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CONCERNS OVER RISE IN DEFAULTS

As pressure mounts, RBI Deputy Guv defends new stressed asset rules

Warns against large number of borrowers, even some highly rated ones, failing on 1-day defaults

ENS ECONOMIC BUREAU
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WITH BANKS and the government putting pressure on the Reserve Bank of India (RBI) for dilution of the new stressed asset framework, RBI Deputy Governor NS Vishwanathan on Wednesday said the new framework for resolution of distressed borrowers is required "to make sure that the excesses observed during the last credit cycle are not repeated and we don't end up in a similar situation few years down the line".

"The RBI believes that a focused framework for resolution of distressed borrowers which respects and enforces the sanctity of the debt contract is required... I would say certain changes are sooner brought in than later. The search for that perfect time for a long overdue reform can become a never ending exercise," he said. "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 future."

On February 12, 2018, the RBI withdrew all existing stressed asset schemes and the joint lenders forum (JLF) mechanism and banks were told that they must start working on a resolution plan even if an account is overdue by a day. The RBI had said failure to come up with a resolution plan in 180 days would lead to the account being referred for insolvency proceedings. The new framework has evoked criticism from the government and bankers. The argument against the new rules is that working on a resolution after one day of default was unfair and the requirement to refer stressed accounts for insolvency after 180 days would lead to a pile up of cases at the National Company Law Tribunals.

Vishwanathan said the debt contract embedded in bank loans in India has been continuously losing its sanctity, especially where the borrowing is large. "There is a need to change this and restore the sanctity of the debt contract, lest bank debt becomes subordinate even to equity. The new framework is aimed at doing this. Prompt repayment to banks is critical because they access unlimited uncollateralised funding from among others, the common persons, on the strength of the banking licence," he said at an event organised by the National Institute of Bank Management.

"The lenders have complete freedom to decide on the contours of the resolution plan. However, the credibility of the resolution plan is sought to be ensured through the requirement of independent credit evaluation by credit rating agencies," he said.

NPAs went up from 4.62 per cent in FY15 to 7.79 per cent in FY16, and rose to 10.41 per cent by December 2017, he said.

"The data shows that a large number of borrowers, even some highly rated ones, have failed on the 1-day default norm. This has got to change. If borrowers fail to pay on the due date because of a cash flow problem, banks should see that as an early warning indicator warranting immediate action. If borrowers, with ability to pay on the due date, delay it routinely or because they see other arbitrage options, that must change too," Vishwanathan said.

"Bankers should warn their customers that 1-day default will lead to their being on watch for resolution," he said. "As the likelihood of income or recovery from a loan decreases, the amount to be kept as provisions by the banks should increase. If the resulting drain on bank profits has to be contained, the action to address stressed assets should commence no sooner than the emergence of early signs of stress," Vishwanathan said.

If a borrower delays coupon/principal payment on a corporate bond even for one day, the market would penalise 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, etc., to name a few. So far, defaults in bank borrowings have not attracted similar reactions. Only when the overdues stretch beyond 90 days, the loans would be classified as NPAs. "Hence, efforts by lenders and borrowers have been to avoid the account having to be de jure classified as NPA, notwithstanding the de facto status. What this means is that debt contract embedded in bank loans in India has been continuously losing its sanctity, especially where the borrowing is large," he said.

RBI warns on retail credit

Mumbai: RBI Deputy Governor NS Vishwanathan on Wednesday cautioned banks against the "herd movement" in the retail credit exposure. "There appears to be taking hold a herd movement among bankers to grow retail credit and the personal loan segment. This is not a risk-free segment and banks should not see it as the grand panacea for their problem riddled corporate loan book. There are risks here too that should be properly assessed, priced and mitigated," Vishwanathan said. With corporates defaults, risk averse bankers have been focusing more on personal, auto and home loans in order to expand their business. **ENS**

'India needs a healthy public sector'

Pune: India can't live without a thriving public sector, M Damodaran, former Sebi chairman said. "We need a healthy public sector, don't think merit lies in privatisation. We need to fix the public sector by diagnosing the problem. India can't live without a thriving public sector," he said. "Ownership of the public banks ensures that is not a strong public sector bank," he said. This creates a problem as ownership is not equivalent to management. **ENS**