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End of LIBOR

Indian banks and companies need to be guided by policymakers through this transition

As companies that borrow in overseas markets get ready for a new era post-2020, one in which the London Interbank Offered Rate no longer exists, policymakers need to gear up too, to smoothen the process. This transition is not likely to be easy, as trillions of dollars of loans and derivatives will have to be re-priced. While some companies may benefit, many could incur losses and legal as well as account-related problems could emerge. LIBOR, which is the rate at which banks borrow wholesale unsecured loans from each other, has been the world's most preferred benchmark so far. But it is not difficult to see why the decision to discontinue the rate was taken. The manner of arriving at the LIBOR has come under severe criticism since 2012, when it was found that a few banks were manipulating it. The rate is based on the estimates of the cost of funds of a panel of banks and therefore reflects the credit profile of a narrow set of banks. The rate is also no more relevant since the transactions in the interbank market have dwindled since the global financial crisis. With over $300 trillion of loans and derivatives referenced to it, the transition could cause a severe upheaval in global markets.

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Of concern is the fact that many firms are either unaware or unwilling to make the adjustments needed to transition to other alternative reference rates, yet. According to the Bank of England, in loan markets, LIBOR-linked lending continues to dominate. Despite the announcement of the phase-out, many new long-dated derivative contracts, maturing after 2021, continue to be benchmarked to the LIBOR. But the sooner companies begin adjusting to the new regime, the better. With Indian firms increasingly turning to overseas market for their financing needs, challenges lie ahead. A large part of the external commercial borrowings, that account for 38 per cent of our external debt, is likely to be referenced to the LIBOR, with the ultimate interest rate charged dependent on the credit risk profile of the company. Indian banks as well as corporates need to find a viable alternative benchmark.

It is good that the Indian Banks' Association has set up a working group to study the impact of the transition. The Reserve Bank of India should also study the impact of this change and issue guidelines to banks. Many countries have begun offering alternatives to the LIBOR. Since mid-2018, the UK has begun publishing the revamped Sterling Overnight Index Average (Sonia) and the US is publishing Secured Overnight Financing Rate (Sofr). The Euro short-term rate (estr) and Japan's Tokyo overnight average rate (Tonar) are other alternatives for borrowers. The RBI could study these options and help suggest the most viable rate to overseas borrowers. Besides this, the central bank will also have to guide banks and companies on the manner in which the transition needs to be accounted for in the books.

FROM THE VIEWSROOM

It's just not football

The Bulgarian fans' behaviour brought shame to the sport and themselves

Sport can be sublime and the performance of sportspersons has often been compared with art. The accomplishments of sportspersons, especially those achieved against severe odds, have justly been celebrated over the years.

But sport has also always had a dark and ugly side to it. This was in full display on Monday, when England played Bulgaria at the Vasil Levski Stadium in Sofia during a Euro qualifier match. The match was marred by constant racist chanting by the home fans — especially during the first half — with a section of the crowd even indulging in a display of Nazi salutes. The racist chanting was so bad that play had to be stopped twice to warn the crowd of abandoning the match.

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In the midst of all this nasty behaviour, the England team has won all-round praise for keeping its composure and continuing with the match. Tyrone Mings of England must have wondered what he did to deserve such a vile atmosphere, that too on his debut match for his nation. But he soldiered on, despite having the option of walking off the pitch. Incredibly enough, the Bulgarian goalkeeper Plamen Iliev did not find anything wrong with some home fans' behaviour and even added that the England players were "overreacting". Bulgarian manager Krasimir Balakov even said that he had not heard anything untoward — but after much pressure, he apologised for the home fans' racist behaviour. Bulgarian football chief Borislav Mihaylov resigned after these sordid events, but not without initially trying to weather the storm.

Racism was rife in the world of football in the 1970s and 80s, especially in England. England's football "hooligans" were much dreaded when they travelled abroad to watch their team play. But things improved remarkably in the 1990s, and now we have only isolated incidents of racist behaviour in English stadiums. But the 'racism virus' has now caught on in some countries in Eastern Europe, and the UEFA must do more to eradicate it.

