Indian Economy: Some Contemporary Perspectives
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Lecture – 26
Indian Economy- Indian Banking Crises 2

So, now let us start. So, we were talking about the twin balance sheet syndrome and how the economic advisor has defined in terms of giving its Indian characteristics as a characterization of the twin balance sheet syndrome.

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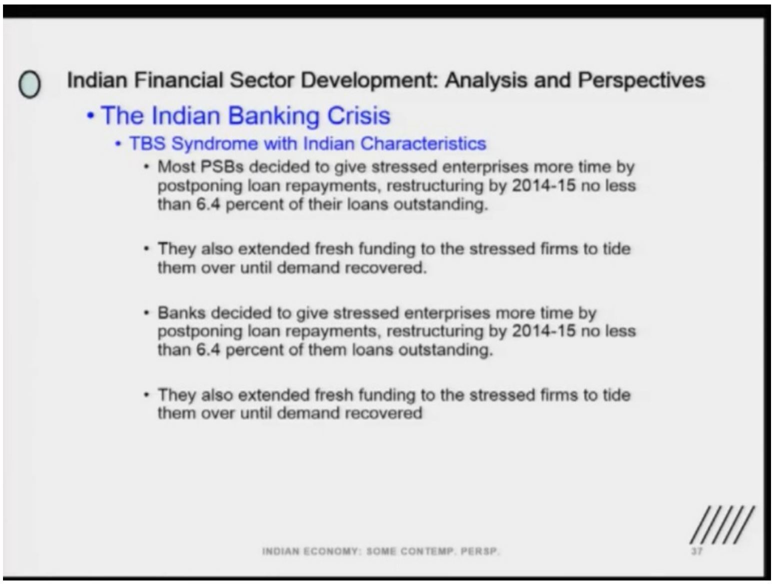

So, in most of the cases, it was found that most of the PSBs were giving extra time to the firms to think about the or, going for restructuring the, postponing of loan repayment so that these firms may be able to pay after, after some time. They were also extended fresh funding to the stressed firm so in most of the cases, we found that in, in the case of the first world countries mostly US and UK and even Japan, most of the real estate crisis started with the reporting of the banks as major losses. But in case of India, it was not the case. Most of the banks were quite large-hearted and they had supported the funding strategies of the, most of the firm's banks decided to give stressed enterprises more time by postponing loan payments, restructuring. So, this I have already mentioned.

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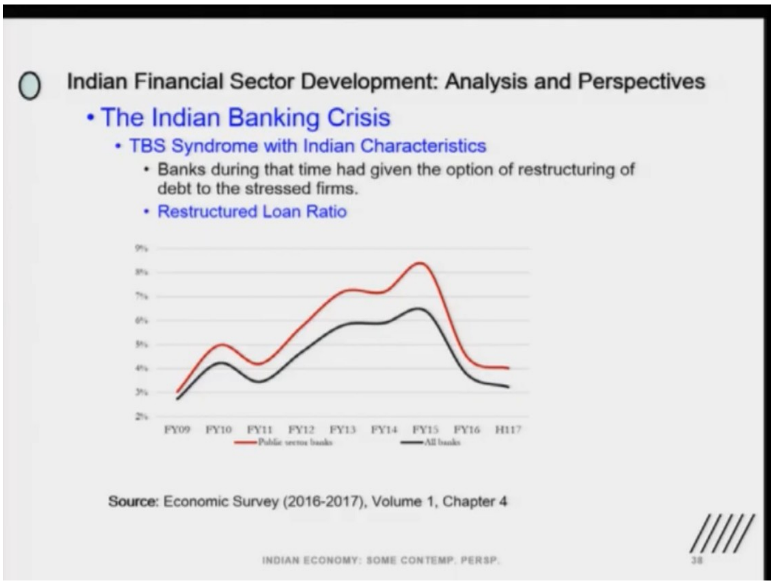

If you think in terms of restructured loan ratio then you find that whatever the amount that has been restructured compared to the total loan that the firm has been given so if you think in terms of that ratio then you find that from 2009 onwards till 2014, it was a, the ratio was quite higher which means that restructuring incidences were quite high.

