BY
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IS THE NEW DEVELOPMENT FINANCE INSTITUTION ANSWER TO INDIA'S INFRASTRUCTURAL CHALLENGES?

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Is the new Development Finance Institution answer to India's infrastructural challenges?

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Introduction

The infrastructure sector is one of the key sectors for India to achieve higher economic growth rates and requires major investments into projects to push the growth rates higher. The infrastructure sector requires long-term and non-recourse financing, which is inherently risky in nature due to higher credit costs, high risk of delay and failure of projects. In the post 1990s period, this challenging task fell at the doors of the commercial banks due to the changing economic policies of the country with the reduced role of the existing Development Finance Institutions (DFIs). Over a period of the past couple of decades this resulted in bank credit turning into a high level of non-performing assets (NPAs). The NPA crisis that the banks have been going through has been much debated and discussed, unless resolved soon, can have serious consequences for the financial system. A large chunk of the NPAs are observed to be from the infrastructure sector. On the other hand, the large infrastructure projects also create socio-environmental problems like displacement, land acquisition, centralised decision making, and ecological losses among many others.

The recently released RBI's Financial Stability Report in July 2021 has projected that the non-performing assets of banks could rise from around 7.48 per cent as of the end of March this year to 9.8 per cent of total assets by March 2022 under a baseline scenario and to 11.22 per cent under a severe stress scenario. The projections given in the July report are much less pessimistic than the report released in January, in which the RBI had said that bad loans could double in a severely stressed scenario and can go up to 14.8 percent.[2] This is despite the steady write offs by banks to keep their books clean.

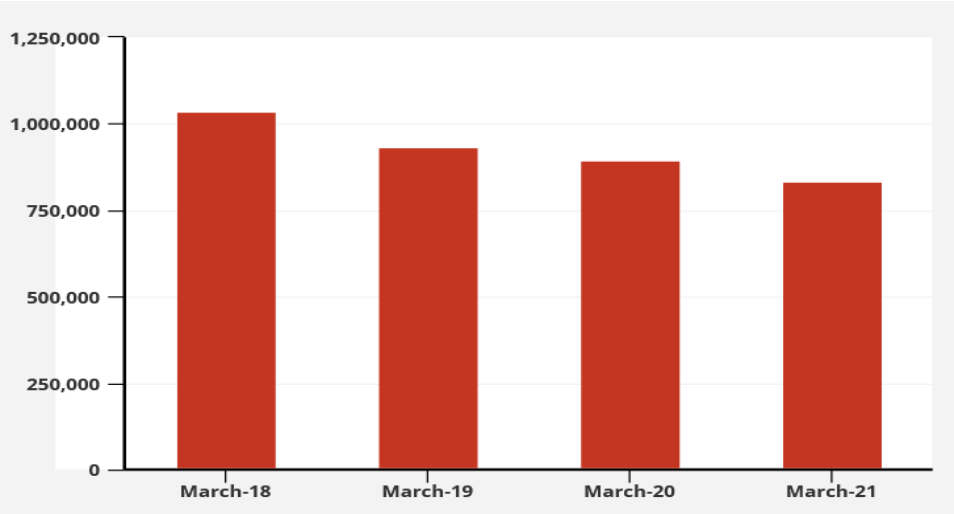
The gross NPAs of Scheduled Commercial Banks were Rs. 10,36,187 crore on 31.3.2018, Rs. 9,33,779 crore on 31.3.2019, Rs. 8,96,082 crore as on 31.3.2020, and Rs. 8,34,902 crore (provisional data) as on 31.3.2021.[3] (Fig. 1)

[2] https://www.ndtv.com/business/reserve-bank-of-india-rbi-financial-stability-report-july-2021-banks-buffers-strong-enough-to-withstand-future-shocks-2477149

