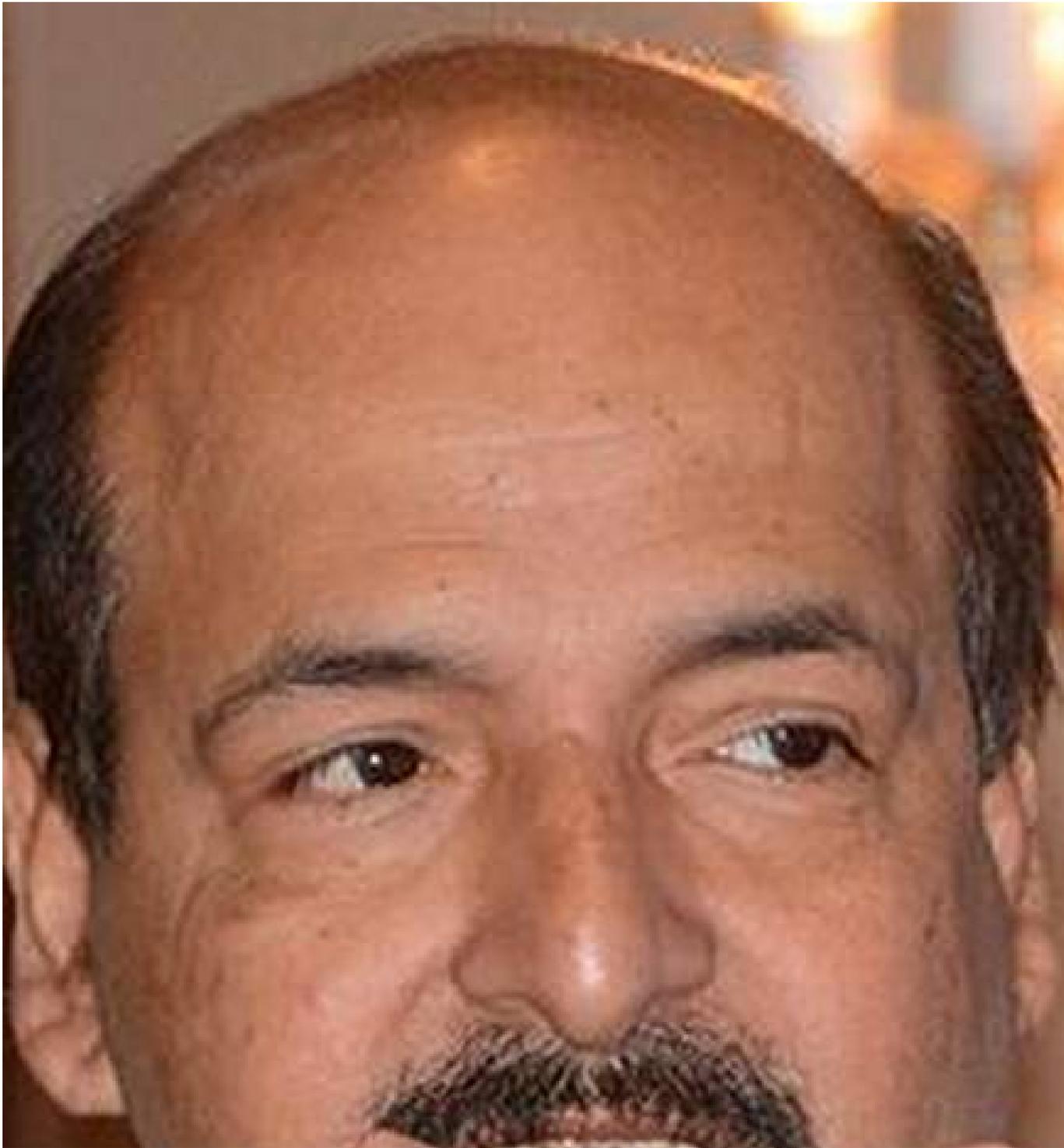


The RBI is beginning to bare its fangs

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NS Vishwanathan, Deputy Governor, Reserve Bank of India

The central bank's Deputy Governor read out the riot act to both the banks and borrowers in a recent speech

With its recent actions and statements, the RBI is sending out the message that it is no longer business as usual on the regulatory front

Reserve Bank of India Deputy Governor NS Vishwanathan's speech last week at the National Institute of Bank Management, Pune, must rank as one of the most significant speeches ever by a central bank mandarin in India.

In a Virat Kohli-like innings, Vishwanathan was on the front foot driving bankers (and borrowers) to all parts of the field while setting forth what are really nothing more than first principles of lending and borrowing.

