E-ISSN: 2708-4523
P-ISSN: 2708-4515
AJMC 2021; 2(2): 44-50

www.allcommercejournal.com
Received: 25-05-2021
Accepted: 27-06-2021

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Reforms in banking sector during covid scenario-reflections on Indian economy

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Abstract
The banking sector in India is sufficiently capitalized and well-regulated by the RBI. The 2008 global meltdown and resilience from the economy is well appreciated. The Global economy underwent the economic shock with the Covid-19 crisis. The first and second wave had far reaching implications for the world economy. The Indian financial sector definitely felt the pinch. The RBI through the reform measures and packages had been correcting the slippages in the banking system. The present study is a study of the covid scenario under the first and second covid wave. The study covers the reforms in the banking sector and how the recovery pathways were constantly worked out in the country.

Keywords: banking, financial crisis, reforms

Introduction

Banking system in the pre-Covid-19 period

Over the last few years, India has been dealing with the Twin Balance Sheet (TBS) crisis. This was a consequence of high levels of non-performing assets (NPAs) in an inadequately capitalized banking system, combined with over-leveraged and financially weak firms in the private corporate sector).

The government and the banking regulator (Reserve Bank of India (RBI)) took a series of steps to address the crisis. These included putting the weakest 10 banks in a Prompt Corrective Action framework, which prevented them from expanding their books; initiating investigations by the Central Vigilance Commission (CVC), Central Bureau of Investigation (CBI), etc. against senior officials of the banks; and directing banks to trigger the Insolvency and Bankruptcy Code (IBC, 2016) against defaulting firms and accept large haircuts even when capital to provide for the losses was not sufficient.

The outbreak and rapid transmission of the new Coronavirus has wreaked massive damage across global economies. In India, the economy has been witnessing acute growth pangs for over a year. The Covid-19 pandemic is making matters worse for it, an already fragile economy aspiring to reach the $5 trillion mark by 2025. This, in turn, obviously places the economy's financial ecosystem in high jeopardy.

Shadow banking sector crises

The Covid-19 outbreak and ensuing lockdown have hurt almost all industries in India, but for the country's $370 billion shadow banking sector, this might be the last nail in the coffin. Over the past two years, several non-banking financial companies (NBFC) in India have been dealing with bad news upon bad news, including a cash crunch, the high cost of capital, and burgeoning bad loans. Moody's said the inability of borrowers to repay loans amid the Covid-19 crisis, coupled with a six-month moratorium on repayment allowed by India's central bank, will lead to a disruption of inflow for NBFCs, even as outflow will have to continue.

Timeline of what went wrong for India's NBFCS

June 2018: IL&FS defaults for the first time on repayment of commercial paper (short-term borrowing) and inter-corporate deposit (unsecured borrowing) worth Rs450 crore ($60 million).

July 2018: Non-executive chairman Ravi Parthasarathy, who played a pivotal role in the company's growth, resigns after over 30 years of service at IL&FS.

He is swiftly replaced by Hemant Bhargava, managing director of Life Insurance Corporation of India (LIC). While the resignation is an exercise in damage control, news reports claim that all is not well with IL&FS. A professional in infrastructure financing space tells Business Standard newspaper that Parthasarathy's tenure was "too long and too opaque." The article also states that the company is highly leveraged as its subsidiaries have a large capital requirement.

September 2018: IL&FS defaults on repayment of a Rs 1,000 crore short-term loan from Small Industries Development Bank of India. This alarms credit rating agencies, which start downgrading the company and its subsidiaries.

October 2018: The effect of NBFC rout spreads like a wildfire across the stock and debt markets. On Oct. 11, Nifty and Sensex hit a six-month low of 10,234 and 34,001, respectively.
Bond prices fall due to the sell-off and yields continue to rise, making it more expensive for NBFCs to borrow. The average cost of borrowing for corporates has gone up by 100 basis points since April 2018, making it harder for NBFCs to borrow, and hits their ability to stay afloat.

