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Banking reforms must be on the top of the new govt's agenda

May 19, 2019

THE HINDU BusinessLine

The new government must get down to the task of governance reforms at PSBs

As a prolonged and acrimonious Lok Sabha campaign winds to a close, the Indian electorate can now heave a sigh of relief. But the political party or coalition which takes over reins at the Centre will not have this luxury. It will have its task cut out to put the sputtering economy back on track, which will mean taking up the unfinished agenda on economic reforms. Reforms in banking must surely figure at the top of this to-do list. After inheriting a banking system that was staggering under the weight of undisclosed non-performing assets (NPAs), the incumbent government led by the RBI, did manage to force banks to disclose evergreened loans and provision for them. A new Bankruptcy Code was legislated to allow lenders to take charge of the resolution process. But beyond this, most of the energies have gone into fire-fighting operational issues at public sector banks (PSBs) and scrounging up capital to keep them afloat. While investors and depositors can take heart from the worst of this NPA crisis being behind them, they have very little assurance that a similar one will not recur in future.

To prevent an encore of the NPA crisis, structural reforms at PSBs are imperative on three counts. One, the poor credit appraisal and risk management systems which led to them concentrating their loans in a handful of borrowers need drastic overhaul. RBI recently imposed tighter curbs on the group-level and firm-level exposures of banks, capping them at 40 per cent and 20 per cent respectively of Tier-1 capital. But such limits cannot substitute for the PSBs' lack of in-house talent in credit and project appraisal, which needs urgent fixing. RBI needs to work on internal early warning systems that leverage analytics to head off credit bubbles too. Two, while mis-judgement can be condoned, strict enforcement action needs to be taken against bankers who willingly colluded with corporate borrowers to evergreen loans. There's also need for a thorough overhaul of recruitment policies at PSBs, greater accountability from their top managements and Boards and performance-linked compensation. Three, political interference has played an egregious role in diverting bank funds to crony capitalists. Fixing this issue requires deep-rooted governance reforms that distance the management and Boards of PSBs from their promoter — the Central government. A roadmap for the transfer and gradual dilution of the government shareholding in PSBs is now critical, as is the strengthening of the toothless Bank Boards Bureau. RBI on its part needs to work through recent setbacks to the IBC process to put it back on its feet.

Apart from all this, the confidence that the Indian public and depositors place in banks seems to be taken for granted, amid every new crisis. The new government must quickly get to the task of raising the deposit insurance cover for retail depositors, which has remained at a measly Rs.1 lakh for over two decades.

RBI now uses divergence to compel banks to improve their loan-loss ratios

Manojit Saha
MUMBAI, MAY 18, 2019 THE HINDU

Delayed NPA recognition also amounts to under-reporting

At least three public sector banks that have reported earnings for the January-March quarter have mentioned 'divergence' in bad loan recognition and have made provisions for such loans.

Divergence takes place when the Reserve Bank of India (RBI) finds that a lender has under-reported (or not reported at all) bad loans in a particular year and hence asks the lender to make disclosures if under-reporting is more than 10% of bad loans or the provisioning.

Three state-run banks — Union Bank of India, Indian Bank and Central Bank of India — had reported divergence while announcing the results. In all these banks, divergence was spotted for the financial year 2017-18.

Higher provisioning for divergence was one of the reasons for them to report losses for the quarter. Interestingly, divergence was identified not because these banks hadn't classified the loan as non-performing assets (NPA) but because they were late in classifying them.

NPA classification

Since the date of classification as NPA had been pushed back, the banks had to make higher provisioning due to the ageing factor. In the first stage of NPA, which is the 'sub-standard' category, 15-20% provision is required and for next category, which is 'doubtful', a 40% provision is required.

"During the annual inspection, RBI supervisors pointed out that if one bank has identified an account as NPA six months earlier, for example, then why have other banks delayed in recognising the same. So, banks have been asked to classify the account as NPA on an earlier date, which means, increase in provisioning requirement due to ageing factor," a top official from a public sector bank said.