[3] http://164.100.47.194/Loksabha/Questions/QResult15.aspx?qref=25133&lsno=17

Figure 1: Gross NPAs of Scheduled Commercial Banks from March 2018 to March 2021

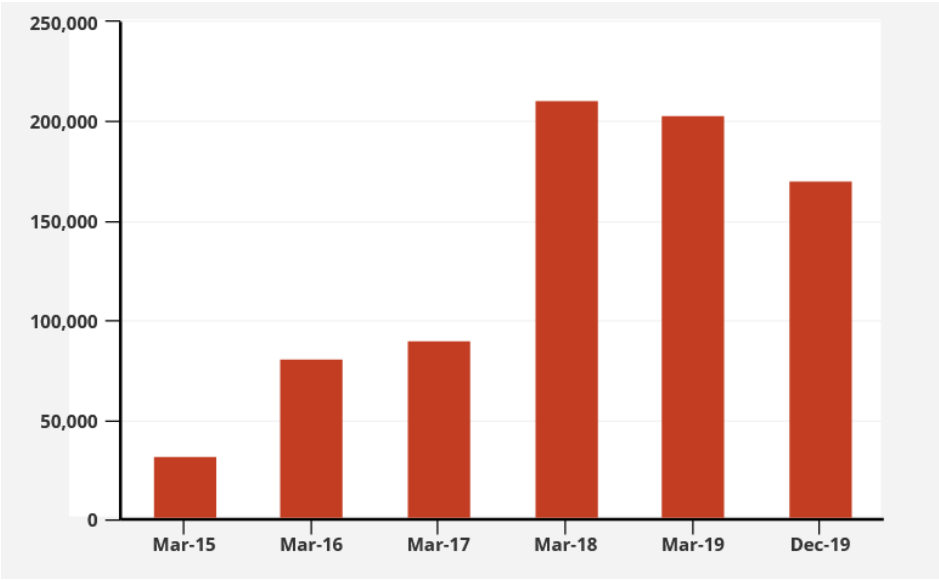
Amount in Rs Crore



The sector-wise NPAs as given in the RTI reply by the RBI for the infrastructure sector which includes power, road, telecommunication and other infrastructure is Rs 31,836 crore (March 2015); Rs 80,680 crore (March 2016); Rs 90,115 crore (March 2017); Rs 2,11,324 crore (March 2018); Rs 2,03,017 crore (March 2019); Rs 1,70,483 crore (December 2019).

Figure 2: Gross NPAs of Scheduled Commercial Banks in Infrastructure Sector from March 2015 to December 2019

Amount in Rs Crore

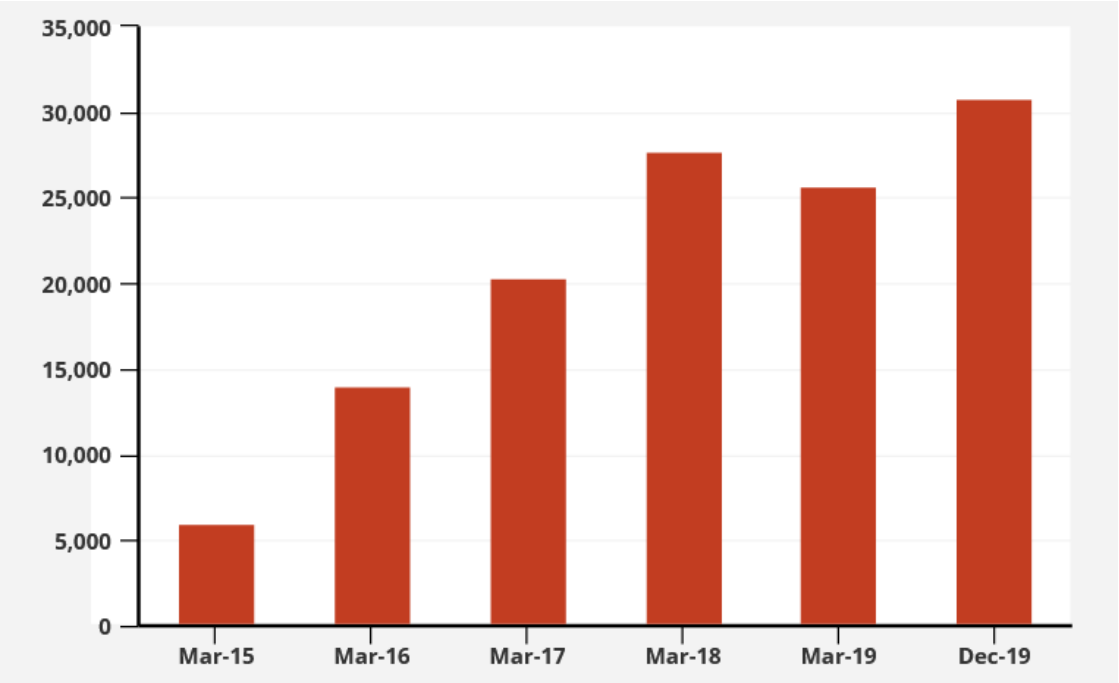


As of March 2019, NPA of both, infrastructure and construction sector combined, was Rs. 2,28,747 crore, which is 24.45% of total GNPA (Rs. 9,33,779 crore) of SCBs.

