Will bank recapitalisation fix NPAs?

The move on the part of the government to inject capital of 2.11 lakh crore into public sector banks (PSBs) is commendable and a decisive step.

In making this move, there was an implied acceptance that the recovery process set up through the Insolvency and Bankruptcy Code (IBC) reform had not been working at the desired pace. When the Reserve Bank of India asked PSBs to work on the recovery process for 12 large exposures which account for 50% of the total non-performing assets (NPAs) worth 8 lakh crore in the banking system, it was expected that by December 2017, the banks would recover about 2 lakh crore. But it's already November and we know that recovery is eluding us and the process may take longer. Till then the banking system will starve for capital.

Capital needs

In addition, the first few resolutions that have taken place so far have suggested that the size of the haircuts the banking system is expected to take will perhaps be much more than the original estimate of about 50% of the exposure amount. This means that there will be additional loss of capital. We are at a stage where the recovery will become more expensive in terms of capital in the banking system. If you take a haircut of 90% then you have to write off additional 40% of the exposure amount, and that would hurt your capital requirement. Therefore, there must have been a view that till the recovery process gathers momentum, more capital would be required. There is also a time dimension associated with this equation.

The economic value, and therefore the value recovered from borrowers, may perhaps grow after 8-10 quarters. At present, the value at which the resolution happens is sub-optimal. The government's decision to put more capital into the banking system could pay off if the banking system were to hold these assets for this period.

Focus on clean-up

It is significant that capital is being infused into banks. This could give the banking system a good breathing time to enhance its credit portfolio and restore value out of the NPA accounts. We may have to watch the situation unfolding over the next three years. During this time, the regulator, banks and the government will have to focus on the quality of public sector banking assets, the NPAs and the recovery. There has been a broad-brush approach to the quality assessment. The system will have to conduct more analysis, more evaluation sector-wise in terms of its potential for value restoration and enhancement. They will have to understand which sector is in a position to restore more economic value in six to eight quarters. Some sectors may perhaps take longer.

The last thing the economy and the banking system can afford is a further drop in economic value. What may be perceived as a 8 lakh crore problem today might grow into a much larger amount. The quality of governance will play a significant role in this regard. There has not been any worth-while effort on this unfortunately. There will have to be more reforms to put a higher order of governance in the banking sector. Ensuring performing boards at public-sector banks do become more critical.

The last point which is equally important is that as long as the government wants to hold on to 51% equity in PSBs we cannot have periodic injection by way of recap bonds.

To fund the economy, the government will have to make a yearly budgetary allocation of the amount of capital required by PSBs. Programmes such as Indradhanush and small budgetary allocations will not work. The PSBs need budgetary allocation of at least 75,000-80,000 crore each year.

Ashvin Parekh is Managing Partner of Ashvin Parekh Advisory Services LLP

(*as told to Anuradha Raman*)

C.H. Venkatachalam

The announcement of a stimulus into PSBs has been apparently understood as a bounty for the banks. A euphoria is being projected that the government has been too generous to the banks and is serious about helping them to resolve the bad loans crisis. The quantum of capitalisation announced leads one to believe so. In reality, this will not enable banks to recover the alarmingly huge bad loans which is the main issue confronting them.

Stressed assets

The total stressed assets, bad loans, and restructured loans in banks are in the region of 15 lakh crore. From AIBEA, we have been demanding the publication of names of defaulters and to declare wilful default as a criminal offence. Successive finance ministers have avoided both these demands.

Instead of taking tough action on defaulters, the NDA government came out with a “novel scheme” to foist insolvency and bankruptcy proceedings on defaulters. This measure is not going to result in the recovery of bad loans. That is why the RBI has asked PSBs to be prepared for a deep haircut, up to 50% of the dues. Recently, on one account, a bank managed to recover just 6% of the total loan amount of 950 crore. On 12 accounts, the dues are 2.5 lakh crore. One can only imagine the additional provisions banks will have to make this year. There are more skeletons in the cupboard.

Rewarding the defaulter

But why this sudden rush to ‘punish’ corporate culprits? The fact is that this is not a punishment, rather it is a reward. The defaulter promoter can himself bid before the IBC proceedings. Obviously, he is likely to be the highest bidder. So, he will retain his company but will have to shell out less than what he borrowed. This is legal innovation to pay less. But in the bargain, banks will lose huge amounts. One can safely predict that all banks will be running into losses by the end of the current financial year. Last year, while the gross operating profits were 1,58,982 crore, after provisions for bad loans (1,70,370 crore), the net loss was 11,388 crore. This year, it is bound to be worse. The IBC is only a ploy to extend favours to big corporates to escape from their liability at the cost of the public exchequer.Now let us see whether the recap announced by the Finance Minister will help PSBs, labelled as inefficient and incompetent. If banks would have recovered these loans, their interest revenue would have been more, income levels higher, profits high and they would have generated capital internally out of the profit. That door is closed because banks cannot recover loans through the IBC route. Thus, the banks' capital gets eroded and the capital adequacy ratio (CAR) becomes adverse.