Some bankers said the identification was pushed back by two years in some cases. Since banks had to increase their provisioning, this resulted in higher provision coverage ratios (PCR).

Central Bank of India's provision coverage ratio had improved to 76.6% as on March 31, 2019, from 63.31% a year earlier, while Union Bank's improved to 66.24% from 57.18%. Indian Bank's provision coverage ratio was 65.72%. In 2009, RBI had mandated a 70% provision coverage ratio, which resulted in banks increasing their coverage. However, in April 2011, the mandate was withdrawn.

Provision coverage ratio

With the asset quality of banks starting to worsen from about 2013-2014, the PCR level of banks has fallen sharply.

Now, the banking regulator has found a way to increase the loan-loss ratio without mandating any particular level.

Financial sector mishaps will bring discipline

K.T. Jagannathan & N Anand & K. Bharat Kumar
MAY 19, 2019 THE HINDU

Asset-liability mismatch, funds diversion in NBFCs must be looked into: Murugappa Group chairman

He is soft-spoken yet conveys a clear sense of command over whatever he speaks about. He has a penchant for cracking crossword puzzles. And, his clarity of thought expresses itself in a no-nonsense way. In this free-wheeling interview, M.M. Murugappan, executive chairman, Murugappa Group, talks on a wide range of subjects. Edited excerpts:

Uncertainty has been prevalent in the NBFC sector. A liquidity crunch is causing missed opportunities. Is such uncertainty unprecedented?

Problems have remained latent. All these cannot come up overnight. These have to surface at some point of time or the other. Once it surfaces, then there is a domino effect. So, in a way, if you look at it positively, I think this will bring in discipline. And in the long term, business velocity will improve.

How are you tackling the fallout of issues that have cropped up in the financial services sector?

You have to be proactive and plan accordingly. Today, every stakeholder and certainly investors want to know what our risk management approach is. In financial services particularly, managing risk is as important as acquiring customers and servicing them. Therefore, we will continue in our financial services businesses to look for quality opportunities and manage our risks well. We will use technology to do so and be efficient across all aspects of business.

Credit has tightened in the marketplace. What is your take on this?

This phenomenon will be there. Some amount of tightening will take place and must take place. With far greater discipline and confidence that arises out of it, there could be shakeouts. But then, companies will be looking to do quality business... as customers become disciplined and ensure that EMIs are on time ... the risk we take with two or three EMIs is gone now. We have to make accounting provisions for it. Overall, the discipline is good. It may indicate only a temporary slowdown.

Two points add to the latency ... what is missing is the long-term availability of funds particularly for infrastructure. So, when you do not have sources of long-term funds, people obviously will tap into sources of funds which are short-term in nature and at a lower cost. It will lead to these types of practices. Second is the diversion of sources of funds. Regulators should look at both these angles.

Is the Insolvency and Bankruptcy Code helping industry?

Conceptually, it is a good thing. Maybe, it needs to play out in the right way. Resolutions are taking time.

Is it true that post IBC, traditional industries are afraid of accessing bank funds? Are you wary of bank funding?

We are not wary of bank funding. We are certainly traditional and conservative. We are going to diversify our funding sources to try and match requirements. There is plenty of funding available today for a good corporate.

Now there may be a view that a certain amount of funding should be raised only through bonds. Good traditional companies will always look at their source and mix of funds in a very cautious way.

Though India has many good things to offer, our image has a negative tinge in terms of stories of financial fraud. How do you view the situation?

I am very positive on India. From my group's perspective, we are long-term players, in terms of history, legacy, approach and what we do... we look to the future. I am quite confident of the India growth story. We had some temporary blips caused by various things. There may be immediate concerns. But from longer-term point of view, the India story is good.

These changes that we are seeing ... in the financial sector and general reforms ... are in the right direction. All these are going to strengthen the stability of the economy. Good groups are not averse to approaching banks, and banks are eager to work with us.

Going by the happenings in the telecom and airline sectors, do you think we need to have regulated competition?