But after 2015 when we had an AQR process it has come down because then these, these losses were exposed and then there were certain regulatory procedures put in place and that did not allow so much that did not give so much exposure to or so much space for the banks to work closely with the, the distressed firm.

So, in that situation, you can see that from till February 2013, it was a slight moderation but again it, it goes up by 2014-15 and but July 2015 onwards we can see that there is a decline and if you remember in in February 2000 fiscal year 2013 we had almost like a crisis situation where we had gone for rolling back of the most of the stimulus packages announced during 2008-09 global financial crisis. So, at that time it was found that since most of these firms are now in a good position and it had become quite unbearable for the government also to continue those policies and it was putting a checker of the government also.

So, in 2013 government had rolling back of, of those fiscally stimulus packages and that also resulted in moderation and then we had our domestic uncertainties. And then in terms of economic policy also government had gone for FDI in retail at that time. So, all those issues were taking place and the country was also preparing for the next general election in 2014 so all these uncertainties had somewhat decline trend but after that it increased quite extensively but AQR process, Asset Quality Review in 2015, it, it reduced the whole process.

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So, in terms of restructured loan if you want to ask then restructured loans or assets are that assets which have extended, extend, extended repayment period, reduced interest rate, converting a part of the loan into equity, providing additional financing, or some combination of these measures are called these.

Now, written off, off assets are those assets statement of bank will indicate are those which means that lender is having very limited or I would say no hope of recovery so written off assets are those that the bank or lender does not count, the money borrower owes to it which means that whatever the amount that the advance or the, the outstanding amount that is there that banks or the lender does not acknowledge.

The financial statement of the bank will indicate that the return of loans is compensated through some other way. So maybe, maybe some other in terms of either the, the physical assets or any kind of asset that the bank has taken over. So, in it is, after this the bank starts taking over the you might be reading in newspapers houses or, or any kind of investment that this businessman or this particular firm has done. So, it will be start taking over all those things. Written off assets are quite important. In most of the cases it is told that once it is written off, it will not be part of but it remains but there are certain ways to, to recover that.

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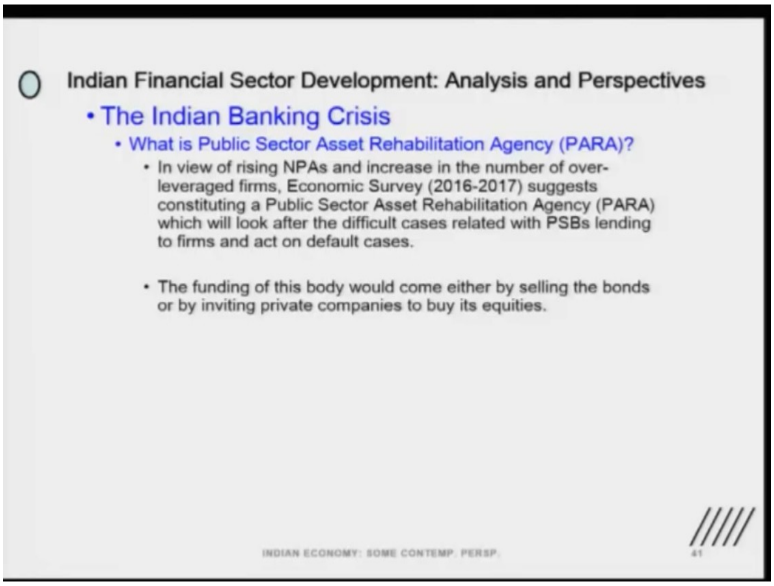

It also mentioned about so Economic Survey in, a box it mentions about Public Sector Asset Rehabilitation Agency (PARA). Under PARA it was mentioned that since when we had the NPA rise and the increase in the over-leveraged firms it was decided that they will be setting up a Public Sector Asset Rehabilitation Agency called PARA which will identify the large exposure cases mostly which are of huge amount 5000 Crore or 10,000 Crore.

