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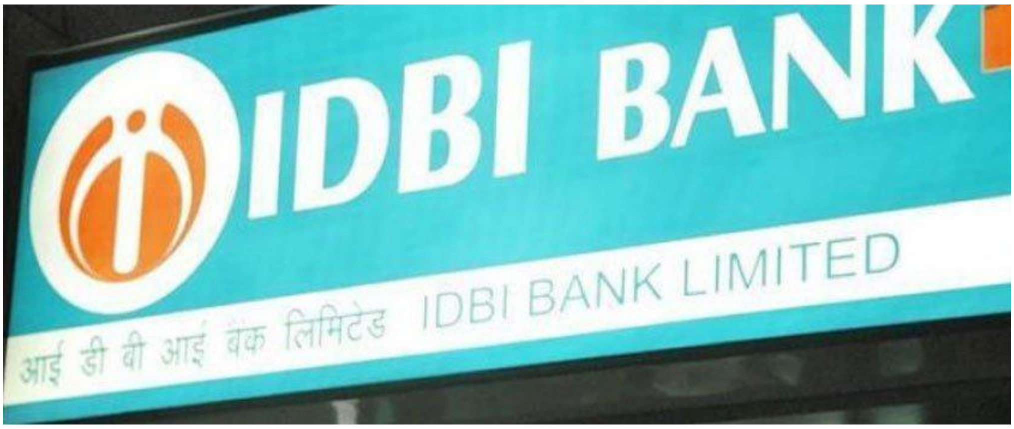
How IDBI fell in huge NPA trap in 20 years after bailout from government

Moneylife Digital Team 30 November 2017 17



Pointing out the faulty lending policies as main reason for huge non-performing assets (NPAs) for public sector banks (PSBs), the Public Accounts Committee (PAC) of Lok Sabha, has **expressed shock on how IDBI Bank fell in debt trap in 20 years after the government cleared its balance sheet.**

In its report on Stressed Assets Stabilisation Fund (SASF) for IDBI Bank, which was presented to the Lok Sabha on 18 July 2017, the PAC said, "... **the creation of SASF, mergers, capital infusions are not able to address the problem of rising NPAs** and now the government would have to think innovatively for a long-term solution."

"The Committee, therefore, desire that after analysing the sectors where NPAs are rampant, insurance of the loans may be made mandatory for those sectors and since personal guarantees and securities are also not yielding desired results, professional bodies may be engaged for underwriting the loans and the collaterals should be mandatorily insured. The Committee while acknowledging that this will increase the cost of loans, desire that incentives may be offered, at the time of payment of last instalment, for borrowers who pay off their loans timely.

The Committee exhort that **exemplary punishment should be awarded to the officials who work in tandem with big corporate and siphon off the money of public exchequer without adequate collaterals or personal guarantees**," the PAC headed by Mallikarjun Kharge, said in its report.

During 2004, the government created Stressed Assets Stabilisation Fund (SASF) as Trust or special purpose vehicle to acquire stressed assets of IDBI and recover NLO dues against these assets.

At first, **636 non-performing assets** (NPAs) with a net loan outstanding (NLO) of **Rs. 9,004 crore** of IDBI Bank was transferred to SASF.

The government, then provided Rs 9,000 crore to SASF, which in turn were invested in government securities, redeemable in 20 years and pledged back in securities with IDBI. However, as on FY2015-16, government securities of only Rs 4,515 crore were redeemed as against a balance of Rs 4,486 crore. Highest recovery of Rs 927.68 crore was effected in 2006-07. The PAC noted that bulk of the recovery of Rs 2,608.29 crore was effected in initial period between FY2006 to FY2008.

The Committee report also reveals that audit of SASF was entrusted to Comptroller and Auditor General (CAG) in May 2013, almost eight years after it was set up. The CAG Audit pointed out several deficiencies in managing SASF, including delay in entrusting Audit, inadmissible exchange of cases between SASF and IDBI and ineffective personal guarantees owing to absence of income and property details, not ascertaining net worth or income of promoters for settling accounts and short recoveries.