As per the information in the RTI if we include the construction sector as well this would further add Rs 5,966 crore (March 2015); Rs 13,973 crore (March 2016); Rs 20,361 crore (March 2017); Rs 27,772 crore (March 2018); Rs 25,730 crore (March 2019); Rs 30,817 crore (December 2019). (Fig. 3)

Figure 3: Gross NPAs of Scheduled Commercial Banks in Construction Sector from March 2015 to December 2019

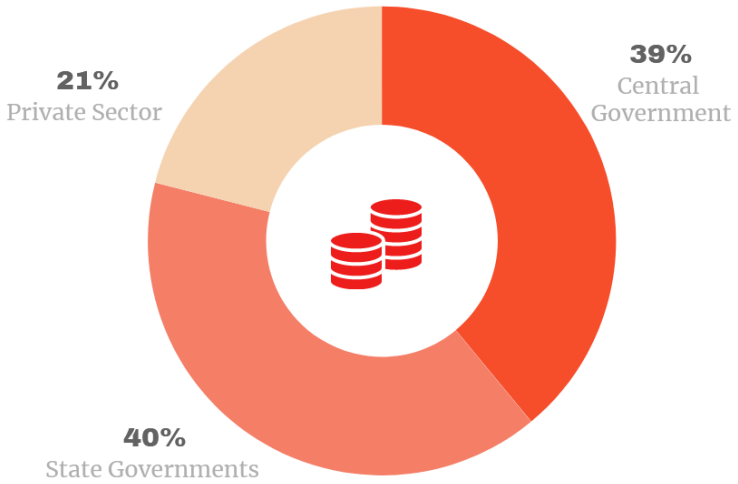
Amount in Rs Crore



In December 2019, the government announced the launching of the National Infrastructure Pipeline (NIP) to implement infrastructure projects across the country. NIP includes sectors like transport, water and sanitation, social infrastructure, commercial infrastructure, energy, logistics, real estate, tourism, information technology. There are more than seven thousand projects listed under NIP. The total investment estimated under NIP is amounting to Rs 111 lakh crores. The share of the central government and the states in the projects would be 39% and 40%, respectively, while the private sector would contribute 21%.[4]

[4] https://indiainvestmentgrid.gov.in/

Figure 4: Share of Central Government, State Governments and Private Sector in NIP



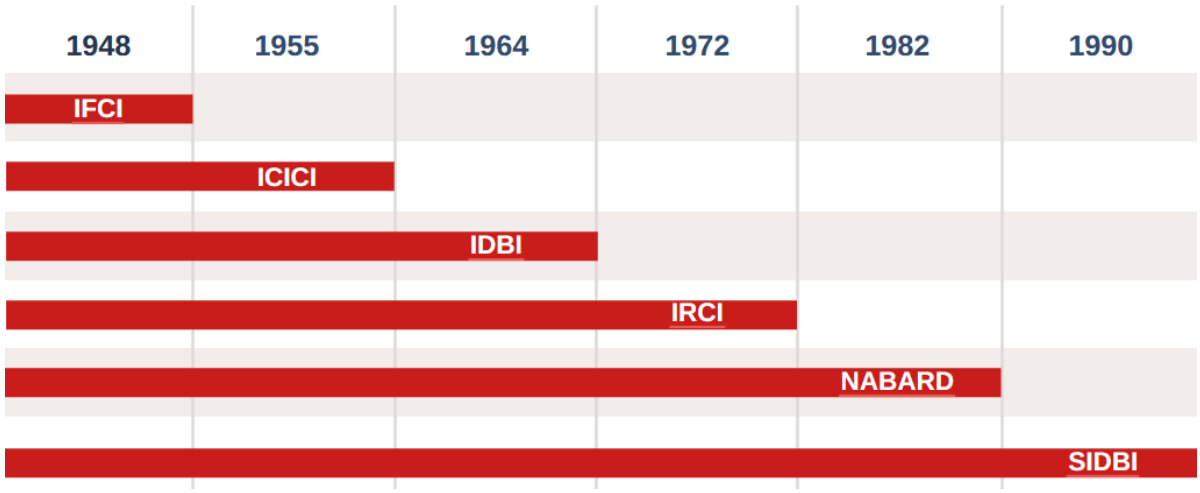
In the context of the growing number of infrastructure projects and the investments required there has been a consistent discussion and reporting on the need for a specialised institution for financing large infrastructure projects. This specialised institution has also been in demand from the private companies and other industrial entities. The impact of the COVID pandemic has also played a big role in squeezing the credit situation for the projects and hence the increased discussions and proposals to create a new Development Finance Institution (DFI) to fund infrastructure projects which have proved a challenge for the commercial banks to finance in the long term. There also appears to be a realisation that the expected amount of private financing would be difficult to raise considering the amount of financing required for infrastructure projects, along with the failure of public private partnerships in bringing in private investments and operating infrastructure projects.

