Tackling 'Twin Balance Sheet Syndrome'

Why in news?

The Financial Stability Report (FSR) of the RBI indicated that the challenges of 'twin balance sheet syndrome' (TBS) is fast receding.

What is 'Twin Balance Sheet Syndrome' (TBS)?

- 'Twin Balance Sheet Syndrome' (TBS) is a scenario where banks are under severe stress due to:
    1. High levels of non-performing assets (NPAs)
    2. High provision requirements
    3. Low profits and
    4. Low capital adequacy ratios (CAR)
- Under TBS the corporates are overleveraged to the extent that they cannot repay their loans.
- In the mid-2000s, infra companies faced TBS problem.

What is the status of TBS at present in Indian banking sector?

- TBS is fast shaping into a '***Twin Balance Sheet Advantage***' (TBA).
- This is due to the improvement in the performance of banks and the corporate sector through various measures and efforts.
- The analysis based on 6 BSI indicators in FSR show that the banks are well-capitalised and capable of absorbing macroeconomic shocks over a one-year horizon even in the absence of any further capital infusion.

> ***Data -*** *The gross non-performing assets (GNPAs) of banks sharply fell from 11.5 % in FY18 to 3.9% in FY23. The return on assets (ROA) of banks trailing in the negative zone (-0.2%) in FY18 improved significantly to 1.1% by FY23.*

How TBS was tackled?

- The corporate sector, banks and the RBI played a critical role in tackling the perils of TBS.
- **Banks -** Significantly improved their performance to come out of the toxic loan crisis.
- Banks also came out of irrational lending.
- **Corporate sector -** It realised the risks of excessive borrowing.

- Corporates started deleveraging balance sheets.

- **RBI Measures -** The merger of PSBs during 2017-21 brought them down from 27 to 12 and turned PSBs into stronger entities with potential higher risk appetite.

- **Data collection and sharing -** Introduced the Central Repository of Information on Large Credits (CRILC) to enable banks to share information on large loan accounts of ₹5 core and above in 2014.
- RBI insisted collection of information on loans overdue up to 90 days known as Special Mention Accounts (SMA).
- The RBI having detected divergence in the asset quality data introduced an Asset Quality Review (AQR) in September 2015.
- **IBC -** The enactment of the Insolvency and Bankruptcy Code (IBC) in 2016 and the formation of the Insolvency and Bankruptcy Board of India (IBBI) helped hasten problem loan resolution.

- **EASE -**To perpetuate TBS, PSBs needed large capital infusion.
- To fulfil that condition, the government introduced another set of bank reforms called 'Enhanced Access to Service Excellence' (EASE) in 2018.

- The format of EASE reforms got modified and now EASE 5.0 is in use.
- **Bad bank -** National Asset Reconstruction Company Ltd (NARCL), also had to be formed to tackle toxic assets.

What lessons can be learnt from the TBS experience?

- Banks and the corporate sector will have to work in unison to harness the full potential of their newly acquired strengths.
- **Banks -** Now the banks have strong stability, and adequate working regulatory controls, banks will now have to focus on improving the quality of credit origination, monitoring, and control of credit.
- The risk governance and all 3 lines of defence in risk management (SMAs) should be well equipped to ring-fence the banks against credit risk.
- The internal credit rating system needs to be more robust.
- The development of a strong talent pool in managing credit risks like Credit risk managers, should receive priority.
- **Corporates -** Proportionality in lending to the corporate sector must be maintained with the right kind of credit assessment.
- The corporate sector should adopt responsible borrowing and ensure timely repayment of loans to bring down the cost of borrowing.
- Taking advantage of the scenario, banks and corporates can play a more strategic role in taking the economy to a higher trajectory of growth to put it into the orbit of developed economies in coming years.

Quick Facts

Banking Stability Indicator (BSI)

- BSI is an overall assessment of changes in underlying conditions and risk factors that

have a bearing on the banking sector's stability during a period.
- The six composite indices represent risks in six dimensions are soundness, asset quality, profitability, liquidity, efficiency, and sensitivity to market risk.

References

1. Business Line - Lessons from twin balance sheet syndrome
2. TOI - Twin balance sheet problem to twin balance sheet advantage