In 10 cases, the settlement amount or amount recovered was below the net loan outstanding (NLO) amount aggregating to short recovery of Rs 1,590.49 crore. Out of the 10 cases, in one case of SIV Industries Ltd, valuation of assets was not done and consequently the share of the Trust was also not available. In the case of SJK Steels Plant Ltd, pro-rata share of the Trust (SASF) was not available. Since the Policy provided that value of security including collaterals available (on pro-rata basis) as also amount of statutory liabilities and workers' dues, was the basis of settlement amount, it was essential to carry out valuation to know the potential for recovery. The steel sector companies are major defaulters and the Trust has taken substantial hit.

For instance, in respect of Malavika Steep Ltd and Usha Ispat Ltd promoted by Vinay Rai and Anil Rai of Usha Group, the settlement amount is only Rs 41.78 crore (7.03%) and Rs 48.07 crore (14.94%) as against NLO of Rs 594.54 crore and Rs 321.80 crore, respectively. The Trust in spite of having personal guarantees from the promoters of various borrowing companies did not try to ascertain the net worth of the promoters to realise optimum sum.

The PAC, while looking at 21 settled cases, observed substantial short recovery where the settlement amount was lower by Rs 587.47 crore when compared with NLO of Rs1,144.64 crore. It stated, "Although personal guarantees of some of the promoters of the firms were available with the SASF, the SASF did not make efforts to ascertain the net worth. Income of the promoters before arriving at the settlement amount. Thus such settlements below NLO, without assessing the financial capability of the promoters actually benefitted the promoters."

The PAC said, in 36 out of 39 unresolved cases selected by Audit for examination, the SASF could recover only Rs 150.54 crore as against NLO of Rs 1,888.69 crore. "The short recovery in these cases was to the tune of Rs 1,738.14 crore. The (CAG) Audit analysis of the shortlisted 39 cases reveal that in 11 cases, personal guarantees were taken from the promoters/ borrowers and only on four cases property details were available and the SASF also did not collect the income tax returns from the guarantors…The Committee, while looking at the cases, took note of the fact that there are substantial number of cases where recovery has been made below NLO.

The Committee express strong displeasure and direct the Ministry (of Finance) to look in to all such cases where settlement below NLOs have been approved and fix responsibility of the officers responsible for the same," the report says.

In December 2016, the Reserve Bank of India (RBI) placed IDBI Bank under prompt corrective action (PCA) for breaching two thresholds, high net NPA and negative return on assets (RoA) as on 31 December 2016. As on December 2016, net NPA of IDBI Bank at Rs 20,649 crore constituted 9.61% of total net advances of the Bank. "Further," the **PAC said, "increasing gross NPA and net NPA of IDBI Bank at Rs 44,752 crore (21.25%) and Rs 25,206 crore (13.21%), respectively as on March 2017 compared with gross NPA of Rs 24875 crore (10.98%) and net NPA of Rs14,643 crore (6.78%) as on March 2016, are indeed alarming".**

"The Committee is shocked to note that in less than 20 years after the government cleared the balance sheet of IDBI, it has again fallen into debt trap of NPA. **The Committee is of the considered opinion that the huge NPA of the PSBs point towards their faulty lending policies**," the PAC added.

How the new financial regulation law will affect the banking sector

The RBI's regulatory role could be undermined. Deposits of customers could be used to bail-in banks reeling under corporate defaults.

Sruthisagar Yamunan **Scroll.in** **3 Dec 2017**

Are the savings people slowly accumulate in their bank accounts safe? This question seems inherently counter intuitive. Banks are always associated with financial security. Anyone who deposits money in their bank accounts expects the financial institution to give them back their money when they want to withdraw it.

However, what if the financial situation of the bank deteriorates so much that it becomes unable to repay the deposits it holds? This situation of a sick bank was envisaged as far back as 1961, when the Indian Parliament passed the Deposit Insurance and Credit Guarantee Corporation Act.

Under that law, deposits of up to Rs 1 lakh, including interest, are protected by the insurance cover that the bank takes. This means that the payment of all deposits up to Rs 1 lakh are guaranteed even if the bank sinks. Anything over and above Rs 1 lakh does not have this protection, which means there is a theoretical possibility that a bank account holder with a large deposit might lose a lot of money if the bank goes down.