There have also been several reports by international financial institutions discussing India's infrastructure financing deficit. ADB's report titled 'Meeting Asia's Infrastructure Needs' published in February 2017 estimated that as per the baseline estimates the cost to address India's infrastructure deficit was around USD 230 billion per year. If the estimates were climate-adjusted, this deficit would have grown to USD 261 billion in the 2016-2020 period. The WB noted that the Government of India estimated that under the 12th Five-Year Plan (2012-2017) USD 1 trillion would have been needed to bridge India's infrastructure gap.

History of DFIs in India

In India and other parts of the world DFIs are not a new concept to promote long term infrastructure projects and their financing. In India post-independence, the first DFI to be established was Industrial Finance Corporation of India (IFCI) in 1948. The second one was the Industrial Credit and Investment Corporation of India (ICICI) in 1955. And the third was Industrial Development Bank of India (IDBI) in 1964. The Industrial Investment Bank of India was established in 1971 as Industrial Reconstruction Corporation of India Ltd. (IRCI), the National Bank for Agriculture and Rural Development (NABARD) and EXIM Bank in 1982 and Small Industries Development Bank of India SIDBI in 1990. These were established to extend medium and long-term credit to industrial projects, considering that the private sources of financing were largely absent[5].

Figure 5: Year of Establishment of earlier DFIs in India



In the 1970s, the creation of NABARD and the National Housing Bank (NHB) demonstrated a sectoral shift in the nature of these financial institutions and their roles. Sector specific financial institutions also included - EXIM Bank, National Housing Bank, and Housing and Urban Development Corporation.

However, post 1990s when India saw the setting of economic reforms in the country, the role of the post-independence financial institutions and specifically DFIs in

[5] 'Development Finance Institutions in India Past, Present and the Future', Economic and Political Weekly, Vol LVI Nos 26 & 27, June 26, 2021

financing long-term infrastructure and industrial projects was drastically reduced under the financial reforms introduced as part of the opening of the Indian economy with the withdrawal of concessional funding via long term operation (LTO) funds from the Reserve Bank of India (RBI). The changes in the government policies pushed DFIs to raise finances at market rates, making their operations unviable. Further, Narasimham Committee (II) recommended that DFIs should either be converted into banks or non-banking financial companies (NBFCs), resulting in a complete shift in the way big projects and industries were being financed with commercial banks taking the role of DFIs. Industrial Investment Bank of India was closed, IFCI was converted into a non-deposit taking NBFC while ICICI and IDBI were converted into full-fledged commercial banks.

National Bank for Financing Infrastructure and Development (NaBFID)

In the above context, the Indian Parliament passed the new legislation to form a new Development Finance Institution (DFI) named the **National Bank for Financing Infrastructure and Development (NaBFID) Bill, 2021** on 25th March 2021.[6] The formation of a DFI has been a long sought after measure by various stakeholders for financing infrastructure projects with long gestation periods instead of the dependency on commercial banks. This also in some sense brings to conclusion the ongoing debates in various circles regarding the need for a DFI to push infrastructure development in India to higher growth levels.

The Act notes that, in the past two decades, banks and other non-banking financial institutions became an important source of financing for the infrastructure sector. However, this has led to problems in the banking sector with the infrastructure sector contributing a big chunk of the non-performing assets that exist presently. The other source for financing, the corporate bond market, is not sufficiently deep and is inadequately mature to meet India's infrastructure financing requirements. In the above context, the new DFI was deemed necessary to facilitate and to enable flow of low cost, long-term, patient capital in the form of debt from India or abroad into greenfield infrastructure projects.

[6] https://prsindia.org/files/bill_track/2021-03-22/The%20National%20Bank%20for%20Financing%20Infrastructure%20and%20Development%20Bill,%202021.pdf

It states that, the **National Bank for Financing Infrastructure and Development (NaBFID)** shall be wholly owned by the Central Government to begin with, in order to foster confidence in its stability and sustainability and to raise resources at competitive rates. It will provide the institution with grants and contributions, guarantees at concessional rates for foreign borrowings and any other concessions. Dilution or sale of stake may be considered once the Institution has achieved stability and scale in its business operations but the Government would at all times hold twenty-six per cent of the paid-up voting equity share capital of the Institution.

