

RGICS



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RGICS LEGISLATIVE BRIEF (July, 2017)

**The Banking Regulation (Amendments) Act,
2017**

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KEY MESSAGES

- Increasing involvement of RBI in business and commercial decision may create a conflict of interest and dilute its role as a regulator
- Not enough being done by government to address the core issue of the twin balance sheet problem facing the Indian economy
- Recent judgment¹ by Gujarat High Court on Essar Steel vs RBI, may make it difficult for this Amendment to be tenable as it would once again require RBI to explain why it would push only some businesses into bankruptcy while letting others renegotiate.

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PART I. Introduction

From flexible refinancing of infrastructure loans to changing the fee structure of asset reconstruction companies and strategic debt restructuring, the Reserve Bank of India has made many attempts to resolve the Non Performing Assets (NPA) crisis. However, according to the Financial Stability Report of the RBI the gross non-performing advances ratio of banks increased sharply to 7.6 percent from 5.1 percent during the period September 2015 and March 2016. The Banking Regulation Amendment 2017 was introduced by the governmentⁱⁱ, as one of the key solutions for resolving the crisis of stressed assets

PART II: Major Provisions

The Banking Regulation (Amendment) Ordinance 2017 was approved on May 4, 2017. In order to resolve the cases related to stressed assets, the Amendment inserts provisions in the Banking Regulation Act, 1949. According to the Act, the stressed assets are loan accounts where the borrower has defaulted in debt repayments or where the repayment schedule has been restructured. The major provisions in Amendment are as follows:

- The Central Government may authorise the Reserve Bank of India (RBI) to issue directions to banks for initiating proceedings in case of a default in loan repayment. These proceedings would be under the Insolvency and Bankruptcy Code, 2016.
- The Ordinance allows the RBI to issue directions to banks for resolution of stressed assets from time to time.
- The RBI may specify one or more authorities or committees to advise banks on resolution of stressed assets. The members on such committees will be appointed or approved by the RBI.

Essentially the Amendment addresses the ‘gap’ that existed in the CDR (corporate debt restructuring), SDR (strategic debt restructuring) and S4A (Sustainable Structuring of Stressed Assets) mechanism by giving RBI the power to micro-manage settling bad loans.

This mechanism will help provide ‘cover’ to banks and their employees, so that they will be able to take decisions regarding NPA’s, without worrying that they’re actions may not be questioned or misconstrued by vigilance agencies.

PART III: Concern and Criticism

The draft of the ordinance begins by taking note that ‘the stressed assets in the banking system have reached unacceptably high levels’ and also adds that “urgent measures are required for their resolution”. But considering the magnitude of the NPA crisis, the solution will not be easy. It will include losses and pain for the banks as well as for borrowers. The main concerns and criticism of the Amendment are:

- **Empowerment of Central Government:** The first provision of the Amendment gives more power to the Union Government to direct the RBI to take necessary steps to solve the NPA resolution once a default has been established. This is a striking change in comparison to the earlier provisions of the Banking Regulation Act, which did not allow the government to direct the RBI to enforce NPA resolutions for default casesⁱⁱⁱ. In an area, which is strictly the domain of the central bank, the Union Government’s foothold is objectionable on the ground that it undermines the central bank’s authority over such matters.
- **The Insolvency and Bankruptcy Code, 2016 may come in the way of Central Bank’s actions:** The new Amendments will link the provisions of Insolvency and Bankruptcy Code 2016 to the Banking Regulation Act. Before the Union Government directs the RBI to initiate the NPA resolution process, the government has to establish it as defined under the Code. Provisions under this Code require that the entire insolvency exercise must be completed within 180 days under IBC. The deadline may be extended if the creditors do not raise objections on the extension. For smaller companies, including startups with an annual turnover of Rs. 1 crore, the whole exercise of insolvency must be completed within 90 days and the deadline can be extended by 45 days. However, there was no such linkage in the Amendments that are being proposed. Therefore, it may come in the way of the central bank taking action against any bank for ignoring a default^{iv}.
- **Business and Commercial decision:** Approving loans are a business and commercial decision of the Banks. As a sound regulator, RBI should prevent the possibilities of bad loans^v. Resolving NPA’s is also a part of each banks charter, however over the past few years it has been seen that bankers were unwilling to take large hits on the bad loans as they were unsure of recapitalization and were also unwilling to take decisions on bad loans as they were wary of criminal investigations and feared reprisal.

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While the proposed amendment has been welcomed by the banks as it is seen as a sort of ‘hand-holding’ by the regulator it will increase the RBI’s involvement in commercial decisions taken by banks and virtually means that business decisions are being shifted upstream to the central bank– an area which is clearly not the domain of the regulator. Instead, as a central bank, the RBI’s role should focus on insisting that bad assets are recognized, provided for and that banks have adequate equity capital.

The recent judgment of the Gujarat high court in Essar Steel India Ltd versus the RBI where the court observed that “it would be appropriate for RBI to see that the benefit of all its schemes is equally offered and extended to all without any discrimination.”^{vi} Clearly the court seems to be of the opinion that the regulator should not be pushing banks to move only some accounts into bankruptcy while letting others renegotiate. Government must take into cognizance the courts view on this matter as via this Amendment it is essentially creating a situation where the RBI will pick and choose businesses that must go in for bankruptcy and those that must not.

PART IV: Conclusion

Considering the magnitude of the Indian Banking crisis, the Amendments in the Act may not really address the underlying issues in the NPA crisis. The Banking Regulation Act has already empowered the RBI in order to direct the banks, but the Amendments in the Act seem to be a case of over-reach by the regulator. Further, the fact remains that most of the stressed assets will not fetch their book value when sold or liquidated. Which leaves the core issue unanswered – given the financial condition of most PSU banks today they may not be able to make extra provisions for speedier resolution of stressed assets – in which case how will the double balance sheet problem facing the economy be addressed in a sustainable manner?

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PART VII. REFERENCES

ⁱ <http://www.livemint.com/Opinion/wta3x2WGsTdGopBzNpSV1O/Saving-capitalism-from-capitalists-Try-harder-RBI.html>

ⁱⁱ The Banking Regulation (Amendment) Ordinance, 2017. Available at <http://www.prsindia.org/uploads/media/Banking%20Ordinance%202017/The%20Banking%20Regulation%20Amendment%20Ordinance%202017.pdf>

ⁱⁱⁱ <https://scroll.in/article/837106/non-performing-assets-ordinance-meant-to-empower-rbi-actually-gives-more-teeth-to-the-government>

^{iv} <https://scroll.in/article/837106/non-performing-assets-ordinance-meant-to-empower-rbi-actually-gives-more-teeth-to-the-government>

^v <https://thewire.in/133484/banking-regulation-act-ordinance/>

^{vi} <http://www.livemint.com/Opinion/wta3x2WGsTdGopBzNpSV1O/Saving-capitalism-from-capitalists-Try-harder-RBI.html>