How RBI's Feb 12 circular changed the way banks dealt with stressed assets

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Come Tuesday, the Reserve Bank of India's circular on resolution of stressed assets revised framework — commonly known as February 12 circular — will turn one.

It was just one of the 192 circulars issued by the central bank last year. Yet, the anniversary bears significance. After all, the circular forced stressed companies to declare bankruptcy and was also a reason that added to the rift between Mint Road and North Block.

"I was in the banking industry for 36 years," says Ashwani Kumar, former chairman and managing director of Dena Bank. "But I don't remember a single circular being as powerful as the one issued on February 12, 2018. According to the circular, even one-day default leads to NPA (non-performing asset)." Kumar retired from the government-owned bank in December 2017, two months before the controversial circular was put in place.

Banks on the Brink

According to the circular, lenders had to classify a loan account as stressed if there was even a day of default. The bankers had to mandatorily refer all accounts with over Rs 2,000 crore loans to the National Company Law Tribunal (NCLT) or the bankruptcy court if they failed to resolve the problem within 180 days of default. Lenders, said the circular, had to file an insolvency application under the Insolvency and Bankruptcy Code 2016 within 15 days of the completion of the 180-day deadline. The circular also withdrew the loan resolution mechanisms the RBI had implemented, such as Corporate Debt Restructuring and Strategic Debt Restructuring.

The move caught banks unaware ahead of the 2017-18 result announcements. All government-owned banks except two highly conservative ones — Indian Bank and Vijaya Bank — posted losses for the year. Punjab National Bank and State Bank of India posted net losses of Rs 12,283 crore and Rs 6,547 crore, respectively. Banks were in the red as they had to account for higher NPA provisioning, as mandated in the circular.

The circular also hit infrastructure, power, iron and steel and textiles, among others, as most non-performing loans were in these sectors. Within that segment, the stressed assets of the power sector stood out. The outstanding loan of scheduled commercial banks to the sector was Rs 5.65 lakh crore as on March 2018, according to RBI data.

Stress Factor

February 12, 2018

RBI issues a circular revising the resolution mechanism for stressed assets; puts pressure on banks and India Inc

August 27, 2018

Allahabad High Court refuses to grant interim relief to power companies seeking stay on RBI circular

September 11, 2018

Supreme Court orders status quo on the circular and asks that all pending cases challenging the circular be transferred to it

February 7, 2019

New RBI Governor Shaktikanta Das says in a press meet in Mumbai there is no proposal to modify the circular

Thirty-four stressed coal-based thermal power plants became the talking point, as the ministry of finance furnished their names to the parliamentary committee on energy, which in turn submitted its report on the sector in August last year. The outstanding debt in these stressed project was of Rs 1.74 lakh crore as of June 2017, based on RBI data. The ministry said the accounts of seven of those projects, corresponding to an installed capacity of 7,620 MW, were resolved, the report said. There is no clarity on what has happened to the rest of the accounts.

“The RBI did the right thing in cleaning up the system. This one-time prescription was required. But all stressed assets are not finding buyers now. For example, bankrupt steel companies are attracting buyers; similar companies in the power sector are going unsold,” says Ajay Dua, former Union industry secretary.

There is no data on the size of the NPAs after the circular and how many companies have actually turned bankrupt. In a written reply to

ET Magazine's query, a spokesman of Chennai-based Indian Bank said the impact of the circular on the bank was of Rs 1,275 crore in 13 loan accounts. He did not name the defaulters.

The circular was challenged in the courts as well. In the Allahabad High Court, Independent Power Producers Association of India argued their members were by no means wilful defaulters, as the defaults arose because of extraneous reasons such as lack of availability of coal and gas, delay of payment by distribution companies, lack of power-purchasing agreements with the states and tariff-related disputes, among others. It was also argued that if the circular was implemented, projects of about 30 GW (gigawatts) would find their way to bankruptcy courts, leading to a mammoth erosion of enterprise value of the companies concerned.

The high court, in an order dated August 27, 2018, refused to grant any interim relief to power companies. The case then moved to the Supreme Court, which has so far ordered a status quo on the implementation of the circular.

Year of Flashpoint

The year 2018 was unusual in the central bank's 85-year history. It saw government versus central bank bouts.

The February 12 circular was one of several flashpoints of the tussle — the others being diamond merchant Nirav Modi engineered Rs 14,000 crore PNB fraud and the Centre's continuous prodding of the central bank to release some foreign exchange for an upgrade of the nation's core sector.

But the RBI refused to budge an inch on its circular, calling it a necessity to clean up banks' books and also to create a robust credit culture. The entire government machinery indirectly put up its might behind independent power producers, who dragged the banking regulator to the court.

The tussle with the RBI ended when Urjit Patel resigned as the governor. His 27-month tenure was the shortest by any RBI chief since 1992. Patel, however, had said he was resigning due to personal reasons.

In a press conference held in Mumbai on Thursday, new RBI Governor Shaktikanta Das said there was no proposal to modify the circular. Irrespective of what happens, the February 12 circular will always be the one that shook India Inc.