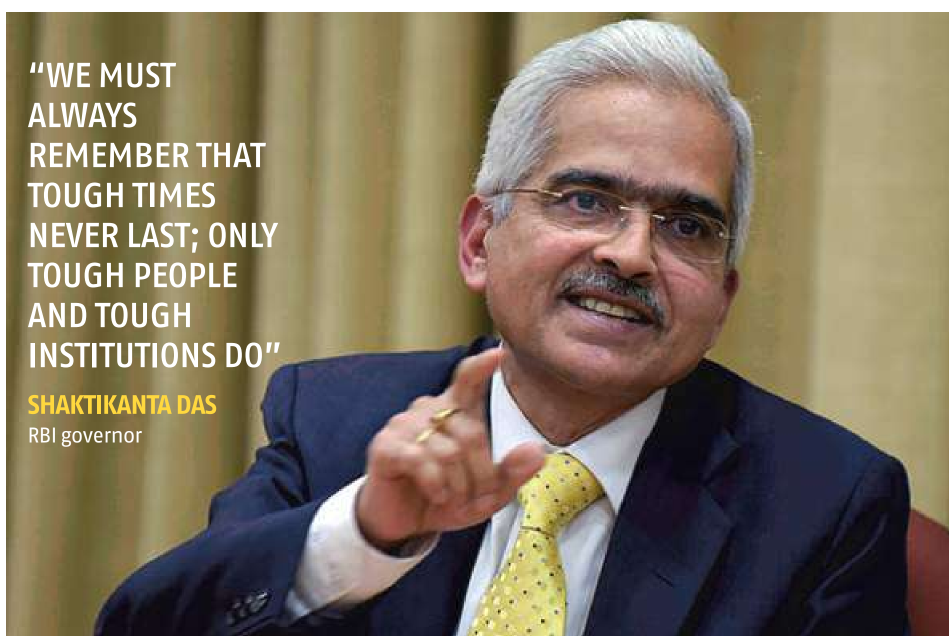
Rush hour ahead

Piecemeal regulatory forbearance will not go far and tougher questions will be asked of both Mint Road and banks, reports **Raghu Mohan**



"We must always remember that tough times never last; only tough people and tough institutions do," said Reserve Bank of India (RBI) Governor Shaktikanta Das, when he announced a raft of measures to tackle the fallout of coronavirus (Covid-19) on the economy. It was a signal the days ahead will stretch both banks and Mint Road; so be prepared. Are we?

The asset quality of banks and the demands on their capital position due to its further deterioration must rank among the top concerns. The central bank has moved on the double to put in place a three-month moratorium on the servicing of term loans. But there has been no relook at income recognition and asset classification norms, the status of additional provisioning under the central bank's June 7 circular, and the road ahead under the Insolvency and Bankruptcy Code (IBC) in these stressful times.

Says Divyanshu Pandey, Partner at J Sagar Associates, "There is good reason to give a three-month break for the timelines under the June 7 circular. An idea has been floated that the IBC process itself may be suspended for six months. A like thought process may be good for the June 7 circular as well."

The merger of four sets of state-run banks, effective April 1, has led to a reset of a quarter of the banking system's assets, and there is nothing to suggest that these entities will not require fresh capital down the line – and we have a handle on only their pre-Covid asset quality as on date. This holds true for private banks as well and may call for a rethink of their current capital structures.

Notes Nikhil Shah, managing director, Alvarez & Marsal (India): "The Budget has not provided capital for state-run banks given the significant recapitalisation of over $30 billion provided between FY17 and FY19. Most businesses have been severely impacted operationally and financially, and those that were overleveraged or had liquidity constrained prior to the crisis, will have the most difficult time."

"My biggest worry is that the measures announced so far, commendable as they are (from a borrower's point of view), come with their share of operational difficulties," says a banker. Another lender, less charitable, is of the view that "it would have been better if the RBI had called for a videoconferencing of banks' chief executives so that some of the ground-level operational issues could have been handled better."

You have far too many moving parts.

The nuts and bolts

It has been gathered on good authority that it had been conveyed to the central bank that the insistence that the three-month breather "shall be contingent on lending institutions satisfying that the same is necessitated on account of the economic fallout from Covid-19," will not fly. Borrowers, especially micro, small- and medium-enterprises (MSMEs) service the interest part just in time before the 90-day non-performing asset (NPA) norm kicks in. It is in the nature of the business as payment cycles are lumpy to begin with. This is the case even for term-loans structured as equated monthly instalments at the time of extending the facility. Many borrowers who had genuinely intended to square their limits with banks by the close of FY20 are simply not in a position to do so because of the disruption during the month.

"To say that you should be able to pin-point stress to Covid-19 is not practical. The RBI could have simply said the account should have been 'standard' – that it is not an NPA, rather than insist it should have been 'regular' at all times, suggests a banker.

