Fallouts of RBI’s Tightening Regulatory Grip

What is the issue?

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

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- There is a palpable economic slowdown in the last couple of years and many borrowers are unable to repay their debts.
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- As bad loans piled up, a progressive tightening of rules was unleashed by RBI to address the NPA problem since 2015.
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- Incidentally, this has effectively curtailed the discretion of banks and borrowers to reach a negotiated settlement – which is prolonging resolutions.
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- 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.
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- 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.
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- This tightening of rules, has meant stumping up of more cash, lower

profits, and restrictions on the ability to lend more.
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What were the specific tightening measures?

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- The new insolvency law that come into force in 2016, and growing outrage against instances of corporate fraud have left banks bleeding.
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- In February, RBI did away with several schemes such as Strategic Debt Restructuring (SDR), which allowed banks to grant extra time to borrowers.
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- 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.
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- 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.
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- Many have argued that this approach would cramp lending by banks at a time when most indicators show that growth is on the upswing.
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Is RBI's zeal for addressing the bad loans hurting growth?

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- The RBI Governor Raghuram Rajan had stated in unambiguous terms that clean up definitely deserves higher priority for fixing the economy.
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- There seems to be consensus to this view among all of RBI's higher ranking officials and their policy direction is clear.
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- Hence, RBI is consciously overlooking the fact that credit supply in the economy is reducing, which will definitely have consequences for

growth.
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- 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.
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What are the lessons from elsewhere?

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- Most other economies have also resorted to tighter banking regulations to tide over the bad loans problem.
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- A tougher operational environment has inevitably led to conflicts between the banking regulator and the owners (It is predominantly PSUs in India).
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- Some tensions in this regard are already visible between the RBI and Government, but there have also been some positive spin-offs too.
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- A palpable behavioural change has been observed among some borrowers as promoters fear an aggressive bank takeover if they fail to service their debts.
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- Notably, post the 2008 financial crisis, banks in the West have also been subject to rigorous standards and changes of rules.
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How does the future look?

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- A system that doesn't disrupt the economy, but still delivers for it – and rules need modifications to suit situations.
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- And when risk-taking increases, it must not be at the expense of the resilience of banks to any future downturn in the economy.
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- For policymakers, balancing growth imperatives with regulations is a difficult choice to make as it requires political stamina to pursue long timelines.
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- 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.
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- In India's case there is a greater risk of budgetary allocation being pumped in for aiding public banks during distressing times.
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- Hence, solving the entire mesh of issues hinges not only on financial sector practices but across all economic domains.
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Source: Indian Express

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