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DEPUTY GUV SAYS Complaints that the timeline given to regularise a defaulter's account is insufficient are misplaced

RBI Scotches Speculation on Easing Default Norms

Our Bureau

Mumbai: Mint Street has virtually scotched speculation regarding the easing of norms on default classification, saying that the new rules seek to change the credit culture in a country where even big companies that can repay on time tend to game the system to earn additional income.

Complaints that the timeline given to regularise a defaulter's account is insufficient are misplaced and the effort is to ensure that arbitrage between different markets are eliminated, Reserve Bank of India (RBI) Deputy Governor NS Vishwnathan said Wednesday.

"It is a behaviour change in repayment of credit that has to come about," Vishwanathan told graduating students at the National Institute of Bank Management. "The data show that a large number of borrowers, even some highly rated ones, have failed on the 1-day default norm. This has got to change."

On Feb. 12, the central bank came up with a tight set of norms for the recognition of default, seeking to put in place a system to resolve such delinquencies. It scrapped all the existing programmes for restructuring, such as Corporate Debt Restructuring and other plans. It made the bankruptcy proceedings under the Insolvency and

Bankruptcy Code the sole law for resolving defaults. Banks were mandated to treat an account as a defaulter from the day 1 when it missed payments, withdrawing the earlier latitude of 90 days.

"The idea is to nudge lenders and borrowers to take timely corrective action so that the deterioration in the asset quality is avoided to the extent possible," Vishwnathan said. "At the same time, with defaults being reported to a central database, which is accessible to all banks, the credit discipline is expected to further improve."

The mandate to declare the default the very next day after the defined payment schedule would also correct a long overdue arbitrage between the loans and the bond markets.

"If a borrower delays coupon and principal payment on a corporate bond even for one day, the market would penalize the borrower heavily – the rating would be downgraded, the yields on the bonds would shoot up, cost of further financing would increase, suits would be filed by investors," said Vishwanathan. "So far, defaults in bank borrowings have not attracted similar reactions."

Making banks come up with a resolution plan within 180 days is to ensure that banks are proactive.

"One has to note that 'default' in payment is a lagging, not leading, indicator of financial stress of a borrower and the framework provides 180 days after a default to put in place a resolution plan," he said. "Lenders need to be proactive in monitoring their borrowers and be able to identify financial stress, using a combination of leading indicators."

The criticism that the timing was not right for such tightening of norms is misplaced, he said.

"The search for that perfect time for a long overdue reform can become a never-ending exercise," said Vishwanathan. "I am not sure whether the protagonists of the view that the reform was untimely know when the right time is other than that it is some time in the future!."