The important thing is that everyone should get value for money. Should unit price necessarily be cheap? Is the consumer getting value for money? People who are able to sustain alone are able to remain strong. Even the normal consumer has aspirations.

Captains of industry can try and foster this. People today are seeking value for money. They are willing to pay for services, even in the repair and maintenance space. That sector will grow.

Is the Indian economy in a robust condition or is it facing challenges?

Economy stability is there. India is not an unstable country. Today, we are not creating enough jobs. Where are those jobs going to come from? They have to come from a combination of organised industry, entrepreneurship, government and utilities. They have to come from across all sectors.

Where do you see job opportunities in your group firms?

We are expanding feet on the street. We need a lot of people in financial services. Today, people are not available for jobs. We recruit people for attitude and train them for skill.

Are you into supporting new-age firms? Are you investing in start-ups?

Yes, we are doing it in pockets, but not as a policy yet. We are working with some start-up firms.

We are giving them an opportunity to test their hypothesis in our group ... be it manufacturing, financial services, engineering or agriculture.

We are not fussy about where in the world we do this ... naturally, proximity to India is better. We are trying to give people opportunities. The core thing about the Murugappa Group is that we look at things from a long-term view.

Can you elaborate on your tie-up with the Indian Space Research Organisation for technology to make lithium-ion batteries?

The Indian Space Research Organisation has a technology to make lithium-ion batteries. It is a technology that has not scaled yet.

They have chosen many parties in India to provide the technology. The mandate of the government research organisation is basically to propagate this with many companies in the country.

We have taken this to understand the technology, rather than to make lithum-ion batteries, and look at supplying materials to the makers of such batteries.

NBFC crisis to top agenda of new govt

K Ram Kumar Mumbai | May 19, 2019, BUSINESSLINE

Rising concerns over continued turmoil in the sector

Finding a solution to the continuing turmoil in the NBFC sector, which has been facing an asset-liability mismatch as well as funding issues, is set to top the agenda of the new government at the Centre.

The distress among non-banking financial companies is being closely monitored by both the Finance Ministry and the Reserve Bank of India.

"The NBFC sector has been moving from one crisis to another ever since the IL&FS issue cropped up in September last year. There are growing concerns that the issue has remained unresolved for too long, and could now impact lending activities and growth," said a person familiar with the development.

Funding crunch

NBFCs have been complaining that raising funds is becoming more and more difficult with flow from banks almost drying up.

"The question is: what can be done to help the sector? The RBI has already taken a number of measures but there does not seem to be an adequate solution," said the person.

Redemption pressure

But with concerns that there could be more defaults as redemption pressures mount, the government is likely to swing into action. Initial discussions among stakeholders are understood to have already started.

Corporate Affairs Secretary Injeti Srinivas had also recently pointed to the imminent crisis in the NBFC sector, flagging the credit squeeze, over-leveraging, excessive concentration, massive mismatch between assets and liabilities and misadventures by some very large entities.

Similarly, veteran banker Uday Kotak had also warned that the turbulence in the financial sector could eventually impact the real economy as well. Marzban Irani, CIO-Fixed Income, LIC Mutual Fund, feels that NBFCs' liquidity problem could be alleviated if the RBI opens a separate repo window under the liquidity adjustment facility for banks for on-lending to NBFCs.

Non-bank worries

DBS, in a report, observed that worries over non-banks have been revived after rating downgrades of more names and concerns over their exposure to mutual funds.

“Short-term borrowing costs, including those of commercial papers and certificate of deposits have risen. This has added to worries over sufficient funding availability for non-banks, as the latter seek to shift away from money markets and into funds, bond issues, credit/securitisation from banks and/or offshore borrowings.

“Most of their borrowings are likely to be routed to repair balance sheets, refinance liabilities and improve the funding mix rather than into fresh growth capital, weighing on sectors that rely heavily on non-banks’ funding,” said the foreign bank.

