AIBEA's Banking News

11, 12 JANUARY, 2021

NEWS BULLETIN FROM ALL INDIA BANK EMPLOYEES' ASSOCIATION

Banks' gross NPAs may rise to 13.5% by Sept: Financial stability report

Banks will have to brace for a rollback of regulatory forbearance that was announced in the wake of Covid-19, and enhance their capital positions, the RBI said

Abhijit Lele & Raghu Mohan | Mumbai
January 12, 2021 BUSINESS STANDARD

The FSR mentioned that "stress test results indicate that four banks may fail to meet the minimum capital level by September 2021 under the baseline scenario, without factoring in any capital infusion by stakeholders

The Reserve Bank of India's (RBI's) Financial Stability Report (FSR) of December 2020 has stated that banks' gross non-performing assets (GNPAs) may rise sharply to 13.5 per cent by September 2021, and escalate to 14.8 per cent, nearly double the 7.5 per cent in the same period of 2019-20, under the severe stress scenario.

And banks will have to brace for a rollback of regulatory forbearance that was announced in the wake of the pandemic, and enhance their capital positions.

The FSR, released on Monday, gave a caveat: "Considering the uncertainty regarding the unfolding economic outlook, and the extent to which regulatory dispensation under restructuring is utilised, the projected ratios are susceptible to change in a nonlinear fashion".

This suggests that the RBI's forbearance measures may not be giving an accurate picture on the stress currently.

In his foreword, RBI Governor Shaktikanta Das noted: "Stretched valuations of financial assets pose risks to financial stability. Banks and financial intermediaries need to be cognisant of these risks and spillovers in an interconnected financial system."

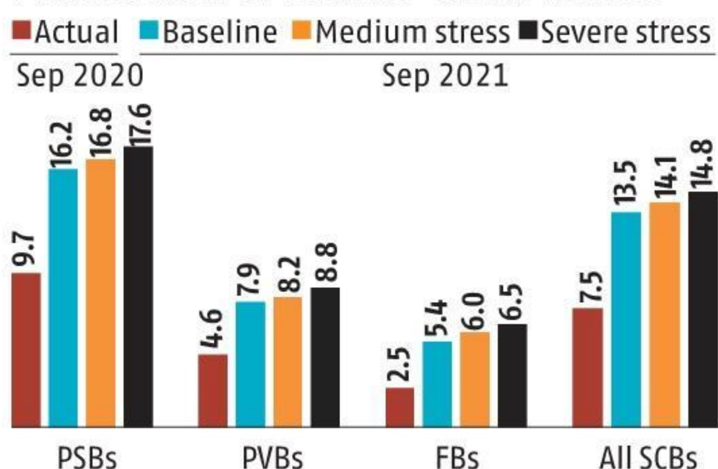
The growing disconnect between certain segments of financial markets and real sector activity, pointed out in the last FSR (June 2020), has got further accentuated, with abundant liquidity spurring a quest for returns. Within the financial market spectrum too, the divergence in expectations in the equity market and the debt market has grown.

State-run banks are seen being the worst-affected among bank groups with their GNPA ratio expected to increase to 16.2 per cent by September 2021 under the baseline scenario from 9.7 per cent in September 2020. And to a high of 17.6 per cent in a severe stress scenario.

The implications for capital adequacy (cap-ad) are as follows. Systemic cap-ad is projected to drop to 14 per cent in September 2021 from 15.6 per cent in September 2020 under the baseline scenario and to 12.5 per cent under the severe stress scenario.

The FSR mentioned that "stress test results indicate that four banks may fail to meet the minimum capital level by September 2021 under the baseline scenario, without factoring in any capital infusion by

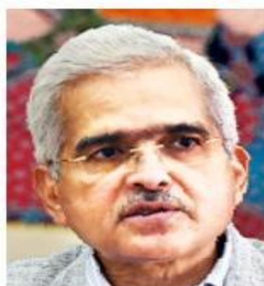
stakeholders. In the severe stress scenario, the number of banks failing to meet the minimum capital level may rise to nine”.



