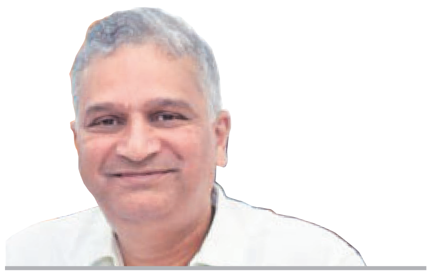


GUEST COLUMN

MADAN SABNAVIS

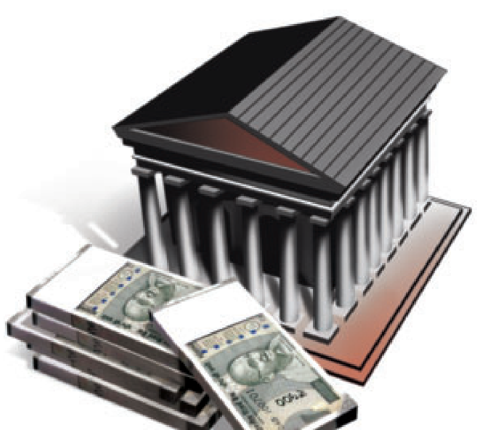
Privatisation and debt are on the radar of bankers

Public sector banks (PSBs) are in a fairly strong position today after going through a rather stressful period following the asset quality review five years ago. Profits are looking good, and more importantly, provisioning for bad loans has come down. The Insolvency and Bankruptcy Code is in motion, as is the National Asset Reconstruction Company, and hence the resolution part of the story is also addressed to a large extent, though it is a work in progress.

The Budget will be presented against the background of a possible recession in the West which will go hand-in-hand with a regime of high interest rates. India will still be the fastest-growing economy, at least numerically, though admittedly a plethora of issues need to be addressed. What would be the areas of interest for banks in this Budget?

First is the question of whether or not the government will make a provision for capitalisation of PSBs?

This is important because, while growth in credit will slow down, it will still be above 10 per cent. While lower provisioning and higher profits, which come in a rising interest rate regime, will lead to increase in net worth, there could still be a case for some capital infusion, especially if the investment cycle is to start moving. A factor that may also work in favour of domestic credit is the regime of high interest rates in the West, which will make external commercial borrowing dearer when combined with the depreciating rupee. Hence, having access to capital would help.



Banks were challenged in 2022 by the sluggish growth in deposits, which have not kept pace with credit. One reason is that deposits, unlike debt mutual funds, do not offer any tax breaks

Second, banks have been challenged in 2022 by the phenomenon of sluggish growth in deposits, which have not kept pace with credit. One of the reasons is that deposits do not curry any tax favour. Debt mutual funds, for example, which compete with deposits, provide tax breaks if held for over three years. There is a legitimate demand here for parity on tax treatment, so that bank deposits regain their attractiveness.

Third, the fiscal deficit will be of interest for banks. This is so because it will determine the gross borrowing programme of the government, which has to be supported by the banking system. In FY24, there will be repayments of around ₹4.5 trillion, which will push up the gross borrowing programme. The conundrum this time is that banks are facing a paucity of funds, with growth in deposits lagging. Hence, if a large borrowing programme has to be supported, there could be further pressure on liquidity. Excess investments under the statutory liquidity ratio are currently upwards of 8 per cent for most banks.

Fourth, the policy-level stance on the Emergency Credit Line Guarantee Scheme will be of interest, as it has run well so far. The questions that will be waiting to be answered are whether or not there will be a sunset clause; and whether an extension will be provided to more sectors. Small businesses have benefited from this scheme, or else it would have been hard for them to borrow from banks.

Fifth, the view taken on interest payments by the government will intuitively provide a clue on the direction of interest rates (assumed by the government). It is widely expected that after the February policy, the Monetary Policy Committee will pause on rate actions before lowering the repo rate. The interest cost assumed in the Budget will throw some light on how the central bank will be managing the liquidity situation.

Sixth, PSBs will also be waiting to hear more from the government on its stance on privatisation of some of them, as this was proposed a couple of years back, but has not been taken up so far.

