# RBI reduced to a toothless regulator with no power over cronyism

**Bloomberg** April 3 | Updated on April 03, 2019 Published on April 03, 2019


You don't adopt a modern insolvency law in the expectation of damaging the credibility of your central bank. But that's just what has happened in India.

The country's Supreme Court on Tuesday struck down a controversial 2018 directive from the Reserve Bank of India, which gave lenders a 180-day deadline to resolve non-performing loans before having to refer the defaulting borrowers to a bankruptcy tribunal.

The verdict is a serious blow to the bank officials, who have been trying to tackle one of the world's worst bad debt problems with some early success. Yet it is a huge relief to several Indian industries, especially the country's power-generating companies, which are saddled with stranded capacity and too many borrowings.

They had sued the central bank, arguing that a 2017 law introduced to empower the central bank on corporate defaults (and thereby beef up India's new insolvency code) was unconstitutional.

Luckily, the companies failed in their broader attempt to overturn the new law. The judges ruled that it was good, and agreed that it did give the RBI greater scope to intervene on insolvencies. Nonetheless, they still decided that the bank had overreached with its February 2018 circular on the 180-day deadline.

The Supreme Court found that under the new law, India's government has to instruct the RBI on specific defaults it wants settled by the bankruptcy tribunal. As such, the regulator was wrong to take sweeping, general action of its own.

## RBI's dwindling authority

The verdict reduces the RBI's dwindling authority by another couple of notches. Urjit Patel, the former bank governor, saw the 2018 circular as a potent weapon against crony capitalism. His predecessor, Raghuram Rajan, had started forcing banks to come clean about the true extent of their $200-billion-plus stressed asset problem. Still, recognition is only the first step to resolution.

Under-capitalised state-owned lenders prefer to keep kicking the can down the road. Take Reliance Communications, the mobile phone operator controlled by Anil Ambani, the younger brother of India's richest man. An out-of-court restructuring of the company never got anywhere. Unpaid banks kept dithering on legal action, even as the firm closed its main business. But an overseas creditor, Sweden's Ericsson, swooped in, went to the bankruptcy tribunal, and got itself a handsome settlement. State Bank of India and other lenders are still waiting to see even a partial return of capital.

Such examples abound. That's why Patel gave foot-dragging lenders a hard deadline on when they would have to take errant debtors to the insolvency tribunal. And that made him enemies. Big power companies protested that broken government promises had caused the sector's financial woes, which meant they deserved forbearance. (Of course, when banks snatch the assets of small entrepreneurs, the fault is always with the borrower).

For politically-connected industrial families, the very idea that lenders would take away their assets and sell them perhaps even to foreigners is unthinkable. In the face of such powerful resistance, Rajan gave up as RBI governor and went back to the University of Chicago after a single three-year term, and Patel resigned abruptly late last year. In the world of the Indian promoter, as controlling shareholders are known in the country, cronyism is not an aberration. Given India's opaque sources of political funding, it's an organising principle of economic activity.

## A hopeless war

In the end, the RBI was fighting a just but hopeless war against the cronies. Tuesday's 84-page Supreme Court order marshals impeccable legal logic to show that Patel's 2018 circular assumed a freedom of action that legislators never meant to give him. But who will blow the whistle on this endless game of extending bad loans if the RBI, the banking regulator, cannot? The government?

We will know after the general elections on May 23. When Prime Minister Narendra Modi's administration drafted the RBI into the bad debt fight, and got it to force banks to send two batches of large corporate defaulters to the insolvency tribunal, it did appear it was serious about changing the credit culture.

But then it shifted course dramatically by anointing a known RBI-baiter, S Gurumurthy, a Chennai-based accountant, who had attacked Rajan for making lenders tell the truth about non-performing loans as a director on the central bank's board.

This gradual weakening of the central bank is a great shame, because in the brief time the RBI got to play bad cop, it did some good police work.

Among the firms that ended up in insolvency thanks to the central bank's prodding is Videocon Industries, whose financial creditors are owed $8.4 billion. One of its associate companies, Videocon Telecommunication, is also bankrupt with a debt load of $3.5 billion. And that's not even counting operational creditors. Venugopal Dhoot, the controlling shareholder, is under investigation in a favour-for-loan scandal involving ICICI Bank's former CEO, and her spouse.

The rot runs deep, and somebody needs the legal authority to clean it up. Maybe the RBI will have to sit out the campaign. But how many knocks can it take before people lose faith in it as an institution altogether?

**Bloomberg**

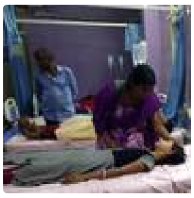
Published on April 03, 2019



courts and legal    RBI and other central banks    Insolvency and Bankruptcy Code

0

COMMENTS



Next Story

**Health cover policyholders may soon be able to receive claim amount in instalments**