

Rush hour and tougher questions ahead for both Mint Road and banks

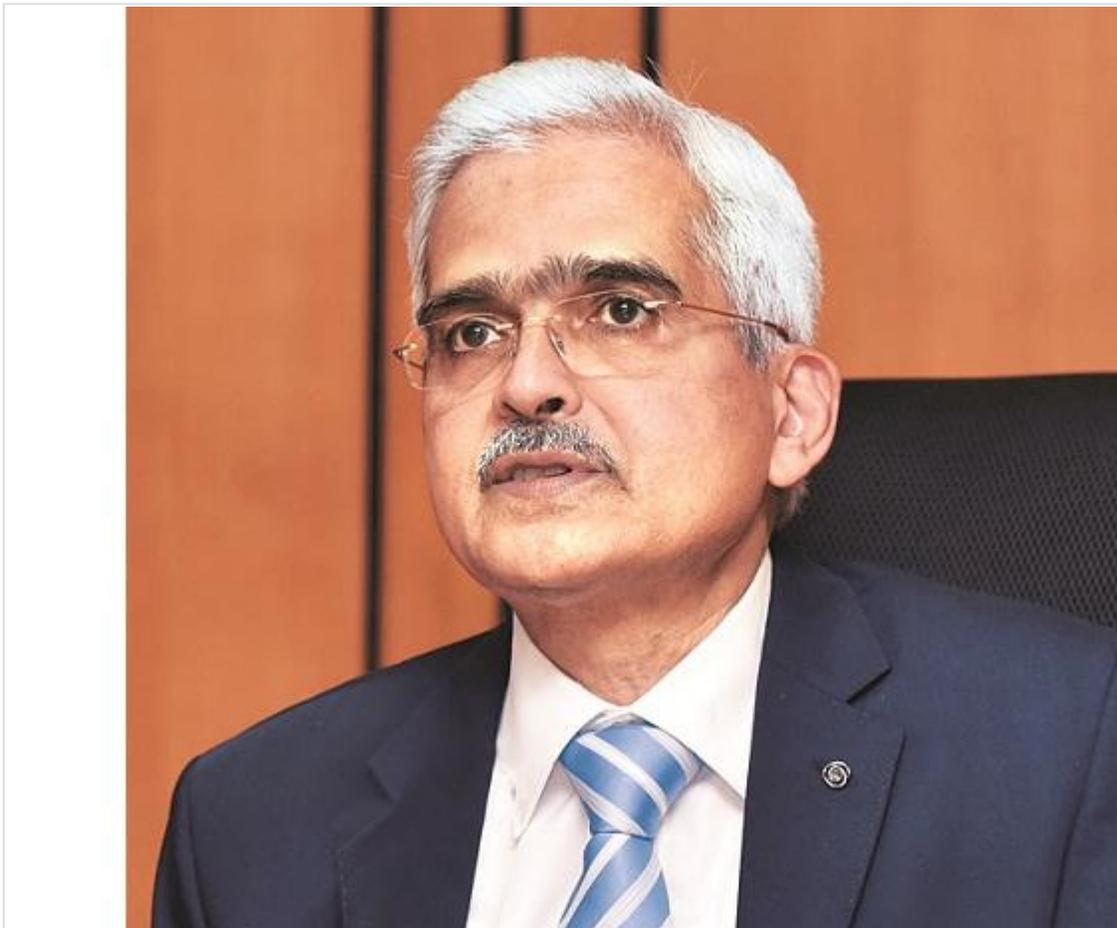
Piecemeal regulatory forbearance will not go far and tougher questions will be asked of both Mint Road and banks, reports Raghu Mohan

Raghu Mohan April 07, 2020 Last Updated at 01:44 IST

“We must always remember that tough times never last; only tough people and tough institutions do,” said Reserve Bank of India (RBI) Governor Shaktikanta Das, when he announced a raft of measures to tackle the fallout of coronavirus (Covid-19) on the economy. It was a signal the days ahead will stretch both banks and Mint Road; so be prepared. Are we?

The asset quality of banks and the demands on their capital position due to its further deterioration must rank among the top concerns. The central bank has moved on the double to put in place a three-month moratorium on the servicing of term loans. But there has been no relook at income recognition and asset classification norms, the status of additional provisioning under the central bank’s June 7 circular, and the road ahead under the Insolvency and Bankruptcy Code (IBC) in these stressful times.

Says Divyanshu Pandey, Partner at J Sagar Associates, “There is good reason to give a three-month break for the timelines under the June 7 circular. An idea has been floated that the IBC process itself



RBI Governor Shaktikanta Das

may be suspended for six months. A like thought process may be good for the June 7 circular as well.”