The budget will definitely be a prelude from where the RBI will take over in its February policy.

The writer is Chief Economist, Bank of Baroda, and author of Lockdown or Economic Destruction? *The views are personal*

The big green reset

Major changes are afoot in the credit markets as the transition to a low-carbon economy gathers pace, reports **Raghu Mohan**

On January 25, we will cross a key milestone: The Reserve Bank of India (RBI) will conduct the first ever auction of sovereign green bonds (SGrBs). Two securities for a cumulative ₹8,000 crore will be on sale — five- and 10-year SGrBs, each for ₹4,000 crore. (The proceeds are to be deployed in government projects that aim to reduce the economy's carbon footprint.)

In FY24, we may be on the cusp of a noticeable shift in the way credit is appraised and extended. A green taxonomy is in the works — to help lenders better assess climate risks in their books, scale up green and sustainable finance, and mitigate the risk of "green-washing."

Speaking at the *Business Standard* BFSI Insight Summit in Mumbai (December 22, 2022), RBI Deputy Governor M Rajeshwar Rao said: "A formal definition of green finance along with a taxonomy is the need of the hour, as it would enable more precise tracking of finance flows to green sectors in India, which in turn would help design effective policy, regulations and institutional mechanisms directed towards increasing both public and private investments."

Progress towards a low-carbon economy has quickened. The SGrB auctions come within three months of Finance Minister Nirmala Sitharaman finalising the sovereign green bonds framework last November. It followed the RBI's *Survey on Climate Risk and Sustainable Finance* in July 2022, and the Securities and Exchange Board of India's reporting architecture on sustainable finance a month later.

On the green road

Green Finance in India: Progress and Challenges, a paper in the RBI's January 2021 monthly bulletin (by Saurabh Ghosh, Siddhartha Nath and Abhishek Ranjan of the central bank's Department of Economic and Policy Research) observed that "the cost of issuing green bonds has generally remained higher than other bonds." The average coupon rate for green bonds issued since 2015 with maturities of five to 10 years has been higher than those on corporate and government bonds of similar tenure.

Now, the pricing at the maiden SGrB auctions next week will set the benchmark for India Inc's green bonds, as such issuances will have a mark-up over SGrBs. This will be keenly watched, since it will have an impact when India Inc draws up its capex ambitions for the decades to follow. And we are in completely uncharted waters.

"Even globally, much of the carbon accounting methodologies are still evolving. There is also a chasm on climate risk — where environmental scientists don't understand finance well enough and finance professionals don't completely understand the science," said Deepak Parekh, chairman of mortgage lender HDFC, while speaking at the 21st World Congress of Accountants on November 21.

He added: "I have heard many laments saying that lack of climate and emissions data is the biggest hindrance. Yet, hiding behind lack of data is not an excuse. There is no reason why the Indian financial system, for instance, cannot collaborate together on climate risk and measuring financed emissions."

Just what is the pain for banks?

"Climate-related risks are manifesting through traditional risk channels," says Rajiv Anand, deputy managing director, Axis Bank. These include the borrower's inability to repay loans (credit risk); reduction or re-pricing due to climate regulation (market risk); reduced access to funding due to changing market conditions (liquidity risk); legal and compliance risk related to climate-sensitive investment (operational risk); and reputational risk arising from changes in market and consumer sentiment.

"There's a lack of certainty about the severity and frequency of these risks, making it even more important for banks to proactively identify and manage the risks and opportunities that are arising from climate change," Anand adds.

The transition will vary across sectors.

"While India is working on a specific taxonomy, it's not an issue when it comes to lending to green sectors like solar LED lighting or electric vehicles," notes Govind Sankaranarayanan, co-founder and chief operating officer, Ecofy — a new-age "green" shadow bank. "But yes, when it comes to other sectors, like pharmaceuticals, then taxonomy becomes critical. One can always look at the way the European Union (EU) has gone about it until we have our version of a taxonomy."