Its objectives include developing a deep and liquid bond market of international standards for long-term infrastructure financing in India. It would also facilitate the development of markets for interest rate derivatives, credit derivatives, currency derivatives and such other innovative financial instruments as may be necessary. The financing objectives would involve establishing a credible framework that attracts equity investments from domestic and global institutional investors as well as debt investments, including green finance, from investors, aligned to their risk appetite and asset-liability profile.

Further, the NaBFID would also be empowered to lend to, or invest in, infrastructure projects, prioritising systemic risk mitigation, credit enhancement, subordinate debt, debt maturities suited to project life spans and to raise long-term finance for the same. In addition to project structuring, monitoring and monetisation of completed projects by itself or through its subsidiaries, promoting innovation in financial products and services, including issuing long-term bonds with explicit or implicit sovereign guarantee, underwriting and dealer services.

Objectives

As per the Act, the institution shall have both developmental and financial objectives –

- It shall coordinate with the Central and State Governments, regulators, financial institutions, institutional investors and such other relevant stakeholders, in India or outside India, to facilitate building and improving the relevant institutions to support the development of long-term non-recourse infrastructure financing in India including the domestic bonds and derivatives markets.

- It shall lend or invest, directly or indirectly, and seek to attract investment from private sector investors and institutional investors, in infrastructure projects located in India, or partly in India and partly outside India.
- The authorised share capital of the Institution shall be one hundred thousand crore rupees (1 lakh crore) divided into ten thousand crores of fully paid-up shares of ten rupees each. The shares of the institution may be held by the Central Government, multilateral institutions, sovereign wealth funds, pension funds, insurers, financial institutions, banks, and any such institution.

Functions and Powers

The functions and powers of the institution includes –

- To form subsidiaries or joint ventures or branches, in India or outside India
- To co-ordinate its operations and the operations of various institutions engaged in the field of infrastructure finance
- To set up trusts under the Indian Trusts Act, 1882 for establishment of funds for such nature as would assist in financing of infrastructure projects, including real estate investment trusts and infrastructure investment trusts
- To support the development of a deep and liquid market for bonds, loans and derivatives for infrastructure financing
- To lend and invest in infrastructure projects, including by underwriting credit, securitisation of its receivables, etc.
- To extend loans and advances to any company or statutory corporation or trust or any financial institution funding infrastructure
- To take over or refinance existing loans extended by a lender for infrastructure projects
- To transfer loans and advances granted by it, with or without the securities, to trusts
- To subscribe to or purchase, underwrite, acquire, hold or sell stocks, shares, bonds, debenture stocks, debt securities, obligations and securities, commercial papers, certificates of deposit or debentures issued or guaranteed by any

company or trust or registered society or co-operative society or association or the Central Government or any State Government or any financial institution funding infrastructure

- To borrow or raise money by way of loans or otherwise both in rupees and foreign currencies or secure the payment of money by the issue and sale of debentures, debenture stock, bonds, obligations, mortgages and securities of all kinds
- To borrow money from the Central Government, scheduled banks, financial institutions, mutual funds, any class of persons, and from any other institution or authority or organisation notified by the Central Government
- To issue participation certificates or debt securities, and promote and facilitate securitisation of loan portfolio of companies and other entities engaged in the development and financing of infrastructure and create and develop a secondary market for the securitised receivables including by way of acting as an intermediary
- To lend to or invest in or acquire professional or technical services of companies operating in the infrastructure domain across the life cycle of projects
- To act as an intermediary in respect of transactions or services relating to debt securities issued by infrastructure companies and financial institutions
- To apply for, receive, accept, administer and manage grants, aids, subsidies, funds or donations, etc., from national and international sources including World Bank, New Development Bank, Japan International Co-operation Agency, United States Agency for International Development, Kreditanstaltfür Wiederaufbau, European Investment Bank, Asian Development Bank, International Finance Corporation and other organisations and agencies, and organise and facilitate foreign participation in infrastructure development projects
- To issue guarantee, letters of comfort, or letters of credit for loans or credit arrangements made, or, debentures or bonds issued, by any financial institution funding infrastructure projects

- Acquire an undertaking including the business, assets and liabilities of any institution the principal object of which is the promotion or development of infrastructure financing
- Act as a financial intermediary for the purpose of promotion, financing and development of infrastructure projects and facilities located in India, or partly in India and partly outside India, through developing and disseminating appropriate financial instruments, negotiating loans and advances of all nature, and formulating schemes for mobilisation of resources
- Open any account in any bank in or outside India or make any agency arrangement with, or act as an agent or correspondent of, any bank or other institution

Other Provisions

The Government shall prescribe a concessional rate of fees, not exceeding 0.1 per cent at which Government guarantee may be extended to the Institution for borrowings from multilateral institutions, sovereign wealth funds, and such other foreign institutions as may be prescribed.

