Need for Balanced Loan Restructuring Scheme: RBI Governor

Why in News

Recently, the **Reserve Bank of India** (RBI) governor has called for a balanced loan restructuring scheme to tackle the **Covid-19** related stress.

Key Points

- The **financial stability of the banking sector** needs to be kept in mind while providing loan restructuring along with **depositors' interest.**
  - There are crores of depositors (small depositors, middle-class people, retired persons) who depend on deposit income while borrowers are only in lakhs.
  - The **loan restructuring** includes **altering the terms of existing loans,** usually to make them more favorable to the borrower. For example, the lender may restructure a loan to receive a **lower interest rate or monthly payment.**
    - Restructured loans are most common if the borrower states that he/she can no longer afford payments under the old terms.
- The governor does not want a repeat of the **Non-Performing Asset** (NPA) surge that happened after 2014 with loan restructuring.
  - The **economic measures** taken by the RBI in the wake of the global financial crisis of 2008-09, led to a surge in bad loans from 2014-15.
- The idea behind loan restructuring was **to protect viable businesses** that are facing genuine cash flow problems. The revival of business **will ensure NPA levels are kept low** and also ensure quick economic recovery.
- However, the governor cautioned that the economic recovery would be gradual, as the upticks in some sectors appear to be levelling off as **efforts towards reopening of the economy are confronted with rising infections.**

Background

- In the recent **Monetary Policy report**, RBI has allowed banks to restructure loans to reduce the rising stress on incomes and balance sheets of large corporates, Micro, Small and Medium Enterprises (MSMEs) as well as individuals.
    - A large number of firms that otherwise maintain a good track record are facing the challenge as their debt burden is becoming disproportionate, relative to their cash flow generation abilities.
- The RBI set up a committee headed by **K.V. Kamath** on restructuring of loans impacted by the Covid-19 pandemic.
    - The committee was tasked to recommend parameters for one-time restructuring of corporate loans.
    - The committee recommended **five fi nan cial ra tios and sec tor-spe cific thresh olds** for res o lu tion of Covid-19 re lated stressed as sets in 26 sec tors.
    - It also specified that restructured loan tenure cannot be extended beyond two years.

Issues Involved

- The major criticism of the **restructuring scheme** is the select 26 sectors identified by the **K V. Kamath committee.** However, there are many other sectors that are eligible for a restructuring scheme.
    - The 26 sec tors in clude au to mo biles, power, tourism, ce ment, chem i cals, gems and jew ellery, lo gis tics, min ing, man u fac tur ing, real es tate, and ship ping among oth ers.
- As per the RBI, **only those borrowers** which were classified as standard and with arrears less than 30 days as at 1st March 2020 are eligible for restructuring.
- The **two year period is also very short for economic recovery.** Given the GDP contraction and no second economic stimulus by the government in sight, the recovery will take longer than two years.
    - In May 2020, the government announced the **'Atmanirbhar Bharat Abhiyan** (or Self-reliant India Mission)' with an economic stimulus package — worth Rs. 20 lakh crores aimed towards achieving the mission.

Way Forward

The loan restructuring must be a temporary step as continuing it for long may lead to an **inflation surge, currency crisis, and financial instability.** It is important that post-Covid-19, regulatory measures are rolled out in a very careful and orderly manner and the financial sector returns to normal functioning **without relying on the regulatory relaxations as the new norm.**

Source: IE