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Concerns with Rescuing IL&FS

Why in news?

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Union government has taken decisions in favour of IL&FS to ensure the needed liquidity by the company.

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What is IL&FS issue about?

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- Infrastructure Leasing & Financial Services (IL&FS) is a Non-Banking Finance corporation (NBFS) which lends for infrastructural projects.

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- The infrastructure lender has a total consolidated debt of close to Rs 1 lakh crore, and it started to miss deadlines on its debt obligations beginning August 27, 2018.

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- It has already defaulted on around Rs 450 crore worth of inter-corporate deposits to Small Industries Development Bank of India (SIDBI).

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- The panic in the fixed income market due to the IL&FS default has led to a liquidity freeze, and fund managers say it is putting pressure on the equity markets too.

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- With IL&FS desperately looking for a bailout, state-owned insurance behemoth LIC came forward to help the company.

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What is the government's decision on IL&FS?

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- IL&FS company is listed as “systemically important” by the Reserve Bank of India, and with over Rs. 1,15,000 crore of assets and Rs. 91,000 crore of debt, it is too big to fail.
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- The inter linkages between IL&FS and other financial sector entities such as banks, mutual funds and infrastructure players are too strong and the company would have taken them all down with it if it were allowed to fail.
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- Union government has explicitly stated that needed liquidity will be arranged for IL&FS from the financial system.
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- Government had also sent out an unambiguous message to the markets that it will not allow the company to fail.
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- The Centre’s has decided to supersede the Board of Directors of the troubled Infrastructure Leasing & Financial Services (IL&FS).
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What are the concerns with government’s decision?

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- The annual general meeting of shareholders of IL&FS on September 29 had approved a rights issue of Rs. 4,500 crore and a debenture issue of Rs. 15,000 crore.
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- But which lender or shareholder would commit to extending support to the company when it was defaulting regularly and the same set of people responsible for the mismanagement continued to be in charge
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- Against this backdrop, a change in management and the appointment of experienced people should lend confidence to lenders and investors, but government has delayed to act in this regard.
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- In fact, a lot of the turbulence witnessed in the debt and stock markets due to the IL&FS issue could have been avoided had the government acted earlier.
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What measures needs to be taken?

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- Any rescue plan for the beleaguered company obviously had to begin with replacing the existing management that was responsible for mismanaging its affairs.

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- Considering the size of the company, the problem appears to be one of liquidity and not solvency it is a classic case of over-leveraging, and an asset-liability mismatch caused by funding projects of 20-25 years payback period with relatively short-term funds of 8-10 years.

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- There is a felt need here for long-term finance sources for infrastructure projects.

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- The LIC and some insurance companies are the only domestic sources and they too do not lend beyond 10 to 12 years.

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- The Centre and the RBI should look at ways to deepen the debt markets where infrastructure players can borrow long-term.

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- It also needs to be analysed how a company listed as “systemically important” managed to fly under the radar with mis-governance.

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Source: The Hindu

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