B Baskar Deputy Editor

MSME loan freebies, and the NPA fallout

Another huge build-up of NPAs is round the corner, even as it may not show up in the books of public sector banks this fiscal

MADAN SABNAVIS

The idea of loan *melas* is disruptive and the present thrust being provided to the SME sector through the banking channel can cause a bit of worry. The steps that have been spoken of are in the form of widening the reach of banks — especially those in the public sector — to ensure that there is better flow of funds.

Besides the setting of targets to be met by the banks, there have been announcements of one-time settlements for such loans, and not calling missed payments as NPAs (non-performing assets) till March 2020. The concern to alleviate their problems is palpable, considering that this sector has been adversely affected on account of both demonetisation and the implementation of GST. There are also schemes such as loans to be sanctioned in 59 minutes and special trading portals. In this context, it would be instructive to examine how these assets have performed.

Adversity in lending

The top six banks in the public sector (SBI, BoB, PNB, Canara Bank, Bank of India and Union Bank) and private sector (ICICI, HDFC, Axis, Kotak Mahindra, IndusInd and YES Bank) have been considered for this analysis. The table provides information of NPAs of these banks in both the priority and non-priority sectors for FY19.

The table shows that the private sector banks had a better NPA ratio compared with their public sector counterparts, the former's being a little over half of that of the latter. The ratios across both the priority and non-priority sectors are interesting, as they present different pictures.

In the case of priority sector, the PSBs had a distinctly higher NPA ratio of 10.04 per cent as against 2.04 per cent for private banks. Clearly, this difference has got a lot to do with the choice of customers as well as the mindset of borrowers. Across all priority sector segments barring personal loans, PSBs had double-digit ratios with the peak being in the industry category at 16.5 per cent. This refers to the SME lending or MUDRA loans which come under priority sector lending.

For services, which would once again primarily be by the SMEs in this segment, the ratio was 10.6 per cent. The private banks had much lower numbers of 1.5 per cent in industry and 1.56 per cent in services. Therefore, there has clearly been a case of adverse selection which can be attributed to an extent to the nudge provided from above, which is missing in the case of private banks, where the decisions are taken based more on commercial considerations. Also, the PSBs have to take responsibility for not appraising potential customers in an efficient manner.

There is also the case of a moral hazard that has permeated the borrowers, especially in agriculture, where the prospect of a farm-loan waiver gives an incentive to delay payments.

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This explains why the ratio is higher at 11.36 per cent for PSBs as against 3.78 per cent for private banks. While the former may be faulted for lower level of due diligence when disbursing credit, the pressure from above cannot be ruled out, especially as there has been relentless pressure on public sector banks to meet targets to provide support to this sector.

The same does not hold for private banks, which do similar kind of lending mandated by the priority sector norms and are able to manage a cleaner portfolio.

Performance analysis

Gross NPA ratios for 6 public sector and 6 private sector banks for FY19 (%)

	Priority		Non-Priority		All	
	PSBs	Private	PSBs	Private	PSBs	Private
Agri	11.36	3.78	2.56	2.8	10.69	3.71
Industry	16.45	1.5	15.79	8.89	15.87	7.68
Services	10.57	1.56	9.89	2.85	10.1	2.49
Personal	2.15	0.91	1.97	1.11	2.02	1.07
Total	**10.04**	**2.04**	**5.7**	**4.53**	**7.01**	**3.86**

Source: Annual Reports of all 12 banks for FY19

Declaring assets

The non-priority sector NPA ratios for the two sets of banks present a contrasting picture. In the case of PSBs, the ratio is lower than that for the priority sector even though for industry, the ratio remains above 15 per cent as against the 8.89 per cent of private banks, which is relatively lower, but still high nonetheless.

This can be attributed to the fact that after the AQR (asset quality recognition) was introduced by the RBI, the PSBs went on a massive clean-up operation and these assets came to the fore. They had larger exposures to sectors which got embroiled in controversy — such as steel, power, mining and telecom — which subsequently went through the CDR process before landing in the IBC net. For the private banks, this scenario came with a lag; which is why for some of them, the NPAs to industry in particular have risen of late.

Interestingly, in the case of personal loans, the NPA ratios for the PSBs, though low, have been higher than those of private banks. This means that there is scope for them to improve their credit appraisal systems, which will mean reskilling as the retail segment has become progressively more important and the regulators — the RBI and SEBI — are working towards moving long-term funding to the corporate bond market.

