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View: Interventions, a four-pronged approach, have made clean and credit-ready banks the new normal

BY ET CONTRIBUTORS | FEB 28, 2020, 11.52 PM IST

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Banking and other financial intermediaries, the engine driving India's economic ship, had to have watertight protection. New rules created space for those who sign up for a journey where clean, formalised business matters.

More than animal spirits, what were needed were saintly spirits. Calibrated interventions were taken, and a four-pronged approach within a compressed timeframe enabled jettisoning the excess cargo of non-performing assets (NPAs), while sealing points of water ingress.

The first prong was clean and responsible banking, underpinned by a non-interference policy in bank decision-making. Arm's-length appointments of top bank management were introduced where merit alone mattered. Project cash flows were ring-fenced, enforcement of the terms of loan agreements and prior validation of backward and forward linkages were made integral to lending processes.

The number of banks in loan consortium was capped, reducing borrowers' ability to play one lender off against another. This was accompanied by data-driven risk-scoring and scrutiny, comprehensive diligence across data sources and strengthened credit appraisal. Stressed asset verticals were set up to prevent new NPAs, and focus on recovery from big defaulters. Specialised monitoring agencies are now a feature of all large loans, with early warning signal systems in place.

Making accountable and disciplined financial conduct the new normal was the second prong. Insolvency and Bankruptcy Code (IBC),

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and amendments debarring wilful defaulters and connected parties, put owners on notice that failure to settle dues now meant irrevocable loss of ownership.

Amendments were effected to the Securitisation and Reconstruction of [Financial Assets](#) and Enforcement of Security Interest Act (SARFAESI), 2002, for stringent recovery processes, and to the Negotiable Instruments Act to deter issuance of cheques without sufficient funds.

The Fugitive Economic Offenders Act was enacted to deter recalcitrant borrowers from fleeing. Default, except due to genuine commercial failure, now carried consequences. Systemic strengthening was effected through freezing of 3.38 lakh shell company accounts. Equity created out of bank borrowing at the parent company was no longer par for the course.

Capital Benefit

Massive public sector bank (PSB) recapitalisation of Rs 4 lakh crore is the third prong, ensuring capital ratios comfortably above regulatory thresholds. Record recovery of over Rs 4 lakh crore has been effected over the last five years. Provision coverage ratio is at a seven-year high of 77%. NPAs and slippages are declining with improved asset quality. Occurrence of frauds has declined sharply from over 0.6% of gross advances earlier to 0.2% in 2019-20.

The number of [PSBs](#) under Prompt Corrective Action (PCA) is down from 11 in 2017 to four. And, 12 out of 18 PSBs are in profit this year, against 19 out of 21 in loss just two years ago. Bank consolidation has followed.

The Bank of Baroda-Vijaya-Dena amalgamation has yielded operational efficiency gains in year one itself. 56 regional rural banks (RRBs) have also been consolidated into 45. Their success has led to further announcement of a mega-merger of 10 PSBs into four.

As the fourth prong, it was also made clear that adherence to probity and high standards of governance applied equally to public and private financial entities. Security of public money in banks is paramount.

Weaknesses in cooperative banking needed to be addressed through amendment to the Banking Regulation Act empowering [RBI](#) to effectively regulate cooperative banks. The unchecked menace of duping the poor of their deposits has been addressed by enacting the Banning of Unregulated Deposit Schemes Act. Further, public confidence has been bolstered by increasing deposit insurance cover

from Rs 1 lakh to Rs 5 lakh.

A well-considered approach was evolved to deal with non-banking financial companies (NBFCs)/housing finance companies (HFCs) as well. The RBI Act was amended to transfer regulation of HFCs from [National Housing Bank](#) to RBI, and empowering RBI for resolution of vulnerable NBFCs and HFCs. This helped RBI initiate orderly resolution for default by a large HFC. So, despite defaults, the sector has stabilised and the market is now differentiating on the basis of fundamentals.

The bar has been raised for other players in the financial ecosystem as well. Regulation of assignment of ratings by credit rating agencies, and mandatory disclosure of 30-day defaults by listed entities to such agencies, restored confidence in ratings. Independent oversight of auditors has been entrusted to the National Financial Reporting Authority.

What if any of the above sector entities had failed? The financial sector has weathered the storm and is now back on an even keel. New ways of working are getting hardwired in the financial sector. It has rebuilt its capacity to not just support, but act as a multiplier for creating economic value.

Invest and Gain

The build-up of economic activity involves various links in an interdependent chain. Consumption and investment growth rely on this chain. Sustained efforts have ensured that banks and financial institutions are no longer the weakest link. The other links must now gain strength and generate traction for the chain to move and for money to circulate. The investment, both public and private, has to be fast-tracked, especially in sectors in rural areas where the multiplier effect is most.

For this, technology and large-scale data are crucial. Data from GST filings, Central Registry of Securitisation Asset Reconstruction and Security Interest (Cersai) and other databases now interface with banking systems, providing a wealth of information for sharper underwriting. The technological foundation for smart, tech-enabled banking for the future has been laid.

The writer is finance secretary, Gov. Views are personal

This is the second part of a three-part series

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