Bankruptcy court should be the final option: Rajan

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Highlights

- Former RBI Governor Raghuram Rajan is of the view that bankruptcy court should be the final option and loan renegotiation should be done under its shadow, not in it.
- "Banks and promoters have to strike deals outside of bankruptcy, or if promoters prove uncooperative, bankers should have the ability to proceed without them," he said in a note prepared for the Parliament Estimates Committee at the request of its chairman Dr. Murli Manohar Joshi.
- Dr. Rajan's statement assumes significance in the backdrop of the ongoing resolution of 20 power sector NPA accounts where there's a tussle on between the RBI and banks.
- In a different context, the former RBI governor blasted those who were saying that the RBI was responsible for the slowdown in credit and the economy because of its push to recognise NPAs, calling such claims "ludicrous".

Cleanup not the problem

- "Cleanup was part of the solution, not the problem," he said, pointing out how public sector banks had started soft-pedalling on loans to industry, agriculture and MSMEs since April 2014, well before the cleanup process began in the second half of fiscal 2015.
- This was even as they pushed hard on personal and housing loans, where the NPAs were low.
- "The slowdown is best attributed to over-burdened public sector bank balance sheets and growing risk aversion in public sector bankers," he said, pointing out that private banks had not slowed down on their lending to industry.
- Their aversion was also visible in the way they slowed down on accepting deposits relative to their private sector peers.
- Conceding that the RBI "should probably have raised more flags about the quality of lending in the early days of banking exuberance," Dr. Rajan said that with the benefit of hindsight, the RBI should not have agreed to forbearance.
- He also defended the much-criticised asset quality review initiated by him during his tenure, saying that it was necessary because banks were simply not recognising bad loans, not following uniform procedures for recognition, and not making adequate provision for loans that had stayed as NPAs for a long time.
- Looking ahead, Dr. Rajan said that governance of public sector banks had to be improved by professionalising boards and depoliticising appointments by handing it over to the Banks Board Bureau.
- He suggested introduction of outside talent into top management of PSBs given the talent deficit they faced.

Additional Info:

What is 'Non-Performing Asset (NPA)'?

- A nonperforming asset (NPA) refers to a classification for loans or advances that are in default or are in arrears on scheduled payments of principal or interest.
- In most cases, debt is classified as nonperforming when loan payments have not been made for a period of 90 days.
- While 90 days of nonpayment is the standard, the amount of elapsed time may be shorter or longer depending on the terms and conditions of each loan.

The Effects of NPAs

- Carrying nonperforming assets, also referred to as nonperforming loans, on the balance sheet places three distinct burdens on lenders.
- The nonpayment of interest or principal reduces cash flow for the lender, which can disrupt budgets and decrease earnings.
- Loan loss provisions, which are set aside to cover potential losses, reduce the capital available to provide subsequent loans.
- Once the actual losses from defaulted loans are determined, they are written off against earnings.

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