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Budget 2021 sets stage for fresh showdown between Centre and unions

By: Saurabh Sharma | Feb 02, 2021

Despite protests on farm laws, the Centre has gone ahead and proposed in the budget presented yesterday to sell some PSUs, one insurance company and two PSBs.

From improving infrastructure to easing credit to encouraging value-added exports to skilling programs, MSMEs were not forgotten.

Prime Minister Narendra Modi is determined to undertake structural reforms despite serious pushbacks from the Opposition on Farm Acts. But some of the proposed reforms, although advisable and necessary, may pit him against a different set of unions and same opposition parties — much like what is happening now over farm laws. His government is struggling to get out of a crisis which it never did anticipate for doing what many — economists and opposition leaders— had been propagating and promising for years to unshackle the farm sector. However, what is favourable in the eyes of economists and experts may not necessarily be viewed similarly by some on the ground.

New farm reforms for which Centre is being battered right, left and centre were recommended by top agricultural economists and were promised by Congress in its manifesto for Lok Sabha polls in 2019. But now, that same party has changed its stance and is demanding repeal of all three laws. Not only parties but economists — Raghuram Rajan, Kaushik Basu, Abhijit Banerjee — too have expressed their apprehensions and questioned the Centre on the way reforms were introduced. All three had at some point batted for some kind of farm reforms that have been undertaken now.

Despite all this, the Centre has gone ahead and proposed in the budget presented yesterday to sell some PSUs, one insurance company and two PSBs. It has also proposed to transfer some assets of railways and few airports for operations to private players. Now, these ideas have been supported in the past by economists and as well as opposition parties to bring efficiency in the management of the economy. But again, what may be good economically may not be good politically. The government's proposal to privatise some PSUs met with stiff opposition by Rahul Gandhi and Mamata Banerjee.

Hours after the proposal, Gandhi said that the government was planning to handover India's assets to PM's 'crony capitalist friends'. For years, economists have been in favour of the government cutting down its stake in state-run enterprises. However, the Opposition has opposed this move saying the Centre is selling the national assets of select few corporates.

During her Budget speech, FM Sitharaman said the divestment process of BPCL, Air India, Shipping Corporation of India, Container Corporation of India, IDBI Bank, BEML, Pawan Hans, Neelachal Ispat Nigam limited among others would be completed in 2021-22. Other than IDBI Bank, she said, the government has proposed to take up the privatization of two Public Sector Banks and one General Insurance company in the year 2021-22.

Now, the fear is that the Centre may have to brace for another round of face-off with bank unions and political parties that have already expressed their objection to proposed privatisation of some PSUs and PSBs. Apart from PSUs, the Centre has proposed to roll out some core infrastructure assets under the asset monetization programme. They are: NHAI Operational Toll Roads, Transmission Assets of PGCIL, Oil and Gas Pipelines of GAIL, IOCL and HPCL, AAI Airports in Tier II and III cities, Railway Infrastructure Assets, Warehousing Assets of CPSEs such as Central Warehousing Corporation and NAFED, and Sports Stadiums.

While opposition says the Centre should divest stake or sell only dead PSUs, the experts and economists argue that even the profit-making PSUs will go belly up if they are not sold in time. They say the government would fetch good value if strong PSUs are sold in time and if they are held little longer, their worth will decline. The Centre has experienced this with IDBI Bank and Air India. Air India's privatisation was approved in 2017 but it is yet to see any buyer.

Economic arguments aside, the Centre will now have to fight the perception that it is against the poor, middle class and farmers. Now, this has to be done on the ground and in Parliament, where political parties would try to stall any proposal involving interest of masses. Considering the nature of proposals in the budget, a fresh showdown is likely between the Centre and Opposition in the House. However, despite farmers' protests, the government may not see as determined a protest by banks or PSU unions for two reasons. Their numbers don't match that of farmers' and they may be offered favourable terms under VRS.