Hedging costs in connection with any borrowing of foreign currency by the Institution for the purposes of granting loans and advances or its repayment, to insulate the Institution from any fluctuations in the rates of exchange, may be reimbursed by the Central Government in part or in full.

<u>The Act also outlines the steps for the formation on other DFIs by any person –</u>

Any person who intends to set up a development financial institution, in addition to the Institution established under this Act, shall make an application to the Reserve Bank for licence. The Reserve Bank may in consultation with the Central Government, grant licence subject to such criteria, terms and conditions as may be specified by the Reserve Bank by regulations. The Institution to which licence is granted under sub-section (2) shall be subject to the provisions of the Reserve Bank of India Act, 1934 or the Banking Regulation Act, 1949. The regulations made by the Reserve Bank shall apply to the Institution established under this Act to such extent as are not inconsistent with the provisions of this Act.

No suit, prosecution or other legal proceedings shall lie against the Institution or its Chairperson or other directors, employees or officers for anything which is done in good faith or intended to be done under this Act, or the rules or the regulations made thereunder, including in respect of assets created or transferred to the Institution

The Institution shall not, except as otherwise required by this Act or by any other law, divulge any information relating to, or to the affairs of, its constituents except in circumstances in which it is, in accordance with the law or practice and usage customary among bankers, necessary or appropriate for the Institution to divulge such information.

Every director, member of a committee, auditor, officer or other employee of the Institution or of the Reserve Bank, whose services are utilised by the Institution under the provisions of this Act, shall, before entering upon his duties, make a declaration of fidelity and secrecy in the form set out in the First Schedule.

The specific role of DFIs

As mentioned earlier, the role of a DFI is to provide enough credit to large infrastructure projects which may have long gestation periods while tackling market challenges and financial crisis as well as associated risks and uncertainties. It has also been argued that since DFIs are focused on infrastructure development for the national economic development, making them an important piece in the puzzle of infrastructure development. DFIs are legally obligated and have policy backing to finance public welfare projects.

The main objective of a DFI is not to profit from financing projects. They remain commercially viable due to significant backing by the government and its institutions like the central bank. This makes them important to deliver on broader community development goals. On the other hand, other financing institutions like commercial banks focus on immediate financial returns that may weaken overall community development objectives. In India DFIs have focused on infrastructure and industrial development, while others have brought financing to specific industries or sectors that commercial banks may not be unwilling to fund.[7]

[7] https://thewire.in/business/budget-2021-dfi-development-banks-long-term-infrastructure-financing-indian-economy

Critical Issues that need to be addressed

Despite the importance of DFIs in creating long term credit lines for large infrastructure projects in the country, even in the current context, there are questions that need to be answered and lessons that need to be learnt.

In the Indian context, governance of DFIs is a concern of huge importance, since these are public institutions transacting large sums of taxpayer's money. In the current context of heightened public scrutiny, these institutions are required to be open for public disclosures and information dissemination regarding their financial transactions and with increased accountability for their operations and lending practices. The new institutions also need to establish mechanisms to check financial irregularities in its lending practices. It is also crucial to understand the difference between the earlier institutions and the new one to avoid the pitfalls that the earlier ones suffered.

One important aspect with regards to the new DFI is that long-term sources of large chunks of funding need to be developed. Unless this happens it can be a difficult challenge for the DFI to operate. The dependence on the RBI and the government for funding has not worked that well in the past. The case for the bond market to supply enough credit and the private investment into infrastructure projects has also not shown very encouraging trends, though the government has shown willingness to open the sector for investments by entities like pension funds, sovereign wealth funds and others. The new DFI can also raise funds through loans from multilateral development banks and bi-lateral agencies for investment in infrastructure projects in India.

The government has provided an initial capital of Rs 20,000 crore and a grant of Rs 5,000 crore. It is expected that the DFI would raise Rs 5 lakh crore based on the timeline of the NIP to complete projects till 2024. However, Rs 5 lakh crore is 4.5% of the kind of investment that is envisaged under the NIP for the infrastructure projects. NIP has more than 7,000 projects that require investment of Rs 111 lakh crore in sectors like roads and highways, ports, railways, power projects, water and sanitation and urban sector projects till 2024.