The merger of four sets of state-run banks, effective April 1, has led to a reset of a quarter of the banking system’s assets, and there is nothing to suggest that these entities will not require fresh capital down the line – and we have a handle on only their pre-Covid asset quality as on date. This holds true for private banks as well and may call for a rethink of their current capital structures.

Notes Nikhil Shah, managing director, Alvarez & Marsal (India): “The Budget has not provided capital for state-run banks given the significant recapitalisation of over \$30 billion provided between FY17 and FY19. Most businesses have been severely impacted operationally and financially, and those that were overleveraged or had liquidity constrained prior to the crisis, will have the most difficult time.”

“My biggest worry is that the measures announced so far, commendable as they are (from a borrower’s point of view), come with their share of operational difficulties,” says a banker. Another lender, less charitable, is of the view that “it would have been better if the RBI had called for a videoconferencing of banks’ chief executives so that some of the ground-level operational issues could have been handled better.”

You have far too many moving parts.

The nuts and bolts

It has been gathered on good authority that it had been conveyed to the central bank that the insistence that the three-month breather



ALL EYES ON THE ROAD

- A relook at banks' income recognition and asset classification norms
- An easing of the additional provisioning norm and incorporation of a three-month breather with regard to the trigger points of the central bank's June 7 circular
- Charting the path ahead under the Insolvency and Bankruptcy Code (IBC)
- Visibility on the fresh capital needs of state-run banks; handle only on their pre-Covid asset quality as on date
- Rethink on private banks' current capital structures
- Delinking the three-month moratorium on loans from lending institutions satisfying themselves that it is necessitated due to Covid-19
- A fresh forbearance package for micro, small and medium

“shall be contingent on lending institutions satisfying themselves that the same is necessitated on account of the economic fallout from Covid-19,” will not fly. Borrowers, especially micro, small- and medium-enterprises (MSMEs) service the interest part just in time before the 90-day non-performing asset (NPA) norm kicks in. It is in the nature of the business as payment cycles are lumpy to begin with. This is the case even for term-loans structured as equated monthly instalments at the time of extending the facility. Many borrowers who had genuinely intended to square their limits with banks by the close of FY20 are simply not in a position to do so because of the disruption during the month.

“To say that you should be able to pin-point stress to Covid-19 is not practical. The RBI could have simply said the account should have been ‘standard’ – that it is not an NPA, rather than insist it should have been ‘regular’ at all times, suggests a banker.

Banks, on their part, are being inundated by all kinds of requests and clarification from borrowers — big and small. Can it be creatively ensured that they are not treated as dud accounts, by sanctioning a fresh limit? Some queries on forbearance are far too complex for them to answer.

The Securities and Exchange Board of India (Sebi) has allowed credit rating agencies (CRAs) to relax temporarily their norms for recognition of default on rated instruments. This is to be applicable to all rated instruments, including term and working capital loans, debentures, fixed deposits, and commercial papers (CPs). Says Subodh Rai, Senior Director at CRISIL Ratings: “The move by Sebi and RBI will ease the operational challenge faced by borrowers in the immediate term. CRISIL will factor the moratorium, if any, subject to the relevant bank’s policy and investor’s inclination to allow moratorium.”

But here is the tricky NPA classification bit, and it has nothing to do with the mere non-recognition of defaults by CRAs. If there is to be a default in the servicing of interest on debentures or money

A fresh forbearance package for micro, small and medium enterprises

market instruments, will it mean that the term loans of the borrower are not to get a moratorium? Take a situation wherein a default on these instruments of a borrower had already happened say, in the month of February. If the term loans are to get a moratorium after all, what if the borrower were to divert funds to service the interest on debentures or CPs? This has implications

for mutual funds, and also non-banking financial companies which are heavily dependent on bank lines for their funding.

“Debenture interest payments are not to be treated like term loans when it comes to its servicing. It brings its own share of challenges,” notes Pandey. These aspects require greater clarity from the authorities, and calls for closer co-ordination between the central bank, Sebi and the Pension Fund Regulatory and Development Authority.

Now join the dots: the message that comes across is “we started well, but it could have been better”. You simply can’t have more of the same.

That said, Covid-19 will be leveraged to lobby for all manners of forbearance, and the sins of the past may well be forgotten. The central bank, in its Financial Stability Report of June 2013, quoted Edward J Kane to drive home a point: “Bankers understand the financial safety net as a politically enforceable implicit contract that they have negotiated with their national governments”. And “lobbyists create a taxpayer ‘put’ by creating an excessive fear in the minds of regulators for letting banks’ accounting decisions or health be called into question.” Do mull it over; it’s worth the grind.