Source: RBI

WARNING BELLS

- **Systemic capital-adequacy may fall to 14% in Sept 2021 from 15.6%** in Sept 2020 under the baseline scenario, and to 12.5% under severe stress scenario
- **Four banks may fail to meet minimum capital level by Sept 2021 under the baseline scenario,** without factoring in any capital infusion by stakeholders.
- **In severe stress scenario,** this could rise to nine banks
- **Centre may have to fast-track** the recapitalisation of state-run banks
- **Credit by NBFCs grew by mere 4.4%,** as against 22% in 2018-19



"STRETCHED VALUATIONS OF FINANCIAL ASSETS POSE RISKS TO FINANCIAL STABILITY. BANKS AND FINANCIAL INTERMEDIARIES NEED TO BE COGNISANT OF THESE RISKS"

Shaktikanta Das, RBI governor

The FSR has also made a tweak.

In the last FSR, a one-time additional scenario of “very severe stress” was introduced in view of the uncertainty around the pandemic, its economic costs, and delay in the data-gathering process. With a better appraisal of

the pandemic's impact on economic conditions, it is assessed that the worst is behind us, though the recovery path remains uncertain. Accordingly, stress tests have reverted to the regular 3-scenario analysis in this issue.

The FSR does not explicitly refer to recapitalisation, but noted the pandemic threatened to result in balance sheet impairment and capital shortfalls, especially as regulatory reliefs are rolled back.

"In addition, banks will be called to meet the funding requirements of the economy as it traces a revival from the pandemic," Das added in his foreword.

This basically is a reiteration of the RBI's position in its Report on Trend and Progress of Banking in India (2019-20), which said "the modest GNPA ratio of 7.5 per cent at end-September 2020 veils the strong undercurrent of slippage".

The accretion to NPAs in accordance with the RBI's income recognition and asset classification norms would have been higher in the absence of the asset quality standstill provided as a pandemic relief measure. And that given the uncertainty induced by the pandemic and its real economic impact, the asset quality of the banking system may deteriorate sharply.

The FSR hinted the Centre might have to fast-track the recapitalisation concerns of state-run banks without referring to the subject directly.

"Banks have sufficient capital at the aggregate level even in the severe stress scenario but, at the individual bank level, several banks may fall below the regulatory minimum if stress aggravates to the severe scenario."

With the stress tests pointing to deterioration in the asset quality of banks, an early identification of impairment and aggressive capitalisation are imperative for supporting credit growth across various sectors, alongside pre-emptive strategies for dealing with potential NPAs. Dividend earning from state-run banks is uncertain because the RBI has said that banks are not to make any dividend payment on equity shares from the

profits pertaining to the financial year ended March 31, 2020, so that they can support lending.

Banks need to prepare for these adversities by augmenting their capital base.

While easy financial conditions are intended to support growth prospects they can have unintended consequences like encouraging leverage, inflating asset prices and fuelling threats to financial stability, the report said.

As for non-banking financial companies (NBFCs), credit given by NBFCs grew by a mere 4.4 per cent as compared with 22 per cent in 2018-19. Gross NPAs of NBFCs increased to 6.3 per cent on March 2020 from 5.3 per on March 2019. Asset quality is expected to deteriorate due to disruption in business operations caused by the pandemic, especially in the industrial sector, one of the major recipients of NBFC credit.

Indian banks' bad loans may rise significantly: Financial stability report

Indian banks may see bad loans double despite signs of an improvement in the economic impact of the Covid-19 pandemic

Reuters | MUMBAI January 11, 2021

Representational image of non-performing assets (NPAs)

Indian banks may see bad loans double despite signs of an improvement in the economic impact of the COVID-19 pandemic, a report from the Financial Stability and Development Council said on Monday.

The gross Non-Performing Assets of banks may increase from 7.5% in September 2020 to 14.8% under a severe stress scenario. Even under a baseline scenario it may rise to 13.5% by September 2021, the council said.

"It is assessed that the worst is behind us, though the recovery path remains uncertain," the council's Financial Stability Report released by the Reserve Bank of India said.

The council is an umbrella group of regulators and releases the FSR report twice yearly to give a detailed overview on the health of the Indian financial system.

RBI Governor Shaktikanta Das said in his foreword to the report that maintaining the financial health of banks remained a priority and that lenders must look at raising capital and altering their business models to sustain future expansion.

The report also highlighted the challenges to the banks' capital positions and said four lenders might fail to meet the capital requirement by September under a baseline scenario and could rise to nine banks in a severe stress scenario.

The central bank did not give the names of the lenders it was concerned about nor elaborate on the different scenarios.