Also, with the new external benchmarking system that came in force from October 1 for SMEs and retail customers, the market risk originating from re-pricing periodically would pose a challenge. When it comes to SMEs, the risk would double as they would also inherently be more vulnerable to turning into NPAs.

Future risks

What does this mean? The present overdrive to bail out the SME segment through various banking measures is fraught with a big risk of enlarging the NPA size, especially for PSBs. As banks do not have to classify them as NPAs for missed payment this year, the numbers to be presented for FY20 may not present the right picture for both manufacturing and services. This can also cause bunching in the subsequent year, when the NPAs are recognised.

All this will mean that the stability that may have been achieved in these ratios for banks may be ephemeral. And as PSBs are finally owned by the government and therefore have to pursue common goals, greater care has to be taken when disbursing loans as they are more vulnerable relative to private banks.

The writer is Chief Economist, CARE Ratings. Views are personal

Focus of climate finance needs to change

For poorer countries, funds for 'adaptation' make more sense than 'mitigation'. A retreat from climate hotspots is to be explored

NILANJAN GHOSH
ANAMITRA ANURAG DANDA

The Climate Action Summit held at New York in September (amidst one of the largest environmental protests ever and a heart-wrenching speech from Greta Thunberg) seems to be inflicted by the age-old assumption that adaptation (impacts) to climate change has its limits, and mitigation (causes) deserves more emphasis. There is scant acknowledgement that large parts of the underdeveloped and the developing world might not have the wherewithal for mitigation. Under such circumstances, adaptation seems to be the only answer.

Historically, mitigation projects have always been preferred for funding over adaptation projects. But, the Green Climate Fund (GCF) remained a rare exception, offering funding for both mitigation and adaptation, while being guided by the UNFCCC principles and provisions. The GCF provides support in the form of grants (45 per cent of allocated fund till date), loans (42 per cent), equities (9 per cent), guarantees (2 per cent), and results-based payments. At present, the share of funds allocated by GCF to adaptation projects is 24 per cent and mitigation 42 per cent, while the balance 34 per cent is classified as "cross-cutting", but with a larger mitigation component. The low level of funding to adaptation can be attributed to two factors: First, adaptation is a new endeavour without much "expertise" available; and second, it primarily provides local benefits.

Adaptation funding

Adaptation experts from the LDCs and SIDs feel that the GCF has failed to channel funding to the most vulnerable communities in the most vulnerable countries, because of its mandate to act as a "bank", seeking returns on its investments. In absence of revenue streams, adaptation projects have mostly remained micro and small, and thus incremental rather than transformative. The GCF's emphasis on fiduciary and fund management capacities of both recipient country governments and implementing entities have made access to large-scale funding difficult.

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Economic value Relocation is sensible

The GCF also insists on genuine adaptation projects, not development proposals dressed up as adaptation, due to which adaptation projects from Bangladesh and Ethiopia have been rejected lately.

A solution for this may be found in the Generic Adaptation Decision Framework (GADF) that we have proposed in an article co-authored with Jayanta Bandyopadhyay and Sugata Hazra in the *Journal of Indian Ocean Region*. The GADF has been proposed to help rationalise between choices of *in-situ* adaptation (adaptation in the vulnerable region) and managed retreat (movement to safer regions). Our GADF suggests that managed retreat should be thought of if three conditions are satisfied: the socio-economic well-being under the business-as-usual (or status quo) is diminishing; the cost of *in-situ* adaptation is higher than the business-as-usual scenario; and net current value of *ex-situ* adaptation (or strategic and managed retreat) is highest of all the adaptation scenarios.

If managed retreat is found to be the best option, then development of the host location could be designed to generate a revenue stream for private investors as well as the GCF. Even the source location could generate revenue through forest regeneration and tourism concession.

Sundarbans delta

This has an application in the Sundarbans delta, which has been encountering a relative-mean-sea-level rise of the Bay of Bengal at the rate of 8 mm/year over the last decade, and is subject to regular instances of land-loss and disappearance of islands. The proportion of high intensity events (cyclones) appears to be increasing, possibly as a result of rising sea surface temperatures.