February 2019: Anil Ambani-owned Reliance Home Finance defaults on loan repayment of Rs40.08 crore to Punjab & Sind Bank.

April 2019: Another Anil Ambani-owned firm, Reliance Commercial Finance, is also on the verge of default, according to CARE Ratings.

May 2019: Investors flock to strong private NBFCs such as HDFC and quasi-sovereign financing companies like Rural Electrification Corporation, Power Finance Corp, National Bank for Agriculture and Rural Development, National Housing Bank, and LIC Housing Finance.

June 2019: DHFL, one of the leading housing finance companies, fails to repay commercial paper worth Rs225 crore due to the lack of liquidity and inability to raise fresh funds.

July 2019: Reserve Bank of India (RBI) governor Shaktikanta Das says the central bank is taking steps "to ensure a collapse of another NBFC, especially a large one, doesn't happen."

August 2019: Mutual funds, which have been a primary source of funding for NBFCs for long, turn extremely cautious. The exposure of debt mutual funds to the sector drops by 20% year-on-year.

September 2019: The cost of borrowing continues to rise for NBFCs.
Reliance Group decides to shut down Reliance Home Finance and Reliance Commercial Finance, which had become insolvent.
Real estate financier Altico Capital defaults on interest payment and credit rating agencies downgrade its debt to junk status.

December 2019: The RBI observes that bad loans in the sector have risen between March 2018 and September 2019, and the higher cost of borrowing and increased risk aversion has led to a drop in loan growth.

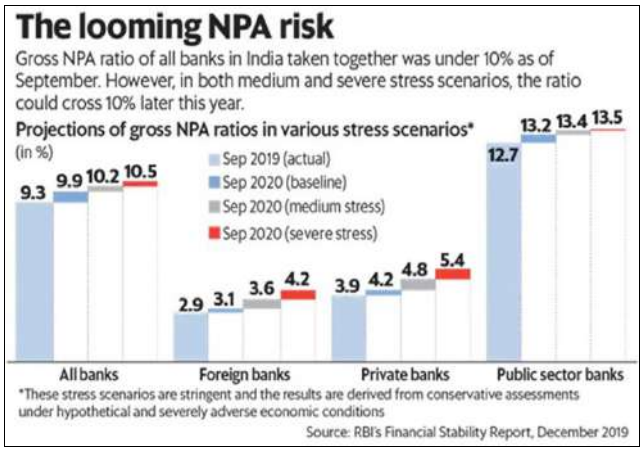
March 2020: As part of the measures to fight the Covid-19 crisis, the RBI offers a three-month moratorium for repayment of loans. But it is unclear if beleaguered NBFCs can avail of it.

April 2020: NBFCs seek clarification from the RBI on whether they are eligible for a moratorium.

May 2020: India's largest lender State Bank of India and government-owned Punjab National Bank provide moratorium to NBFCs.
Pune-based Bajaj Finance says 27% of its loan book is under moratorium while its net profit drops sharply as it makes Rs900 crore provisioning for Covid-19 related issues.
The RBI declares it is extending the moratorium on repayment of loans by another three months till end of August. Moody's believes this will end up "weakening solvency of NBFCs (and) in turn will pose a risk to the stability of the broad financial system because banks have large direct exposures to them."

Covid-19 lockdown – its impact on India's BFSI sector
Here's a look at five BFSI domains that have been impacted the most by the current lockdown:

1. Non-Performing Assets (NPAs)
According to a report released by S&P Global Ratings, Indian banks are likely to see an increase in their NPA ratio by 1.9% in 2020, following the economic slowdown caused by COVID-19 pandemic. Going by the report, this can further worsen the banks' credit cost ratios by around 130 basis points (bps).