NPA vigil has improved corporate culture

Srinivas Dindi | January 10, 2021

THE HINDU BusinessLine

The government measures and RBI provisioning norms have helped India Inc cope with Covid

Indian corporates have so far been able to weather the Covid shock. This provides occasion to take stock on how corporate credit evolved over the last decade, enabling corporates to face the current unprecedented stress.

Indian corporates emerged relatively unscathed from the 2008 Global Financial Crisis and entered into the last decade with hope driven by huge infrastructure opportunities thrown up by the government.

The absence of development financial institutions did not deter banks from funding these ventures despite maturity mismatches of assets and liabilities. Corporates which could bag bids had floated number of SPVs which were literally single asset companies with no restrictions on the part of the parent to extend corporate guarantee.

Banks were also not aware of the serious implications going forward if the underlying asset did not perform.

The going was good till these assumptions proved to be optimistic. At the same time, a number of scams had surfaced during the UPA II regime. While nothing concrete could be proved except in a few cases, it had an adverse impact on the economic environment, deflating the overall sentiment and leading to policy paralysis.

Intervention of courts

Courts also had to intervene in the interest of natural justice cancelling mining licences which had further dampened the sentiment. All these factors led to stress in the corporate balance sheets which in turn resulted in stressed bank balance sheets.

Promoters who could siphon off/divert funds, started showing a disinclination to resolve the stress, leaving it to banks. In turn, banks resorted to restructuring loans to ensure there was no dilution of NPV which provided for maintaining asset quality as standard, while the resolution plan was neither helping corporates nor banks in the long run. Subsequently, however, the tide turned.

At this juncture, the then RBI Governor Raghuram Rajan coined the term 'Skin in the Game', bringing in a series of measures. These included:

reporting of irregularity/default to Central Repository of Information on Large Credits (CRILC) for sharing of information among banks/FIs; disbanding CDR mechanism and transferring the responsibility of stress resolution to a consortium of banks under Joint Lenders Forum (JLF) while minimising the policy intervention from the RBI; 5/25 scheme with an option to refinance every five years depending upon cash flow visibility to ease the asset-liability mismatch for banks; Strategic Debt Restructuring with a change of management bringing in the concept of sustained and unsustained debt, etc.

Though all these were withdrawn subsequently, they brought in some discipline and change in thought process among bankers as well as promoters.

A landmark regulation at this stage was to treat restructured accounts as NPAs which, in the short term, proved to be a pain point for both banks and corporates. But both are now reconciled to this and are keen to establish viability before being subjected to restructuring.

The government's Insolvency and Bankruptcy Code is another landmark initiative to distinguish unviable entities and proceed with liquidation.

Similarly, with demonetisation and GST implementation, while battles were lost in the form of adverse impact on unorganised cash economy, the larger battle was won as reflected in increased digital payments and financial inclusion.

Banks have been leveraging technology to improve due diligence and monitoring functions. All these measures have instilled a sense of discipline among promoters who now need to have the wherewithal to withstand losses or risk losing their companies.

All these measures have made corporates resilient over a period and helped them withstand the impact of Covid.

There has been a gradual improvement in solvency, gearing and liquidity ratios of corporates over the last decade.

This fact is also reflected in the relatively low number of corporates opting for restructuring under Covid norms and promoters trying to avoid the tag of a 'restructured account'.

RBI raises concerns over zero-coupon bond for PSB recapitalization

PTI New Delhi | January 10, 2021

The government resorted to recapitalisation bonds with a coupon rate for capital infusion into PSBs during 2017-18 and interest payment to banks for holding such bonds started from the next financial year

The Reserve Bank of India (RBI) has expressed some concerns over zero-coupon bonds for the recapitalisation of public sector banks (PSBs) and discussion is on between the central bank and Finance Ministry to find a solution, according to sources.

The government resorted to recapitalisation bonds with a coupon rate for capital infusion into PSBs during 2017-18 and interest payment to banks for holding such bonds started from the next financial year.

To save interest burden and ease the fiscal pressure, the government has decided to issue zero-coupon bonds for meeting the capital needs of the banks.

The first test case of the new mechanism was a capital infusion of Rs 5,500 crore into Punjab & Sind Bank by issuing zero-coupon bonds of six different maturities last year. These special securities with tenure of 10-15 years are non-interest bearing and valued at par.

However, the RBI has raised some issues with regard to calculation of an effective capital infusion made in any bank through this instrument issued at par, the sources said.

