# India needs a mega-bailout. Here's how to do it

**Bloomberg** June 7 | Updated on June 07, 2019 Published on June 07, 2019


## An effective solution to resolve the funding woes of NBFCs

Another shadow bank in India has missed a bond payment. That's a reminder to the new government that a mega-bailout of the country's distressed financial industry is now unavoidable.

Ever since the collapse of infrastructure financier-operator IL&FS Group in September, the funding woes of the country's non-bank lenders (those banks that operate without state-guaranteed deposits or access to central-bank liquidity) have kept worsening.

The latest casualty is **Dewan Housing Finance Corp**, which missed payments due on June 4 and had its short-term credit rating cut to default at the local affiliate of S&P Global Ratings. Mutual funds, which have vigorously lent surplus household and corporate cash to Dewan and many such financiers, are trapped. Their search for yield has gone wrong.

**Also read: DHFL default: RBI to ensure financial stability**

This crisis has systemic written all over it because the market can no longer distinguish financiers that are illiquid from those that are insolvent.

**Also read: NBFCs feel sting as Mutual Funds cut exposure**

Nothing short of a Troubled Asset Relief Programme, of the kind enacted by the US during the 2008 credit crisis, will restore confidence.

Here is one possible blueprint:

## 1. Set up 'Maiden Lane' equivalents

The Reserve Bank of India (RBI) could establish special-purpose vehicles akin to the Federal Reserve's Maiden Lane instruments created to rescue Bear Stearns Cos and American International Group Inc, or AIG. They could be numbered 1 to n.

**Also read: MPC acts on cue to revive the economy**

Whoever wants to buy the more stable assets of a troubled shadow bank (say, mortgages or auto finance), can make a proposal for a carve-out. The remaining assets typically construction debt will be bought by the Maiden Lane equivalents, funded with loans from the RBI.

Equity in the dismembered financiers will be rendered worthless, but all creditors, including mutual funds, will be made whole.

## 2. Create a land bank

Will the RBI lose money by warehousing risky construction debt? Not if it can persuade the government to create a land bank.

As Vikas Oberoi, the CEO of Mumbai-based Oberoi Realty Ltd, pointed out on an earnings call last month, developers are trying to monetise land so bad that you can't make business out of that.

Has the money raised against shady collateral from shadow banks gone to some private accounts in Singapore or Switzerland?

Let those investigations proceed apace, but the government should immediately create a land bank into which struggling developers will be persuaded to sell a part of their holdings *in lieu* of state-guaranteed land-bank securities, which they can take to a commercial bank and get the cash to repay creditors and complete more advanced projects.

As for projects the developer refuses to part with, they will be taxed heavily if they remain unsold, something Singapore does to keep inventory moving. Over time, urbanisation will lift property values.

If the land bank is able to turn a profit in future in excess of its carrying cost, a mechanism to share the bounty with the developers can be considered.

## 3. Refinance maturing loans

Suppose a business owner wants to re-mortgage a residential or commercial property to take out a working capital loan. The world of these small borrowers and of their customers is turning bleak, not because President Donald Trump and China are fighting, but because local financing costs have become unbearable. A decently priced refinance offer from someone will be a big relief.

Let that someone be a state-sponsored vehicle. It will make a transparent online bid, based on credit scores, for every loan against property coming up for refinancing. Borrowers can choose to to go with the new option, stick to their original creditor (if its willing to refinance), or seek their loan elsewhere.

The refinancing vehicle will pool the loans it writes and parcel them out as securities to investors. Preventing a $55 billion working capital market from drying up for small businesses will go some way toward lifting GDP growth, which hit a five-year low in the March quarter.

## 4. Lubricate the banking system

The RBI bought two-thirds of the net issue of government bonds in the financial year that ended in March.

In two moves in March and April, the central bank even took a total of $10 billion in dollars from banks and gave them rupees for three years, and yet liquidity in the banking system has only recently gone into surplus after hitting a deficit of Rs 1,49,000 crores ($21 billion) in late April.

**Also read: Dollar-rupee swap: A favourable exchange**

On Thursday, the RBI cut its benchmark interest rate by 25basis points, the third reduction in 2019. More cuts are coming, but for the lower rates to get passed on to final borrowers, liquidity must be more than ample. If that means more quantitative easing-style bond purchases, so be it.

## 5. Switch off the air-conditioning

The RBI has not exactly covered itself in glory with its lax supervision of the shadow banks. But this is the hot and humid season in Mumbai, a perfect opportunity for the central bank’s soon-to-be-bolstered supervision team to call market participants including rating companies, lenders and everyone it has any power over, for uncomfortable meetings with the air-conditioning turned off.

New regulations like the proposed liquidity buffer for shadow lenders are welcome. But even the thickest of rule books means nothing without robust policing.

*(The author Andy Mukherjee is a Bloomberg Opinion columnist)*

Published on June 07, 2019



NBFC

COMMENTS

Next Story

**Large NBFCs see significant jump in public deposits in FY19**