So, it will identify those and act on those default cases. But the, but it was also, it was also recommended that the money will majorly come from the government or the subsidiaries of the government, but some part may also be, be generated by inviting private companies or buy it, or by buying its equities. So, that was the first step taken that how to go for some kind of minimizing the risk of spill-over so, so that all other activities are safe guarded. So, for the first time the PARA institution was designed to make sure that the, the public sector banks exposures are limited and there is some hope of recovery.

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Then the chapter 4 also mentioned about the Phoenix and Containment Scenarios. Phoenix in the sense that you simply go for augmentation of demand and the investment cycle. And this investment cycle once, once we have a better economic scenario, the firms will also have, have a good earning, and once we have good earnings then these good earnings will also reduce the, the bad dept of the firms and as a result once we have a recovery of the firm then this recovery will also have a positive impact on the bank. So, so this is how it, it works.

Then we have the Containment Scenario. So higher nominal growth which means that since we have an exposure of so if we count the NPAs in nominal terms and since we have the better economic growth so and if we have a higher nominal GDP then of course this will lead to a higher economic growth. So, in nominal terms, the exposure may look very smaller compared to the GDP as a whole and this is also one way of reducing it.

But these two are just some kind of projections or some kind of, of scenarios but in real terms such exposures of 7 lakh crore NPAs has to be taken care in, in a directed manner and in a regulatory manner so that in future such type of cases do not appear and there is a whole lot of understanding for the maintenance of the banking sector health plus the investment process in the private sector. So, for this purpose this Economic Survey has mentioned about the Phoenix and the Containment Scenarios.

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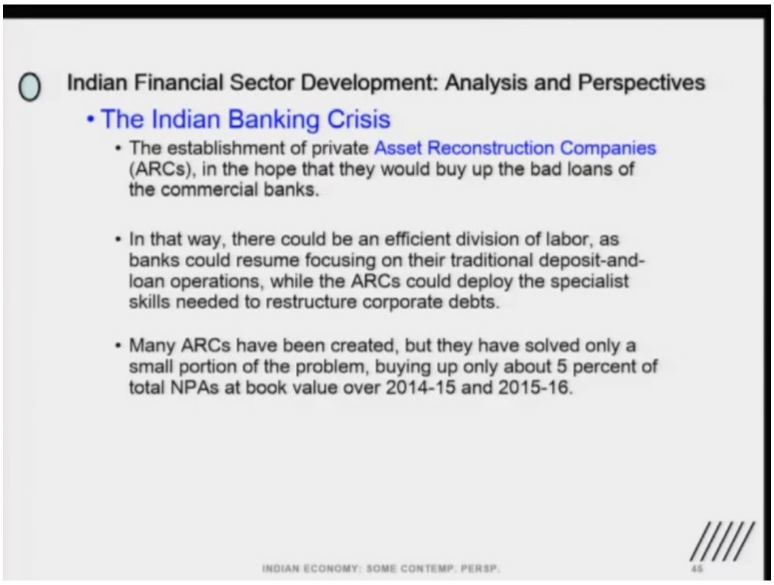

Then they had also gone for setting up the Asset Reconstruction Companies and the task was given to ARCs that they will be buying up the bad loans of the commercial banks and once they have these bad loans then once these banks start recovering then once the appreciation takes place then they can make money or it can be sold back to the banks.

So, which means that once we have the, the ARCs into play then most of the banks a majority of the human resource or the physical capital was directed to monitor or to utilize or to look for some kind of settlement with regard to the NPAs. It was decided that since most of these funds are from commercial banks and commercial bank business should focus on the profit-making avenues so at that time the manufacturing loans and the household's loans were the most important safeguards for these banks. And at that time, it was felt that these banks should be given more, more autonomy in terms of focusing on their core business compared to thinking about only NPAs or stressed assets. So, at that time Asset Reconstruction Companies were set up just to keep this in mind.