Banks, on their part, are being inundated by all kinds of requests and clarification from borrowers — big and small. Can it be creatively ensured that they are not treated as dud accounts, by sanctioning a fresh limit? Some queries on forbearance are far too complex for them to answer.

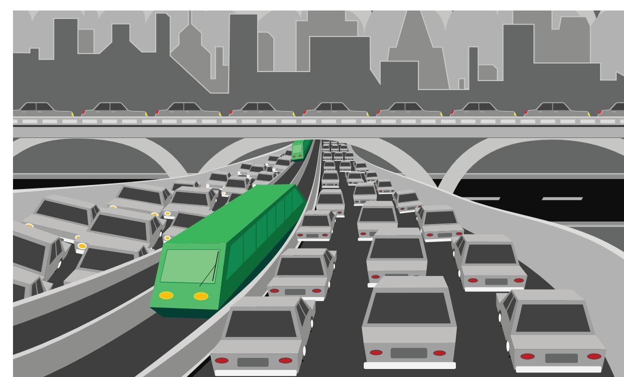
The Securities and Exchange Board of India (Sebi) has allowed credit rating agencies (CRAs) to relax temporarily their norms for recognition of default on rated instruments. This is to be applicable to all rated instruments, including term and working capital loans, debentures, fixed deposits, and commercial papers (CPs). Says Subodh Rai, Senior Director at CRISIL Ratings: "The move by Sebi and RBI will ease the operational challenge faced by borrowers in the immediate term. CRISIL will factor the moratorium, if any, subject to the relevant bank's policy and investor's inclination to allow moratorium."

But here is the tricky NPA classification bit, and it has nothing to do with the mere non-recognition of defaults by CRAs. If there is to be a default in the servicing of interest on debentures or money market instruments, will it mean that the term loans of the borrower are not to get a moratorium? Take a situation wherein a default on these instruments of a borrower had already happened say, in the month of February. If the term loans are to get a moratorium after all, what if the borrower were to divert funds to service the interest on debentures or CPs? This has implications for mutual funds, and also non-banking financial companies which are heavily dependent on bank lines for their funding.

"Debenture interest payments are not to be treated like term loans when it comes to its servicing. It brings its own share of challenges," notes Pandey. These aspects require greater clarity from the authorities, and calls for closer co-ordination between the central bank, Sebi and the Pension Fund Regulatory and Development Authority.

Now join the dots: the message that comes across is "we started well, but it could have been better". You simply can't have more of the same.

That said, Covid-19 will be leveraged to lobby for all manners of forbearance, and the sins of the past may well be forgotten. The central bank, in its Financial Stability Report of June 2013, quoted Edward J Kane to drive home a point: "Bankers understand the financial safety net as a politically enforceable implicit contract that they have negotiated with their national governments". And "lobbyists create a taxpayer 'put' by creating an excessive fear in the minds of regulators for letting banks' accounting decisions or health be called into question." Do mull it over; it's worth the grind.



ALL EYES ON THE ROAD

- A relook at banks' income recognition and asset classification norms
- An easing of the additional provisioning norm and incorporation of a three-month breather with regard to the trigger points of the central bank's June 7 circular
- Charting the path ahead under the Insolvency and Bankruptcy Code (IBC)
- Visibility on the fresh capital needs of state-run banks; handle only on their pre-Covid asset quality as on date
- Rethink on private banks' current capital structures
- Delinking the three-month moratorium on loans from lending institutions satisfying themselves that it is necessitated due to Covid-19
- A fresh forbearance package for micro, small and medium enterprises

Lockdown and rewiring banks

GUEST COLUMN

HIMANISH CHAUDHURI
Partner, Deloitte (India)

With the spread of Covid-19, governments have mandated lockdowns and social distancing, thereby creating a paradigm shift in the working of banks, from a traditional office space towards an agile, responsive and dynamic mode of operating.

While banks and financial institutions have invoked their existing business continuity plans (BCP), the current situation calls for a more adaptive and reactive BCP. Banks have invoked their BCPs for critical functions and that has helped them in keeping their branches and critical operations active. However, for areas such as support functions, IT vendors, auditors and on-going projects, the efforts to achieve seamless integration with the prevailing situation are still continuously evolving and they are working towards building a dynamic BCP.

Data management

Protection of data, with the migration to work-from-home outside the secure networks, through remote devices and open networks, brings its own challenges. Banks will be required to significantly augment their monitoring, and fraud prevention tools, for detection of unauthorised movement of data. And policies around data transfer between banks and external vendors need to be strengthened.