However, this has never happened since 1961. Figures from banking unions suggest that the 21 public sector banks, which corner 82% of the banking business in India, together pay about Rs 3,000 crores as insurance premium on deposits to the Deposit Insurance and Credit Guarantee Corporation, a subsidiary of the Reserve Bank of India. This framework, however, is all set to witness a significant shake up when Parliament takes up the Financial Resolution and Deposit Insurance Bill, 2017, for legislative approval, possibly in the upcoming Winter Session itself.

Banking unions have stridently opposed this bill for a variety of reasons. The unions said in a joint statement last month that the proposed law will open up public sector banks for liquidation or amalgamation, which could put the deposits of customers under severe risk. Worse, provisions dealing with deposit insurance are ambiguous in the draft law, with no explanation on the amount to be insured by the banks.

The bill also provides for a bail-in option, which means depositors could lose control of their money – essentially be forced to bear a loss on their holdings – which could be converted into securities such as shares in the bank in case the bank's financial situation deteriorates.

Over and above these concerns, some people in the banking sector also feel that the new law erodes the powers of the Reserve Bank of India substantially by creating what is called a Resolution Corporation, which will oversee all matters relating to restructuring of these financial institutions.

The new law

A joint parliamentary committee is currently studying the draft Financial Resolution and Deposit Insurance Bill, 2017. The committee is expected to come out with its report soon, following which the bill is likely to be taken up for legislative approval in Parliament.

The locus of the proposed law could be found in the February 2016 Budget speech of Union Finance Minister Arun Jaitley, who said that the government was keen on setting up a framework that would instill better financial discipline among banking institutions and make stronger provisions to protect public money.

Matters moved swiftly after this announcement. A committee under Ajay Tyagi, additional secretary of the Department of Economic Affairs, was set up in March 2016. The committee released the draft law in September that year. The government gave the public less than 20 days to comment on the draft bill, and this process of discussion was closed on October 14, 2016. The following June, the Union Cabinet cleared the bill, which was later tabled in Parliament in August, just a day before the Monsoon Session came to an end.

Political parties, including the Congress and the Trinamool Congress, expressed their displeasure at the manner in which the bill was tabled and also criticised the move to form a new joint committee to study the draft when a select committee for finance was already available.

The Resolution Corporation

The primary concern expressed by banking unions is the provision in the law that creates a new Resolution Corporation.

C.H Venkatachalam, general secretary of the **All India Bank Employees Association, s**aid that so far, the Reserve Bank of India had exclusive powers to determine the financial health of a bank and recommend remedial measures in case banks got into financial trouble. But the proposed Resolution Corporation will usurp this crucial power, thereby weakening the regulatory role of the Reserve Bank of India.

"The new law seeks to amend all exclusive laws governing financial institutions, including the State Bank of India Act," he said.

The proposed Resolution Corporation will determine if there is an "imminent risk" of the bank failing financially and will trigger what it feels would be the right remedy. It will also replace the Deposit Insurance and Credit Guarantee Corporation and take over the role of providing deposit insurance.

According to Chapter II of the bill, the corporation will have a chairperson and one representative each as ex-officio member from the finance ministry, the RBI, the Securities and Exchange Board of India and the Insurance Development and Regulatory Authority. It will also have a maximum of three full-time members appointed by the Union government, and two independent members. Banking unions said that the very composition of the corporation will give supreme powers to the Union government rather than the RBI to determine the fate of a bank.

Thomas Franco of the State Bank of India union said that the new bill raised a larger systemic question. "The State Bank of India Act makes it clear that the bank cannot be liquidated," he said. "The new law is getting rid of this important provision."