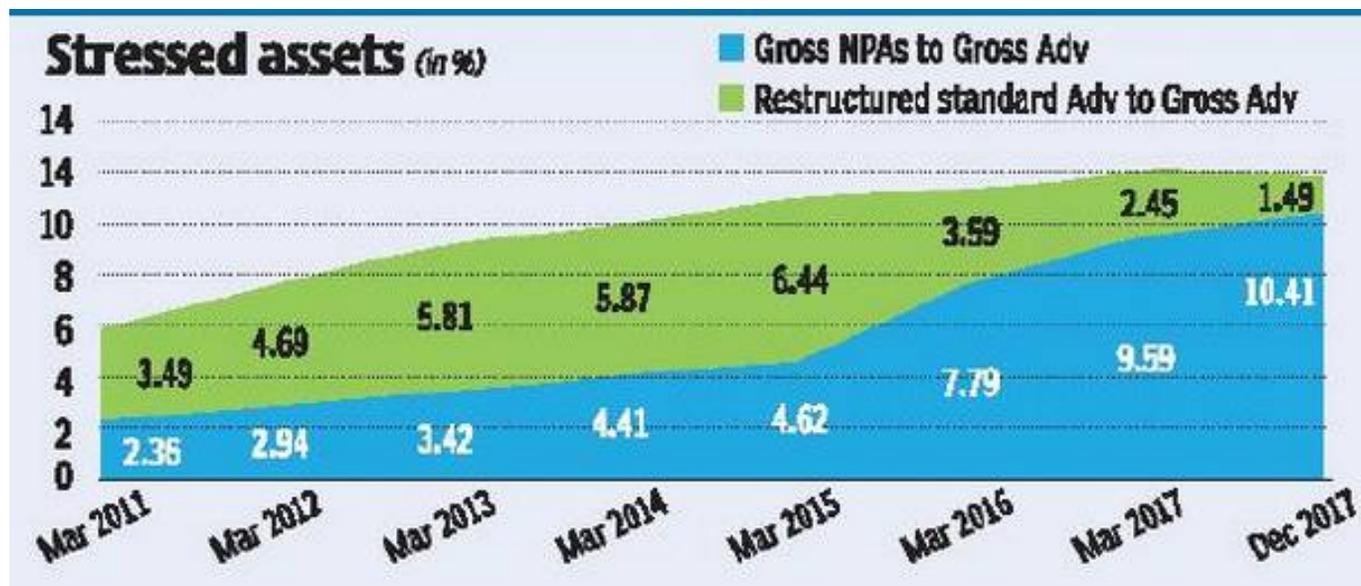
The significance of the speech is that the RBI has sent out a very clear message that it is not business as usual any more on the regulatory front.

When central bank governors speak one usually has to read between the lines to get the real import but the NIBM speech is as blunt as it can possibly get.

Vishwanathan explicitly called out the collusion between the banker and the borrower to ensure that a non-performing loan is not recognised as one on the books.

Successive resolution plans over the years starting with the Corporate Debt Restructuring Scheme, the Strategic Debt Restructuring and the S4A were all compromised only because the central bank's forbearance on asset qualification provided the restructuring plan met certain conditions was totally misused.

A good example here is Kingfisher where a consortium of banks, in 2011, restructured the loans and even converted part of the outstanding into equity at prices higher than the prevailing market price just to ensure that the account would be classified as healthy.



Breaking the nexus

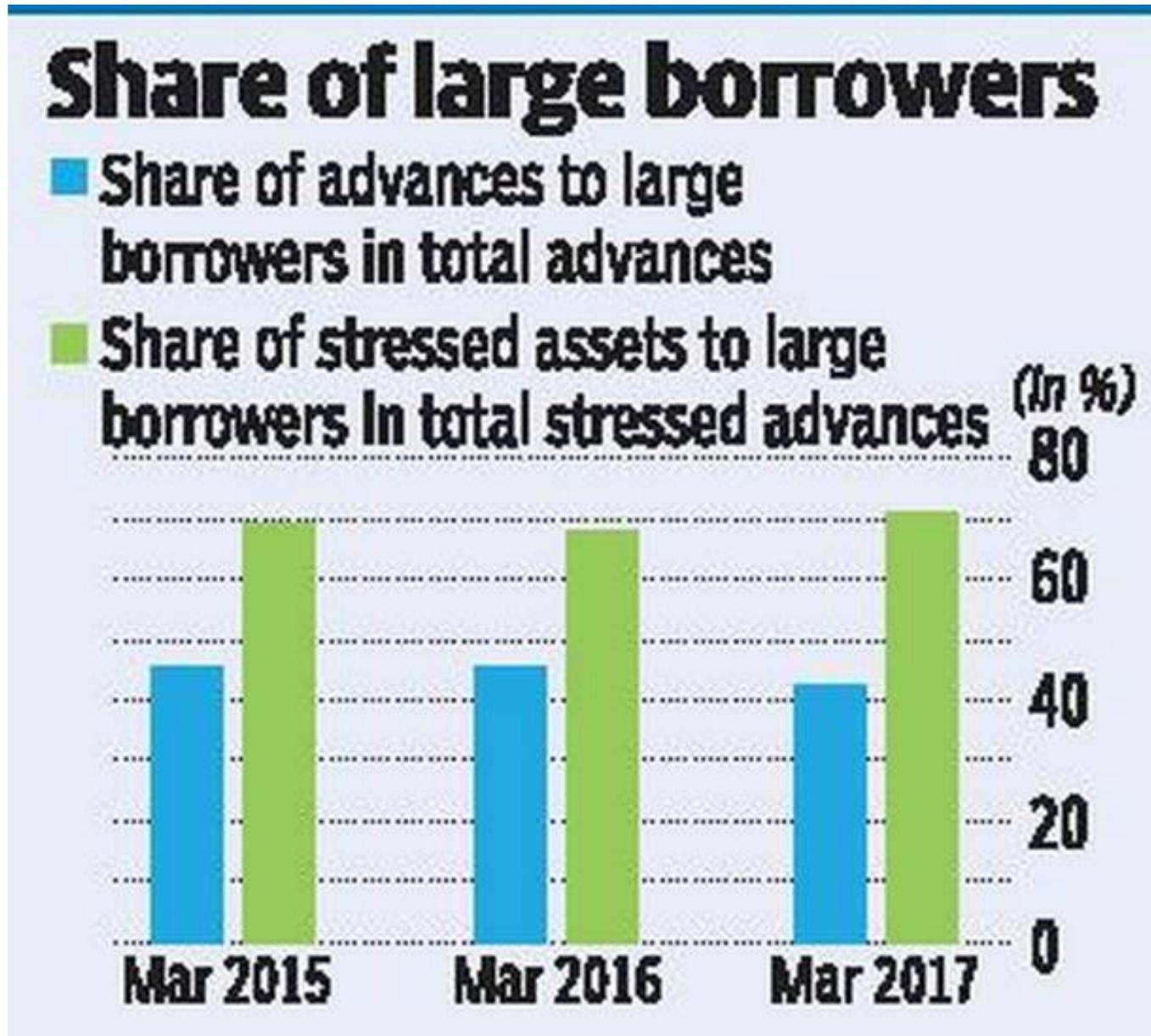
Referring to his boss, Governor Urjit Patel's speech last month where the latter had spoken about the borrower-banker nexus, Vishwanathan said: "Prolonging the true asset quality recognition suited both the bankers and the borrowers. The former could make their books look cleaner than they actually were; the latter could avoid the defaulter tag even while, in fact defaulting..."