The challenge for teams that have functioned only on office premises or on the shop floor is the transition to remote working. For example, front-end functions have significantly reduced; however, the impact on client servicing has significantly increased. Assistance to existing clientele, quick response in implementing measures to combat the lockdown, while ensuring effective communication with customers, and re-establishment of contact have to be areas of focus. Another area which has been impacted are third-party vendors and their talent working on banks' premises. A changeover to move data to the vendor is a risk that needs to be evaluated by all banks.

> **Key areas which have been impacted are third-party vendors and their talent working on banks' premises. A changeover to move data to the vendor is a risk that needs to be evaluated by all banks**

Today's environment demands the need for remote working. However, once the novelty has worn off, the stress of its challenges will become more apparent, with the lack of boundaries, undefined roles and responsibilities, and social isolation, amongst others. Additionally, banks and financial institutions have limited work from home, and flexi-work policies and have not conducted rehearsals of such scenarios. The inadequate knowhow and competencies to migrate to collaborative tools are also key factors in the effective migration to the offsite working model in banks. Adaptive methods to deal with on-boarding new hires and exits of existing employees are also areas that need to be looked into by banks, to facilitate smooth transitions, in and out of a bank.

Risk management

With the Reserve Bank of India's (RBI's) relief packages, it is now crucial that banks adhere to ensure adequate implementation and due compliance and make the necessary tweaks within their systems and processes to accommodate the necessary changes. For example, the three-month moratorium period for repayment of loans will require change in computation logics, change in asset classification and modifications to the customer statement of accounts, among others. Adequate tracking, testing, and collaboration with vendors needs to be done, to incorporate such changes.

Vulnerabilities in cyber risk have not been adequately envisaged until lately by banks and financial institutions. There has been a rise in cybercrimes, and ransomwares — for example, a ransomware called "Coronavirus", steals and encrypts data, whereas another newer ransomware, "CovidLock", locks a victim's phone. Another key aspect to be considered is the continuing risk given the uncertainty around the situation.

NEXT TO LITTLE IN THE WORKS

The investment pipeline in the economy is choked with four out of the six key indicators – investment rate, bank credit offtake, industrial production of capital goods, and new investment projects showing deterioration while investment intensions and market borrowings have shown some signs of resilience. These parameters are likely to see a downward revision with coronavirus – the impact of which will play out in the coming months.

Gross fixed capital formation (GFCF) — an indicator of investment demand — as a percentage of GDP, fell to nearly two-decade low. It is estimated at 27.5 per cent of GDP as per the second advance estimate for FY20 – lower by 1.5 per cent a year ago. GFCF is estimated to contract by minus 0.6 per cent for the first time in the past 17 years. This number may be revised downwards as the year-end phenomenon of increasing investment in March will not materialise.

KEY INVESTMENT INDICATORS

Indicator	Period	Movement
Investment rate (GFCF as % of GDP)	FY20 (Est.)	↓
Bank credit	FY20	↓
Capital goods	FY20 (Apr – Jan)	↓
Investment intentions- filed	9M FY20	↑
Corporates' market borrowings	FY20 (Apr – Feb)	↑
New investment projects	9M FY20	↓

Source: CARE Ratings

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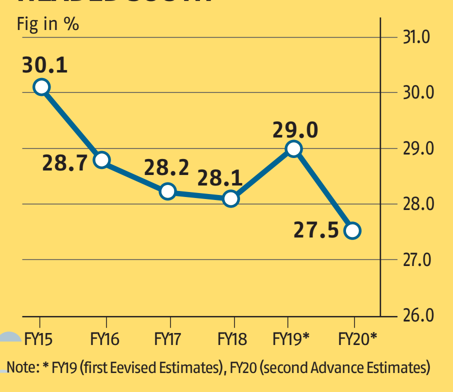
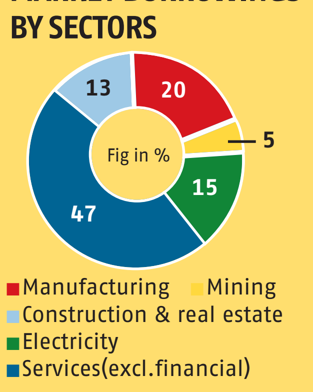
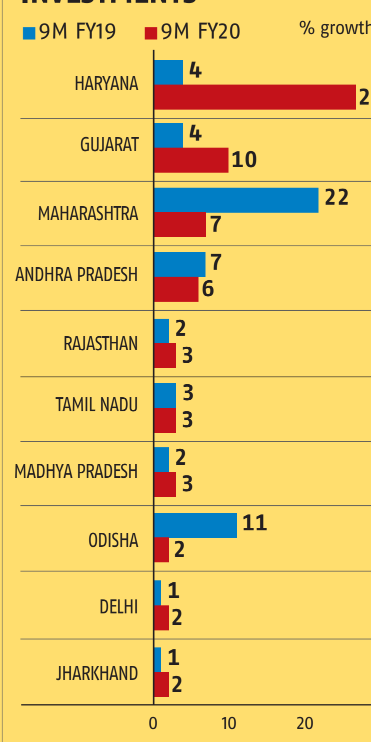