Budget 2021: How bad bank model of ARC, AMC, AIF would work

Budget 2021 news: Currently, the banks have gross NPAs of around 7 per cent which is expected to rise to 15 per cent by September this year if the situation deteriorates

Anand Adhikari | February 1, 2021 | BUSINESS TODY

Union Budget 2021-22: The banks burdened with stressed assets and limited capital will find it difficult to manage the NPAs. There is also limited capital that the government can provide

The Union Budget 2021 -22 has proposed setting up of a bad bank under the ARC (asset reconstruction company), AMC (asset management company) and AIF (alternative investment funds) model to acquire, manage and turnaround bad loans.

The ARC will acquire bad loans from banks at a negotiated price (at a discount from book value) and pay by way of cash and security receipts. The funds for buying the bad loans will come from the sponsors (government and banks etc) as well as alternative investment funds. The AMC will restructure and turnaround the bad loans and charge a fee.

Currently, the banks have gross NPAs of around 7 per cent which is expected to rise to 15 per cent by September this year if the situation deteriorates. The Covid disruption has already created a lot of stress in the banking system.

The current forbearance framework hides the actual NPAs. Take for instance, the RBI has provided a two-year loan restructuring to retail as well as corporate borrowers. In addition, the Supreme Court had earlier directed that loan accounts which were not declared NPAs till August 31, 2020 will not be classified as NPAs till further notice.

The total stress in the banking system would be in excess of Rs 15 lakh crore. The banks burdened with stressed assets and limited capital will find it difficult to manage the NPAs. There is also limited capital that the government can provide. This is where the bad bank model would step in and help both the government and banks.

The bad bank idea was first floated in the Economic Survey 2017. In fact, there is already IBC (Insolvency and Bankruptcy Code) to deal with bad loans, but recovery rate is not higher. The current framework of bankruptcy code is not yielding a good value for banks. For many assets, the sale has to be done at a dirt-cheap price, which comes at a loss to banks

In addition, there are dozens of ARCs in the market. The existing ARCs also have limitations in terms of capital or the funds to buy large assets. In fact, the banks are not very happy with ARC sale as the realisations from bad loans are very low.

The proposed Bad Bank has to better than both the IBC and the ARCs in terms of 'pricing' and also 'faster recovery.'

The bad bank will go a long way in housing the assets of national importance - the power assets, roads, steel and other infrastructure assets. These assets will have value for banks in future and also the country.

But there are challenges for the government in the bad bank. Clearly, there is no room for using taxpayers' money for setting up a bad bank. The capital should come from private funds. There are already global distressed funds interested in India. There are also private equity players which the government should rope in

The management of a bad bank has to be with professionals. The bad bank should not become a platform for bankers on deputation or post retirement job for bankers. There has to be industry expertise with eminent members on the board.

New Asset Reconstruction Committee: Banks likely to ask RBI to relax norms

Shritama Bose | February 4, 2021

THE FINANCIAL EXPRESS

The new ARC will have the advantage of the loan exposures being clubbed across banks, although this, too, is prone to challenges

RBI's September 2016 circular mandated that, with effect from April 2018, banks would need to continue providing for loans sold as if they still were on the books

Lenders, backed by government, could approach the Reserve Bank of India (RBI) for relief on provisioning for assets sold to the proposed asset reconstruction committee (ARC). They are expected to seek a relaxation of the September 1, 2016, circular which requires them to provide for an asset, assigned to ARCs, as if it were still on their books. Moreover, they are likely to ask the ARC be exempt from making future provisions for the assets it buys.

Experts observed that given banks are already holding a fairly high level of provisions incentives were needed to push banks to sell loans via a 15:85 model. The model implies that the sellers get 15% as upfront cash payments and security receipts (SR) for the remaining 85% of the value.

Should these exemptions be granted, it will give the new institution an upper hand over existing players, experts said.

Finance minister Nirmala Sitharaman said in her Budget speech on Monday an ARC would be set up to help banks deal with bad loans and later clarified the government would not be funding it. However, financial services secretary Debasish Panda has hinted at provisioning relief being offered through a government guarantee. Panda told reporters on Tuesday sales to the new ARC would be a cash-neutral transaction for banks. Since the regulator may insist on provisioning to support this arrangement, banks may request the government for a guarantee that could satisfy the regulator, Panda said.

