Recap and reform

The Narendra Modi government has formally kickstarted its recapitalisation exercise for public sector banks (PSBs) by announcing a Rs 88,139 crore infusion through a mix of issuing special recap bonds (Rs 80,000 crore) and direct budget support (Rs 8,139 crore) during 2017-18. The move is well-timed. There are currently some 40 defaulting companies whose loan accounts have been identified for "resolution" by the RBI. The next few months should see quite a few resolution transactions — liquidation or buyout of the said entities' assets by new investors — materialising at least in sectors such as steel. Banks should, then, be able to recover some of these loans, albeit with "haircuts", and make adequate provisions for the balance uncollectable amounts. That is where recapitalisation comes in; cleaning-up balance sheets by absorbing loan losses requires banks to be well-capitalised.

It would be wrong, however, to assume that PSBs will resume lending in a big way, now that we have a concrete recapitalisation plan, along with a robust insolvency and bankruptcy code, finally in place. Stressed loans (that is, those that are non-performing as well as restructured or rolled-over) made up 16.2 per cent of the outstanding advances of PSBs as on September 2017. Out of the Rs 88,139 crore of capital infusion for the current fiscal, as much as Rs 52,311 crore would be going to 11 weak banks that are under so-called prompt corrective action (PCA). Such banks are prohibited from entering into new lines of business, accessing costly deposits or borrowings, and lending to "sensitive sectors" like real estate and capital markets. Clearly, the capital that is being injected is meant only to cover their provisioning requirements (against stressed loan ratios as high as 25 per cent) and protect depositors' interests. Non-PCA banks would receive the remaining Rs 35,828 crore, a part of which they can use to write off bad debts and the rest as "growth capital" for fresh commercial lending.

The Modi government's recapitalisation plan is expected to cost a total of Rs 2.11 lakh crore over two years. This cost — to be ultimately footed by the taxpayer, even if largely through the annual interest payable on the recap bonds — could arguably have been much lower had the programme (together with the bankruptcy resolution framework) been initiated in the early part of its tenure. Having lost precious time on that front, the government should hasten on a linked reform: Improving governance standards in PSBs. That can come only by reducing state ownership in these banks to below 50 per cent. The government's own dominant stake should be transferred to a separate holding company, which will secure the former's financial interest, while at the same time ensure these banks operate as autonomous and professionally-managed entities.

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