

11.10.20

Measures taken by RBI & Govt of India

1) 5:25 or 5/25

In June 2014, RBI introduced 5:25 scheme of refinancing for the revival of ^{stressed} asset in Infrastructure sector & Core Industries. RBI asked the banks to extend the loan period upto 25 years & also review the interest rates on outstanding loans every 5 year.

This evergreening technique provides additional time to borrowers & reduces the burden of interest for the existing loans.

2) In 2015, RBI announced Strategic Debt Restructuring Scheme (SDR) to provide an option to the borrower for conversion of loan into equity shares (Debt Equity swap) involving change of ownership of the borrower company.

- 1. Extension
- 2. Litigation
- 3. Sale of loan (to ARC)
- 4. A ownership

3) In year 2016, Scheme for Sustainable Structuring of Stressed Assets (S4A) was announced by RBI in which an independent agency decides as to how much of the loan is sustainable & how much is unsustainable. Leaving sustainable amount in balance sheet shares are issued to banks for unsustainable portion as part payment of loans. It is similar to SDR because there is Debt Equity swap but in this case minor part is converted hence there is no change in Ownership.

4) The Govt of India announced "Indradhanush Scheme" for the banking system in year 2015, which was a 7 point formula of Banking Reforms. These points were as follows \rightarrow A to G (Indradhanush)

A \rightarrow Appointment (of Professional managers)

B \rightarrow Bank Board Bureau

C \rightarrow Capitalisation

D \rightarrow Distressing of Balance Sheet of Banks

E \rightarrow Empowerment

F → Framework of Accountability

G → Governance Reforms

The enactment of Insolvency & Bankruptcy Code (IBC) in 2016 opened new possibilities for the time bound resolution of the stressed corporate assets. Several cases were referred to the National Company Law Tribunal for the resolution under IBC & the outcomes have been very encouraging. In Feb, 2018, RBI issued a revised framework for the resolution of stressed corporate assets & withdrew all existing instructions including 5:25, SDR & S4A. Banks were advised to follow IBC for the resolution of Bad loans. Guidelines for Prompt Corrective Actions & for establishing Early Warning System were issued for the early detection of stressed loans. Under these guidelines Banks are asked to classify their standard assets as follows —



| Category | | For loan due |
|---------------------------|---|--------------|
| Special Mention Account 0 | | 1 — 30 days |
| SMA | 1 | 31 — 60 days |
| SMA | 2 | 61 — 90 days |

Banks are asked to report the credit information of loans amounting to 5 cr or more to the Central Repository of Information of Large Credit (CRILC) on monthly basis & of the Defaulters on weekly basis. For loans exceeding 1 billion an Independent Credit Evaluation by an authorised Credit Rating Agency is also required.

Moreover, Banks with high NPAs, inadequate capital & poor profitability are issued PCA guidelines requiring them to hold further lending.

Prompt
Corrective
Action



NBFCs in India & the Shadow Banking System

In the aftermath of IL & FS & DHFL event several measures were undertaken to strengthen the regulation & supervision of the NBFCs in India. Reserve Bank of India Act 1934, has been amended to provide additional powers to RBI in respect of NBFCs regarding raising capital requirement, removal of directors & auditors, audit of accounts of their group companies & their resolution through amalgamation, reconstruction etc. RBI has framed Liquidity Framework for the NBFCs in the wake of current liquidity crisis. The regulation of Housing Finance Companies have been transferred by Govt. of India in August 2019, from the National Housing Bank to the RBI.

Some NBFCs have been found doing Shadow Banking business. It refers to the activities that operate outside the formal banking sector & hence are not regulated. RBI has tried

to improve their regulation by extending Banking guidelines & prudential norms to this sector. Further, RBI policy encourages the entry of Non-Deposit taking NBFCs & the conversion of large NBFCs into small finance banks & payment banks.

IBC, 2016 (Insolvency & Bankruptcy Code)

IBC is an act to consolidate & amend the laws relating to Reorganisation & Insolvency Resolution of the corporates, partnerships & individuals in a time bound manner.

The earlier bankruptcy system was highly fragmented because of multiple jurisdictions & their decisions were often appealed, stayed or overturned by the overlapping jurisdictions. IBC consolidates all existing laws including SARFAESI Act, 2002, RDDBFI Act, 1993 (Recovery of Debt Due to Banks & Financial Institution, SICA, 1985, Presidency Town Insolvency Act 1909 & Provincial Insolvency Act 1920.

