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RBI in driver's seat

Bad loan steps are welcome, more waiting to be done

The new regulation on the bad loan problem of India's banking sector may prove to be just what the doctor ordered under the given circumstances. The Ordinance amending the Banking Regulation Act gives powers to the Reserve Bank of India (RBI) to direct banks to initiate bankruptcy proceedings against defaulting companies, and to take decisions on behalf of lenders while dealing with stressed assets. It also gives the government the powers to authorise the central bank to invoke the insolvency code against defaulters. Apart from dealing with bad assets, the banking regulator will also set up oversight committees to direct banks and joint lenders' forums (JLFs) to deal with the stressed assets.

A stronger hand was required in the resolution of bad loans as all of the RBI's attempts since January 2014 have not succeeded for multiple reasons. Most of the central bank's plans, be it the corrective action plan by the joint lenders' forum (JLF), strategic debt restructuring, the 5:25 flexible structuring scheme, or the scheme for sustainable structuring of stressed assets (S4A) have only been successful at the margin. Also, with the risk that a banker's decision today might be questioned in his golden years by probe agencies or the judiciary, nobody wanted to take any risk. The comfort factor provided by the RBI, however, could help bankers to swing into action in the next few months. The other problem has been the lack of consensus in the JLF as small banks with less exposure and less skin in the game often ended up sitting on the fence and delaying the entire process. The RBI has taken this problem head on by putting the onus on lenders to adhere to timelines in finalising and implementing the corrective action plan. From now on, if a decision is agreed upon by a minimum of 60 per cent of creditors by value (earlier 75 per cent) and 50 per cent of creditors by number (from 60 per cent) in the JLF, it would be binding on all lenders.

There are, however, some important issues that require more clarity — the reason why the stock market, which had been quite optimistic about the resolution scheme, saw a correction in the bank stock rally on Friday. For example, the RBI will have to set up oversight committees, which would require the identification and selection of experienced executives and professionals who can take these decisions. The moot point is whether the committees would be in a position to find buyers for the whole or part of the stressed assets in a dampened economic environment. Most buyers have so far been interested in only the profitable part of the assets and it's an open question whether the committees can find a way out of this problem.

Though the bad loans issue is a matter of immediate concern, the government would do well to look at the larger problem of the public sector banks (PSBs). RBI Deputy Governor Viral Acharya has laid out a detailed road map in this regard, some of which are worth considering. Mr Acharya spelt out five options for a resolution of the stress: One, healthier PSBs could raise private capital and thus reduce the government's burden of recapitalising banks; two, some banks with assets or loan portfolios that are in good shape can sell them on the market; three, a consolidation exercise that leads to fewer but healthier banks; four, under-capitalised banks could be subjected to corrective action; and five, the government should look at disinvesting some of its ownership in the restructured banks. These are sensible suggestions, which could change the dynamics of India's financial sector.