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Bankers feel annual forensic audit, info sharing can help avoid costly errors

By ET Bureau | Mar 09, 2016, 04.00 AM IST

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MUMBAI: Never buy promises by promoters that they would bring in their share of equity in a struggling company at a later date. Don't hesitate to pull the plug on a company that's sliding into an abyss. These are among the lessons Indian banks have learnt from the biggest ever loan default by a company - [Kingfisher Airlines](#).

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The courtroom drama that's now playing out has made bankers believe that banks have to conduct an annual forensic audit and share information about borrowers to avoid such costly mistakes.

Furthermore, the credit evaluation system has to improve because the domination of state-run banks often results in small ones relying on whatever leaders such as State Bank of India and [ICICI Bank](#) decide. Banks must insist on collateral that will last in value and a 'wilful default' tag has to be made a criminal offence so it instils fear among those bent on gaming the system, they said.

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Banks have to first know the business that they are lending to and secondly, must not be afraid to stop incremental loans if something goes wrong. This requires day-to-day monitoring because bankers have to be able to predict when things go wrong

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"Banks should not consider intangible assets like brands as a security against any loan and lenders should insist that promoters give personal guarantees for taking loans," said Deepak Narang, who, as an executive director of United Bank of India, was the first to declare [Vijay Mallya](#) a wilful defaulter. "The act of wilful default should also be made a crime under the law so that there will be legal provisions against people who divert funds."

SBI is leading the legal battle in the Supreme Court and Debt Recovery Tribunal against liquor baron Mallya after his Kingfisher Airlines defaulted on more than Rs 6,000 crore of loans in 2012. Ever since, practices at banks have been questioned and the regulator has come up with new rules aimed at preventing such a recurrence.

"I would suggest forensic audit of bank loans every year instead of doing it just in emergencies," said former Corporation Bank chairman Ramnath Pradeep. "Also, the moment a loan becomes non-performing asset (NPA), banks refuse to touch it. Instead, such loans should be monitored day-to-day and get special attention. This mentality has to change."

One of the biggest loopholes in the [Indian banking](#) system is that often one lender does not know what the other is doing. In the absence of an integrated database, it isn't possible for banks to establish how much an entity may owe to other banks. A borrower could take a loan from one bank to repay another. It was easy for promoters to conduct this merry-go-round with banks.

RBI has tried put a full stop to this practice. In 2014, it initiated a Central Repository of Information on Large Credits with data on borrowers above Rs 5 crore. It also forced banks to recognise likely defaulters early and work out a package to keep loans good. Since banks didn't behave in the way the regulator wanted, the RBI recently fine-tuned it by forcing noncooperative banks out of the mechanism known as the Joint Lenders' Forum.

Another key factor that keeps even regulators sleepless is poor ability of banks to evaluate projects. "One of the major reasons which hinders the NPA management of the banks is the inadequacy of the credit appraisal

capacities of the banks because we know that there is only one consulting firm and few desks in some selective banks," RBI Deputy Governor R Gandhi said recently. "There is a need for additional technical capabilities to undertake evaluation and restructuring needs of the project. Banks will have to strengthen their in-house desk as well."

Another drawback is banks' reluctance to cut their losses and move out by selling at whatever price the market would buy the remaining assets.

In the case of Kingfisher Airlines, instead of pulling the plug, the banks converted their loans into equity, hoping that Mallya would bring in his share of funds, which never came. Instead, if the banks had put up the assets for sale, their losses may have been curbed.

"Banks have to first know the business that they are lending to and secondly, must not be afraid to stop incremental loans if something goes wrong," said a consultant who worked with Mallya and asked not to be identified. "This requires day-to-day monitoring because bankers have to be able to predict when things go wrong. Mallya got carried away in his business and did some blunders. Banks should have cut their losses."

Banks are now being forced to recognise bad loans immediately and cut their losses. And it is RBI Governor [Raghuram Rajan](#) who is leading the effort.

"An alternative approach is to try to put the stressed project back on track, rather than simply apply band-aids," Rajan said recently. "This may require deep surgery. Existing loans may have to be written down somewhat because of the changed circumstances since they were sanctioned. If loans are written down, the promoter brings in more equity and other stakeholders like the tariff authorities or the local government chip in, the project may have a strong chance of revival and the promoter will be incentivised to try his utmost to put it back on track."

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