Incidentally, the Hong Kong-based Asia Securities Industry & Financial Markets Association released its first *Green Taxonomy Survey* last month on the common themes and issues in sustainable finance in the Asia-Pacific region and beyond — 75 per cent of the respondents were using a taxonomy with the *EU Taxonomy of Sustainable Activities* dominating.

A lot is at stake as we take the green path.

The *2023 ESG Outlook from Moody's Investors Service*, an analysis of the transition plans of rated non-financial companies, suggests that those most exposed to carbon-transition risks are the least likely to disclose ambitious and detailed carbon-transition plans, making them least prepared for increased scrutiny of corporate transition plans, and the associated credit implications.

Its data shows that few rated companies in the oil and gas, mining and agriculture sectors disclose such plans. And "this may, in part, reflect the financial and technological challenges that entities in these sectors face in cutting their emissions, and the legal actions they may expose themselves to if they set ambitious targets that they cannot meet."

"Companies could see their cost of capital increase if investors lose confidence in their ability to manage the transition," says Rebecca Karnovitz, vice-president (senior credit officer), Moody's Investors Service. "In our latest environmental risk heat map, 16 sectors with $4.9 trillion of debt have high, or very high inherent exposure to carbon-transition risk. These sectors include oil and gas, regulated and unregulated electric utilities, automotive manufacturers, chemicals, steel, shipping and airlines."

In effect, transition costs will be passed on to the end-user as pricing across the supply chain gets impacted. It would lead to elevated social risks for a range of public and private entities owing to high cost-of-living concerns, and heightened refinancing risks for lower-rated issuers for which governance attributes tend to weaken resilience to external shocks — even as the macroeconomic, financial and geopolitical fallout of the pandemic and the Russia-Ukraine conflict continues to exacerbate ESG (environmental, social, and corporate governance) risks.

The RBI's *Financial Stability Report* (*FSR*, July 2021) observed that a cross-industry disciplinary forum is needed to launch a comprehensive climate risk assessment. A key prerequisite is to develop emission reduction pathways for energy-intensive sectors, map them onto macroeconomic and financial variables, and integrate them with quantitative climate risk-related disclosures to develop a holistic approach to addressing the financial stability risks arising out of climate change.

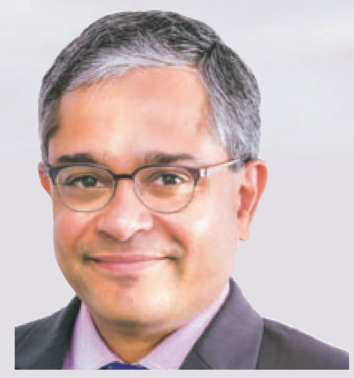
Welcome to the world of green finance.

A formal definition of green finance along with a taxonomy is the need of the hour. It would enable more precise tracking of financial flows to green sectors

M RAJESHWAR RAO
Deputy Governor,
Reserve Bank of India

I have heard many laments saying that lack of climate and emissions data is the biggest hindrance. Yet, hiding behind lack of data is not an excuse

DEEPAK PAREKH
Chairman,
HDFC



There's a lack of certainty about the severity of climate-related risks. It is important for banks to proactively manage the risks and opportunities

RAJIV ANAND
Deputy Managing Director,
Axis Bank

In our latest environmental risk heat map, 16 sectors with $4.9 trillion of debt have high or very high exposure to carbon-transition risk

REBECCA KARNOVITZ
Vice-President (Senior Credit Officer),
Moody's Investors Service

GREEN BONDS ISSUANCE SINCE JAN 1, 2018

(Corporate and government: All maturities)

Country	Amount issued ($ mn)	Number of bonds issued	Amount issued as % of all bond issuance	Number of bonds issued as % of all bond issuance
Euro Area	196,854	594	1.70	0.4
China	63,023	183	0.30	0.2
USA	35,421	71	0.20	0.2
Japan	111,815	88	0.10	1.1
South Korea	11,781	44	1.00	0.4
Central & Southern America	8,869	53	0.50	1.0
India	7,992	22	0.70	0.3
South East Asia	7,208	86	0.60	1.4
Australia & New Zealand	5,878	15	1.10	0.8
UK	5,311	17	0.40	0.5
Hong Kong	4,781	19	0.50	1.0
Singapore	496	9	0.05	1.2

Source: RBI Bulletin, January 2021

Foreign banks: Where to from here?

