RBI rejects plea to relax June 7 circular

Loans of ₹1.8 trillion, for which agreement has been signed by banks, are likely to be referred to IBC

HAMSINI KARTHIK
Mumbai, 17 November

With no resolution in sight for nearly ₹3 trillion of stressed assets, banks seem to be reaching a dead end with respect to the inter-creditor agreements (ICAs) signed for these loans.

Sources said banks had sought some relaxation from the Reserve Bank of India (RBI) on timelines and modalities for reaching a resolution under the regulator's June 7 circular on a prudential framework for resolution on stressed assets. However, highly placed sources said the regulator was unwilling to budge on its stand.

"As banks aren't making much progress on ICAs signed under the circular, there was another representation made to the RBI asking for an extension in timelines and allowing all categories of lenders, including mutual funds and pension funds, to form part of the ICA. But, the RBI has made it clear that the circular will be upheld in its original form," said a top official of a large bank.

KEY FEATURES OF JUNE 7 CIRCULAR

- Once a borrower is reported to be in default by any of the lenders, all lenders will have to undertake a review of the borrower's account within thirty days from such default
- During the review period, lenders may decide on the resolution strategy
- In case where resolution plan is set to be implemented, all lenders will enter into an inter-creditor agreement (ICA) during the review period
- Any decision under the ICA agreed by 75% of lenders by value and 60% by number will be binding on all the lenders
- Resolution plan should be implemented within 180 days from the end of review period
- If resolution plan is not implemented within time, all lenders are required to make additional provisions of 20% within 180 days from the end of review period
- Additional 15% provisioning is required in 365 days from the commencement of review period

The timeline for implementing the resolution plan under the circular would lapse, on a case-to-case basis, from early January. It is estimated that loans worth ₹1.8–2 trillion or nearly two-thirds of the ₹3-trillion stressed assets under the purview of ICAs, may be referred for resolution under the Insolvency and Bankruptcy Code (IBC).

Bankers say the provisioning burden would be huge if the resolution plans aren't implemented within time. To mitigate the immediate provisioning burden, banks are looking at resolving these loans under the IBC.

According to the June 7 circular, banks have to make an additional provisioning of 20 per cent if the resolution plan isn't implemented and within a year another 15 per cent, taking the burden of additional provisioning burden to 35 per cent. The circular, however, allows for reversal of this provisioning if resolution is pursued under the IBC.

"Banks will, therefore, prefer to opt for resolution outside the June 7 circular, though ICAs might not be terminated ahead of its deadline," said a person working closely on resolving stressed loans.

This implies that while banks may have to make additional provisioning in the March quarter of this fiscal year, the provisioning could be subsequently reversed in the same quarter and/or in the June quarter of the next fiscal year, as and when IBC proceedings are invoked and the case admitted in the courts.

Bankers, however, believe that the June 7 circular isn't a total failure with respect to resolution, as some loans to the power sector may find success. "For companies, which have long-standing power purchase and fuel supply agreements, banks are willing to restructure these loans. Problem is with companies with weak balance sheets and those who have suffered impairment losses in the recent quarters," said a senior executive of a private bank.

"Their ability to function as a going concern has come under threat. No amount of handholding can help them and these cases have to be referred to the IBC," the executive said.

Odd decisions and the consequences

EXIM MATTERS

T N C RAJAGOPALAN

The commerce ministry has restored the benefit of duty drawback at All Industry Rates (AIR) to deemed export, with retrospective effect from December 5, 2017. A welcome development but it raises some questions.

Deemed export refers to supplies within India of goods made in India for specified purposes or to specified entities.

The objective is a level playing field for domestic manufacturers in specified cases. For example, an export oriented unit may import its requirements duty-free. A domestic manufacturer can compete with such duty-free imports if relieved of the tax/duty burden on inputs and finished products. So, the deemed export provisions, besides other dispensations, allow drawback i.e refund of the taxes/duties paid on the inputs.

> **What caused the ministry to deny the drawback at AIR for deemed export in 2013? And, what has now happened in 2019 to restore the benefit with retrospective effect? The reasons are far from obvious**

The notified AIR for various export products is based on the weighted averages of the consumption of imported/indigenous inputs of a cross-section of exporters and the average incidence of duties suffered on these.

Deemed export is eligible for claim of drawback at AIR, without furnishing any evidence of actual duty incidence. In 2013, the Directorate General of Foreign Trade issued Policy Circular 9/(RE-2013)/2009-14, dated October 30, 2013, denying drawback at AIR on deemed export; it allowed drawback of only basic customs duty, against evidence of actual duty incidence. The next Foreign Trade Policy (FTP), notified on April 1, 2015, gave legal effect to the decision.

That position was reiterated in the FTP revision on December 5, 2017. That decision has now been reversed with retrospective effect.

