

Business Standard

How opportunistic behavior can worsen India's \$200 bn-plus bad loan crisis

A capital-constrained economy like India can't afford a jungle raj in finance

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Illustration by Ajay Mohanty

Snatch-and-grab is the new hallmark of Indian finance. As a banker friend in Mumbai put it to me only half-jokingly, a unit of "grabbed" cash collateral in hand is worth more than two units of hypothetical receivables.

Yet this is no laughing matter. Not only is opportunistic behavior going to worsen India's \$200

billion-plus bad loan crisis, but now that everyone from the government's sleuths to the courts are joining the melee, the ensuing chaos will limit the recovery for lenders and threaten depositors.

Rajnish Kumar, chairman of State Bank of India, sat down for a chat with me at the Bloomberg Equality Summit in Mumbai this week. He had highlighted the problem last month by blaming what he called the selfishness of one bank for a default by Altico Capital India Ltd., a nonbank lender to property builders. When asked why his HDFC Bank Ltd. had choked Altico by helping itself to the money the shadow financier had raised elsewhere and parked with him, Aditya Puri, the managing director of India's most valuable lender, replied: "What is out-of-turn? It is my security and I will exercise it."

Now the regulator, the Reserve Bank of India, will decide whether Kumar's unhappiness is a case of sour grapes or if Puri did indeed cross a line. For State Bank of India, Altico is just one of the several instances where the taxpayer-funded bank has been at the receiving end.

SBI didn't drag tycoon Anil Ambani's Reliance Communications Ltd. to an in-court bankruptcy process, hoping instead that Ambani would be able to sell assets to his brother Mukesh, India's richest man, out of court. Ericsson AB, an operational creditor, pursued the opposite strategy and got itself a very decent court-enforced settlement by invoking the younger Ambani's personal guarantee.

More recently, SBI's Kumar received a fresh blow when India's enforcement directorate, tasked to fight economic crime, attached the assets of insolvent Bhushan Power & Steel Ltd. on suspicion of money laundering by its previous management. Both the new owner, who won control of Bhushan during bankruptcy, and Kumar, who's waiting for his check, are impatient. Yet, thanks to the enforcement directorate, the \$2.8 billion sale has now been put on hold by an adjudicating authority.

ArcelorMittal, too, has also been waiting endlessly to conclude a near-\$6 billion purchase of Essar Steel India Ltd., the most keenly watched Indian bankruptcy. There, Kumar and other creditors are facing a legalized version of snatch-and-grab: An appellate authority has held that rights of financial creditors like SBI are no superior to those of unsecured operational creditors.

Finance 101 is being turned upside down in India. Take securitization. It got a bad rep during the 2008 subprime crisis, but the reality is that for India's cash-starved shadow banks to survive, they must package more of their small-ticket loans into securities and sell them on to people like Kumar, who have a more stable source of funding: deposits.

How hard is this? A court order is blocking the troubled Dewan Housing Finance Corp., which is seeking a restructuring of its \$12 billion liabilities to Kumar and other creditors, from putting cash collected from homeowners into accounts from which holders of its mortgage-backed securities are paid. Six of these bonds were downgraded this week by Moody's Corp. affiliate ICRA — three of them defaulted. These notes were supposed to perform for investors even if Dewan went bankrupt. Securitization will not lead to a safer financial system in India if this basic tenet is flouted.

Small savers may not understand the nuances of high finance, but they're the ones who feel the pain when a cooperative bank goes up in flames and the regulator puts limits on cash withdrawals. That's what happened recently after a \$1 billion fraud at Punjab & Maharashtra Co-operative Bank. The Reserve Bank is playing with fire. Imagine the consequences if, say, housing societies decide to move money out of smaller institutions and into too-big-to-fail SBI or HDFC Bank. Bailing out even small parts of a large deposit-taking industry will become a headache for Indian taxpayers.

A capital-constrained economy like India can't afford a jungle raj in finance. Only a set of clear rules can end the cash grab by powerful intermediaries and state authorities. Once powerless depositors join in the free-for-all, it will be too late.