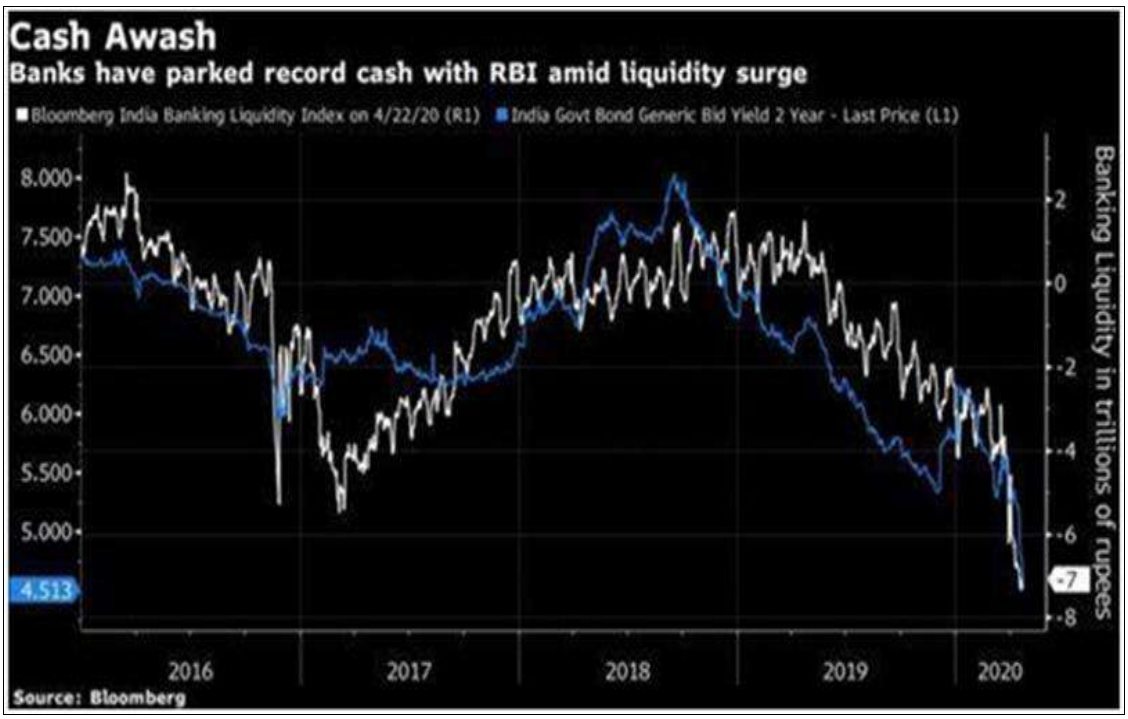
(**Source:** Live Mint)

Fig 1: The looming NPA risk

Central banks like the Reserve Bank of India (RBI) have taken measures that include increasing liquidity, implementing rate cuts, and providing targeted loans to affected industries. By relaxing its regulations, the RBI is providing a temporary moratorium to affected individuals and companies, who will only need to start repayments from June 2020.

2. Impact on bank loans

NPAs seem to be only the tip of the iceberg. The current crisis has definitely increased the liquidity in India's banking system with surplus cash growing to over 4 lakh crores. However, high liquidity has not encouraged fresh banking loans, as most banks continue to play it safe because of the prevailing economic uncertainty.



(**Source:** Yahoo Finance)

Fig 2: Cash Awash

Additionally, banks in India could see a major spike in bad loans as more borrowing companies begin to default on their loan payments due to the lack of economic activity. RBI has already implemented multiple measures including a rate cut of 75 basis points, interest deferment on working capital, and a 3-month moratorium on all term loans – all aimed towards boosting lending.

3. Stressed assets

Although such RBI measures may boost the lending of fresh loans, banks seem to be facing the consequences of past loans as they try to deal with the growing number of bad loans in their balance sheets. Such loans have been the outcome of years of easy money lending. Defaulting cases on large corporate loans are now seeking a resolution under India's bankruptcy code.