For deemed export to be made, domestic producers will henceforth be better placed to compete with duty-free import. The requirement of making drawback claims only on the basis of documents evidencing payment will not be there in the coming days. To that extent, the latest change will help domestic producers.

However, it is doubtful if most deemed exporters could claim the benefits for supplies made between December 5, 2017, and October 31, 2019. For, they had taken note of the denial of drawback at AIR and did not bother to do the documentation that would have enabled them claim the benefit at a later date. In fact, many, with the denial of drawback at AIR, were not price-competitive and lost their orders against cheaper duty-free import.

Also, many were denied their drawback at AIR even for supplies made between October 30, 2013, and March 31, 2015. The policy allowed the benefit but a policy circular denied it.

Another issue is the time limit of 12 months from date of supply for making the drawback claim.

The entitlement is now restored with retrospective effect. So, quite a few claims to be submitted in the coming days will be time-barred. Will the entitlements be cut due to the late submission? The DGFT should clarify.

What caused the ministry to deny the drawback at AIR for deemed export in 2013? And, what has now happened in 2019 to restore the benefit with retrospective effect? The reasons are far from obvious.

It is also interesting that the benefit was restored when an additional secretary in the ministry was holding temporary additional charge as Director General of Foreign Trade (DGFT), and just a day or so before another officer, already appointed as DGFT a week earlier, was to take charge.

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'Will step up recoveries, increase provisions in H2'

The September quarter saw an uptick in slippage in micro, small, and medium enterprises (MSMEs) and agriculture loans. Union Bank of India Managing Director and Chief Executive Officer **RAJKIRAN RAI G** tells **Nidhi Rai** about the lender's plan to recover loans and how it envisages the asset quality after merger. Edited excerpts:

There is a slight increase in your non-performing assets (NPAs) from agri and medium and large industry. What is the reason, and what is the outlook on these?

The outstanding NPAs in large corporate category have declined while that of MSME rose marginally. The increase in outstanding NPAs in agriculture sector is higher than that of the previous quarter, and concentrated in a few geographies. We have put in place robust monitoring systems to proactively prevent new slippages and are positive on recoveries in the coming quarters.

Large borrowers' exposure has come down substantially. Are you being conservative in your approach?

The decline in exposure to large borrowers was marginal and limited to specific sectors. Apart from construction and trade, which saw a slight decline, exposures in all other sectors have increased or remain at the same level during the September quarter.

Credit cost has increased. What's the reason?

Credit cost up to the June quarter has been in line with our guidance. However, for the September quarter, the bank had to provide higher provisions on accounts identified under divergence and fraud provisioning on one major iron and steel account. We expect our credit cost to be around 3 per cent for this fiscal year due to elevated provisioning for Q2FY20 and other normalised ageing and normal provisioning for fresh slippages in the first half.

How comfortable are you with lending to infrastructure finance, and housing finance firms? Are you comfortable with the loans you have already given?

We are very much active in lending to viable infrastructure projects and NBFC/HFC segments. Our exposure to these segments increased, in absolute terms, in the September quarter, while exposure to infra stood above to that of in the June quarter, albeit marginally. We will continue to take exposure in NBFCs, with strong parentage and financials and viable infrastructure projects.

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When most of your peers have pushed their provision coverage ratio (PCR) to nearly 80 per cent, yours is much lower. Does this indicate the remaining two quarters will also be consumed by provisions for bad loans and write off?

The average PCR of peer PSBs stood at 75 per cent and we are at 67.7 per cent as of the September quarter. For the forthcoming quarters in FY20, we aim to reach the PCR of about 70 per cent by way of providing appropriate provision according to the laid down rules.

The Supreme Court set aside a verdict by the National Company Law Appellate Tribunal in Essar Steel case. How much recovery you are expecting from this case?

We are expecting recovery of ₹2,000 crore. On account of this, there will be unlocking of provision to the extent of ₹850 crore. Besides, there will be positive impact of another ₹250 crore on profit and loss account of the bank.

Post merger, how do you envisage the asset quality of the merged entity to be like?

We are just half way in FY20 and it would be too early to comment on the asset quality of amalgamated entity. We, however, shall assess the position at an appropriate time to have a realistic view on business/asset quality of the combined entity.

How many people you have hired in the past two quarters and how many more you are planning to hire this fiscal year?

Man power planning is an annual exercise for us. We expect this to be more important and critical considering the amalgamation process that is underway. We need to assess the position, keeping the requirements as a combined entity post merger. We may have a clear view on this aspect probably in the last quarter once we work out finer details.

For start-ups, compliance time may be 1 hr a month

PRESS TRUST OF INDIA
New Delhi, 17 November

The department for promotion of industry and internal trade (DPIIT) has proposed significant cut in the compliance time to just one hour per month for start-ups as part of measures to ease regulatory requirements for budding entrepreneurs, an official said.

