan on Dividend Policy

Why in news?

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The Reserve Bank of India (RBI) is reportedly studying the feasibility of a dividend policy and planning for a separate one.

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What is Dividend policy?

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- Dividend policy is the set of guidelines a company or nation uses to decide how much of its earnings it will pay out to shareholders.
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- Some evidence suggests that investors are not concerned with a company's dividend policy since they can sell a portion of their portfolio of equities if they want cash.
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- This evidence is called the "dividend irrelevance theory," and it essentially indicates that an issuance of dividends should have little to no impact on stock price.
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What is India’s dividend policy?

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- The central bank transfers its surplus to the government in accordance with Section 47 (Allocation of Surplus Profits) of the RBI Act.
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- The act says that the amount will be arrived at after making provision for bad and doubtful debts, depreciation in assets, contributions to staff and

superannuation fund.
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- By which RBI had transferred Rs 306 billion of its surplus to the government, which was less than half the Rs 659 billion it gave a year earlier.
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What are the concerns with government’s demand?

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- As the amount fell far short of the Budget target, the finance ministry had asked the RBI for an additional Rs 130 billion.
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- After putting up initial resistance on grounds that the lower dividend was due to the costs associated with demonetisation and the need to provide for contingency reserves, the RBI gave in and transferred Rs 100 billion as interim dividend.
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- The government’s pressure on the RBI for a policy is unwarranted as the central bank has already said in its annual report for 2015-16 that it has prepared a “draft economic capital/provisioning framework to assess its risk-buffer requirements in a structured and systematic manner”.
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What is RBI’s recent stand on dividend policy?

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- The recent plan of RBI require it to transfer dividend policy to the government a pre-determined portion of the surplus it earns.
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- The policy, which is being discussed on the insistence of the government, would require amendments to the RBI Act.
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- The matter was raised by the government’s nominees to the RBI board following differences over the dividend paid for 2016-17.
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- This framework will be used for determining the surplus transferable each year to the Centre, in that context the demand for a separate policy makes little sense.
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- But government has different opinion on this move by RBI, as RBI holds excess surplus than any other central bank.
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What measures needs to be taken in this regard?

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- The central bank’s board which has government nominees, should be the best judge of the amount of contingency reserve it needs.
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- There are also suggestions from experts that a part of the RBI’s capital be used for other purposes such as recapitalisation of banks.
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- It would be better if the current practice of extensive pre-Budget discussions between the government and the RBI on the payout by the latter continued.
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- Central banks and the governments in both the UK and the US do precisely that, thus a separate policy will only create dissonance.
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Source: Business Standard

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