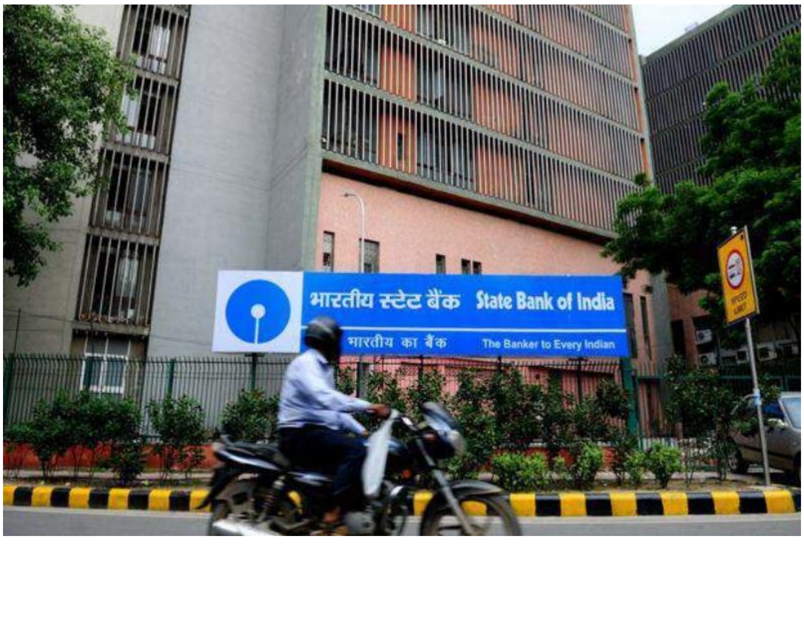
Franco added that the Bill, in the form it is currently in, looks like the launching pad for further diluting public sector banks. "Instead of taking on the non-performing assets problem, which was created by corporate defaulters, the government is attempting dilution of banks," he said.

The government, however, has consistently maintained, as seen from the objectives of the bill itself, that the new law will only bring in more financial discipline. It will complement the new bankruptcy code put in place in 2016 that aims at recovering defaulted loans.

Venkatachalam pointed out that the law gives all powers to the Company Law Tribunal in case of liquidation. This, in the context of public sector banks, is unwarranted. "The public sector banks are currently not covered under the Companies Act," he said. "So why this provision? They should continue to be governed exclusively by the Banking Regulations Act."

Under the proposed law, no court other than the Company Law Tribunal will be able to take cognisance of disputes on liquidation.

There is also a major concern of the violation of labour rights. There are clauses in the bill that enable the Resolution Corporation to terminate employment or change the compensation structure of bank employees when the bank goes through various stages of resolution. The employees may not be able to claim compensation for loss of employment, which, unions said, is a direct violation of the right to constitutional remedies guaranteed under Article 32 of the Constitution.



The bail-in clause

The bail-in clause included in the proposed law is perhaps the provision that immediately affects depositors.

A bail-in clause is one where the creditors of the bank would be forced to bear a part of the loss in case the institution sinks. All depositors are considered creditors in banking terms. In fact, they are unsecured creditors, in the sense that no depositor seeks security from banks while making their deposits. The bank uses these deposits to extend loans and earn interest.

Under the proposed bill, a bail-in will be triggered in consultation with the appropriate regulator, which in the case of banks would be the RBI, if the proposed Resolution Corporation is satisfied that a bank needs a dose of capital to absorb losses and continue to function without breaking down. This clause excludes insured deposits, which, under existing rules, means a sum of up to Rs 1 lakh with interest would be protected. The rest of the amount could be converted into securities like stocks of the bank.

A senior banking executive of the Indian Bank said on condition of anonymity that this was perhaps an improvement from the existing scenario, where amounts over Rs 1 lakh would be lost completely. “Your money will be converted into a security instead of being lost,” the banker said.

But Franco is not convinced by this argument. “There is an assumption here that the bank will recover after the capital infusion,” he said. “What if it doesn’t? What will be the worth of the equity then?”