The proposal is part of the Start-up India Vision 2024, prepared by the department to promote the growth of budding entrepreneurs.

Under this vision document, the department has also proposed several other measures such as facilities of debt financing, setting up of 500 new incubators and accelerators, creating innovation zones in urban local bodies, deployment of entire corpus of ₹10,000 crore fund of funds, operationalise credit guarantee scheme, and establishment of a seed fund.

The department has floated a note seeking views of different ministries on this document. Currently, start-ups comply with a plethora of requirements such as GST filings, tax returns and other local laws every month, the official said. Compliance to these processes takes a lot of time and cost.

Further, it has proposed providing work orders and pilot projects from the Centre, ranking of ministries and central public sector undertakings for their increased engagement with start-ups, and organising a global start-up event in the country.

STATSGURU

Deepening slowdown

ECONOMY OBSERVERS are finally spelling out the gravity of the slowdown India finds itself in. Before the financial year began, the Reserve Bank of India thought the Indian economy would grow 7.4 per cent in FY20. Over eight months, it gradually revised the estimate downward to 6.1 per cent. Last week, State Bank of India projected FY20 growth at 5 per cent, and a top Delhi-based think tank expects the economy to grow only 4.9 per cent.

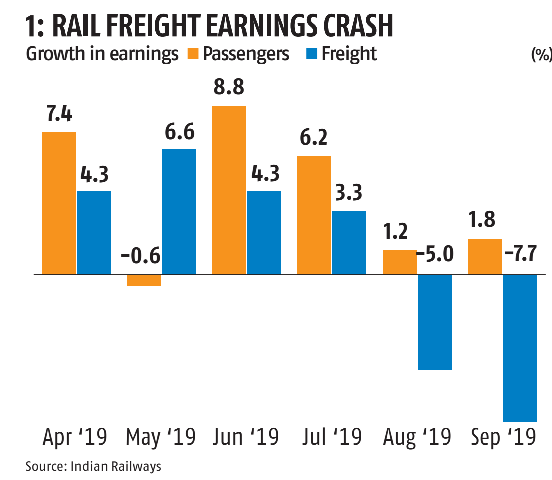
What could be the reason for these successive downward revisions across the board? Some key indicators make it evident.

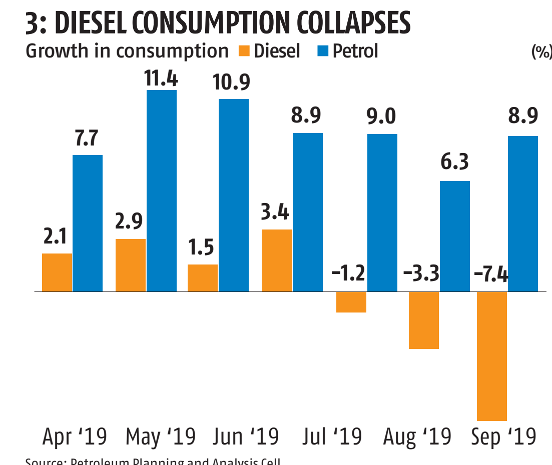
Earnings from rail freight are gradually reducing and contracted by 7.7 per cent in September 2019 (*chart 1*). This indicates declining industrial demand. Air travel did pick up in FY20, but is now looking down, showing slackening demand (*chart 2*). While petrol consumption seems on track, diesel consumption has tanked, reaffirming industrial slowdown (*chart 3*).

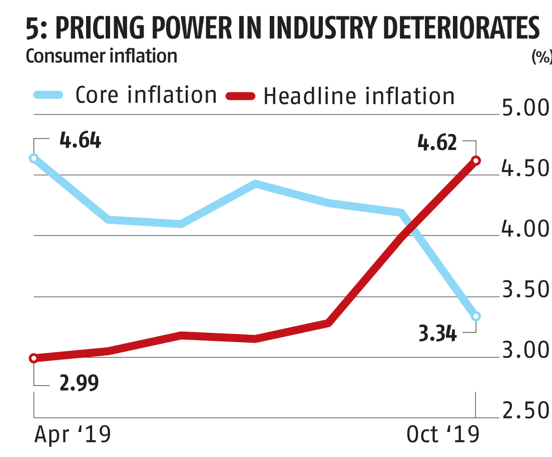
The index of industrial production (IIP) shows the areas of stress in the economy (*chart 4*). Even pharma has come under pressure.

Core inflation is a measure of inflation without volatile components like food and fuel. It represents business demand and pricing power of companies. While it was driving overall inflation up until recently (strong demand), it has now fallen below the level of overall inflation (weak demand) (*chart 5*). On the external front, while exports remain poor, imports are increasingly falling in FY20, showing deepening economic stress (*chart 6*).

ABHISHEK WAGHMARE







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