ACT NOW

Decisive and swift action in the form of systemic reforms is needed to deal not only with the stock of existing NPAs but also to arrest their creation

Ever since the former governor of the Reserve Bank of India (RBI), Dr. Raghuram Rajan, introduced the Asset Quality Review in 2015, India's banking sector has been continuously in the news, and mostly for all the wrong reasons. The review has brought to the fore significant amount of stress in the banking system, especially in the public sector banks (PSBs). The asset quality has been on a downhill journey over several quarters now and the gross non-performing assets (GNPAs) ratio of Scheduled Commercial Banks (SCBs) stood at 9.1 per cent as on September 2016, pushing the overall stressed advances ratio to 12.3 per cent, as per the Financial Stability Report (FSR) released by the RBI in February 2017. In addition, banks are capital starved. It has been estimated that Indian banks need a total of ₹3.7 trillion to be infused as capital between fiscal 2017 and 2019 to meet the Basel-III norms, of which the government infusion should be ₹1.4 trillion. As a result, banks have very little appetite for taking fresh exposures in new projects. The corporate sector is also under severe stress, thus making this essentially a 'twin balance sheet problem'. Unfortunately, all this is happening when India is actually in a sweet spot. By recording the highest growth rate among all major economies, India has once again caught the imagination of global investors. But our inability to revive the private sector investment appetite may cost us dear.

Five sectors, namely, mining, iron & steel, textiles, infrastructure and aviation, account for more than half of the total stressed advances. All these sectors create national assets and once such NPAs are resolved, they will generate long-term benefits for the economy in terms of creating wealth, jobs and fuelling entrepreneurship. Thus, the RBI has tried out a number of refinancing and restructuring initiatives, but those did not quite yield the desired results. Subsequently, ideas of setting up of Public Sector Asset Rehabilitation Agency (PARA), Bad Bank and National Asset Management Company (NAMC) have also been floated. But all these have been non-starters. The issue of NPA evaluation has been the bone of contention where all initiatives have so far come to nought. In the process, precious time has got lost.

I am not yet aware of any scientific methodology by which we can arrive at the exact evaluation of an asset which has gone bad. With multiple parameters involved, some degree of subjectivity always creeps into the assigning of different weightages to these factors. The final figure is often, at best, a 'guesstimate'. In private sector banks, a bad loan can be written off or sold to an ARC with the approval of the board. Private banks suffer the loss, but the matter is brought to a closure. But PSBs are afraid to take 'haircuts', lest they get hauled up by investigative agencies at a later stage. Fear of such penalisation has multiplied after some recent incidents. PSBs now consider status quo to be a safer option. In the process, all the stakeholders stand to lose and there is colossal wastage of resources.

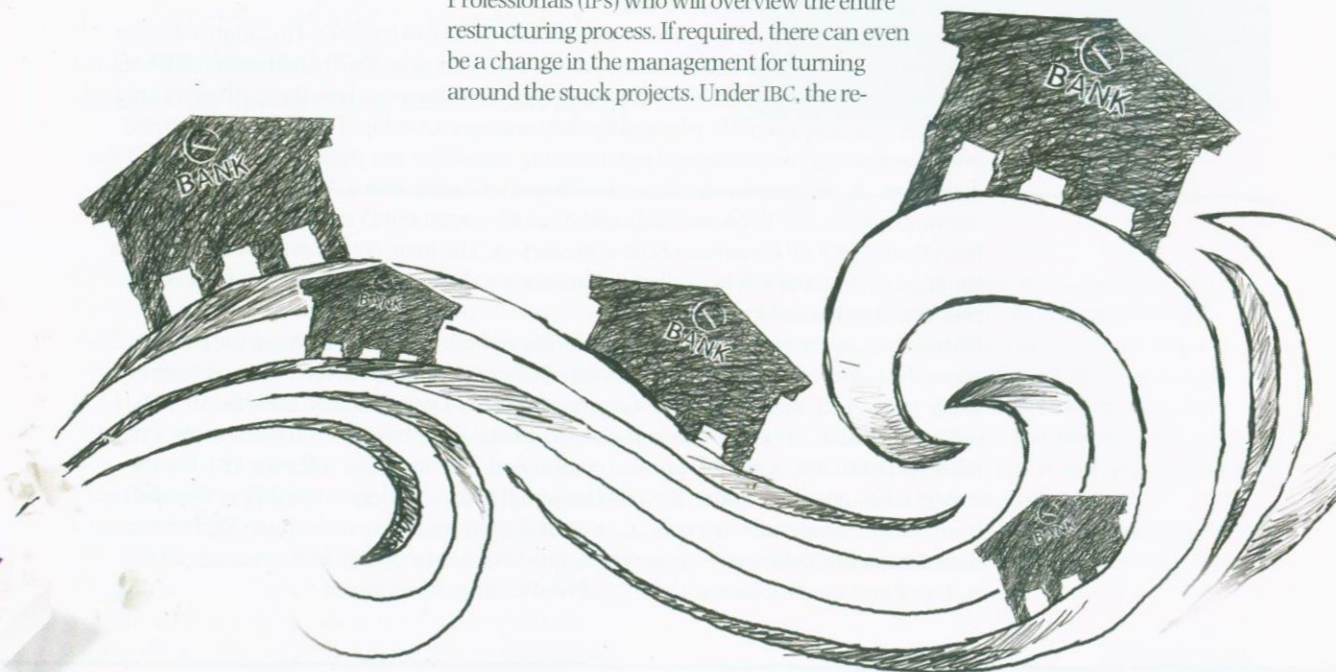
Five sectors, namely, mining, iron & steel, textiles, infrastructure and aviation, account for more than half of the total stressed advances. All these sectors create national assets and once such NPAs are resolved, they will generate long-term benefits for the economy in terms of creating wealth, jobs and fuelling entrepreneurship