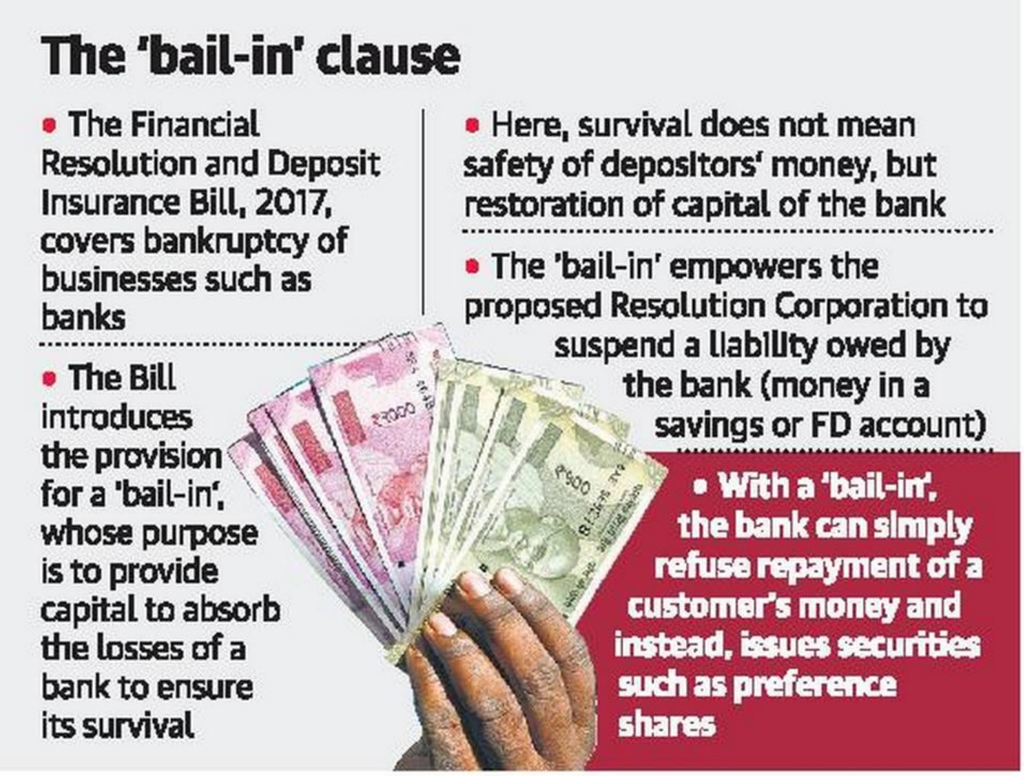
Also, depositors put their money in public sector banks because they know the government will bail out the bank if it collapses. But through the new bill, the government is virtually indicating that there will be no bail out from its side.

“This bail-in provision will only create panic,” said Franco. “The moment news gets out that a bank is financially sick, there will be a rush to take deposits out as confidence of a government bail- out does not exist." This will only expedite the fall of the bank.

Those opposing the new law argue that its fundamental idea is to transfer the burden of non-performing assets created by corporate defaulters to the common people. **"Bail-in means bailing out big corporate defaulters," Venkatachalam alleged**

FM seeks to allay depositors' fears, hints at review of Bill

SPECIAL CORRESPONDENT NEW DELHI, DECEMBER 02, 2017



'The Financial Resolution and Deposit Insurance Bill could undergo corrections'

Bank depositors' fears about the safety of their savings — once the Centre enacts the proposed new law for resolving financial entities' bankruptcy — may be premature as the legislation is still at the drafting stage and could see several 'corrections' before its passage, Finance and Corporate Affairs Minister Arun Jaitley said on Friday.

Expected to be tabled in Parliament's winter session that starts on December 15, the Financial Resolution and Deposit Insurance (FRDI) Bill of 2017 proposes scrapping the Deposit Insurance and Credit Guarantee Corporation (DICGC) that guarantees repayment of all bank deposits up to Rs. 1,00,000 in case a stressed bank is liquidated.

Ambiguity over savings

There is ambiguity on how depositors' savings will be protected in stressed banks and other financial entities under the new law, which also includes a 'bail-in' option to resolve financial entities' stress. A bail-in option entails a bank issuing securities in lieu of the money deposited in its coffers. Asked about the implications of this clause, Mr. Jaitley said the drafting process of the Bill was still under way and it could be reviewed as part of the regular drafting process for new legislation. "The Bill still has to go through the overall drafting process. The Parliamentary committee can offer drafting suggestions. Thereafter it will go back to the Cabinet," Mr. Jaitley said.