RBI's September 2016 circular mandated that, with effect from April 2018, banks would need to continue providing for loans sold as if they still were on the books. The rule was applicable if the SRs received in the sale comprised more than 10% of bank's own bad loans. Consequently, hybrid cash-and-SR deals have dried up and banks have been offering bad loans to ARCs almost exclusively on an all-cash basis.

The new ARC will have the advantage of the loan exposures being clubbed across banks, although this, too, is prone to challenges. Industry executives FE spoke to said banks hold varying levels of provisions against the same asset and that would complicate the process. A senior executive in the stressed assets market believes private banks may not want to transfer the asset at book value. Implementation issues apart, he pointed out that no lender would want to make additional provisions if the asset is to be transferred in a 15:85 structure.

RBI tightens internal audit framework for NBFCs, UCBs

Our Bureau Mumbai | February 03, 2021

THE HINDU BusinessLine

NBFCs of Rs.5,000-cr, UCBs of Rs.500-cr asset size to implement it by March 31, 2022

The Reserve Bank of India (RBI) on Tuesday issued guidelines on risk-based internal audit (RBIA) framework for Non-Banking Financial Companies (NBFCs) and Primary (Urban) Co-operative Banks (UCBs) which they need to implement by March 31, 2022.

The RBIA framework has been specifically mandated for supervised entities (SEs) — all deposit-taking NBFCs; all non-deposit taking NBFCs (including Core Investment Companies) with asset size of Rs.5,000 crore and above; and all UCBs with asset size of Rs.500 crore and above — to enhance the efficacy of their internal audit systems and processes.

RBI asked the SEs to place the RBIA circular before their Board in its next meeting. The implementation of these guidelines as per timeline specified should be done under the oversight of the Board.

The central bank observed that the internal audit function should broadly assess and contribute to the overall improvement of the organization’s governance, risk management, and control processes using a systematic and disciplined approach. The function is an integral part of sound corporate governance and is considered as the third line of defence.

The supervised entities (SEs) will have to move towards a framework which will include, in addition to selective transaction testing, an evaluation of the risk management systems and control procedures in various areas of operations. This will also help in anticipating areas of potential risks and mitigating such risks.

Audit plan and review

Per the guidelines, RBIA should undertake an independent risk assessment for the purpose of formulating a risk-based audit plan which considers the inherent business risks emanating from an activity / location and the effectiveness of the control systems for monitoring such inherent risks.

The RBIA policy must be reviewed periodically. The risk assessment of business and other functions of the organization shall at the minimum be conducted on an annual basis. Every activity / location, including the risk management and compliance functions, shall be subjected to risk assessment by the RBIA, according to the guidelines.

The SEs RBIA policy should also lay down the maximum time period beyond which even the low-risk business activities / locations would not remain excluded for audit.

The Audit Committee of the Board (ACB)/ Board should formulate and maintain a quality assurance and improvement program that covers all aspects of the internal audit function.

The quality assurance program may include assessment of the internal audit function at least once in a year for adherence to the internal audit policy, objectives and expected outcomes.

RBI said a consolidated position of major risks faced by the organization needs to be presented at least annually to the ACB/Board, based on inputs from all forms of audit.

Authority and competence

The regulator wants senior management of SEs to ensure that the RBIA function is adequately staffed with skilled personnel of right aptitude and attitude who are periodically trained to update their knowledge, skill and competencies.

RBI emphasised that the internal audit function must have sufficient authority, stature, independence and resources thereby enabling internal auditors to carry out their assignments properly.

The Head of Internal Audit (HIA) shall be a senior executive with the ability to exercise independent judgment. Except for the entities where the internal audit function is a specialised function and managed by career internal auditors, the HIA shall be appointed for a reasonably long period, preferably for a minimum of three years.

RBI said requisite professional competence, knowledge and experience -- including banking/financial entity's operations, accounting, information technology, data analytics, forensic investigation, among others.-- of each internal auditor is essential for the effectiveness of internal audit function. The collective skill levels should be adequate to audit all areas of the SE.

