

# Banks can now address NPAs more effectively

The promulgation of the ordinance amending the Banking Regulation Act, 1949 is a very timely decision, stresses Prem Rajani, managing partner of the legal firm Rajani Associates

**N. Mohan: What are the major enabling provisions in the recent ordinance amending the Banking Regulation Act? Do you think it is an effective measure to resolve NPAs issues?**

**Prem Rajani:** The ordinance basically provides for two enabling provisions in the Banking Regulations Act, 1949 (the BRA), wherein RBI has been empowered to issue directions to the banks (i) to initiate action against defaulters in terms of the Insolvency and Bankruptcy Code, 2016 (Insolvency Code); and (ii) for resolution of the stressed assets and formation of any committee for the said purpose.

I believe the ordinance is likely to be an effective measure to resolve the issue of NPA. Pursuant to the Ordinance, the RBI has issued a circular wherein it has, inter alia, clarified that (i) a corrective action plan could include flexible restructuring, SDR, S4A, (ii) facilitated the decision making in Joint Lenders' Forum (JLF) meetings by reducing the required percentage from 75% to 60% in value, and (iii) empowered the executives of banks to implement JLF decision without any further reference to bank board.

The RBI is also in the process of constituting a committee to advise the banks for decision making for cases, which should be referred under the Insolvency Code. However, how far the insolvency proceedings are likely to succeed is yet to be seen, considering that the insolvency regime itself is at very nascent stage.

**It is a fact that lack of capital for the banks is the main hurdle, especially for the public sector banks, in coming out of the crisis. The ordinance does not necessarily address this issue.**

Even though the ordinance does not explicitly address the issue of lack of capital, through the ordinance, the central government has essentially empowered



**Prem Rajani is of the view that the new ordinance will help RBI to get into the act of solving the mounting distressed assets of banks**

RBI to fast-track the recovery of stressed assets in an effective manner. The ordinance appears to be one of the few steps towards assisting the banks to come out of the dreaded issue of the over looming NPAs. The initial steps taken by RBI in furtherance of the ordinance seems positive and it appears they would yield effective results. As for further capitalization of the banks, it is more for the finance minister to allocate funds in the union budget.

**Do you think RBI would not have been able to discipline the banks in the absence of such an ordinance?**

One may perhaps say so as the BRA, always had provision (section 35A) which enabled the RBI to issue necessary directions under certain circumstances. However, the ordinance has given more

teeth to RBI to act effectively in the problem of NPAs coupled with the reconstitution of the oversight committee. The ordinance presumably will create a decision enabling environment, which will mandate the banks to take vital decisions in relation to the stressed assets at the appropriate stage.

**What are the real reasons for banks to be not eager in addressing the issue? There are several existing provisions under law like asset quality reviews, asset reconstruction companies, S4A and the strategic debt restructuring scheme.**

There is no doubt that besides the ordinance, there are various existing mechanisms to resolve the issue of NPAs. It is seen that majorly public sector banks are heavily affected with the issue of stressed assets. According to me, what was lacking was the approach of such bankers in making a decision in relation to the stressed assets. This is coupled with the fact that the executives of the banks feared that if a radical decision, such as one-time settlement or haircuts, it may entail investigation by the authorities.

Besides, in the JLF, absence of authority and consensus also procrastinated the resolution of the NPAs. This issue has now been addressed by the RBI vide its circular dated 5 May 2017, whereby not only the banks have to ensure that their executives are empowered to take decision without further approvals, but RBI has also made it clear that non-adherence to the instructions and timelines would result in monetary penalties.

**Is it possible to guess a figure of the total stressed assets of the banking system in the country? The finance ministry has pegged it at ₹9.6 trillion.**

It is not possible to guess a figure of the stressed assets in the banking system. However, the figures of the stressed assets

have been affirmed by the finance ministry. Thus, I reasonably believe that the same is correct. Considering the tendency among certain banks to occasionally ever-greening the loans, the figures may perhaps be more.

**Do you think the provision enabling RBI to take direct action against defaulters stand scrutiny of law?**

I believe the RBI has been entrusted with the task of providing an enabling framework for the banks. Further, the ordinance being a policy decision of the central government, the directives given therein are within the contours of the framework of RBI. It is unlikely that the challenge to the validity of the ordinance will be sustained.

