



Fallouts of RBI's Tightening Regulatory Grip

What is the issue?

\n\n

\n

- In the coming weeks, many banks in India are expected to report weak results.
- This is expected on account of the fact that there is a progressive tightening of rules for rules in dealing with bad loans.

\n

\n\n

Why did RBI tighten the rules regarding NPAs?

\n\n

\n

- There is a palpable economic slowdown in the last couple of years and many borrowers are unable to repay their debts.
- As bad loans piled up, a progressive tightening of rules was unleashed by RBI to address the NPA problem since 2015.
- Incidentally, this has effectively curtailed the discretion of banks and borrowers to reach a negotiated settlement - which is prolonging resolutions.
- Historically, any loan that has seen a default of over 90 days is classified as a bad loan in India and procedures to deal with them has largely been lenient.
- But rules had to be tightened, as there has been a reluctance to address the issue head-on because of pressure from influential

borrowers and PSU banks.

\n

- This tightening of rules, has meant stumping up of more cash, lower profits, and restrictions on the ability to lend more.

\n

\n\n

What were the specific tightening measures?

\n\n

\n

- The new insolvency law that come into force in 2016, and growing outrage against instances of corporate fraud have left banks bleeding.

\n

- In February, RBI did away with several schemes such as Strategic Debt Restructuring (SDR), which allowed banks to grant extra time to borrowers.

\n

- Rules to classify a loan as 'bad' or a 'Non-Performing' was tightened to mark even a day's slippage - which got all stakeholders worried.

\n

- But despite these concerns the banking regulator (RBI) has stayed firm in its dictacts by holding that the sanctity of debt agreements needs to be restored.

\n

- Many have argued that this approach would cramp lending by banks at a time when most indicators show that growth is on the upswing.

\n

\n\n

Is RBI's zeal for addressing the bad loans hurting growth?

\n\n

\n

- The RBI Governor Raghuram Rajan had stated in unambiguous terms that clean up definitely deserves higher priority for fixing the economy.

\n

- There seems to be consensus to this view among all of RBI's higher ranking officials and their policy direction is clear.

\n

- Hence, RBI is consciously overlooking the fact that credit supply in the economy is reducing, which will definitely have consequences for growth.

\n

- Notably, RBI has publicly acknowledged that its lax attitude towards bad loans in earlier, is what has lead to the current NPA burden of Rs.8.9 lakh crores.

\n

\n\n

What are the lessons from elsewhere?

\n\n

\n

- Most other economies have also resorted to tighter banking regulations to tide over the bad loans problem.

\n

- A tougher operational environment has inevitably led to conflicts between the banking regulator and the owners (It is predominantly PSUs in India).

\n

- Some tensions in this regard are already visible between the RBI and Government, but there have also been some positive spin-offs too.

\n

- A palpable behavioural change has been observed among some borrowers as promoters fear an aggressive bank takeover if they fail to service their debts.

\n

- Notably, post the 2008 financial crisis, banks in the West have also been subject to rigorous standards and changes of rules.

\n

\n\n

How does the future look?

\n\n

\n

- A system that doesn't disrupt the economy, but still delivers for it – and rules need modifications to suit situations.

\n

- And when risk-taking increases, it must not be at the expense of the resilience of banks to any future downturn in the economy.
\n
- For policymakers, balancing growth imperatives with regulations is a difficult choice to make as it requires political stamina to pursue long timelines.
\n
- Ridding banks of bad loans and cleaning up balance sheets are a very critical that requires prudent and active policy engagements to tide the cliff.
\n
- In India's case there is a greater risk of budgetary allocation being pumped in for aiding public banks during distressing times.
\n
- Hence, solving the entire mesh of issues hinges not only on financial sector practices but across all economic domains.
\n

\n\n

\n\n

Source: Indian Express

\n



IAS PARLIAMENT
Information is Empowering

A Shankar IAS Academy Initiative