Many ARCs were created at that time but they had solved only a small portion of the problem buying up only 5 percent of the total NPAs at the book value that was between 2014-15 and 2015-16. So, since public sector banks were involved and since these ARCs were smaller in size and were, they were having not so much power so as a result most of these PACS they were not, not adhering to their guidelines, revealing the proper details. As a result, these companies had a very tough time in dealing with the public sector banks.

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Then there were also government committees that also set up some kind of a Special Purpose Vehicle SPV, which is a company set up for a specific purpose to which all stressed power generation, power generation assets could be transferred after they were acquired by the lenders which means that it will pass on to the banks and banks will again pass on to the Special Purpose Vehicle. The department of financial services in the finance ministry would identify these assets and these projects would then be auctioned. So, which means that they have, they will be first identified and then a Special Purpose Vehicle will help in that direction. This also did not work in the case of India in that way.

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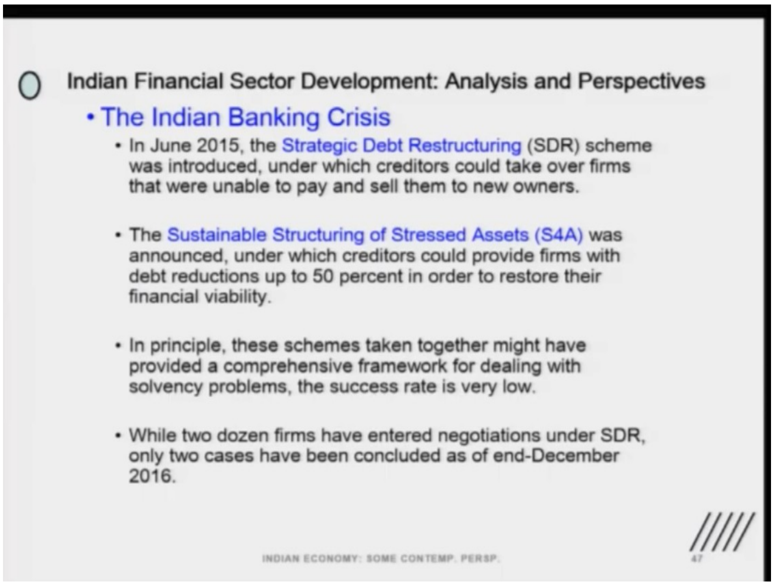

Then in June 2005, there were a formation of a Strategic Debt Restructuring scheme under which creditors could take over firms that were unable to pay or sell them to the new owners. This was quite a stringent guideline coming from the central bank and this had created some kind of controversy in the, and it was also felt that since these, since these firms were in large in size so for example, the first time, for the first time the Economic Survey 2017-18 had mentioned about the top 12 defaulters under that we had the names of Bushan Steel then we had GMR, GVK then we had Lanco then we had a then we had ASR steel.

So, once we have such type of large firms coming into the, the NPA list then it becomes really difficult that which particular firm will buy. So was, under which the creditors would take over. Taking over such large firms becomes really difficult and even if they are not able to pay loan it is not so easy to sell to the new owners. It may be for the smaller firms which are of less than 500 Crore or 200 Crore. It is easier if they are not able to repay but selling GMR or even GVK it becomes really difficult. So, Strategic Debt Restructuring was also done only for the smaller forms but not for the larger firms.

Then the deputy governor at that point of time doctor Viral Acharya had suggested this. Sustainable Structuring of Stressed Asset was announced under which creditors would provide firms with dept reduction up to 50 percent in order to restore their financial viability. But this is, this was not the new, new case. It was done earlier also when these firms were not doing good at that time most of the banks had given the option to the firms that they can go for Restructuring. So, this also became somewhat restructuring process that was earlier done by the bank. So, the S4A was not very much different.

In principle, these schemes taken together might have provided a comprehensive framework for dealing but the solvency problem that they had solved it was quite low. While two dozen firm have entered into the, the negotiations under SDR, only two cases have been concluded as of December 2016. So, this was the case that how these firms had gone for such type of so whatever measures at that time government took it was really difficult to monitor and then it, it for the government also it became really difficult to understand.