STRESS TEST

GNPA (in %)

	PSB	All banks
March 2019 (actual)	**12.6**	**9.3**
March 2020 (projection)		
Baseline	12.0	9.0
Medium stress	12.1	9.2
Severe stress	12.2	9.6

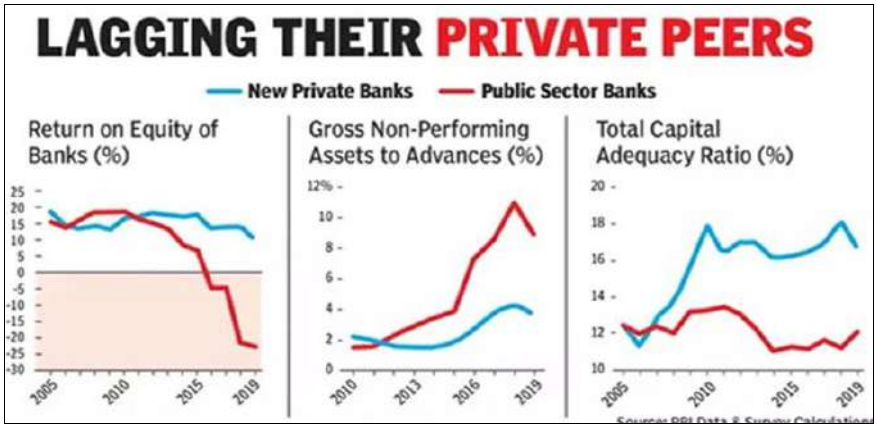
(**Source:** Business Standard)

Fig 3: Stress Test

With reduced economic activity, banking executives are projecting few buyers for stressed assets. The asset quality pressure for both banks and NBFCs is expected to rise in the financial year 2021. As a result, credit costs for NBFCs could grow by 50-100% over the next quarters, which also brings us to the next impact.

4. Bank profitability

Such credit costs coupled with low credit growth is projecting record low profitability for the financial sector, measured by the Return on Assets (RoA) ratio. RoA is likely to reduce by 50-90 basis points in the financial year 2021.



(**Source:** Times of India)

Fig 4: Lagging their private peers

On the positive side, India's largest bank, SBI is expecting a 4-year high on RoA in this fiscal year. This has been enabled mainly by higher margins on net interest and higher income from interests.

5. NIM and other impact

COVID-19 is also impacting the Net Interest Margin (NIM) of the financial sector. NIM growth mainly depends on internal factors such as Capital Adequacy Ratio (CAR) and Current & Savings Account Ratio (CASA) that have been on the decline. In the coming weeks, NIM is further likely to reduce due to an increase in bank NPAs.

As reported on April 1st, here are the 5 best – and worst – banks ranked by its CASA ratio.

Worst five	Casa ratio (%)
DCB Bank	23.0
City Union Bank	23.4
IDFC First Bank	24.1
South Indian Bank	25.2
Lakshmi Vilas Bank	25.9
Best five	**Casa ratio (%)**
Kotak Mahindra Bank	53.7
United Bank of India	51.4
Bank of Maharashtra	48.1
IDBI Bank	47.7
Allahabad Bank	47.2

(**Source:** Economic Times)

Covid-19 Impact on India's BFSI sector

Highlights from the Report:

- Banks and NBFCs to witness an increase in liquidity and capital adequacy issues
- Increase in cashless payments accompanied by the rise in usage of digital channels
- Artificial intelligence, data analytics and automation technologies to find greater applications in operations and customer service
- Increase in bad loans and NPAs for Banks and NBFCs
- Rise in the health insurance business and COVID-19 specific loans and insurance products to appear
- Development of cyber security solutions to prevent fraudulent activities

(**Source:** Economic Times)

Apart from NIM and the CASA ratio, banks are likely to be adversely impacted by the increased cost of deposits and lower interest income. However, with the RBI lowering its reverse repo rates, banks can improve their retail asset business towards the end of the year.

Like any other nation, India's BFSI sector is largely dependent on a robust economy and business activity for growth. With the current pandemic, the health of this sector will depend on the quick recovery of India's economy. To steer the country through these unprecedented times, the RBI and the Indian government have implemented several fiscal measures that are providing relief to financial institutions.

