

STRIKING A BALANCE: ON STRESSED ASSETS

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

The efforts of the Reserve Bank of India to clean up the non-performing loans mess in the banking system suffered a setback in April when the Supreme Court shot down its circular of February 12, 2018, terming it *ultra vires*. Version 2.0 of the circular, titled “Prudential Framework for Resolution of Stressed Assets”, issued by the central bank on June 7, manages to retain the spirit of the original version even while accommodating the concerns of banks and borrowers. The RBI has achieved a good balance between its objective of forcing a resolution of stricken assets and giving banks the elbow room to draw up a resolution within a set timeframe without resorting to the bankruptcy process. Banks will now have a review period of 30 days after a borrower defaults to decide on the resolution strategy, as compared to the one-day norm earlier. They will also have the freedom to decide whether or not to drag a defaulter to the insolvency court if resolution does not take place within 180 days of default. Banks had no such option earlier. By making an Inter Creditor Agreement between lenders mandatory, the RBI has ensured that they will speak in one voice, while the condition that dissenting lenders should not get less than the liquidation value puts a floor on recovery from the resolution process.

The RBI's nuanced approach now is noteworthy. There will be disincentives in the form of additional provision of 20% to be made by banks if a resolution is not achieved within 180 days and a further additional provision of 15% if this extends to a year. If that is the stick, the carrot is that they can write back half of the additional provision once a reference is made to the insolvency court and the remaining half can also be clawed back by banks if the reference is admitted for insolvency resolution. This approach will give banks the freedom to explore all options before referring a defaulter to the insolvency process. Instead of treating banks like truant schoolchildren who need to be disciplined with the stick, the RBI has graduated to treating them like responsible adults who know what is good for them when it comes to handling defaulters. Of course, the RBI was forced to wield the stick originally only because banks resorted to evergreening loans and pushing NPAs under the carpet. It is to be hoped that they will now uphold the trust placed in them by the RBI. The central bank, anyway, retains the right to direct banks to initiate insolvency proceedings in specific cases by drawing on its powers under Section 35AA of the Banking Regulation Act. Meanwhile, the government has to assess what ails the insolvency resolution process, which has got bogged down in the case of several high-profile defaulters, beginning with Essar Steel. The delays in resolution are not good optics, and the gaps that defaulters typically use to subvert the process must be plugged. Ultimately, the RBI's efforts will be negated if banks, put off by the long delays in the resolution process, choose not to refer cases to the insolvency court.

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