Bankers and borrowers also got a short lecture on the sanctity of the debt contract and the prevailing credit culture where the time schedule for loan repayments is respected more in the breach.

The comparison to repayments on corporate bonds with that on bank loans is stark.

Delaying repayment on a corporate bond even for one day would result in downgrading of the borrower's rating making it more expensive for him to raise funds in the future and even lead to legal action by investors.

But the same borrower can merrily default on his payment to banks without attracting any strictures. The debt contract on bank loans has lost its sanctity and needs to be corrected, is the message.



Early detection

Another first principle that Vishwanathan underlined was on how lenders need to be proactive in monitoring their borrowers and identify financial stress early. It is a sad comment on the prevailing credit culture that the regulator has to stress on the basic lesson in banking that default in repayment is a lagging and not a leading indicator of the borrower's financial stress. If a lender is proactive and does his job diligently he should be able to take steps to stop the default.

There has been criticism of RBI's February 12 circular from banks over the one-day default clause saying that it is too stringent and impractical.

Yet, it is shocking to note that a large number of borrowers, including some highly rated ones failed to pass the one-day default norm going by Vishwanathan's speech. According to him, based on first few reports received from banks under the new reporting system non-payment on due date seems to be the norm.

No mood for excuses

Often, the stock excuse from borrowers for delayed payments is that their customers failed to pay up on time. But the RBI appears in no mood to take these excuses anymore.

“The repayment schedules of loans should take into account such idiosyncratic risks and.... Second, there must be enough skin in the game for the borrower...banks allow excessively high leverage thus ruling out any possibility that the borrower can be made to deal with emergencies. This has been possible in an environment in which both the lender and the borrower were not too keen to maintain the sanctity of the debt contract,” thundered Vishwanathan.

More teeth

It is clear that passing of the Bankruptcy Code and the amendment to the Banking Regulation Act last year empowering the RBI to direct banks to refer specific cases to the insolvency process has given fresh heft to the central bank. The RBI has now grown fangs and is not chary of displaying them.

It is well known that stressed assets rose following the surge in credit between 2006-11 when credit grew at over 20 per cent annually, a rate that was much higher than nominal industrial growth. Yet, NPAs were subdued well into 2015 and surged only after 2016. (See graph)

This is thanks to the Asset Quality Review by the RBI that forced banks to categorise loans that they had classified as standard assets into NPAs.

The AQR exposed banks and their reporting systems like no other move of the RBI.

Second, the proportion of stressed assets in large advances is higher than the share of large advances in total advances. What this means is that large borrowers are more prone to default than the smaller ones.

To be sure, this is not something new. The RBI has been highlighting this in its Financial Stability Reports. What's significant is that the DG thought it appropriate to highlight the statistic — it is yet another clear signal to banks that the regulator will put all large borrowers under the lens and monitor them closely hereon.

Govt support vital

This new 'take-no-prisoners' approach of the RBI is appreciable and has to be supported by the other main party in the business — the government.

The RBI is churning the sea of lending in a bid to drain it of all the poison accumulated over the years. If the government desires the nectar of growth that will follow, it has to help the RBI in the churning and not obstruct it. Even if the poison that comes out is unbearable.