In the face of this ferocity of climate change, a long-term strategy for adaptation and mitigation for the delta is proposed by the WWF India Vision 2050, in the form of a managed retreat of population by 2050, and regeneration of mangrove forests in the vacated vulnerable zone. The economic evaluation of planned retreat vis-a-vis a scenario of inaction or "business-as-usual" — considering the various possible benefits (including those of ecosystem services) and costs — reveals that the scenario of a "managed retreat" by 2050 will yield a net economic benefit of 12.8 times of that of the status quo. The clear indications of the community's diminishing well-being, futility of the in-situ adaptation modes, and the net current value of ex-situ economy being highest among all the scenarios creates a case for a GCF grant as also a business case for "managed retreat" in the delta.

Generally speaking, a refined GADF and its application could be part of a GCF grant programme, while implementation could be a mix of loan, equity, guarantee, and results-based payments. Since the GCF is required to channelise up to $100 billion from 2020 annually to the developing countries for both mitigation and adaptation projects, recourse to a refined GADF could serve all the constituencies well.

The writers are with ORF, Kolkata. Views are personal

LETTERS TO THE EDITOR

Send your letters by email to bleditor@thehindu.co.in or by post to 'Letters to the Editor', The Hindu Business Line, Kasturi Buildings, 859-860, Anna Salai, Chennai 600002.

Changing business environment

This refers to 'Cracking the code' (October 17). The idea that India Inc emulate the example of the software industry is timely. From massive on-campus recruitment of engineering graduates in the past, to the recent trend of reskilling its workforce in new technologies , the Indian software industry has come a long way in facing the emerging challenges and changing customer requirements.

'Resilience' is a quality that the rest of India Inc would do well to learn from their counterparts in the software industry. The days of staunch customer loyalty to brands are long past. With the advent of online business portals, even established businesses are facing margin pressures. Lobbying with the government to reduce taxes or provide sops also has its limits.

In the circumstances, the way forward for Indian Inc is to adapt itself to the changing business environment. Baja Auto re-introducing Chetak as an all-electric avatar is one such example. Indian companies also need to become 'customer centric', rather than focus only on 'customer service'.

V Jayaraman
Chennai

Appointment criteria

This refers to 'A suitable deputy governor for the RBI' (October 17). The concerns mentioned are real and the suggestions given are excellent. From 2013 (arrival of Raghuram Rajan) to 2019 (departure of Viral Acharya), despite controversies, RBI observers were of the impression that the government had a genuine interest in infusing professionalism at the top in the central bank. This was reinforced by the choice of members of the Monetary Policy Committee.

The forced exits of two governors in 2016 and 2018, followed by the resignation of deputy governor Viral Acharya, have not augured well for policy stability at the RBI. But, that is no reason to put generalists above professional economists to fill the vacancies.

While there should not be compromise on talent, top positions in such organisations should be reserved for those interested in long-term association. If remuneration or service conditions do not compare well with those in the global market, they should be reviewed for immediate revision.

MG Warrier
Mumbai

Subsidise ZBNF

Apropos 'ZBNF spells *amogh* benefits for this farmer' (October 17). Zero budget natural farming is certainly an experiment worth trying, though the dominating myths have to be cleared by experts, as there is bound to be some tribulations during the transition from the traditional methods adopted thus far.

Rejuvenating the soil fertility is not an overnight process, and only if the government subsidises natural farming and compensates eventual yield loss during the transition, can the experiment be a success.

Rajiv N Magal
Hassan

Who's to blame?

This refers to 'Watchdogs, you have failed the PMC' (see *thehindubusinessline.com*, October 17). The author hit the nail on the head by 'questioning' the role played by each one of three major categories of watchdogs in the PMC Bank imbroglio — the management, internal auditors and the RBI — that were clearly tasked with the responsibility of not only identifying but also preventing the frauds apart from enforcing and implementing effective governance.

Since the entire matter is currently being investigated by the Economic Offences Wing of the Mumbai Police, no claims can be made yet.

However, as revealed by the author, the top management of the PMC Bank could be the real culprit, who craftily stage-managed the show by presenting a highly rosy picture of its books of accounts, in gross violation of the banking sector's well settled prudential norms. While no one should be allowed to make an easy escape on any grounds whatsoever, there should be no witch-hunting either.

The interests of the hapless depositors should also be infallibly and securely watched since these 'sleeping' watchdogs have left behind a whole lot of 'sleepless' depositors.

Kumar Gupt
Panchkula

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