Will banks act proactively to deal with stressed assets or kick the can down the road?

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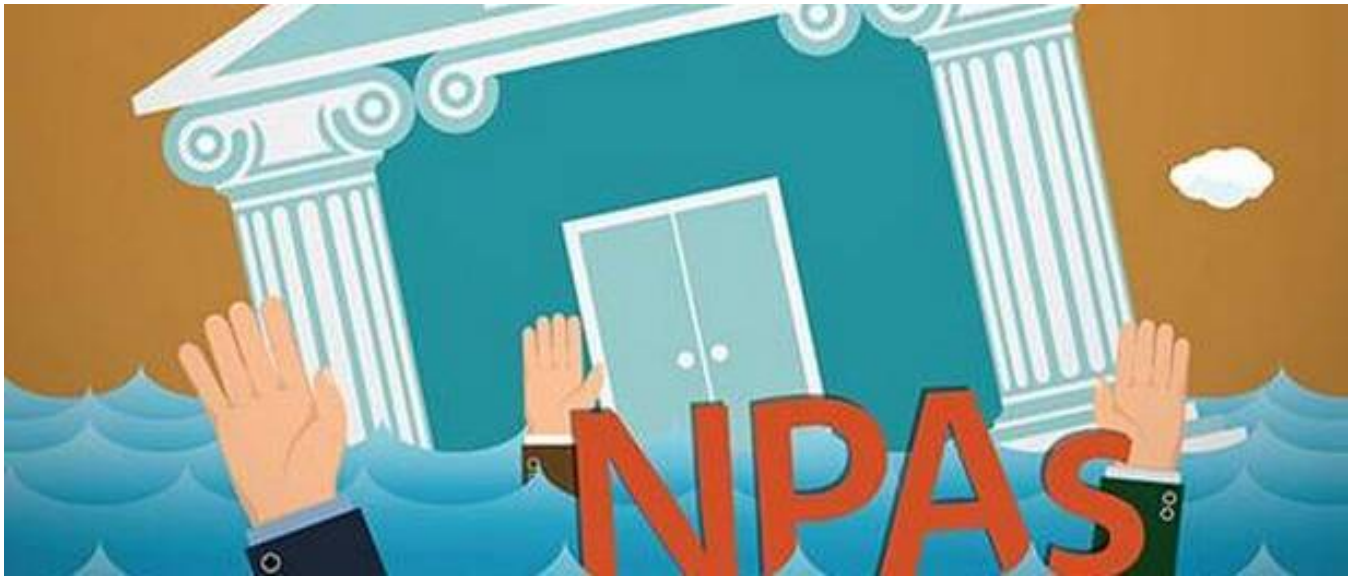

The sword of Damocles hanging over banks' heads has been done away with, thanks to the Supreme Court's ruling that has struck down the RBI's February 2018 circular. The circular in effect requiring banks to compulsorily implement a resolution plan within 180 days of default or file for insolvency under IBC, had been a niggling worry for banks particularly saddled with large stressed power sector accounts.

Banks will continue to have the discretion to file for insolvency under IBC on a case-to-case basis. But given that banks have been tardy in resolving stressed assets on their own in the past, the Supreme Court ruling could delay the resolution process. Importantly, it is unclear whether all the old restructuring schemes that were earlier scrapped under the February circular will become operational. Given that these schemes failed to deliver, resolution could take a back-seat impacting the sector over the long run.

What was Feb circular?

Under the February 2018 circular — the RBI had done away with all the old restructuring schemes — Corporate Debt Restructuring Scheme (CDR), Flexible Structuring under 5:25 scheme, Strategic Debt Restructuring Scheme

(SDR), change in ownership outside SDR, and Scheme for Sustainable Structuring of Stressed Assets (S4A). Banks had to begin resolution process on an account as soon as it is classified as an Special Mention Account-0 — where payments are overdue by 1-30 days — by any one bank within a consortium. In respect of accounts with aggregate exposure of ₹2,000 crore and above, lenders have to draw up a resolution plan within 180 days from default, failing which banks will have to refer the case for insolvency under IBC.

Banks moving out of benevolent provisioning requirements under old restructuring schemes, had to make higher provisioning — as per the NPA norms.

Why the worry?

While the one-time impact of this had led to steep rise in provisioning in the March 2018 quarter for banks, the framework requiring banks to report even one-day defaults and draw up resolution plans within 180 days, was a cause for worry.

The framework required all lenders (100 per cent) agreeing to the resolution plan, as against 60 per cent under JLF, which was a tall ask. In particular, large stressed power sector accounts (amounting to about ₹2 lakh crore) that would find resolution challenging, was a grave concern. Structural issues plaguing the power sector – ranging from non-availability of fuel, projects set up without linkage, lack of PPA, tariff related disputes — would also make it difficult to find buyers under IBC, leading to liquidation and huge write-offs for banks.

What now?

While the Supreme Court quashing the RBI's circular, will not immediately impact banks' profitability or asset quality — chunk of the estimated ₹3.8 lakh crore of debt affected by the circular have been classified as NPAs — it will be a big setback for resolution of stressed assets.

Why?

One, earlier restructuring schemes had failed miserably in resolution of stressed assets. Hence, throwing the ball back into banks' court is unlikely to make any significant headway. The CDR for instance failed on account of short tenure of restructuring and inability of the promoters to infuse the requisite equity. The challenge under JLF was to get everybody on board. Under SDR, which gave lenders the right to convert their outstanding loans into a majority equity stake, finding buyers for large borrowers in core sectors within the 18-month window had proved to be difficult.

Hence, all old arsenals with banks to deal with stressed assets failed due to banks' unwillingness to take decision, accept relevant haircuts and absorb losses.

The February circular made it compulsory for banks to act quickly or refer the accounts to IBC. With this compulsion done away with, it is unlikely that banks will move quickly on resolution hereon. Importantly, the RBI's circular issued under the provisions of Section 35A, 35AA and 35 AB of the Banking Regulation Act (among others) had helped bankers fearing backlash in later years to take decisions. Banks can still move cases under IBC at their discretion, but may not do so readily. Also structural issues continue to plague core sectors such as power, impeding resolution process.

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