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REORGANISING DEBT

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

In order to ease the financial stress of cash-strapped businesses and individuals during the lockdown period, the Reserve Bank of India, in the last week of March, had provided a three-month moratorium for instalments of all term loans. This facility was thereafter extended till the end of August. But with continuing economic stress, and precarious finances, especially of firms in the high-contact services sector, the RBI has now allowed banks the option of restructuring loans of financially stressed firms. The expert committee appointed by the central bank to formalise the framework for restructuring these loans has now provided the finer details of dealing with stressed loans across 26 sectors. But while there is still no clarity on how many of the stressed borrowers will ultimately opt for a restructuring of their loans — data released by banks during their quarterly results revealed that as economic activity picked up, the number of borrowers availing the moratorium had begun to fall —the scale of the problem is daunting. According to the committee report, 72 per cent of banking sector debt to industry has been impacted by COVID-19. Of this, loans worth Rs 22.2 lakh crore (or 42.1 per cent of the debt) were under stress even before the pandemic, while another Rs 15.5 trillion (30 per cent) of loans have been impacted by the pandemic.

The expert committee has favoured a more flexible approach in dealing with restructuring this time around, differentiating between the financial matrix across various sectors, and giving banks the freedom to choose which accounts to restructure. The threshold of the indicators that have been chosen by the committee — a combination of debt and liquidity measures — vary across sectors. The parameters, and the conditions imposed, while appearing relaxed to help stressed companies, seem to be stringent in weeding out companies in a precarious position prior to the pandemic. However, it is possible that some of the thresholds are too high for companies in particularly stressed sectors such as aviation to meet. Further, adopting indicators like Debt/EBITDA (earnings before interest, tax, depreciation and amortisation) in the framework, a departure from past such exercises, implies that highly leveraged companies are unlikely to take advantage of this facility.

The Indian experience with restructuring schemes post the global financial crisis of 2008 has raised concerns this time around too. However, laying down clear entry timelines on which loan accounts are eligible for this scheme can help limit restructuring to those firms whose financial position has been affected by the pandemic. Further, ensuring high provisioning norms, as well as offering the option of reversing the provisions, provided the borrower has repaid a significant part of the loan, could disincentivise banks from misusing the restructuring scheme to keep their balance sheets clean. Stringent checks are needed if the problems of “extend and pretend” that had plagued the earlier restructuring schemes are to be avoided.

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