RAGHU MOHAN

The number of foreign bank branches in India soared to 861 in March 2022, from just 295 in FY17, even as the number of such entities in the country remained almost the same at 45. No, these banks were not on an expansion spree. As the Reserve Bank of India's (RBI's) *Report on the Trend and Progress of Banking in India 2021-22* notes, this was mainly because DBS Bank (India) acquired Lakshmi Vilas Bank (LVB), operating through the wholly owned subsidiary (WoS) route.

The marked shift in the foreign-bank narrative in the post-reform period must also be seen in another context — the renewed talk of privatisation of a clutch of state-run banks. Then RBI governor Raghuram Rajan's plea for more elbow room for foreign banks, articulated in Washington in 2013, also needs re-examining.

In the 1990s and for much of the first decade of the new millennium, there was not a foreign bank which didn't talk of having a large footprint in India — so much so that in 2002, the Dutch ING Group (through ING Bank) took over Vysya Bank. It was the first merger between a foreign and an Indian bank.

The ING Bank-Vysya Bank transaction, which happened when Bimal Jalan was RBI governor, was bold enough to give rise to hopes that foreign banks would make more such acquisitions. It never happened. The RBI under Jalan also took a different stance when, in December 2003, HSBC picked up a stake in UTI Bank (now Axis Bank) — it did not allow the deal to go through.

But hopes soared again when Rajan, as Mint Road boss, speaking in Washington in October 2013, appeared to envision foreign banks even "taking over Indian banks, small Indian banks, and so on", adding that "if you (foreign banks) adopt a WoS structure, we will allow you near-national treatment". But Rajan's use of the expression "near-national treatment" was made along with a caveat on reciprocity: "Your country should allow the same to our own banks."

And, as the RBI's *Report on the Trend and Progress of Banking in India 2012-13* pointed out, "at end-March 2013, there were 43 foreign banks operating in India with 331 branches. As against this, there were 24 Indian banks with 171 branches abroad." Clearly, India has been more favourable to foreign banks. Indeed, the RBI has made it a point to highlight over the years that its policies for foreign banks were not only compliant with India's World Trade Organisation commitments, but also far more generous than other jurisdictions.

Was Rajan's mention of reciprocity the deal breaker? We will never know.

Curiously, in August 2013, the RBI, in its discussion paper, *Banking Structure in India: The Way Forward*, also spelt out the reasons why foreign banks were needed in the country: "It arises primarily to increase competition, promote efficiency of the local banking system and also to bring in sophisticated financial services and risk-management methodologies which can be adopted by the domestic banks. Post crisis, domestic incorporation of foreign banks through the subsidiarisation route has acquired importance."

It was speculated that the departure of Goldman Sachs, Morgan Stanley, and UBS from India in 2013 (after having won banking licences) may have triggered the RBI discussion paper and Rajan's stance. This is unlikely; the exit of the global behemoths had more to do with the changed priorities at their head offices after the global financial crisis of 2008, and was less a comment on India as a business destination.

The reality is that there has been little by way of increase in freedoms for foreign banks — the position of Mint Road has not changed much. There is also nothing to suggest that the DBS Bank-LVB transaction was not an outlier. In fact, India now has only two foreign banks with full-service operations — Standard Chartered Bank and HSBC.

The upcoming Union Budget is expected to offer more clarity on the privatisation of state-run banks. The IDBI Bank sale is yet to go through; and ahead of the January 7 cut-off for expressions of interest, the government tweaked the minimum public-shareholding norm.

It is not unlikely that suitors may seek more reliefs for other state-run banks being privatised. In light of the DBS Bank-LVB deal and Canadian investor Prem Watsa's Fairfax picking up a 51 per cent stake in the Thrissur-based CSB Bank in 2018, why not revisit the RBI's August 2013 discussion paper?