Zero-coupon bond

Since such bonds usually are non-interest bearing but issued at a deep discount to the face value, it is difficult to ascertain net present value, they added.

The discount calculation may vary, which could lead to accounting adjustment, the sources said, adding both the Finance Ministry and RBI are in discussion to resolve the issue.

As these special bonds are non-interest bearing and issued at par to a bank, it would be an investment, which would not earn any return but rather depreciate with each passing year.

Parliament had in September 2020 approved Rs 20,000 crore to be made available for the recapitalisation of PSBs. Of this, Rs 5,500 crore was issued to Punjab & Sind Bank and the Finance Ministry will take a call on the remaining Rs 14,500 crore during this quarter.

This innovative mechanism will help ease the financial burden as the government has already spent Rs 22,086.54 crore as interest payment towards the recapitalisation bonds for PSBs in the last two financial years.

During 2018-19, the government paid Rs 5,800.55 crore as interest on such bonds issued to public sector banks for pumping in the capital so that they could meet the regulatory norms under the Basel-III guidelines.

In the subsequent year, according to the official document, the interest payment by the government surged three times to Rs 16,285.99 crore to PSBs as they have been holding these papers.

Under this mechanism, the government issues recapitalisation bonds to a public sector bank which needs capital. The said bank subscribes to the paper against which the government receives the money. Now, the money received goes as equity capital of the bank.

So the government doesn't have to pay anything from its pocket. However, the money invested by banks in recapitalisation bonds is classified as an investment which earns them an interest.

In all, the government has issued about Rs 2.5 lakh crore recapitalisation in the last three financial years. In the first year, the government issued

Rs 80,000 crore recapitalisation bonds, followed by Rs 1.06 lakh crore in 2018-19. During the last financial year, the capital infusion through bonds was Rs 65,443 crore.

Remaining impact of provisions under divergence at Rs.358 crore: BoI

Our Bureau - Mumbai | January 08, 2021

THE HINDU BusinessLine

Bank of India (BoI), on Friday, said the remaining impact of provisions under divergence as per the Reserve Bank of India's (RBI) Risk Assessment Report (RAR) for the year 2019-20 is Rs.358 crore.

Referring to the report of divergence in the asset classification and provisioning for non-performing assets (NPAs) as per the RBI's RAR for the year 2019-20, the public sector bank said out of the Rs.930-crore provisions under divergence, it has already made provision of Rs.572 crore during the current financial year.

In its comments, BoI observed that total provisions under divergence is Rs.930 crore, which includes divergence in provision for NPA of Rs.394 crore, provision for investments of Rs.23 crore, and shortfall in standard asset provisioning of Rs.513 crore.

The divergence in gross NPA and net NPA as reported by the bank and as assessed by the RBI for FY20 was Rs.63 crore each.

The divergence in provisions for NPA as reported by the Bank and as assessed by RBI for FY20 was Rs.394 crore, the bank said in its regulatory filing.

After taking into account the divergence in provisioning, the bank's net loss increased to Rs.3,886.89 crore against Rs.2956.89 crore reported in FY20, as per the filing.

RBI to restore normal liquidity management operations in a phased manner

Our Bureau - Mumbai | January 08, 2021

THE HINDU BusinessLine

To conduct variable rate reverse repo auction for Rs.2-lakh cr

The Reserve Bank of India (RBI), on Friday, said it will conduct a Variable Rate Reverse Repo auction of 14-day tenor, aggregating Rs.2-lakh crore, on January 15, as part of its decision to restore normal liquidity management operations in a phased manner.

Through this auction, the RBI is seeking to suck out excess liquidity in the banking system, which, as on January 7, 2021, stood at Rs.7,09,041 crore, going by the funds parked in the one-day reverse repo auction.

Marzban Irani, CIO-Fixed Income, LIC Mutual Fund, said: "The RBI is gradually sucking out liquidity. Short-term yields of money market papers, which are below reverse repo rate, will correct."

The Variable Rate Reverse Repo auction is being conducted under the revised Liquidity Management Framework issued on February 6, 2020.

This framework was temporarily suspended in the backdrop of the outbreak of Covid-19, the rapidly evolving financial conditions, and taking into account the impact of disruptions due to the lockdown and social distancing.

However, the window for Fixed Rate Reverse Repo and Marginal Standing Facility (MSF) operations were made available throughout the day. This was intended to provide eligible market participants with greater flexibility in their liquidity management.

