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OPINION

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

As the world marked the 10th anniversary of the fall of Lehman Brothers last weekend, an event which had pushed the global financial system to the verge of collapse, the discussion in the Indian context has shifted to the ongoing non-performing assets (NPA) crisis in the banking system. Indian banks, particularly public sector banks (PSBs), have accumulated a pile of bad debts and are struggling to extend credit.

There has been some progress on the resolution front, with the Reserve Bank of India (RBI) forcing banks to take large defaulters to the bankruptcy court and the government in the process of infusing capital into PSBs. But lenders still have a fair distance to cover. The Insolvency and Bankruptcy Code (IBC) was introduced with great fanfare—lenders' great hope and the answer to India's problem of "capitalism without exit". But Arvind Subramanian's *bon mot* will not be put to bed easily, to judge by the IBC experience since.

The results of RBI's different schemes to enable recovery before the IBC were uninspiring. The IBC shifted the balance of power in favour of lenders. RBI also came up with a new framework for the resolution of stressed assets. It was hoped that these changes will help clean the stock of bad debt and check further accumulation. It hasn't been that straightforward. As former RBI governor Raghuram Rajan put it in his response to Parliament's estimates committee, "The Bankruptcy Code is being tested by the large promoters, with continuous and sometimes frivolous appeals. It is very important that the integrity of the process be maintained, and bankruptcy resolution be speedy, without the promoter inserting a bid by an associate at the auction…Higher courts must resist the temptation to intervene routinely in these cases and appeals must be limited once points of law are settled."

There have been litigations in a number of cases that have not allowed the resolution of stressed assets in a time-bound manner. Not all large cases referred in the first batch under the bankruptcy code have been resolved, even though the deadline has passed. Delays in resolution could undermine the entire process.

The ongoing litigation by stressed power sector firms is a case in point. After they failed to get any relief from the Allahabad high court, these firms approached the Supreme Court. The matter will be now heard in November. Depending on how things proceed then, the IBC's objective of timely resolution—already dented—may well fall by the wayside. The strife between the government and RBI on this front—with the latter opting out of the cabinet secretary-led high level committee on the power sector—doesn't send an encouraging signal either. The way some of these cases now move forward will, to a large extent, determine the future of the bankruptcy process. However, it is in the interest of the banking system that the bankruptcy process is strengthened, so that the accumulation of bad debt can be avoided in the future.

Rajan also highlighted other measures to strengthen the banking system that are worth noting here. For instance, to lower the risk of NPAs, more in-house expertise should be brought to evaluate projects. Bankers need a better understanding of the industry—and it is important that key permissions for projects are attained up front. In cases where risks cannot be reduced, they should transparently be shared between promoters and financiers. Banks need to have the capacity to monitor projects so that those going off track can be restructured in time. Restructuring of incentives will also be required so that bankers are motivated to evaluate and monitor projects. Interestingly, Rajan has noted that MUDRA loans and Kisan credit cards should be examined more closely for potential risks, as targeted credit often affects due diligence on the part of the banks.

Further, it is important that top-level appointments are made in time and a situation where banks function without a chief executive officer, as has often happened in recent years, is avoided. The government and PSBs should also prepare to fill a large number of vacancies that will arise due to retirements at senior levels. As the standing committee on finance showed in its report, most people at the general manager level will retire by 2019-20.

At a broader level, as this newspaper has noted in the past, PSBs require deeper reforms, both on the governance and operational level, to be able to avoid a repeat of what has happened in the last few years. However, the immediate thing to watch is how the resolution of stressed assets progresses.

How important it is to resolve stressed assets in a time bound manner? Tell us at views@livemint.com

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