It's not necessary that all NPAs are bad credit decisions. Often a loan can go bad due to situations which are out of control of both the lender and borrower. Thus, attempting a resolution of an NPA should not end up becoming a blame game. The aim should be to turn around NPAs as early as possible so that the assets created can generate long-term benefits. Of course, if we have enough evidence of willful default, the guilty must be meted out exemplary punishment.

I think the measures suggested so far are too complex in the Indian context. Also, the one-size-fits-all formula will not apply in resolving the NPA issue. The reasons behind bad loans vary from case to case. Thus, customised solutions are needed for each. We need to think simple and come up with workable solutions. As a starting point, we need to review the composition of the PSB Boards. Those Boards routinely have representatives from the RBI, Ministry of Finance, Chartered Accountants, professionals with legal experience, etc. What seems to be missing is the presence of people with adequate industry experience in the Board – those who can provide sectoral insights. The industry perspective is very important in taking a view of the bigger picture while evaluating project proposals and then taking credit decisions. Even after that, if a loan goes bad, the restructuring exercise should ideally be taken by an empowered committee formed by the Board. The committee can consist of the independent directors. Such a committee will be better equipped in coming up with a plan. In cases where a loan has gone bad for a lending through a consortium, the committee can comprise the independent directors of the lending banks so that there is consensus on the restructuring plan. More importantly, the decisions of the committee are made on commercial lines and those should not be subject to investigation later on.

The turnaround attempt should be a time-bound exercise, ideally for a six month period. An extension may be provided in cases where the asset is on the verge of a recovery but may need some more time.

With the recent implementation of the Insolvency & Bankruptcy Code (IBC), the chances of turning around stressed assets have improved substantially. With the IBC, even the empowered committee would not be needed. The creditors and lenders can go through the process set out by the Code. There will be dedicated Insolvency Professionals (IPs) who will overview the entire restructuring process. If required, there can even be a change in the management for turning around the stuck projects. Under IBC, the re-



AJAY THAKURI

structuring plans are to be endorsed by the National Company Law Tribunal (NCLT) thus providing it immunity from any future investigation.

In this regard, RBI needs to issue a clarification on whether an asset which has underwent a restructuring under IBC and has been successfully revived would subsequently qualify as a 'standard asset'.

I would like to add here a few words about the National Company Law Tribunal (NCLT), which was constituted on June 1, 2016, as the single adjudication authority for corporate default cases. With over 25,000 pending corporate insolvency cases expected to move from various forums to NCLT, there is a major concern as to whether NCLT will be able to cope with the projected workload. In the first phase, 11 NCLT benches have been set up – one principal bench in New Delhi and 10 regional benches. Overloading NCLT at the very beginning can become counter-productive. Rather a threshold should be set and only cases above this threshold should be forwarded to NCLT. There should be a clear guideline on the transfer of pending cases to NCLT from the Debt Recovery Tribunals (DRTs) or Board for Industrial & Financial Reconstruction (BIFR), based on the size of exposure, size of consortium, case length, etc. The administrative machinery in NCLT should be gradually scaled up the across the country to ensure its smooth functioning.

All these suggested measures, so far, are meant for dealing with the current stock of NPAs. To arrest the flow of NPAs and to prevent them from happening, there is need for some systemic reforms. The following are some of the thoughts I wanted to share :

- As a starting point, perhaps it is worth reviewing the definition of NPAs. It defies logic why the same yardstick for NPA classification should apply for a car loan, a home loan and a loan for an infrastructure project. The asset classes are vastly different. For example, the variables affecting an infrastructure loan are far more than the other two asset classes. Thus, the risks associated with each asset class are different. By that logic the definition of NPAs should also vary asset-wise.
- There is a need to reduce Indian banks' focus on security rather than the projected cash flows while doing the credit assessments and loan appraisals. This is intriguing, especially keeping in mind the legal environment where security invocation has been long-drawn and often uncertain. Going forward, cash flows should get adequate weightage in lending decisions.
- PSBs need to embrace higher levels of professionalism and adopt more scientific techniques of decision making and due diligence checks. The Banks Board Bureau (BBB) is already on the job for hiring top management recruits for PSBs. Remuneration should not act as a limiting factor.

CONCLUSION

Amidst the ongoing global uncertainty, the Indian economy is like an oasis today. But to get the foreign players excited about investing in India, we first need to revive the domestic investment cycle by our private sector. And for that, we need to quickly fix the 'twin balance sheet problem'. Decisive action in the form of systemic reforms is now needed to deal not only with the stock of existing NPAs but also to arrest its flow. We cannot afford to lose any more time. Let us take the bull by its horns and resolve this issue once and for all. Or else, we will miss out from capitalising on an once-in-a-lifetime window of opportunity that has opened up for India. ◆

The writer is Vice Chairman, Srei Infrastructure Finance Ltd.