'Restore sanctity of the debt contract'

New framework aims to bring about a sea change, says RBI Deputy Governor

OUR BUREAU
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The revised framework for resolution of stressed assets is aimed at restoring the sanctity of the debt contract embedded in bank loans, which has been continuously losing its sanctity, according to NS Vishwanathan, Deputy Governor, Reserve Bank of India.

The revised framework tries to reduce the arbitrage the borrowers are currently enjoying while raising funds through borrowing from banks vis-a-vis raising funds from the capital markets, he added.

"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 and suits would be filed by investors, to name a few," said Vishwanathan.

"So far, defaults in bank borrowings have not attracted similar reaction," said Vishwanathan.

He elaborated that only when the overdue stretch beyond 90 days, the loans would be classified as non-performing assets. 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 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 precisely aimed at doing this," said Vishwanathan.

Prompt repayment

He emphasised that 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.

The Reserve Bank believes that a focused framework for resolution of stressed borrowers, which respects and enforces the sanctity of the debt contract, is required to make sure that the excesses observed during the last credit cycle are not repeated, and that "we don't end up in a similar situation a few years down the line".

On concerns expressed in some quarters that the one-day default clause is onerous, Vishwanathan said: "These concerns are not well founded. Let me tell you why: For cash credit account, the 30-day trigger has been retained. For term loans, where the repayment schedules are predetermined, borrowers need to and indeed have enough notice to arrange funds in time. It is a behaviour change in repayment of credit that has to come about."

Based on the first few reports received from banks under the new reporting system, the top RBI official said non-payment on due date appears to be seen as par for the course by the banks and borrowers.

"The data shows that a large number of borrowers, even some highly rated ones, have failed on the one-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 the ability to pay on the due date, delay it routinely or because they see other arbitrage options, that must change, too," explained Vishwanathan.

Bankers should warn their customers that one-day default will lead to their being on watch for resolution, he said, and added that borrowers, too, should realise that they have to meet payment obligations as per the contract and it is no more sufficient to pay up only by 60/90 days past due date.

"I want to mention here that for the small borrower who may not have the wherewithal to bring funds swiftly in the event of non-payment by clients, the framework makes an exception."

"The framework for restructuring has been consciously made non-applicable to the Micro, Small and Medium Enterprises (MSMEs) with borrowings of Rs 25 crore and less. We have left their resolution framework unchanged from what was outlined for them in March 2016," the Deputy Governor said.
RBI warns banks on risks in retail loans

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Reserve Bank of India Deputy Governor NS Vishwanathan on Wednesday said there appears to be a herd movement among bankers to grow retail credit and the personal loan segment in view of the problem-riddled corporate loan book. He cautioned that there are risks in this segment, too.

"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," said Vishwanathan during the 14th convocation of the National Institute of Bank Management in Pune.

According to latest RBI data, personal loans – including housing, vehicles, consumer durables and credit cards – increased by 20.4 per cent in February 2018, compared to an increase of 12 per cent in February 2017.

Credit to industry (micro and small, medium and large) nudged up only 1 per cent in February 2018 compared to a contraction of 5.2 per cent in February 2017.

Banks have piled into the retail segment as delinquency is much lower vis-a-vis the corporate segment. For example, according to the RBI’s financial stability report, the gross non-performing advances (GNPAs) ratio for housing finance assets, remained flat at 1.55 per cent in September 2017.

"The retail housing segment does not appear to pose any significant systemic risks in the Indian context at present," the report said.
Calls from Delhi to blame for bad loan problem: Ex-SEBI chief Damodaran

Says big private lenders steeped in controversies due to weak corporate governance issues

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Former SEBI Chairman M Damodaran blamed the telephone calls from Delhi to Mumbai for the myriad problems that public sector banks face now and warned against their privatisation to resolve the crisis.

"Telephone calls from Delhi to Bombay, over the years, have been at the root of the problem of public sector banks. People in Bombay have been unquestionably responding to the direction from Delhi," Damodaran told the students of the RBI-run National Institute of Bank Management here on Wednesday during their convocation.

Defending public sector banks, he said, privatisation cannot be the solution for all the bad loans issues they face and blamed their peculiar governance and ownership is-

sues for the problems they face.

"I am not arguing that we should privatisate everything because we've very recent evidences that privatisation is not a synonym for honesty or efficiency or to avoid conflict of interest," he said.

It can be noted that large private sector banks, such as ICICI Bank and Axis Bank, are steeped in controversies due to weak corporate governance practices.

While ICICI Bank is embroiled in a controversy over the alleged conflict of interest involving its chief executive Chanda Kochhar and the business dealings of her husband Deepak Kochhar with the Videocon Group, Axis Bank saw the tenure of its chief Shikha Sharma being cut to seven months from three years, after being nudged by the Reserve Bank in the wake of massive bad loans which have grown more than five-fold during her tenure.

"The answer does not lie in privatisation. The answer lies in the fact that a country as heterogeneous as ours, needs a very strong public sector," said Damodaran.