Getting credit flows back will be next government’s challenge

The Financial Express | May 20, 2019

THE FINANCIAL EXPRESS

Sharp jump in provisioning for next round of NPAs means reviving credit growth tough; low deposit-growth worrying, too

The rising provisioning suggests the NPA cycle may not have ended yet

Banks have now been cleaning up their balance sheets for close to three years after the asset quality review process started in 2016. It was expected that, by now, most of the bad loans would have been identified and adequate capital set aside for these in the event the money cannot be recovered from the borrowers. However, the sharp jump in provisions made by a clutch of state-owned banks for loan losses in the March quarter—both existing and potential—to over Rs 50,000 crore is cause for concern. Moreover, some private sector banks too appear to be setting aside more capital for potential loan losses than one had estimated. The rising provisioning suggests the NPA cycle may not have ended yet. After IL&FS and Jet Airways, there could be other big exposures that could turn toxic. Also, bankers have been red-flagging stress in the real estate sector and MSME space, too. This is a big concern because, while private sector banks should be able to access the markets for equity capital, the state-owned banks may not have adequate growth-capital to fund businesses and consumers in FY20 unless the government comes to their rescue. This is despite the fact that capital adequacy norms have been eased.

The other big concern is the sharp deceleration in credit growth over the last six months, essentially the shortage of affordable credit. The near-collapse of NBFCs and HFCs has resulted in the flow of credit weakening. A look at the loan data shows that banks, too, have been lending a lot less to certain segments. For instance, loans to the consumer durable segment contracted by 68% year-on-year (y-o-y) in March. While some of this could be attributed to lack of purchasing power, it is also a fact that loans that were being offered were not attractive enough. If growth is not to be stifled, businesses must have access to adequate affordable credit. At this point, banks are finding it hard to mobilise deposits, partly because consumers' savings are thinning as their incomes are growing slowly, or are not growing at all. Deposits are now growing at sub-10% y-o-y, but to support credit growth of 13-14%, CRISIL estimates the asking rate of annual deposit growth would be significantly higher at about 10% in FY19 and FY20, compared with around 6% in FY18. The growth in FY19 has been a little over 8%, with outstanding deposits now at close to Rs 126 lakh crore. Unless the economy rebounds, and, therefore, consumer incomes get a boost, it is unlikely banks will be able to attract deposits at a faster pace.

It is something of a chicken-and-egg situation. But while some of the currency-in-circulation should come back to the banking system after the elections, over the longer term, banks need to be able to mop up deposits at a quicker pace, else lending will be constrained. Also, liquidity measures being used by RBI—including open market operations—will help. But, unless the government spends far more than it has budgeted, it would be hard to create jobs and boost consumers' incomes and, thereby, savings. The other option, of course, is to attract more foreign flows into the corporate bond market.

India’s new government inherits an economy riddled with problems

Bloomberg | May 20, 2019

THE FINANCIAL EXPRESS

While Modi’s government’s seized control of the company to contain the crisis, a lingering credit crunch has curbed loans and affected consumer spending. That’s separately triggered concerns about mutual funds that hold debt issued by non-bank finance companies

Going into the elections, both Modi’s Bharatiya Janata Party and the main opposition Indian National Congress were big on pledges to spend billions of dollars to provide income support to the poor and farmers

A set of deep-rooted economic challenges awaits India’s new government after election results are announced May 23.

Arresting an economic slowdown and nursing the nation’s financial sector back to health will be the immediate priorities for the next administration if Prime Minister Narendra Modi’s coalition wins a second term — as exit polls suggest — or his political opponents wrest power from him. A slowing global economy and a protracted trade war between the U.S. and China add to the urgency to fix things at home.

With 7% expansion in the year through March, India has held the crown as the world’s fastest-growing major economy. But that’s quickly changing this year as consumption — which makes up 61% of India’s gross domestic product — weakens sharply, with ripple effects on new investments. GDP data due May 31 will probably show growth cooled in the three months through March from a six-quarter low of 6.6%.

