# Pushing on the loan resolution pedal

Indian banks have habitually swept their bad loans under the carpet by either evergreening or restructuring them—and thus postponing resolution. The Reserve Bank of India (RBI) has done well to yank the rug from under their feet.

The revised framework for the resolution of stressed assets put out by the RBI last week will redefine the way banks function in India—and accelerate the shift of power from borrowers to lenders. Earlier, the regulator had to force banks to initiate bankruptcy proceedings against large defaulters. The fact that the regulator has had to push banks to use their new power against defaulters is rich with implicit meaning.

The basic idea behind the new rules is to simplify the recognition and resolution process of non-performing assets (NPAs) in a time-bound manner. The central bank has also withdrawn schemes, such as the corporate debt restructuring scheme, the strategic debt restructuring scheme and the scheme for sustainable structuring of stressed assets, which were introduced at different points in time to address the issue of bad loans. These schemes were an attempt to build a resolution process without the backing of a bankruptcy law. The revised rules are in the right direction since India now has the Insolvency and Bankruptcy Code (IBC) in place. Also, it comes at a time when capital is being infused in public sector banks.

crackIAS.com

According to the new rules, lenders will now have to report all stressed accounts above Rs5 crore to the RBI's Central Repository of Information on Large Credits on a weekly basis. This will enable real-time tracking of such accounts. Further, resolution plans involving restructuring or change of ownership for accounts with aggregate exposure in excess of Rs100 crore will need an independent credit evaluation by a credit rating agency. In accounts with an aggregate exposure of Rs2,000 crore or more, a resolution plan will need to be implemented within 180 days, or lenders will have to file for insolvency under the IBC. For accounts with exposure between Rs100 crore and Rs2,000 crore, the regulator will announce the timeline at a later date.

The revised framework will clean up the bank balance sheet and benefit the system at multiple levels in the medium to long run. First, it will make recognition and resolution of bad loans transparent. There will be no ambiguity as to what should be done at each stage. In fact, it would force banks to move at a faster pace and make evergreening more difficult.

Second, it will improve credit discipline, as promoters will no longer be in a position to game the system. If the account is not resolved in the given time frame, and the case is referred to the National Company Law Tribunal (NCLT), it is highly likely that the promoter will lose control. Therefore, borrowers will now be more interested in resolving the issue in the given time frame.

Third, an improvement in credit discipline will lead to better allocation of capital, which will help push economic growth in the medium to long run. Both borrowers and lenders will be more careful. Further, since the recognition and resolution of NPAs will happen in a time-bound manner, the system will be able to avoid vast accumulation of bad debt, as has happened in recent years. This will not only make growth more sustainable given the availability of credit but will also reduce the pressure on the exchequer in terms of regularly capitalizing public sector banks.

To be sure, the accelerated pace of clean-up will likely pose some difficulties in the short run. For instance, the implementation of new rules could result in higher NPAs and provisioning requirements. Along with recent losses on the treasury side due to higher bond yields, this could affect the ability of banks, especially in the public sector, to lend in the short run. It is also likely that most of the capital infusion by the government will be used for cleaning up the balance sheet.

Therefore, the inability of the banking system to fulfil credit demand could be a drag on economic growth in the short run.

Furthermore, it is not clear at this stage as to what kind of hit lenders will have to take on accounts that are referred to the NCLT. This will become clear after some of the earlier cases are resolved. It is possible that there could be a demand-supply mismatch of stressed assets in the near term, which can affect valuations, and force lenders to take a deeper haircut. This will again affect their ability to lend. However, both the government and the regulator have shown a fair amount of flexibility in dealing with the NPA problem and are likely to continue to do so in order to minimize the short-term pain of banking clean-up.

The prospect of immediate pain should not be an excuse to ignore the benefits of greater credit discipline for the Indian economy in the coming years.

*Will the revised rules for resolution of stressed assets strengthen the banking system in the long run? Tell us at views@livemint.com*

END

Downloaded from **crackIAS.com**

© **Zuccess App** by crackIAS.com

crackIAS.com