Lending requirements

If banks do not have adequate capital, they cannot lend. This would dampen the economy, which is already in the doldrums. If there is an economic crisis, the next elections will be a question mark for the NDA. Hence to bolster the economy, banks have to be advised to give more loans. To give more loans, more capital is essential. That is why the announcement on recapitalisation.

In the last three years, banks have written off 1,88,287 crore. We have to bear in mind that when banks lose money or when the government recapitalise PSBs, it is all people's money and out of public savings kept in trust in the banks. People's money should be for people's welfare and not to fund corporate default or to recapitalise the banks to adjust these bad loans.

C.H. Venkatachalam is general secretary of the All India Bank Employees' Association (AIBEA)

D.K. Mittal

The decision by the government to further capitalise public sector banks is a welcome move. But does it really solve the problem of the lack of capital adequacy of public sector banks? Let us examine.

Too many infusions

It is the fourth time since the mid-eighties that PSBs are being infused with substantial capital due to high NPAs (15-20 %). The Net Present Value (NPV) of capital infused by the government in PSBs would be well over 10 lakh crore. If capital infusion was the solution, why is it happening again and again? As it turns out, it is a very temporary solution and only treats symptoms and not what causes these symptoms.

The recurrence is because of two sets of issues: governance and regulatory framework. For improving governance of PSBs, questions like the tenure of senior management have to be addressed. This was the recommendation of the Narasimhan Committee of 1991 and 1998. Public Sector Bank chiefs and their managing/executive directors must have a fixed tenure of at least five years. The second issue is the salary structure of senior management. The amount of remuneration they get and the kind of political and economic influence their decisions have are nowhere comparable to what happens elsewhere. To offer incentives by way of very good annual bonus based on performance should enable them to take the right decisions.

Adopt best practices

The third issue would be of professionalisation through lateral entry at the level of general managers and not at the ED/MD level. Fourth, the banking boards need to be manned by professional directors rather than political nominees. Last, accountability needs to be fixed by removing senior management for non-performance.

There are a few gaps in the regulatory framework as well. One of them is joint lending. Borrowers borrow from one bank and go to another and borrow money. Banks do not talk to each other. Also, there are issues in getting loans approved for large projects. Borrowers have to run to 20 banks to get a sanction, which is uneconomical, costly and leads to corrupt practices as bank officials seek favours to agree to a proposal. We need to adopt some best practices by creating a framework for funding of projects (over a size) to be undertaken by one bank which downsells it within a period of, say, 90 days, but could breach exposure limits in that period.

Another issue is the appointment of statutory auditors. In the best private sector companies, the auditors are shortlisted by promoters and then assessed by the Audit Committee and Board. Also, in case of wrong reporting, these have to be punished by at least prohibiting them to audit any financial entity regulated by the RBI, the Securities and Exchange Board of India, the Insurance Regulatory and Development Authority and the Pension Fund Regulatory and Development Authority.

And last, action must be taken against promoters who have siphoned off funds and transferred them to their personal assets. These assets must be forfeited and the RBI needs to move ahead on that.

Quick action plan

To fix NPAs, we need, in addition, resolution of the above issues, a quick action plan. First, NPA cases caused by the cyclical nature of the sector need to be supported if there are no issues with fund utilisation.

For other cases, the right approach would be to do what we did for UTI 64 in 2000-01. Also, we need to deal with NPAs sector by sector like power, roads, steel and so forth. We need to pick NPAs from PSBs of each sector, park them in one place by creating an entity like a SUUTI (specified undertaking of the Unit Trust of India), fund the banks and invite international and national investors to dispose of the assets.

In sum, this infusion is a welcome step but there are issues that should have been dealt with first. The good part is that after putting this capital, the government’s equity would be close to 70-80% in each PSB. The government could make a huge profit by selling this equity after improving the management of PSBs.

D.K. Mittal is a former secretary in the Department of Financial Services

(*as told to Anuradha Raman*)

The definition of harassment needs to be constantly updated, and the process for justice made more robust

END