Dealing with the bad loans

What is the issue?

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- Deciding on recovery of the default loans is being a tedious task for RBI.
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- The decisions that are required when dealing with a bad loan require energy and profit-motivated thinking.
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What are Bad loans and NPA?

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- A loan where repayments are not being made as originally agreed between the borrower and the lender, and which may never be repaid.
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- Under the present NPA concept, there are four categories of accounts.
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- **Standard assets or performing assets** - the accounts in which the instalments are promptly paid without any delay
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- **Substandard assets** - the loan accounts where the principal/interest or principal and interest are not forthcoming for more than 90 days.
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- **Doubtful assets** - no repayments for more than twelve months in the case of loans already categorised as substandard assets and for such loan accounts, the realisable value of securities is more than the liability in the account.
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- **Loss assets** - no repayments for more than twelve months in the case of loans already categorised as substandard assets and for such loan accounts, the realisable value of securities is less than the liability in the account or there are no securities available for the loan accounts.

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What is the present status of dealing NPA?

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- The debt holders have to sit across the table and negotiate about a **possible restructuring.**
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- They have to evaluate what recoveries can be obtained if the **Insolvency and Bankruptcy Code (IBC)** is invoked.
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- They have to form a rational sense of the NPV (net present value) that can be realised by going down the IBC route, and settle for a deal offered by the borrower if the cash offered is higher.
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- If there is no deal, then the IBC has to be invoked, and decisions have to be taken between the multiple offers on hand.
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- Banks in India are particularly bad in dealing the NPA's, as RBI regulations have converted banks into bureaucracies that blindly follow micro-managing regulations.
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- **The ability to look into the future, form speculative views, and manage risk is largely absent in the Indian banking system.**
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- The wrong place for this work is the RBI.
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What measures can be taken?

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- The right place for this work is a **private equity fund.** A private equity fund is fully private, is not hindered by regulation, is able to make sound decisions quickly owing to the absence of bureaucracy, and has strong financial incentives for the decision makers.
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- The right way forward is for banks to sell bad assets to private equity funds.
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- The basics of a regulator is the three process manuals that govern the legislative, executive, and quasi-judicial branches.

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How RBI can be involved in this?

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- **In its legislative function,** the RBI must operate a process manual that governs how regulations are written.
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- **In its executive process,** it must operate a process manual that gives out licences, conducts investigations, and detects wrong-doing.
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- **In its quasi-judicial function,** the RBI must operate fair procedures through which an independent mind will hear both sides and write a reasoned order that will stand the test of appeal at the Securities Appellate Tribunal and then the Supreme Court.
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- These three processes are surrounded by board governance, and the loops of reporting and accountability.
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What is the way forward?

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- It is unfair to place these new burdens upon the RBI, The RBI has its hands full learning how to do inflation targeting and regulate banks.
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- There is not a time to increase the burden upon the RBI’s top management, particularly when the increased work (making commercial decisions about NPAs) will make it more difficult to learn how to do banking regulation.
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- The policy requires thinking through determined management questions in public administration.
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- The RBI’s emergence as a capable central bank and banking regulator is vulnerable by the unlikely combination of functions which has been placed within it.
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- The additional role will be performed poorly and will hamper the core business of building a sound RBI.
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Source: Business Standard

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