Will seek feedback

"The Cabinet will place the recommendations in the public domain and ask for feedback. So I think a lot of corrections will take place," the Minister said. Instead of the DICGC, the Bill envisages a Resolution Corporation under the Finance Ministry with representatives from the stock market and banking, insurance and pension fund regulators. Lenders, which have to pay a premium to the DICGC for insuring deposits of up to Rs. 1 lakh, would have to pay a sum to the Resolution Corporation as per the proposed Bill. But it is silent on the insured amount.

"The Corporation shall, in consultation with the appropriate regulator, specify the total amount payable by the Corporation with respect to any one depositor, as to his deposit insured under this Act, in the same capacity and in the same right," the draft Bill states, creating doubts about the extent of deposits that will be guaranteed as also whether depositors may face varying degrees of haircuts or writedowns on their savings at different stressed entities.

The Corporation will be given a year's time to resolve problems facing firms in trouble.

Promoters bidding for IBC assets have to first pay up dues: Arun Jaitley

NEW DELHI: 30 11 2017 ECONOMCI TIMES

Clearing the air on bar on founders from repurchasing stressed assets, Finance Minister Arun Jaitley today said promoters can bid in the auctions provided they pay the dues on their NPA accounts.

He said there is no blanket bar on promoters from bidding for delinquent companies that are being sold to recover bank dues. Only those who have not serviced their loan accounts by not even paying the interest on loans have been barred.

Tightening rules to prevent errant founders from misusing the 11-month-old bankruptcy law to regain control, the government earlier this month barred promoters whose borrowings have been classified as non-performing for a year or more and that are unable to pay overdue amounts, including interest and charges.

Jaitley said that although certain countries have insolvency laws wherein defaulting promoters are allowed to bid for their own company, the political process in India would not have accepted a situation wherein banks take a substantial haircut only to have the same promoters back.

"The IBC process will go on and we have not barred them completely. There is no blanket bar. All it says is that if you have a nonperforming account on the day of bid please make it a performing account. Standardise your account...

"If somebody says I owe the bank money, but I won't pay the money, I won't even service, but at half the cost I want my company back, I don't think in India it is going to be acceptable," he said at the HT Leadership Summit here.

He said the political opinion in India would not have supported the functioning of the Insolvency and Bankruptcy Code (IBC) if after the substantial haircut the same promoter who ran the company and is a loan defaulter won the firm back.

"Nothing would have changed except that bank would have taken a hit. Now if in the initial number of cases these would have happened and banks take the hit and same people were back again, I don't think the political process in India would have ever supported the IBC," Jaitley said.

The RBI had in June referred 12 steel manufacturers, power and construction companies with over Rs 5,000 crore of overdue loans each to insolvency courts. These include Bhushan Steel, Essar Steel, Lanco Infratech, Monnet Ispat and Electrosteel, for resolution under this law.

In several of these cases, the original promoters themselves are among the bidders.

Amid rising concerns that a defaulting promoter could wrest back control of the company that is under insolvency even as banks take a hit on the loans, the government promulgated an ordinance to amend the IBC.

As per the ordinance, those who have their accounts classified as non-performing assets (NPAs) for one year or more and are unable to settle their overdue amounts include interest thereon and charges relating to the account before submission of the resolution plan would be ineligible to bid in the auctions.

Corporates, promoters, holding companies, subsidiaries, and associate companies or related parties undergoing insolvency resolution or liquidation under the IBC would not be eligible for bidding for the stressed assets.

AIBEA THIS DAY – 4 DECEMBER	
1921	**Com. P K Janardhanam Pillai, former Asst. Secretary, AIBEA, Founder General Secretary, TNBEF (date of birth)**
1922	**Com. P R Bhatia, former Vice President, AIBEA (date of birth)**
1980	**Understandings on major issues reached -5th Bipartite agreement.**
2007	**Badge wearing, solidarity to sponsoring committee of trade unions agitations**

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