

'Bank recap requires extreme care'

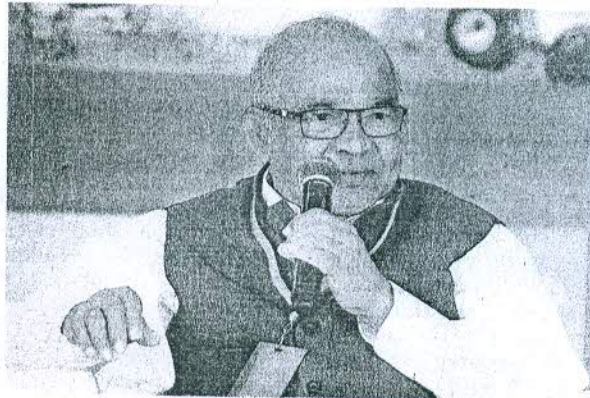
Exercise should be transparent so that it is clear as to who bears the risk, says former RBI chief Reddy

SPECIAL CORRESPONDENT
NEW DELHI

India's ambitious ₹2.11 lakh crore recapitalisation plan for public sector banks must be designed with extreme care to ensure that there is no disproportionate burden on taxpayers and no spill-over effects on the bond and equity markets, former central bank governor Y.V. Reddy said on Friday.

On the Reserve Bank of India's directives to banks for taking specific companies into insolvency proceedings, Mr. Reddy said that this was an extraordinary and unconventional move in the face of the extra-ordinary problem of public sector banks' non-performing assets, but shouldn't be deployed for long.

"In a normal course, it is the responsibility of the board and the owner to do it. You have an extraordinary situation where the problem is essentially in the public



Selective use: Initiating insolvency is unconventional but shouldn't be used for long, says Y.V. Reddy.

sector banks, of which the owner is the sovereign. So the sovereign passes the law, the sovereign owns the regulator and says this is an extraordinary problem, so you do it," Mr Reddy said.

"This is not a normal phenomenon and if the problem is serious, this could be justified, but not for long," he concluded. Delivering the

JRD Tata memorial lecture hosted by Assocham, Mr. Reddy said the country had failed in dealing with the challenges of public sector banks due to political economy reasons, though a solution has been known since 1991.

Arguing that the bank recapitalisation plan is as extraordinary as the RBI's in-

solveny push for NPAs, the former governor said banks need capital irrespective of whether it improves their performance, but flagged a key difference now compared with past recapitalisation exercises such as the one in 1994-95.

"[The] earlier recapitalisation was simple, this is complex. Therefore, the design has to be extremely careful and it should be transparent so we know who is bearing the risk. Any recap will need the taxpayer to pay in some way or the other if the government is taking excessive burden. But the private shareholder is involved now," he said.

Ripple effect

"If the government makes a generous package, they will make a windfall gain. If it is less than generous, they will be affected. Bond markets will be affected if they issue bonds at such a scale. The

money supply will be affected depending on when they mature," he explained.

"How you minimise distortions in the bond markets because of this extraordinary package is very important. This will impact money supply, bond markets, equity markets, (create) windfall gains for shareholders or extraordinary pain for taxpayers," he said. "Ensuring it is fair to the various stakeholders and acceptable to the markets is critical," Mr Reddy pointed out.

The decision to merge public sector banks is not a solution by itself, he said. "In general, if a strong bank is merged with another strong bank, I am not sure it will become stronger. If weak bank is merged with weak bank, I am not sure it will become strong. And if a strong bank is merged with a weak one, there's an equal chance that it will be stronger or weaker than before," he remarked.

RBI DIRECTIONS ON INSOLVENCY PROCEEDINGS

‘Not correct in principle, but justified for limited time’

ENSE ECONOMIC BUREAU
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FORMER RESERVE Bank of India Governor YV Reddy on Friday said that the RBI's approach in directing commercial banks to initiate insolvency resolution against big defaulters is "in principle not correct", but such an unconventional measure can be justified if used for a limited time.

On the government's plans to recapitalise public banks via issuance of recapitalisation bonds, Reddy said its success will depend upon on the design of the bonds.

Delivering the 20th JRD Tata Memorial Lecture, Reddy said the government has resorted to unconventional measures in resolving the issues with public banks. In response to a query on whether the RBI was correct in directing banks to take defaulting companies to the bankruptcy courts, Reddy said: "In the normal situation it is a responsibility of the (bank) board to do this (NPA resolution). You have an extraordinary situation, where the problem is essentially in the public sector banks, for which the owner is the sovereign. So the sovereign owns the banks, the sovereign passes the law, the sovereign owns the regulator."

He added: "So when the sovereign is facing an (external) prob-



YV REDDY
Former RBI Governor

lem, it says that instead of we doing it, you (RBI) do it. So, in a way, I would say it is sort of asking the RBI to take the initiative in solving the problem, is not a normal phenomenon, it is unconventional. Without going into whether it is required or not, whether it will solve the problem or not, the problem is serious, unconventional measures will be justified, but, not for long. In principle, I agree with you, it is not correct."