Impact on NBFCS and HFCS

Overhauling the business model

Owing to disruption due to the pandemic, companies have to adapt to the new normal, which would, in turn, lead to a recalibration of every model and processes

Liability impact

Although measures by the RBI would help in facilitating liquidity to the sector, it may not lead to credit flow in the economy as the lending institutions would prioritise liquidity over balance sheet growth

Collection impact

Lending institutions are likely to observe heightened delinquencies in second and third quarters (after the expiry of the moratorium) as the halt in business activity due to the lockdown would severely impact cash flows of the borrowers.

Reporting impact

Banks follow Indian GAAP, whereas NBFCs and HFCs follow Ind-AS. The difference in quantification and reporting of ECL is likely to have a severe impact on the results of the lending institutions.

The role of RBI in fixing economy

To be able to prepare ourselves for the worst, it is important to focus on not just fiscal policies but also on social policies. Banks are taking initiatives to prevent bankruptcy of enterprises and get ready for a rebound. The World bank approved a sum of $1 billion and released the first tranche for the health sector in India. Also, the Reserve Bank of India structured a series of measures to restore the beleaguered economy that includes liquidity booster service, cutting down of repo rate, TLTRO, short-term funds, reducing LCR, increasing digitalization and many more.

Some of the key measures announced by the Reserve Bank of India and the government to mitigate impact of the pandemic on businesses have been the following:

- 6 month moratorium on EMIs
- Refinancing facilities for all India financial institutions such as the NABARD, SIDBI and NHB
- Constant reduction in repo rates under the liquidity adjustment facility
- Second tranche of targeted long-term repo operations (TLTRO 2.0) for an aggregate amount of INR 50,000 crore

https://www.grantthornton.in/en/insights/articles/covid-19-impact-on-shadow-banking-sector

Rise in WMA limit: Short- Term funding

We can see that banks play a very crucial role to throttle back in reviving the worst economic downturn ever. The RBI increased the short-term borrowing capacity by over 65% for the central government relieving the fear of excessive interest rates and the strain on bond markets through WMA. It has also eased up the borrowing norms and increasing liquidity into markets to balance the investors risk aversion. These raise in WMA limits states the fact that banks are helping the markets against large disruption considering the present tension. Though it is short-term, the government would come up with extra borrowing and liquidity at a stage. These aids would facilitate businesses to meet mismatches in revenue and tide over the current situation.

Slashing reverse repo rate

As the banks eased the rules for frozen dividend payments and has cut reverse repo rate by 25 bps to 3.75% under Liquidity Adjustment Facility (LAF), we can witness an expansion in liquidity across markets as an attempt to temper into normalcy. Through this, the banks can help business to withstand any temporary closure of liability market and to regulate it by lending funds for sustenance. Further, this rate cutting encourages banks to lend more money to the productive sectors and refrain from dumping funds with RBI. Target long term repo operations (TLTRO) with an amount of Rs.50,000 Cr is allocated to the support NBFCs, MFIs and small to mid-sized corporates in different tranches. This reduction in repo rate would benefit in meeting the needs of sectoral credits, refinancing and other finance companies.

Additional liquidity measures

Banking sectors are taking measures to mobilize the support system on an everyday basis with business continuity plans, contingency plans. Also, it has reached out to financial regulators to facilitate capital requirements besides easing loan allocation and cutting interest rates adhering to its center's policies and regulations. The RBI reduced liquidity coverage ratio (LCR) from 100% to 80% to survive the stress by providing short-term resilience to any liquidity disturbance thereby, ensuring liquidity sufficiency. When there is enough flow of liquid assets without impediments, it becomes easy to obtain funds through them.

Pushing banks to digitalization

With the on-going pandemic tension, we can observe that the digital channels are the unanimous option to deliver majority of transactions and services. The pandemic has significantly reduced offline transactions whilst the government is urging people to embrace digital operations as physical currencies could act as carriers and transmitters of the virus. Thereby, we are seeing a 42% increase in the number of people using digital payments fairly which means the present situation has brought it not-so-tech savy crowd closer to the digital environment. Even after the settling of corona crisis, people would still prefer going cashless with QR code based payments, internet banking, touch-based cards, Gpay, PhonePe, etc concerning the aftermath of the pandemic.