Here’s a look at what else the new government should be worried about:

Budget Deficit

Going into the elections, both Modi's Bharatiya Janata Party and the main opposition Indian National Congress were big on pledges to spend billions of dollars to provide income support to the poor and farmers. Keeping that promise at a time when tax collections have undershot targets may come at the cost of India missing, yet again, its fiscal deficit target of 3.4% of GDP for this year. Global credit rating companies are monitoring the number closely and any downgrade could push the nation's debt into junk category.

Jobs

The new government needs to find ways to productively employ about 1 million people entering the workforce every month. India hasn't published official employment data in more than two years, but a leaked statistics office report — which was rejected by the government — puts the unemployment rate at a 45-year high of 6.1%. The Centre for Monitoring Indian Economy Pvt., a private research firm, estimates the jobless rate rose to 7.6% in April.

Shadow Banks

A series of defaults by beleaguered shadow financier Infrastructure Leasing & Financial Services Ltd. last year exposed fault lines among India's non-bank lenders, which accounted for a third of all new loans over the previous three years. While Modi's government's seized control of the company to contain the crisis, a lingering credit crunch has curbed loans and affected consumer spending. That's separately triggered concerns about mutual funds that hold debt issued by non-bank finance companies.

Trade

India last posted a monthly trade surplus in March 2002. Rapid economic expansion since then has meant the nation's imports have far outgrown exports, with oil being the nation's biggest purchase. That's pushed the current-account deficit to more than 2% of GDP last year, making it a key vulnerability for the economy. While India is trying to narrow the shortfall by reducing its reliance on imports and boosting exports, that will prove difficult in a global environment of slowing growth and rising trade protectionism.

Investment

Fixed investments have been almost stagnant at about 30% of GDP in the past four years, while foreign direct investment has declined recently — partly because of the uncertainty ahead of the election, but also due to politically-inspired protectionism and bureaucratic bottlenecks, which have kept investors away. India has missed out on the flow of FDI into regions like Southeast Asia as companies shift production to avoid rising tariffs in the U.S. and China. A stable government with continuity in policy and progress on reforms could boost the sentiment.

"The challenge that we are facing in sluggish private investments needs to be addressed with special attention," analysts at Elara Capital, led by Ravi Muthukrishnan, wrote in a note. "Sticking to fiscal discipline and avoiding crowding out of financial markets, would be key to increase in private investment activity."

In gold we trust: India's household gold reserves valued at over 40% of GDP

Banikinkar Pattanayak | May 20, 2019 THE FINANCIAL EXPRESS

Factoring in the central bank's reserves (608.8 tonne) and an import duty of 10%, the domestic value of the gold stocks at most of the known sources in the world's second-largest consumer will be even higher

Indian gold demand rose 5.2% from January to March, against a marginal fall in the previous quarter, but it still trailed a 7% rise globally, showed the latest World Gold Council (WGC) data

Households in India may have piled up around 24,000-25,000 tonnes of gold, remaining the world's largest holders of the precious metal, Somasundaram PR, managing director (India) of the Londonheadquartered World Gold Council (WGC), has told FE. At Friday's international price, the value of the holdings (25,000 tonne) would be as much as $1,135 billion, or equivalent of more than 40% of India's nominal gross domestic product (GDP) in FY19.

Factoring in the central bank's reserves (608.8 tonne) and an import duty of 10%, the domestic value of the gold stocks at most of the known sources in the world's second-largest consumer will be even higher. Despite subdued demand in recent years, gold holdings have accumulated over the decades, thanks to the traditional penchant for the precious metal.

"We conducted a study two years ago and found the household stocks at around 23,000-24,000 tonne. Now, the stocks may have touched 24,000-25,000 tonne," Somasundaram said. This reinforces the potential of the government's gold monetisation scheme, provided it's made more lucrative and rolled out with better infrastructure, analysts say.

However, the gold schemes (monetisation, bonds and sovereign coins) launched in late 2015 haven't yet generated the desired response. Mop-ups through all these schemes represent just about 2% of the country's annual consumption. With renewed push, though, the collection can go up.