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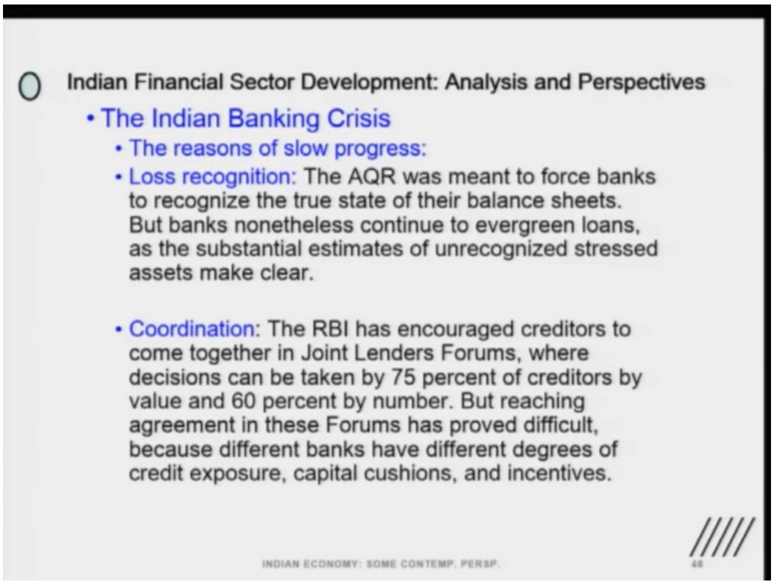

So, it was also felt that whatever measures were taken at that time it was not materialized. And the banking crisis remained one of the hotly debated topics. The exposure of NPAs was quite high at that time. So, there was a loss recognition then there was coordination issue. Loss recognition that as I mentioned that we had from July 15 to December 2016, we had the increase of around more than from 3.5 to 7 lakh crore of NPAs.

So, at that time it became really difficult for the banks to acknowledge and banks were not acknowledging that they have such a high NPA. So, under AQR, it was almost like obligation for the banks to accept that. But banks nonetheless continued to evergreen loans as the substantial estimates of unrecognized stressed assets may clear. So, loss recognition become one of the, the important topics at that point of time because these banks were still helping the stressed firms.

Coordination issue: RBI has encouraged creditors to come together in Joint Lender Forums, where decisions can be taken by 75 percent of creditors by value and 60 percent by number. But reaching out agreement in these Forums had, had proved difficult because most of the, these had different credit exposures, capital cushions, and incentives. So, given the, nature of the contract that was there between firms in terms of advancing loans and different type of restructuring process, different kind of, of exposures it became really difficult in terms of coordination also.

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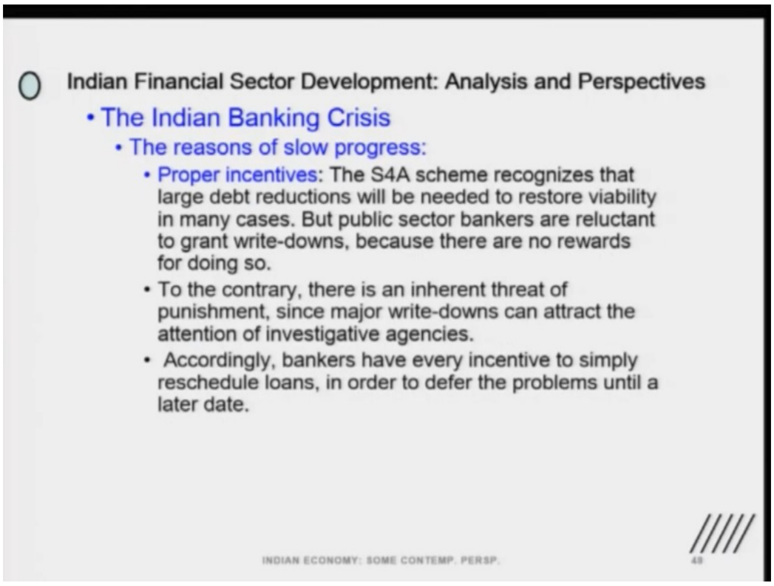

