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HITTING THE REGULATOR

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

On Tuesday, the Supreme Court struck down the circular issued by the RBI on February 12, 2018, which directed banks to refer all bad loan accounts of over Rs 2,000 crore to the National Company Law Tribunal (NCLT) if they failed to come up with a resolution plan within 180 days. The Court has said that the circular was unconstitutional and that a reference under the Insolvency and Bankruptcy Code (IBC) has to be on a case-to-case basis and with the authorisation of the central government. This was in response to the challenge mounted against the RBI circular by companies in the power and other sectors arguing that the defaults were because of extraneous reasons such as lack of availability of coal and gas, and delays in payment by distributors. The court's ruling is a blow to India's banking regulator which had, over the last four years, forced domestic lenders to clean up their balance sheets, by first forcing them to recognise the true extent of their bad loans and making full provisions for them. Against their will, the RBI directed them to take over 40 large bad loan cases to the NCLT.

The latest ruling courts the danger of reversing all these gains. It also marks a dent on institutional and regulatory credibility. With all loan restructuring schemes having been disbanded as part of the simplified generic framework for resolution of stressed assets on February 12, surely the process of resolution will be further delayed, adding to the pressure on banks. Recent data points to the fact that even with a deadline of 270 days, resolution of cases under the insolvency law has stretched way beyond, thanks to gaming by promoters and some borrowers, weakening one of the most structurally important reforms in recent years. A judicial intervention now, as in the coal allocation case, will impose its own costs, including a possible weakening of regulation and leave the door open for more regulated entities to approach the courts against regulatory rulings.

The costs will have to be borne by an economy already in slowdown mode. But it is worth recalling that the fire was first lit by the government which objected to this circular, encouraging infrastructure firms to take on the regulator. That, among other things, led to the exit of Governor Urjit Patel. The Supreme Court ruling should not lead to a further diminishing of the stature of the RBI. It is a moment of reckoning.

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