One important source of funding, it appears could be the disinvestment and asset monetisation proposals that the government has come up with. Though there are

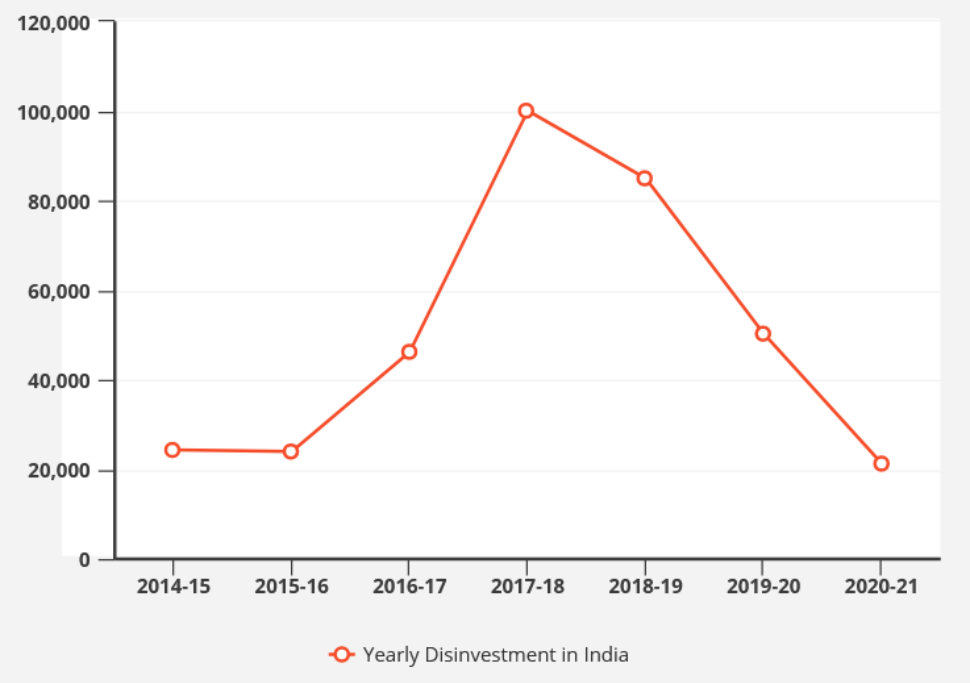
several challenges considering the pandemic situation to raise funds through this route and also the experiences in the past years. The disinvestment targets set by the government in the previous years have not been achieved. More so, serious concerns have been consistently raised regarding the disinvestment or sale of public assets to the private companies.

As per reports, the government has set a disinvestment target of Rs 1.75 trillion for FY22 after failing to complete any big-ticket privatisation in FY21 due to the disruptions caused by Covid. For FY21, it has pared its target to Rs 32,000 crore from Rs 2.1 lakh crore. In 2020-21 disinvestment target was Rs 2.1 lakh crore (Rs 1.2 lakh crore from CPSEs sale and Rs 90,000 crore from financial institutions sale). The target was revised to Rs 32,000 crore, out of which it achieved Rs 21,303 crore. The target for this FY (2021-22) is Rs 1.75 lakh crore.[8]

The total disinvestment amount since 2014 – 15 is Rs 3,51,224 crore. The break-up is given below (Fig. 3)

Year	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Investment in crores	Rs 24,349	Rs 23,997	Rs 46,247	Rs 1,00,057	Rs 84,972	Rs 50,299	Rs 21,303

Figure 6: Yearly Disinvestment Amount in India between 2014-15 and 2020-21



[8] https://www.businesstoday.in/latest/economy-politics/story/disinvestment-target-met-thrice-since-2014-15-67-in-fy21-finance-ministry-290801-2021-03-15

While participating in a debate on the bill, some Members of the Parliament (MPs) raised the issue of lack of parliamentary oversight of the institution. This is an important issue that needs to be addressed and the institution of such a scale and size needs to be brought under the national Parliament's scrutiny. This has also been debated and discussed in political and civil society spaces for some time in the past in the context of the Parliamentary oversight on international financial institutions like the World Bank and ADB and their lending in India.[9]

The performance evaluation of the earlier DFIs in terms of reaching their objectives will help in understanding the gaps and challenges. As lessons from the past it would also be important to look into linking credit guarantee to the actual performance of the project being financed. It is also expected that the new DFI must have norms connecting fund disbursement with the implementation of the ongoing project. The projects under consideration also need to be examined in detail to evaluate their financial viability before financing is authorised for any such projects.

