THE BL INTERVIEW

‘Tightening regulatory norms put pressure on banks’

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The mega proposal to amalgamate Bank of Baroda, Dena Bank and Vijaya Bank to create India's third-largest bank has not gone down well with the market. With Bank of Baroda – presumably the stronger bank – also grappling with a high level of stressed assets over the past two to three years, there is a lot of scepticism on whether the consolidation will drive true synergies. Given the dodgy history of bank mergers in India, is this another feeble attempt to rescue weak banks? Rajeev Kumar, Secretary, Department of Financial Services, says that with all the reforms introduced to clean up the banking system, a repeat of past issues is unlikely. We need big financial institutions in India and consolidation is the way to go. Excerpts:

Do you think the merger is a solution to the ailing the banking sector?

This has to be seen in the context of how the entire bad loan issue began. Excessive lending and the issue of large consortium lending is well known. Smaller banks, following the lead of larger banks, seldom did any due diligence of their own. Cash flows were not ring-fenced. Covenants of sanctions were not followed. Red flags on stressed assets were visible, but not recognised even within the regulatory framework. The other issue has been that banks didn't declare wilful defaults or fraud. The same person sanctioning the loan recycles the account to avoid the account being declared NPA.

There must be role separation – sanctioning and monitoring must be done by two different parties. Some of these issues have been addressed by striking off 2.96 lakh shell companies, limiting consortium number to seven-to-nine (against 30-31 members earlier), and specialised monitoring of loans of more than ₹250 crore. Resolution through the IBC is yet another game-changer.

Hence, some of the earlier issues are unlikely to crop up again. Debarring the wilful defaulters from the IBC process has also made a sea-change in the credit behaviour of borrowers. Against this context and the fact that there is digitisation of banking outreach, having 21 PSBs where there is overlap in branches and operations, does not make sense. Everyone has been talking of consolidation for the last so many years, but when we did it, there is still criticism.

But governance reform in PSBs is imperative if these large institutions are to be competitive and ring-fenced from political interference....

As far as governance goes, the appointment of the top bank officials is now at arm's length and on merit. It is now done by the Banks Board Bureau (BBB), though initially there were some issues.

But would it not have been prudent to wait and see how the resolution under the IBC unfolds before going in for the merger? In recent years, even some of the larger and stronger PSBs have been weighed by huge slippages and losses. Are they capable of subsuming weaker banks?

The question to ask is what led to the worsening finances at PSBs. Some of the regulatory changes made have added pressure on these banks. For instance, the revision in Prompt Corrective Action (PCA) in April last year, which brought in more stringent threshold levels, led to many banks slipping into the PCA category.

Earlier, banks with a net NPA of more than 10 per cent, fell under the PCA (into various risk thresholds based on the level of NPAs). After the revised guidelines last year, banks with net NPA of 6 per cent or more fall under the PCA. Similarly, norms around capital were made more stringent (banks with a total capital adequacy (CRAR) of 'less than 9 per cent' fell under the PCA earlier; the cut-off was increased to 'less than 10.25 per cent' in April last year). Banks are fundamentally strong, the shifting of the goal post and tightening regulatory norms when the NPA recognition cycle was on, added pressure on bank finances.

But then isn't it also true that the RBI's asset quality review and the February circular on stressed assets helped faster and early recognition of NPAs, which would have, otherwise, continued to be brushed under the carpet?

That may be true, but how does a bank come out of the PCA without lending? Consolidation is one way to address the issue. We need big financial institutions in India and consolidation is the way to go. After merging banks, the government can infuse capital and make these institutions stronger. Also, it is not only PSBs that have been weighed by asset-quality issues. Many private sector banks, too, that lend to the infrastructure sector, have been caught up in various issues.

This then begs the question: are commercial banks really capable of undertaking infrastructure lending? Funding very long projects will always be a problem

This is another reason why consolidation is important. After merger, each bank can operate in verticals they have built competencies in – one can do retail, the other MSME, and yet another, infrastructure lending. Hence, there is specialisation within an entity.

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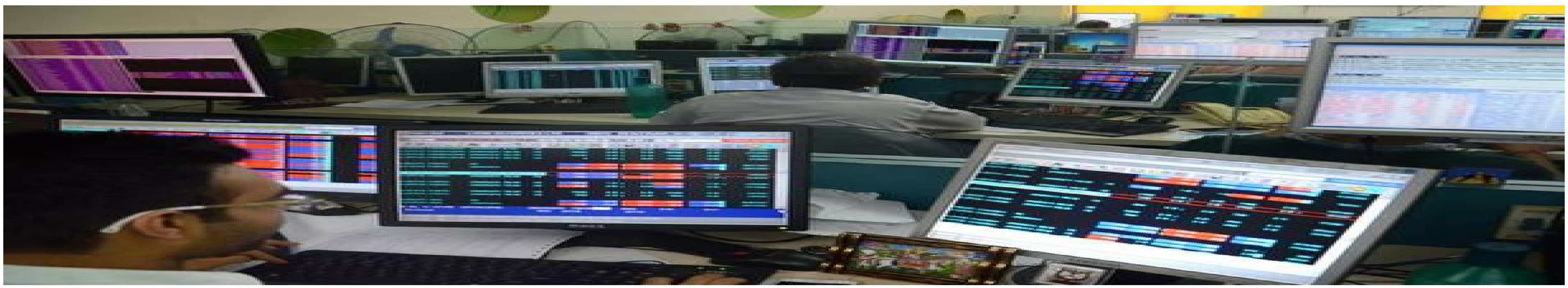

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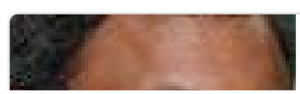

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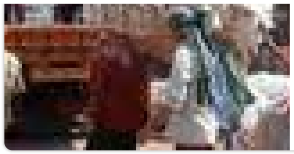

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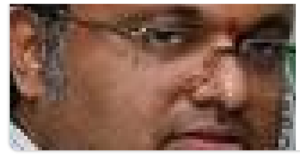

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