Proper incentives which means that the lack of incentive so S4A scheme recognizes that large debt reductions will be needed to restore viability in many cases. But public sector banking, bankers were reluctant to write off, because once you go for write-downs then you have to there, there was apprehension that government agencies will be sent to those managers who have gone for write off and as a result it became quite a…

Some investigative agencies were also tracing those managers which had gone for write-down so it became quite cumbersome task for the regulators also to convince the bank. So, there was no incentive that if you are accepting higher NPAs or you are going for write-down then you will be you will be given incentive. So, bankers have had every incentive to simply rescheduled loans, in order to defer the problem until a later date. So, there was some kind of postponement of, the stressed assets which the banks were, so these were the main reasons that why despite being given so much importance to the revival of the banks, it became quite difficult to implement.

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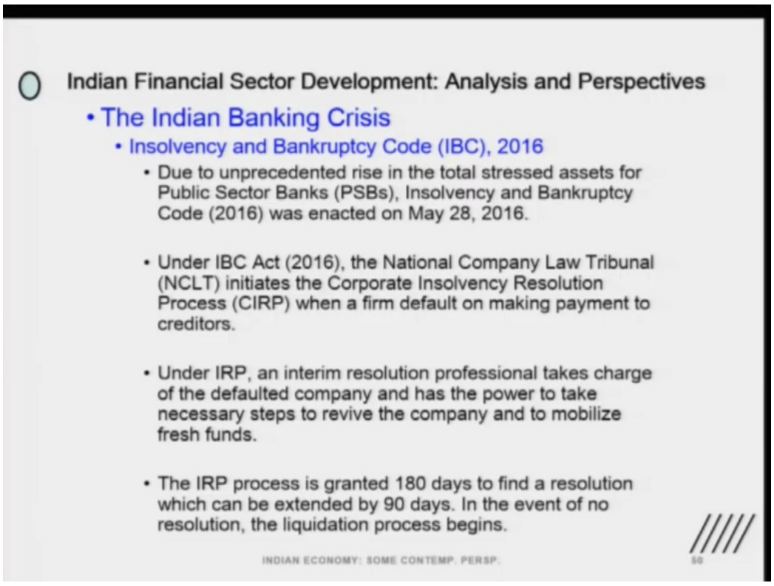

Then we had the Insolvency and Bankruptcy Code in 2016 because when we, when the banking sector crisis was unfolded and then at that time the businessmen were also having a limited option that if you are having a net income or the earnings going down you still have a chance that you can go for bankruptcy procedures, satisfy certain norms and get away, which means that if you are in business, it did not mean that if it failed then it is always some kind of crime and you are supposed to face with legal hurdles.

But there are certain processes through which you can declare some or you can go for disclosures and after that you can go for settlement. So, in most of the first world countries, entrepreneurship has such type of characteristics where the failure or the, the rise are, are calculated in the same way are considered. And if, if there are genuine cases of, of failure or bankruptcy then those cases are dealt in a special manner.

So, due to unprecedented rise in the total stress assets for public sector bank, Insolvency and Bankruptcy Code was enacted on May 28, 2016. And this, under IBS Act, the National Company Law Tribunal initiates the company Corporate Insolvency Resolution Process that is called CIRP. It has some durations and within that durations you have to provide certain rules and regulations. When a firm default on making payment to creditors which means that if you have default cases, under Insolvency Resolution Process an interim resolution professional takes charge of the defaulted company and it, it takes into account, it has the power to take necessary steps and it also has the power to mobilize fresh funds so which means that this under IRP this particular interim resolution professional is entitled to have a such type of power and it can exercise these powers to make sure that the companies have better scenarios.