The other important concerns that need to be addressed include – the environmental, social and human rights safeguards in relation to the lending practices of the institution. These are significant considerations in the present times when debates on climate crisis are getting intense and the climate change induced natural calamities are beginning to be more visible. Similarly, when the larger objectives of the institution include broader public and social welfare projects, it is critical to adhere to national and international policies, guidelines and regulations that set the benchmarks for these to be followed as obligations. The pre-conditions for the sustainable and responsible investments are necessary to be met, when financing is from multiple sources including small savers and social security schemes like pension funds, etc.[10]

It is also understood that the safeguards issue is closely associated with various challenges that are affecting infrastructure projects. The safeguards are necessary to avoid pitfalls in scrutinising and approving the projects as well as avoiding delays that these projects are being impacted with. A recent report by the Ministry of Statistics

[9] https://www.ndtv.com/business/parliament-passes-bill-to-set-up-national-bank-for-financing-infrastructure-and-development-2399029

[10] https://www.orfonline.org/expert-speak/some-issues-ponder-proposed-development-finance-institution-india/

found that out of 1,687 projects, 450 reported cost overruns and 558 reported delays.[11]

The Report of the Task Force for the National Infrastructure Pipeline has deliberated on the Environmental, social and corporate governance (ESG) considerations in detail, it notes -

"Over their lifetime from development to construction to operation all the way through to the end of the economic life, infrastructure assets will face all kinds of ESG issues. These will vary depending on asset type, sector, size, geographic location and stage in the lifecycle. Some of these issues may originate outside the asset but have impact on its technical ability to operate or on its profitability (e.g. temperature rise, increased water scarcity, changing regulations, tariffs). Other issues may be caused by the asset itself and impact its surrounding environment and communities (e.g. water effluent, quality of life of the communities around it, labour conditions, etc.). In the latter case, we speak of externalities. These can and increasingly will impact the asset's financial performance via various feedback loops (e.g. protests of the surrounding community). It is thus important to realise that both directions of impact (impact on the asset, and impact from the asset) may have financial consequences for the investors, particularly if they are "universal owners".

"Industry standards and guidelines are often the foundation for investors' ESG management systems in infrastructure investing. The World Bank Group Environmental, Health and Safety (EHS) Guidelines & Industry Sector Guidelines, the IFC Performance Standards, Equator Principles, PRI Principles, CDC Toolkit and Infrastructure Sector Profile are commonly cited references. The technical expert group (TEG) advising the European Commission on sustainable finance has, in March 2020, published its final recommendations on the EU taxonomy, including "substantial new user guidance" to help investors and companies meet obligations for reporting against the framework. The taxonomy is a list of economic activities and corresponding performance criteria consistent with the EU's commitment to reach net-zero carbon emissions by 2050. The Task Force recommends greater understanding of global ESG standards by ministries and implementing agencies to enable them to assess the expected performance outcomes and document the same in DPRs and also lay down mechanisms to measure and disclose performance in line with India's

[11] https://economictimes.indiatimes.com/news/economy/infrastructure/450-infrastructure-projects-show-cost-overruns-of-rs-4-28-lakh-crore/articleshow/80468072.cms

Nationally Determined Commitments for Climate Change. These will enable global investors to assess their interest in investing in such projects, besides enabling India to report the performance against NDC commitments. It is also suggested to set up a working group under the Ministry of Finance to recommend regulatory changes and other policy measures required to enhance the attractiveness of India to ESG focused funds".[12]

The report dwells on the ESG issues from different perspectives and documents the implications of the large infrastructure projects financed by DFIs. It also provides a set of guidelines and a framework to take this further in terms of project execution. However, the actual test of these would come when the projects are being executed and these guidelines are being implemented in a transparent manner.

It is also important for the institution to ensure its wider reach to connect to various other stakeholders in implementation of the development projects including people's representatives, parliamentarians, citizens, local communities, civil society, workers collectives, etc.

[12] https://dea.gov.in/sites/default/files/Report%20of%20the%20Task%20Force%20National%20Infrastructure%20Pipeline%20%28NIP%29%20-%20volume-ii_0.pdf

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We monitor the investments of national and international financial institutions, engage on policies that impact the banking sector and economy of the country, demystify the world of finance through workshops and short-term courses and help citizens make banks and government more transparent and accountable, for they use public money.

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