Sustaining with RPA

In order to sustain in this ecosystem, banks shall start to accelerate the mobile transaction mechanism, initiating new onboarding capabilities, increasing limits at POS, establishing updates regulation, improving security to manage money online with regulators. Banks adopting RPA improves agility- by automating manual and repetitive tasks such as e-mail responders, support system and account flexibility. Process Automation ensures lesser human intervention thereby reducing the risk of human errors and accelerating processes. Communication and transfer of huge volumes of data from legacy system to new models become seamless with shorter turnaround time per request- for a customer-centric approach. Thus, we can say the RPA brings down labour costs and improves operational efficiency. This is just not all, RPA can tracks customer details in no time and addresses their query quickly reducing waiting period. Once RPA resolves the lower priority tasks, it automatically finds time and space for the employees to focus on high priority tasks and other innovative ideas to improve customer relation.

Support for the financial lenders

The Reserve Bank of India has reaffirmed its faith in the banking system and Governor Shaktikanta Das has assured investors that domestic banks are safe and sound. The central bank has stated it will remain vigilant and step in to preserve financial stability as and when required. Clearly, the RBI is on a war footing, and is prepared to do 'whatever it takes' to keep the economy afloat.

In line with this, Das announced a slew of measures on 27 March to enable financial lenders to navigate the crisis and support borrowers to tide over the rough patch. Key among them are:

1. Policy rate cut by 75 basis points to 4.4%2.
2. Targeted long-term repo operations from a three-year time frame of Rs 1 lakh crore.
3. Provision of additional liquidity through marginal standing facility of Rs 1.37 lakh crore by dipping into the statutory liquidity ratio to an extent of 100 bps.
4. Provision of additional liquidity of Rs 1.37 lakh crore by reducing the cash reserve ratio by 100 bps to 3.0%.
5. Deferment in implementation of capital conservation buffer (62 bps of risk weighted assets) for six months.
6. Non-reclassification of term loans and working capital loans for three months.

Announcements by RBI and after effects

After a series of policy measures announced by the Finance Minister to handhold the economy, the Reserve Bank of India took extraordinary measures and cut Repurchase Options (REPO) rate by 0.75 percent. The rate cut intervention by the RBI will infuse the much-needed liquidity into the market and lower the cost of borrowing. It

is pertinent to mention here that the Monetary Policy Committee (MPC) meeting was earlier scheduled from March 31 to April 3, 2020. However, looking at the deteriorating economic situation amid the crashing stock market, it was preponed to March 25-27, 2020.

The announcements

The Reserve Bank of India has cut the major policy rates, and the changes are as follows-

- The benchmark policy rate, i.e. Repo rate, has been reduced by 75 basis points (0.75 percent). The effective Repo rate stands at 4.4 percent, down from 5.5 percent earlier. This reduction is even higher than the cut in times of global financial crisis in 2009 (4.75 percent).
- The Reverse Repo rate has been reduced by 90 basis points. It stands at four percent now. It has been done in a bid to maintain financial stability and revive growth.
- The Cash Reserve Ratio (CRR) has been reduced by 100 basis points (one percent). After the reduction, CRR is at three percent (earlier four percent) of the Net time and Demand Liabilities (NDTL) for a period of one year.
- The Central bank has urged the banking institutions to defer taking Equated Monthly Installments (EMIs) of all term loans which were due as on March 1, 2020, for a period of three months. The appeal comes at a time when the economy is facing severe demand slowdown.
- The RBI Governor conceded the fact that the overall outlook looks uncertain and the growth in upcoming months will depend on how India fights the Coronavirus menace.

The positive effects

At a time when the country is facing force shutdown, the policy measures have come as a breather. The announcement will possibly have the following effects on the economy.