To resolve NPAs, the RBI has directed banks to refer 12 large NPA cases for resolution under the Insolvency and Bankruptcy Code. The 12 troubled companies being referred to NCLT under the RBI directive — including Jyoti Structures, Bhushan Steel, Monnet Ispat and Electrosteel Steels, Amtek Auto and Era Infra Engineering, among others — account for a debt of around Rs 2.5 lakh crore. For the NPA accounts other than the large 12

cases, an RBI committee had suggested that banks should be required to file for insolvency proceedings under the IBC for these accounts in case banks are unable to agree upon a viable resolution plan within six months.

Speaking on the government's mega capital infusion plan, Reddy said its design will be crucial to ensure that it gives a fair deal to the existing promoters, private shareholders of the PSU banks and the bond market in general.

The government last month announced plans to inject Rs 2.11 lakh crore of equity in the PSU banks — comprising of Rs 1.35 lakh crore through recapitalisation bonds, Rs 18,000 crore from budgetary resources and Rs 58,000 crore to be raised by the banks from the market. Reddy said that the difference in performance of the public and private sector banks should be attributed to governance levels in the types of banks.

To a question whether the RBI needs to lower policy rate in order to boost economic growth, Reddy said the answer is not easy since it is not clear whether lower rates will boost real activity. If a reduction in interest rates improves real economic activity, without reducing financial savings, then the RBI should cut interest rates, he said.

RBI asking banks to take cos to NCLT not correct: YV Reddy

STATESMAN NEWS SERVICE
NEW DELHI, 3 NOVEMBER

Former Reserve Bank of India Governor YV Reddy said today that the Central bank's approach of using unconventional ways to prod banks to take defaulting companies to NCLT for resolution is "in principle not correct". He added that this was "not a normal measure" and should be used only for a limited time.

Delivering the 20th JRD Tata Memorial Lecture organised by Assocham, Mr Reddy said: "In the normal situation it is a responsibility of the (bank) board to do this (NPA resolution). You have an extraordinary situation, where the problem is essentially in the public sector banks, for which the owner is the sovereign.

"So the sovereign owns the banks, the sovereign passes the law, the sovereign owns the regulator. In principle, I agree with

On about the recent Rs 2.11 lakh-crore mega recapitalisation boost for public sector banks over a period of two years announced by the government, Mr Reddy said it was the Centre's responsibility to scour for funds for the public lenders and that is what it was exploring

you that it is not correct (of RBI asking banks to take companies to NCLT)."

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He added that its success will depend on the design of the bonds as it is critical for the PSBs.

On one year of the government's demonetisation move, Mr Reddy said there had been much debate on the

issue.

"It is such a measure that there would be short-term pain and medium-term gains. It's not complete yet. We have seen the pain in short term and are yet to see the medium-term gains," the former RBI Governor noted.

On whether the RBI needs to lower policy rate in order to boost economic growth, Mr Reddy said the answer is not easy since it is not clear whether lower rates will boost real activity.

If a reduction in interest rates improves real economic activity, without reducing financial savings, then the RBI should cut interest rates, he said.

Reddy calls for 'appropriate' bank merger for desired results

NEW DELHI: Sounding a note of caution on bank consolidation, former RBI Governor Y V Reddy on Friday said there is a need to take 'appropriate' decision in this regard as by simply merging a strong bank with a weak one will not produce the desired result.

Reddy also said that there should not be too much clam-

our for cut in interest rates as it would adversely impact bank deposits and push current account deficit (CAD) higher.

"Suppose there is PSB bank A, and if there is a structural problem in bank B; by marrying them, will the structural problem be solved? That's my answer for bank consolidation," he said while answering questions on bank

consolidation on the sidelines of J R D Tata Memorial Lecture organised by Assocham. Reddy further said the right question to ask should be "whether in that particular case it (merger) is appropriate".

The former RBI Governor wondered whether merging a strong bank with another strong one would make the

merged entity stronger.

He further noted that if a weak bank is consolidated with another weak bank then it is not sure whether the weak bank would become strong.

The government had set up a Alternative Mechanism (AM) headed by Finance Minister Arun Jaitley to oversee the consolidation in the public sector banks. PTI

Appropriate bank merger needed for results: Reddy

SOUNDING A NOTE of caution on bank consolidation, former RBI governor YV Reddy on Friday said there is a need to take 'appropriate' decision in this regard as simply merging a strong bank with a weak one will not produce the desired result. "Suppose there is PSB bank A, and if there is a structural problem in bank B; by marrying them, will the structural problem be solved? That's my answer for bank consolidation," he said on the sidelines of JRD Tata Memorial Lecture.