"On a review of evolving liquidity and financial conditions, it has been decided to restore normal liquidity management operations in a phased manner.

"...The Fixed Rate Reverse Repo and Marginal Standing Facility (MSF) operations will continue to be available throughout the day," the central bank said.

The RBI reiterated that it will ensure availability of ample liquidity in the system.

Need to think beyond minimum support prices

PK Joshi & AK Padhee | January 9, 2021

The need is to consolidate farmers, either through cooperatives or FPOs, for producing demand-driven crops for export

The farm-agitations' demand to repeal the three farm laws and legalise minimum support prices (MSPs) baffle us, given the apprehensions over the impact of the laws on the farmers are mostly misplaced

The three new farm laws, since their enactment, have been a subject of intense debate and discussion, especially against the backdrop of the ongoing agitation by farmers mostly from north-west India. The negotiations between the farmers' groups and the Union government have been going on.

Our discussion entails the Farmers Produce Trade and Commerce (Promotion and Facilitation) Act. This law envisages free movement of farm produce from surplus to deficit areas across the country and frees restrictions for any such sale in the physical premises of APMC mandis. Moreover, this legislation also prohibits state governments from levying any market fee, when farmers trade their produce in an 'outside trade area'. The farm-agitations' demand to repeal the three farm laws and legalise minimum support prices (MSPs) baffle us, given the

apprehensions over the impact of the laws on the farmers are mostly misplaced.

Legalising MSP means the right to have minimum prices for 23 agricultural commodities for which the support-price is decided by the government, based on the recommendations of the Commission for Agricultural Costs and Prices (CACP). Legalising minimum prices means market and/or government must procure these declared agricultural commodities at guaranteed prices. When there is a surplus of any commodity, then prices will fall, and there will be no buyer to procure the produce. Then, the farmer has to retain the marketable surplus at his own cost and wait till the prices rise to dispose of the produce. This will obviously be very distressing for the farmers. Alternatively, the government has to procure the commodity at the declared prices. This is not feasible as the government has to create a huge network for procurement for all commodities throughout the year and arrange for stocking and disposal at prevailing (lower) market prices. The demand, therefore, seems illogical and impractical.

Scrapping the three farm laws will be disastrous for the entire agriculture sector, more so for the farmers. Repealing these laws means the continuation of 'business-as-usual', where farmers produce only those commodities that they have been producing since ages. Under the present arrangement, there is no incentive to conserve groundwater, improve efficiency, and diversify agriculture towards more remunerative commodities.

Here are a few examples from various parts of the country, where there is neither reliance on APMC markets nor the MSPs. Moreover, the farmers are small and marginal in these cases and cultivating market-driven high-value commodities. These groups of farmers cited below, are showing the ray of hope for a 'new agriculture' that is transforming into an 'agribusiness profession'. These farmers are producing market-driven commodities, improving resource use efficiency and minimising risks.

We start with the 'Abhinav Farmers' Club', which is a cooperative of about 850 farmers in Maharashtra. They are mostly small and marginal farmers, who have adopted frontier technologies and directly connect with markets (especially big retailers, e-retailers, hotels, etc). They produce flowers, Indian and exotic vegetables, fruits, milk, and dairy products. The members of the club do not rely on MSPs and APMC markets. The club has been responsible for changing the lives of the farmers who are a part of this organisation. The club also provides hands-on training to the farmers from other states.

The second example is 'Mahagrapes', a cooperative partnership firm established by the Maharashtra State Agricultural Marketing Board. Several Grape Growers' Cooperative Societies are part of it. The members of the cooperatives grow grapes for exports. Mahagrapes has become a brand name in European countries and middle-east markets. The farmers follow 'good agricultural practices', adopt improved plant genetic stock, and ensure pesticide-residue free grapes. The grape cultivation has not only increased incomes of the member farmers but also transformed the entire area, with developed infrastructure like pucca roads, good schools, hospitals, and several ancillary activities. India could emerge as a leader in fruits and vegetables at the global level. The need is to consolidate farmers, either through cooperatives or FPOs, to produce demand-driven and need-based fruits and vegetables in selected international markets.