- The reduction in Repo rate will lower the cost of borrowing, and the loans will become cheaper. The reduction in Repo rate is expected to inject Rs 3.75 lakh crore in the economy. In the times of crisis, it will be a huge liquidity support for the country. The real estate sector is expected to gain from this support.
- The slashing of Reverse repo rate will discourage banks from keeping the money with the RBI and will leave them with greater assets to disburse as loans.
- The reduced requirement of CRR will leave banks with more liquidity, which in turn will be forwarded as credit.
- The appeal to defer the EMIs for at least three months will ease the already strained business community, especially the real estate borrowers.

In the backdrop of policy measures announced by the Finance Minister on March 26, 2020, the massive rate cut by the RBI will ease the liquidity crunch and help economy sail through the tough times.

RBI announces additional measures to mitigate impact of second covid-19 wave

The measures were listed by RBI governor Shaktikanta Das on Friday as part of his announcement on the central bank's monetary policy. Reserve Bank of India (RBI) governor Shaktikanta Das on Friday announced additional measures to tackle the impact of the second wave of Covid-19 on the economy and financial markets. The measures were listed by Das as part of his announcement on the RBI's monetary policy and, according to him, were taken based on a "continuous assessment" of the situation by the central bank.

Additional measures as announced by RBI are as follows

1. On-tap liquidity window for contact intensive sectors

A separate liquidity window of ₹15,000 crore opened till March 31, 2022, with tenures of up to three years at the repo rate and kept unchanged at 4 per cent. Under this, banks can provide fresh lending support to hotels, restaurants, travel agents, tour operators, aviation services, private bus operators, car repair services, event or conference managers, spa clinics, beauty parlours and salons.

2. Special liquidity facility to SIDBI

To further support the funding requirements of micro, small and medium enterprises (MSMEs), special liquidity of ₹16,000 crore extended to the Small Industries Development Bank of India (SIDBI). The service to be available at the prevailing repo rate for up to one year, and could be further extended depending on its usage.

3. Enhancement of exposure thresholds under resolution framework 2.0

To extend the benefits of resolution framework 2.0 (announced by the RBI on May 5), to a larger set of borrowers, the coverage of borrowers under the scheme expanded by enhancing the maximum aggregate threshold from ₹25 crore to ₹50 crore for MSMEs, non-MSMEs, small businesses and loans to individuals for business purposes.

4. Placement of margins of government securities transactions

To ease operational constraints faced by foreign portfolio investors (FPIs), authorised dealer banks allowed placing margins on behalf of their FPI clients for transactions in government securities, within the credit risk management framework of banks.

5. Facilitating flexibility in liquid management

Regional rural banks (RRBs) allowed to issue certificates of deposit (CDs) to ensure greater flexibility in raising short-term funds by RRBs. Also, subject to certain conditions, issuers of CDs permitted to buy back CDs before maturity.

6. Availability of National Automated Clearing House (NACH) extended

For customers' convenience, NACH, currently available only on bank working days, proposed to be made available throughout the week effective from August 1, 2021. NACH is a prominent mode of direct benefit transfer (DBT), which facilitates credit transfers such as payment of dividend, interest, salary, pensions etc, as well as payments related to services like electricity, gas, telephone, water etc.

Conclusion: Embracing the new normal

Considering the unprecedented times that we are in today, it is inspiriting to see RBI taking steps to these issues at war footing. We believe these measures to pump in the required liquidity, bring about sufficient credit flow and extend its

hand to provide flexibility in practicing regulatory forbearance. Banks embracing technologies like RPA allow customers to quickly transact or operate their account without having to wait for physical approval. Also, operating with agile methodology means supporting customers at any point during crisis by responding to their redefined expectations, currently, via digital channels. From being a just a support system, technology will now take the frontline in banking sector. Automation will rule over the banking ecosystem and the digital tools will become inevitable pertinent in banking and finance sectors and shall outlast the pandemic. People and businesses will now perceive this as the new normal of the future.

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