The Pro-Revival Approach of the old Insolvency laws led to the delays in the closure of unviable businesses. Hence, they were misused by the corporates & businessmen. According to estimates, the average time of Insolvency of Business has been around 4.5 years as against 0.8 year in Singapore. According to World Bank, India has one of the lowest Recovery rate in the World at about 20% of the amount of Debt.

"Debtor"

IBL proposes a paradigm shift from the earlier "Debtor in Possession Regime" to the "Creditor in Control Regime". It means that now the operational creditors or the financial creditors can trigger a resolution process unlike the earlier system when the debtor himself initiating it.

IBL aims to resolve insolvency in a strict time bound manner. It provides for immediate suspension of Board of Directors & the powers of promoters requiring a professional to take control of the management of the company.

The whole insolvency process is supervised by a Qualified Insolvency Professional. He or she would prepare the insolvency plan & initiate the corporate insolvency resolution process. (CIRP). The matter shall go to adjudicating authority which is NCLT for companies & DRI for others. The ecosystem of IBC is regulated by the Insolvency & Bankruptcy Board of India. (IBBI).

IBBI is responsible for the implementation of IBC & amendments to the rules mentioned therein. It shall regulate the Insolvency Professionals, Insolvency Professional entity like Institution of Chartered Accountant in India & the information utility that will keep all Insolvency Data.

IBBI ^{shall} publish such information as may be required under the Act. It shall conduct research & audit of the performance of the agencies that work therein.

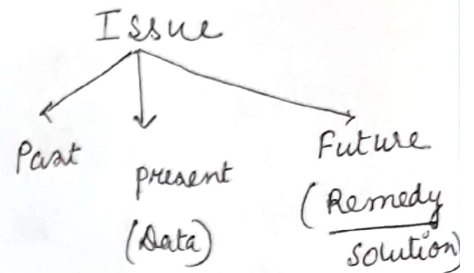
Since coming into force from 1st December, 2016, around 3800 CIRPs have commenced by the end of March, 2020.

Many companies have gone for voluntary liquidation & even RBI has submitted ~~to~~ several large cases. There has been a behavioural change as well & the promoters & the borrowers do not want to be identified as defaulters & in several cases they have paid the amount under dispute. It is expected from IBC that ^{it}_A would enhance ease of doing business in India & help the ~~the~~ Banks to clean up their Balance Sheet.

Q. Discuss how setting up a ^{B₁} Bad Bank in India can tackle the current NPA crisis ^{B₂} What are the associated challenges?

→
Intro. [A] current NPA crisis

Body { [B₁] Bad Bank
[B₂] challenges
[C] conclusion



→ After the lockdown, the NPAs of Indian Banks are expected to cross Rs 11t as estimated by some agencies in India. Although during the last 2 years, the problem of NPA was getting diluted.

Banks are not professional bodies for recovery of loans ~~as they are~~

← as they are meant for loan disbursement. Since the problem of NPA relates to most of the Public Sector Banks in India, the Economic Survey, 2017, suggested establishment

of Public Sector Asset Rehabilitation Agency (PARA) to take over the NPAs of all Banks & act like a Bad Bank. It is a better approach because the problem of NPA gets concentrated into just one Bad Bank instead of making many Banks bad throughout India. We have tried the private asset reconstruction companies in the last 2 decades to do the same thing but they have not yielded results being small & private. Therefore, it can be expected that a large Bad Bank established by Govt. would be a better strategy & moreover now we have the Prompt Framework of IBC, 2016 as well.

The idea of Bad Bank may have few challenges —

- i) It does not address the basic cause behind NPAs of Public Sector Banks in India.
- ii) It would be an extra burden on the taxpayers

iv) The discounted price at which the NPAs would be transferred from PSB, to Bad Bank is difficult to decide.

iv) It would not punish the corrupt management of some PSBs

v) This would overburden just one institution instead of many

vi) PSBs would be prompted to follow same ~~more~~ mal-practices in future.

We can expect that setting a Bad Bank may tackle the NPA crisis but it will require professional approach & implementation with complete transparency & accountability. We must also expect bank reforms to ensure that such problem does not recur in future.