The schemes are part of the broader government effort to curb "non-essential imports" and contain their impact on both trade and current account deficits that exert pressure on the rupee. Since gold already attracts a 10% basic customs duty, and any move to raise it to discourage imports is fraught with risks of higher smuggling.

Indian gold demand rose 5.2% from January to March, against a marginal fall in the previous quarter, but it still trailed a 7% rise globally, showed the latest World Gold Council (WGC) data. The Council now forecasts 2019 Indian demand at 750-850 tonne compared with 760 tonne in 2018.

"The strengthening of the rupee and the fall in local gold prices towards the latter part of the quarter triggered a rise in India's gold demand by 5% in Q1 of 2019 to 159 tonne," Somasundaram said. Looking ahead, gold demand will likely improve in the June quarter owing to traditional wedding season buying, the Akshaya Tritiya festival and rising crop prices, he added.

In addition, the weather department has forecast a normal monsoon this year, which augurs well for the rural economy and gold, he said. The country's gold demand was shaken after demonetisation in November 2016, as many customers feared a crackdown on gold holding, considered by many as one of the instruments to park of black money. While gold demand has recovered from a seven-year low of 666 tonne in 2016 to 760 tonne in 2018, it's still far from as much as 963 tonne in 2010. While the main driver of the Indian demand will continue to be jewellery, consumption of bars and coins is expected to be higher in 2019 than a year earlier.

RBI diktat on Chief Risk Officer provides cover to NBFC bosses

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THE FINANCIAL EXPRESS

It is in this context that the central bank has asked NBFCs to appoint Chief Risk Officers (CROs) and to ensure that they are insulated from various pressures

It is estimated that mutual funds have trimmed NBFC exposure to 27% of AUM (from 34% in Aug-2018) with exposure to NBFC commercial paper down 40%

Though the problems associated with the IL&FS default, and its loans of over Rs 100,000 crore, are still very large, there can be little doubt that deft handling of the situation by the government and RBI ensured the country's financial system didn't freeze up and there was no contagion despite the IL&FS exposure across various sectors. But, even those who felt India had dodged—at least, for now—a bullet wouldn't have envisaged that the rot spread so deep and so wide, or that so many other large NBFCs would have such large exposures. In a note last month, Credit Suisse estimated that, of the exposure to four stressed groups that AMCs have, 11% or roughly Rs 2,200 crore is through close-ended plans aggregating Rs 18,000 crore; around 56% of this is up for maturity in Q1FY19. It is estimated that mutual funds have trimmed NBFC exposure to 27% of AUM (from 34% in Aug-2018) with exposure to NBFC commercial paper down 40%. But there is a need to be watchful since mutual funds have a Rs 320,000 crore exposure to NBFCs (including housing finance companies) and Rs 130,000 crore of this matures over the next three months.

It is in this context that the central bank has asked NBFCs to appoint Chief Risk Officers (CROs) and to ensure that they are insulated from various pressures. So, for instance, any premature transfer/removal of the CRO is to be intimated to RBI's department of non-banking supervision. Similarly, the NBFC's risk management committee and/or board is to meet the CRO once a quarter without the NBFC's MD/CEO being present, all credit products are to be vetted by the CRO and the CRO will even have voting power if s/he is one of the decision-makers in the credit-sanction process. But why is the central bank getting into micro-management? Risk-management is part of the NBFC's job, whether it does it through a risk officer is its internal matter; if RBI feels not enough risk-mitigation is being done, it needs to tighten the rules, ask for more provisioning or other mitigation steps. By mandating the CRO as central to the NBFC's functioning, in effect the central bank is making the CRO responsible for everything that goes wrong; surely that is the job of the MD/CEO and the board? In the NSE co-location case that Sebi ruled on recently,for example, the stock exchange's bosses—Ravi Narain and Chitra Ramakrishna over different periods—argued that they never understood technology and so didn't understand that the technology allowed favourable treatment to a few brokers. In its order, Sebi said this was not acceptable and that they had to take responsibility. It is easy to see how, in the future, various NBFC bosses will now try and pass off the blame to the CRO.