Solution for PSU banks

What is the issue?

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- Given the current economic downturn and the mounting NPAs, the current Indradhanush plan seems to be insufficient.
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- Formulating a more comprehensive plan for reforming the PSU banks becomes inevitable.
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What is the proposed new reform?

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- RBI's deputy governor has suggested a ‘Sudarshan Chakra’ solution for PSU banks, in the place of the earlier 'Indradhanush' plan.
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- It envisages a comprehensive plan which is more focussed and targeted than the 'Indradhanush' plan.
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- It considers four “R”s which are envisioned as key to solving the problems of the banks.
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- They are:
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1. Recognition.
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2. Resolution.
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3. Recapitalization.
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4. Reform.
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What are the features?

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- **Recognition** - The RBI's asset quality review has made a considerable progress in this regard.
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- It has revealed the numbers on gross non-performing asset (NPA) in general apart from those in the PSU alone to be 12%.
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- However, this does not show the true picture as it does not include assets that are "stressed" but not yet NPAs.
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- The market assessment is that when these stressed assets take the form of NPAs, the NPA percentage may increase by up to 6%.
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- Thus, identifying the right proportion of the stressed assets is the first step to resolving them.
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- **Resolution** - The Insolvency and Bankruptcy Code (IBC) is a major reform in appropriately addressing the bad loans problem.
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- The process under IBC will certainly clean up the books of the banks over the coming months.
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- Nevertheless, the challenge is to find new investors who are willing to take over defaulted projects.
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- The banks will have to face huge losses so as to attract new investors and this is sure to have an impact with a corresponding erosion of capital.
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- **Recapitalization** - In 2015, the finance ministry had estimated that the PSU banks needed Rs.2.4 trillion of capital from market, retained profits and the budget.
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- The Fitch Ratings estimate the need to be Rs.4 trillion by end of March 2019, to meet the capital requirements under Basel III.
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- The finance ministry is thus under huge challenge given the mounting NPAs along with pressures for fiscal stimulus to counter the current slowdown.
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- Keeping on stimulating the economy through increased government

expenditure and draining out public funds is not a sound fiscal measure.
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- Perhaps, weak banks that have eroded their capital substantially could be subjected to RBI's "prompt corrective action" discipline.
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- This can limit new commercial lending until their capital position improves.
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- On the other hand, the healthier banks and non-bank financial companies, both private and public, can expand and occupy the lending space created.
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- **Reforms** - 1) Reforms in PSU banks are essential to make them more efficient, and this is needed irrespective of whether or not to recapitalize them.
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- Merging public sector banks cannot be considered a reform to address the problems at present.
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- Instead, there is a need for **reforms** that improve governance, upgrade the skill set, and improve the quality of risk assessment within the PSU banks.
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- 2) Government should think of reducing its **equity to 33%** in selected PSU banks, as recommended by Narasimham II Committee in 1998.
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- The government could still have a controlling position in the board, but the banks could become board-managed companies.
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- This would allow the stronger PSU banks to raise additional capital from the market, possibly from **strategic investors** who are offered seats on the board.
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- Inclusion of strategic investor may make it easier to raise capital without burdening the budget.
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- In all, the scale of the bad loans problem is much larger than was thought and the downturn in the economy necessitates more urgent corrective measures.
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Source: Livemint

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