So, the IRP is granted for 180 days to find a resolution which can extend it to 90 days in the event of no resolution. The liquidation process began which means that the selling of assets of the firm begins to, compensate or to repay the defaulted amount. So, whatever the default that firm has done, whatever is the outstanding amount liquidation process means that when you when you start selling your assets so whatever buildings, or whatever factory that you have it will be valued, and it will be sold to another. So, it means that the, the takeover starts so if somebody, some firm wants to buy that and if there are no conflict of interest then of course it can be transferred.

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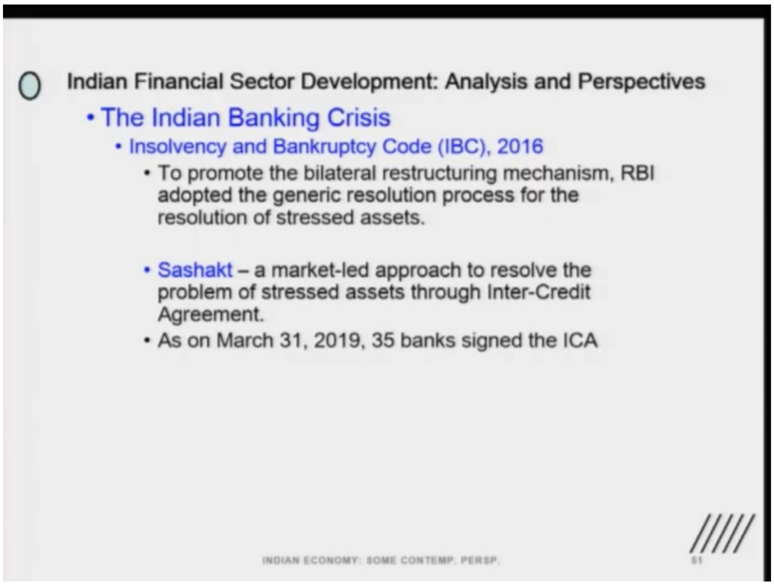

So, for this particular part I have referred the economic survey 2018-19 and if you read the volume two, the finance and intermediation chapter then you find that towards the end, the Economic Survey mentions about the, the detailed aspect of the Insolvency and Bankruptcy Code. So, for the first time, we had gone for such a drastic change and this this one was very much needed it was appreciated also because it has shown very credible progress in terms of coverage, in terms of finding out, out rules and regulations and that is why, this particular norm is called one of the important development post, I would say global post-independence we have such type of, of major development that we have undertaken in the area of financial sector reforms.

So, here to, so our RBI has gone for some kind of generic solution process for the resolution of the stressed asset. They have, they have also implemented a scheme which is called market-led approach to resolve the problem of stress asset through Inter-Credit Agreement which means that how these banks and, and this particular firm is now going to- so that is called Sashakt and as of March 31, 2019, 35 banks had signed the ICA. So, this is also one of the important developments that we have seen.

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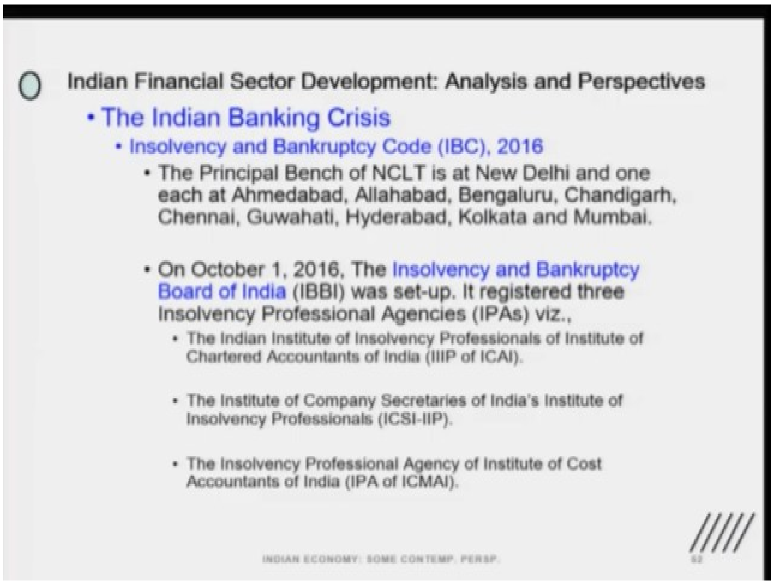

Then we had under IBC, we have the benches in Delhi. You have two benches of IBC. So, in NCLT, you have at Delhi. One each at Ahmedabad, Allahabad, Bangalore, Chandigarh. Then you have Chennai, Guwahati, Kolkata, and Mumbai. Then it also has set up, has gone for setting of agencies. So, now Insolvency and Bankruptcy is now is being considered as one of the important agencies.