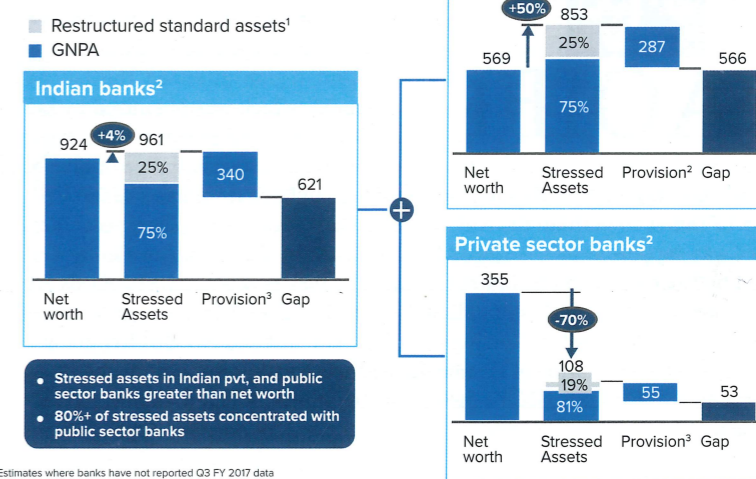
**There is a provision in the ordinance to link Banking Regulation Act to the Insolvency and Bankruptcy Code. Can you explain the nuances of this measure? Will it bring together several existing laws like SARFAESI, SICA, etc.?**

Yes, the ordinance provides that the central government can authorize RBI to issue directions to banks to initiate action under the Insolvency Code. In the Insolvency Code, any default of ₹100,000 or more can result in action against the defaulting entity. Thus, even without the ordinance, it was always open for the banks to initiate actions under the Insolvency Code. However, now by of the ordinance, banks will get the blessings of RBI and central government to initiate action once a default, in terms of the Insolvency Code, has occurred. Interestingly, by linking the Insolvency Code with the BRA, the banks will be empowered to take action against the defaulters as soon as the default, in terms of the Insolvency Code, has occurred, without waiting for the 90 days period before converting a loan account into NPA.

In regard to the second part of the question, with the Insolvency Code coming into force, SICA stands repealed. Thus, the objectives of the provisions of SICA have been seemingly embodied in the Insolvency Code though not on similar lines. However, SARFAESI being an act for the financial institutions to enforce the securities and

**Stressed assets challenge has grown past net worth, with a total provisions gap of ~ ₹600K crores**

Q3 FY 17, ₹'000 crores



1 Estimates where banks have not reported Q3 FY 2017 data  
2 Excluding foreign banks  
3 Provisions for restructured assets for FY2016  
Source: Bank Quarterly Reports, McKinsey analysis

thereby recover their loans, without the intervention of the court, has a different objective from the Insolvency Code.

**Do you think the new norms prescribed by the regulator to distinguish sticky assets are practical and will yield results?**

As mentioned above, certainly the new norms would yield positive result in timely implementation of the JLF decisions and preservation of the underlying economic value of stressed assets. The decision is certainly proactive. However, the extent of the positive result would be revealed with the time to come.

RBI has indicated that it would soon constitute a committee which would work on a framework to assess which cases of NPAs or stressed assets are to be referred under the Insolvency Code. It will be interesting to see what criteria the committee formulates for referring the matter under Insolvency Code.

**Most of the reluctance on the part of the bank managements to show realistic level of NPAs is on account of the impact on the balance sheets. How can this situation be remedied?**

This situation can be remedied by the banks identifying these stressed assets at early stage. This will ensure that the banks take necessary recovery measures for the

stressed assets at the appropriate time to have a permanent solution.

**Do you think there is need for the government to define corruption in order to protect bank officials from corruption charges for genuine decisions they have taken?**

Yes, I think in the long term, the government needs to take steps to protect the honest bank officials against frivolous corruption charges for genuine decisions. However, since the ordinance empowers the RBI to issue directives to the banks to take the necessary actions against the defaulters, situation of genuine decisions being questioned are likely to be far less.

**Finally, will ARCs assume a more strategic and meaningful role in the new scheme of things?**

The main object of the ARC is to explore the best possible potential value of the underperforming assets and the NPAs. It is equally important that such assets are identified by the banks at the appropriate stage which will ensure that the ARC recover the underlying economic value of such NPAs. Thus, ARC will certainly play a very vital role, assuming the ordinance and the RBI circulars are implemented in its true spirit.

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