The SEs may prepare a Risk Audit Matrix based on the magnitude and frequency of risk.

RBI said the internal audit function should not be outsourced. However, where required, experts including former employees can be hired on a contractual basis subject to the ACB/Board being assured that such expertise does not exist within the audit function of the SE.

Plea seeks probe into role of RBI officials in bank scams

Legal Correspondent

NEW DELHI, FEBRUARY 03, 2021

THE HINDU

Officials acted in direct violation of statutes, says petition

BJP leader and MP Subramanian Swamy on Wednesday moved the Supreme Court seeking a Central Bureau of Investigation (CBI) probe into the role played by Reserve Bank of India (RBI) officials in various banking scams that plague the country's economy, causing prejudice to public interest.

The petition, filed by Dr. Swamy and advocate Satya Sabharwal, said the alleged involvement of RBI officials in scams involving various entities, including Kingfisher, Bank of Maharashtra, an Uttar Pradesh-based private sugar organisation, Nirav Modi, Rotomac Global, Lakshmi Vilas Bank, IL&FS, PMC Bank, Yes Bank and First Leasing Company of India, had not been investigated.

The petition alleged that the RBI officials had acted in "demonstrable active connivance" in direct violation of statutes such as the Reserve Bank of India Act, Banking Regulation Act, State Bank of India Act, Banking Companies (Acquisition and Transfer of Undertakings) Act and the Nationalised Bank (Management and Miscellaneous Provisions) Scheme, 1980.

It said information procured through the Right to Information (RTI) Act revealed that "no officer of Reserve Bank of India has ever been held accountable for any dereliction of duty in case of any fraud reported by any bank. This is in sharp contrast to the number of frauds exploding in the banking sector in India aggregating to in excess of over Rs.3 lakh crore".

This lapse has occurred despite RBI retaining the power to monitor, regulate, supervise, audit and direct the functioning of banking companies in the country. "The scheme of the Banking Regulation Act makes the

Reserve Bank of India the alter ego of the bank management, more so in case of public sector banks. Yet, in none of the high-profile banking scams, the Central Bureau of Investigation investigating these scams has not even sought to examine at a cursory the role of officials of RBI," the petition said.

It said Chief Risk Officers in banks are to be appointed by the RBI, however they have been proved redundant.

Banks are required to keep the credit risk management function separate from the credit sanction process towards effective risk management. For bringing a uniform approach and alignment of risk management systems with the best practices, banks are also required to frame a Board-approved policy, clearly defining the roles and responsibilities of the Chief Risk Officer, who shall not have any reporting relationship with business verticals or business targets.

"However, these chief risk officers have miserably failed to perform their duties due to the demonstrable active connivance on the part of the RBI officials," the petition said.

The RBI has failed to protect the interest of various stakeholders, the petition alleged.

'India's weak fiscal position to remain a key credit challenge'

SPECIAL CORRESPONDENT
MUMBAI, FEBRUARY 03, 2021

THE HINDU

Moody's sees increased transparency on subsidy spending

The Union Budget's focus on higher capital expenditure, financial sector reforms and asset sales would help to stimulate growth and supply broad-based credit support, but India's weak fiscal position would remain a key credit challenge compared with its rating peers, Moody's Investors Service said.

The budget projects a narrowing of the central government's fiscal deficit to 6.8% of GDP in fiscal 2022 from an estimated 9.5% in fiscal 2021.

"We previously expected a smaller central government deficit target of about 5.5% of GDP for fiscal 2022 down from around 7.5% of GDP in fiscal 2021," Moody's said on Wednesday.

"However, compared with previous budgets, the gap between our forecasts and the government's, largely reflects increased transparency on subsidy spending and more credible overall assumptions," it added.

The ratings agency said the widening of the deficit in fiscal 2021 was driven almost entirely by expenditure to support Indian households and the economy from the pandemic shock.

"Given India's very high debt burden...this gradual pace of consolidation will prevent any material strengthening in the government's fiscal position over the medium term, unless nominal GDP growth were to pick up sustainably to historically very high rates," the credit ratings agency added.

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