

# Capping NPA-creation: Former RBI Governor Raghuram Rajan has important suggestions

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There has been much debate on the large quantum of non-performing assets (NPAs) at public sector banks and the many reasons why they reached these levels. However, as former RBI Governor [Raghuram Rajan](#) has said, the government needs to focus on the sources of the next crisis, not just the last one. To begin with, the consortium mechanism—which, some say, is one of the causes of the trouble—should be dismantled. The authorities seem to have realised this, and the Inter-Creditor Agreement (ICA) has been initiated. The delay in rolling out this mechanism—the operating guidelines for lead bankers are yet to be framed—suggests there is some disagreement on the terms and conditions. That is not surprising because private sector banks would be justified in ensuring that State Bank of India doesn't get to call the shots.

The consortium approach failed because there were, at times, too many members, all pulling in different directions and also because smaller members didn't always co-operate, thereby delaying prompt action. Also, at times, the bigger lenders bullied the smaller ones. The ICA, therefore, needs to be a watertight agreement, with clarity on accountability for all signatories. Also, the agreements need to have a legal status with penal provisions.

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Ideally, the number of lenders to any company should not be large—else, promoters tend to play one against the other and there are too many different opinions that need to be reconciled. Also, lenders should have more or less equal shares of the total loan exposure or equal skin in the game so as to ensure they pull together. One of the reasons why recoveries of bad loans have not been as high as expected is because banks haven't coordinated their efforts—partly because some of them have insignificant shares of the exposure—and promoters have exploited this weakness.

The prudential limits for lending to individual companies and groups also need to be tightened; the very high headroom meant bankers were less cautious and willing to increase exposures to levels which were clearly not warranted. Smaller limits for loan exposures also reduce the potential for any misuse of bank funds by politicians. Moreover, it will ensure bankers are covered in terms of collateral, which in the past has tended to be thin. The central bank has already tightened the default norms, and resolution needs to begin if the loans are overdue even by a day; this discipline needs to be maintained. In the past, too many loans have been ever-greened. As Rajan has observed, both the out-of-court restructuring process as also the bankruptcy process need to be strengthened. Also, state-owned banks need “outside talent” especially because there is a talent deficit. This can only be done if there is a rethinking on compensation structures.

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