The poultry sector is one of the key drivers for the growth of Indian agriculture. A successful example is of Namakkal district in Tamil Nadu, where nearly three decades ago, a few farmers started poultry farming with 1,000 to 10,000 birds. At present, there are about 1,100 poultry farmers with more than 4.5 crore layer birds for egg production. There are projections that the Namakkal zone is producing about three crores eggs every day. The farmers are rearing improved genotypes.

There are several other successful examples, where farmers neither depend on MSP or the APMC markets. Success is dependent on the farmers' ability to consolidate for production and marketing, either through cooperatives or FPOs. Farmers of the Green Revolution belt are

highly enterprising and can help develop several successful models with policy support during the transition. Reforms in agriculture sector require the support of farmers, state governments, private sector and all connected stakeholders to bring desired results. We only wish that the present opportunity is not wasted.

Auditors cannot share client info with credit raters

KR Srivats New Delhi | January 08, 2021

THE HINDU BusinessLine

CA Institute says data can be given only at auditee's behest, or at a regulator's request

Credit rating agencies may hitherto not find it easy to get information about a company or its management from the statutory auditor of the entity concerned. This is because the CA Institute has clarified that its members are not permitted under the Chartered Accountants Act and the Code of Ethics to share client information with credit rating agencies.

The latest ICAI clarification to the queries from its members is expected to put corporates in a spot and force them do tightrope walking as they will have to balance their relationship with the statutory auditor and the credit rating agency, said corporate observers.

However, the statutory auditor can give feedback to a credit rating agency if explicitly permitted to do so by the client concerned, the Institute of Chartered Accountants of India has said. Any failure to comply with this clarification will be treated as "professional misconduct" and can, therefore, invite disciplinary proceedings, the audit regulator has cautioned.

Code of ethics

Speaking to *BusinessLine*, ICAI president Atul Kumar Gupta said that chartered accountants under their code of ethics are not allowed to share

data of their clients unless the client permits it or when two exceptions come to play. Even where the client does not expressly approve sharing of information, the two exceptions are that the auditors can share if the law of the land requires them to do so or any regulator directly asks the auditor for information.

Feedback mechanism

Gupta said that SEBI had recently issued an advisory and asked credit rating agencies to get a feedback from the statutory auditors. "We are now saying that this feedback mechanism is not falling under the two exceptions that are there in the Code of Ethics. So, either SEBI should say that this is under a law or if SEBI itself asks, our members can directly give the data or feedback to the regulator. But not to a third party like a credit rating agency," Gupta said.

Gupta said the ICAI will in the next few days reach out to SEBI to discuss the issue and see how the matter can be sorted out.

'Not duty bound'

Commenting on the latest ICAI clarification, Amarjit Chopra, former ICAI president, said: "Statutory auditors are not duty bound under law to share information with credit rating agencies. They are duty bound to submit information to regulators like NFRA or courts or the CBI as they (the agencies) have power under law. But credit raters are private agencies. It should also be allowed only when the client permits."

Sanctity of audit

Ashok Haldia, a former Secretary of CA Institute, said that auditors during the course of an audit have unrestricted access to documents and information of the clients. "Allowing the auditor to share information with other agencies these or their assessment, on one pretext or other , without the consent of the auditee, would put at risk the sanctity of audit. The exceptions are, however, when under any law the auditor is required to share information or his findings. Even otherwise rating agencies have access to clients for information. It is desirable that they undertake an

independent exercise and based on that make their own assessment on rating," he said.

U.S. sheds 1.4 lakh jobs as COVID-19 cases surge

REUTERS WASHINGTON, JANUARY 09, 2021

THE HINDU

Dec.'s job losses first in eight months

The U.S. economy shed jobs for the first time in eight months in December as the country buckled under an onslaught of COVID-19 infections, suggesting a significant loss of momentum that could temporarily stall recovery from the pandemic.

Non-farm payrolls decreased by 1,40,000 jobs last month, the Labor Department said on Friday. Data for November was revised up to show 3,36,000 jobs added instead of 2,45,000 as previously reported.

Backstop buffer

The economy has recovered just over half of the 22.2 million jobs lost in March and April.

The unemployment rate was at 6.7% in December.

Despite the labour market weakness, the economy is unlikely to fall back into recession, with a backstop of nearly $900 billion in additional pandemic relief approved by the government last week.

More fiscal stimulus is expected now that the Democrats have gained control of Senate, boosting the prospects for President-elect Joe Biden's legislative agenda.

There is also optimism that the roll out of coronavirus vaccines will be better coordinated under the Biden administration.