Note: * FY19 (first Revised Estimates), FY20 (second Advance Estimates)

MARKET BORROWINGS BY SECTORS



STATE-WISE NEW INVESTMENTS



'Ours is the open-banking model of the times'

PayNearby has scaled up the business correspondent (BC) model using technology to build a hyperlocal fintech network. It has roped in retailers at the first mile to offer both digital financial and non-financial services to the masses. **ANAND KUMAR BAJAJ**, its managing director & chief executive officer, believes he can roll out this model globally, and plans to raise $50 million through equity dilution in what is inherently a "people's business". Bajaj spoke to ***Raghu Mohan***. Edited excerpts:

How is version 2.0 of the business correspondent model different?

It has evolved from a dedicated one-bank model to serving customers of any bank with interoperability; it is bank-agnostic now. The relaxations given by the Reserve Bank of India (RBI) allow us to go beyond 30 kms from the sponsor bank's branch to harness the power of digital for the benefit of our customers. A retail shop in any village can be on-boarded by us with the help of digital due-diligence in addition to their physical verification and training. We are working with the Bill and Melinda Gates Foundation to have BCs within every five kms radius in the country and are sharing our latitude-longitude locations accordingly.

You can appreciate how critical BCs and bank mitras are, especially during the current stressful period arising from coronavirus, to finance minister, Nirmala Sitharaman's statement that there are to be no restrictions in their movements. Ours is truly the 'open banking' model of the times -- home-grown at that.

In the past, stickiness of BCs had cropped up as an issue. How has this aspect been tackled?

Just like in the FMCG sector, the first and foremost requirement is to maintain the quality of services, get the pricing right and have a customer-centric approach. A near 100 per cent uptime is a must as customers need banking 24/7 and they should not be deprived of this requirement. Automation helps in scale and hence, we have automated reconciliations, refunds and fee-management, among others.

Our endeavour is to ensure the success and growth of our retailers, and we employ advanced data-science techniques to help them grow their business. Retailers who serve as BC agents, are called the 'digital pradhans' of their areas. This lends credibility to the already existing trust they have with our customers. Our motto is *'Zidd aage badhne ki'*, and the effort has always been to touch the lives of the retail community positively. They can create a better life for themselves and their families through this partnership. Stickiness is an outcome of trust, empathy and continuous good work.

Q&A

ANAND KUMAR BAJAJ
Managing director & chief executive officer, PayNearby

A key piece in you model is the cash-out part. Now, what if the kiranawalas were to run out of, or do not have cash?

Nandan Nilekani had asked me this question when we presented to him during the deliberations of the Committee for Deepening of Digital Payments last year. You see, even automated teller machines (ATMs) go out of cash; shops run out of stock. So, customers go to the next shop -- it can't be that all shops are out of cash at the same time. Today, alternative approaches to businesses are shut and what is working well are these retail outlets – you present your thumb impression and take your money (effectively, cards with no PIN). Kirana stores have persevered because people are using them. Our model is about taking high-end technology to the bottom of the pyramid in the truest sense.

How do you take care of reputational risks – of the banks involved and that of PayNearby?

Reputation is important even when you are buying a packet of wheat. But then, you trust the neighbourhood retailer who has been around for years. We sort of "sachetise" trust and dispense it through local partners. We have joined hands with the Retailers Association's Skill Council of India to reskill 2 million retailers across the country. In a pilot project last year, we certified 24,000 retailers under the national flagship skilling initiative Pradhan Mantri Kaushal Vikas Yojana. We have been working with retailers to make them partners for financial inclusion in the first mile *'Har Dukaan* Digital Pradhan'.

How have you funded the company?

We took ₹15 crore in seed-funding in May 2016 and have since doubled our net worth. With a presence in 17,000 PIN codes with 800,000 retailers, there is an opportunity to register and activate more of them. We feel proud that PayNearby's services have been called in for national duty of relaying government grants to millions of citizen through our BC channel. To shoulder the government's load in dispensing direct benefit transfers is a very responsible feeling — like soldiers without uniform. This accentuates credibility of our work. We hope to raise our service standards and emerge as a national asset.

Funding in current times is obviously required and we are looking at strengthening our teams, visibility, technology and reach. We are planning to raise $50 million through equity. It will be utilised for non-banking financial services and to scale up our engineering work with use of modern technologies like artificial intelligence, machine learning and location sensing.

> "STICKINESS IS AN OUTCOME OF TRUST, EMPATHY AND CONTINUOUS GOOD WORK. OUR MODEL IS ABOUT TAKING HIGH-END TECHNOLOGY TO THE BOTTOM OF THE PYRAMID IN THE TRUEST SENSE"