So, Insolvency and Bankruptcy Board of India regulates this. In India, it is going to be one of the important areas where the law professionals and the accountancy professionals will be hired and, and licenses are issued there is an if you go on the on the IBBI website then you will find that you have the whole lot of activities mentioned and, and they in the annual report they mention about how many firms they have gone through, the, structure they have gone through the corporate Insolvency Resolution process, to what extent they have reached, how many firms are have gone to the till final stage, where the liquidation is happening, how many firms are, are still under the CIRP process, where it has gone, what is the coverage.

They also have these geographical distributions that in which part of the country you have the highest cases of CIRP and in which areas it is low and then then they also mention about the sectoral classification. So, you have the whole lot of detail.

So, as an economics graduate, I would request everyone to please visit this website and at least have a look what kind of information they have and from where we can learn from these, these institutions. So, they, they simply mention about so it also has created 3 institutions. So, as I mentioned, it is going to be for the accountancy and the cost accountant is going to be one area, the flourishing areas to look for.

So, they have set up Indian Institute of Insolvency Professionals and, and it is mentored by Institute of Chartered Accountants of India. Then they have Institute of Company Secretaries which we have the Secretary's Secretary ship examination so that that Institute has also set up called the Institute of Company Secretaries of India Institute of Insolvency Professionals. Then they have also gone for, then then they have also gone for something called Insolvency Professional Agency of Institute of Cost Accountants of India.

So, this is also one major development that has, has taken place. I, I would say that this particular gigantic architecture, regulatory architecture that that government has allowed, it is going to be expanded further and it is going to have the better features in terms of in terms of going into the, the direction of getting into the Insolvency and Bankruptcy procedures. This this is how it works.

Then after this, we will be going through the cases of where we have talked about - so after this government had also gone for one more scheme that is called Indradhanush Yojana. Under Indradhanush Yojana, what government had gone is that they had gone for giving or re-capitalization of the bank so based on the colour of the Indradhanush, seven schemes they had they had gone for giving certain incentives to the public sector banks wherein they can go for restructuring of their stressed asset plus there was also recapitalization scheme given.

But when we had a September 2018 at that time, we did not expect that the banking crisis will be going ahead in a such a dramatic mode where it will have a spill over effect on the NBFC sector. So, under banking sector whatever we have covered, covered so far it gives you the complete idea about how, and to what extent we have solved the issue of the banking crisis.

But we, but we, going ahead we will have one more session and that will talk about the bankruptcy… that will talk about the twin balance sheet spill over to the number of firms that how many firms were, where are under the Insolvency and Bankruptcy, how many firms had to trial under the IBS code, the new IBS code and then will be also talking about then NBFC crisis.

If you have gone through newspaper and if you have read the newspaper then you find that you have cases of something called IL and FS episode and this episode when, when it was unfolded it created like a Lehman Brother-like situation where in 2007-08 Lehman brother had the declaration of bankruptcy by Lehman Brother, it created shock and similar shock was, observed in case of India where the NBFC sector suddenly came in limelight for all bad reasons and there were cases of default cases and this has resulted in a huge amount of embarrassment for the, not only the banking sector but also for the for the government sector bank.

So, we will be covering that in the next session. We, we will be covering that in the next session and we will try to see to what extent we can understand the NBFC crisis and then after that, we will be having one or two sessions. One session on the financial inclusion specially the, JAM process and Jan Dhan scheme that government has launched and how we can make aware ourselves better with the recent development and country development. Thank you, thank you so much.