Non-Performing Assets (NPAs) of Banks in India

1. Build-up of corporate and banking sector vulnerabilities are grave cause for concern for the government of India as these have serious implications not only for banks to meet capital adequacy norms, but limit scope of lending for further investments and hamper the overall investment environment of the country. Of late, hue and cry have been raised over the wilful defaulters of big ticket bank loans in India. Cumulative gross NPAs of 24 listed public sector banks stood at Rs.3.9 trillion as on December 31, 2015. The Economic Survey 2015-16 tabled in the parliament on February 26, 2016 recommended 4 Rs to address the challenges of NPAs: (i) Recognition - Banks must value their assets as far as possible close to true value as the RBI has been emphasizing, (ii) Recapitalization – Banks' capital position must be safeguarded via infusions of equity as the banks have been demanding, (iii) Resolution - The underlying stressed assets in the corporate sector must be sold or rehabilitated as the government has been desiring, and (iv) Reform - future incentives for the Private Sector and corporates must be set right to avoid a repetition of the problem.

What is NPA?

2. Reserve Bank of India defines an asset including a leased asset, as non-performing when it ceases to generate income for the bank. A 'non-performing asset' (NPA) is an advance where (i) interest and/or instalment of principal remain overdue for a period of more than 90 days in respect of a Term Loan, (ii) the account remains 'out of order' (i.e., outstanding balance remains continuously in excess of the sanctioned limit/drawing power in the account) for a period of more than 90 days, in respect of an Overdraft/Cash Credit (OD/CC), (iii) the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted, (iv) interest and/or instalment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purposes, and (v) any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.

3. Banks are required to furnish a Report on NPAs to RBI as on 31st March each year after completion of audit in which they are required to classify non-performing assets into the three categories: (a) Sub-standard Assets – the assets which have been classified as NPA for a period of less than or equal to 12 months and the current net worth of the borrower/ guarantor or the current market value of the security charged is not enough to ensure recovery of the dues to the banks in full with the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected., (b) Doubtful Assets – the assets which have been classified as NPAs

for a period exceeding 12 months and that collection or liquidation on the basis of currently known facts, conditions and values is highly questionable and improbable., and (c) Loss Assets – uncollectible assets of little value which have been identified by external auditors or RBI inspection but has not been written off from the account.

4. RBI regulation permits banks to allow the defaulting borrowers extra time to repay interests/principals. Besides, in June 2015 RBI allowed banks to restructure their advances to turn loans into equity upto 51% or more in the firms which had the potential to become defaulters. The restructuring of advances was allowed in 3 stages: (a) before commencement of commercial production / operation; (b) after commencement of commercial production / operation but before the asset has been classified as 'sub-standard'; and (c) after commencement of commercial production / operation and the asset has been classified as 'sub-standard' or 'doubtful'.

Facts regarding NPAs in India

5. The asset quality (the risks associated with the assets) of banks in India has come under stress in recent times. Gross nonperforming advances (GNPA) of Banks increased from Rs.1.3 trillion in December 2011 to Rs. 3.0 trillion in March 2015, while gross advances of the Banks during this period increased from Rs.43.3 trillion to Rs.66.9 trillion. Thus, non-performing assets increased at about one and a half time faster than growth of overall bank advances in India.

6. Eighty six per cent of the NPAs are in the public sector banks. Shares of private banks and foreign banks in NPAs are 10% and 4% respectively. Share of gross non-performing assets of public sector banks to their gross advances increased from 3.22% in December 2011 to 5.63% in December 2014 which then slightly declined to 5.1% in September 2015. The aggregate stressed advances (including gross non-performing assets plus the restructured advances) increased from Rs. 2.2 trillion in December 2011 to Rs. 6.6 trillion in March 2015. At the end of September 2015, public sector banks had stressed assets (gross plus restructured assets) at 14.0 per cent of the total, followed by private sector banks at 4.6 per cent and foreign banks at 3.4 per cent.

7. Economic Survey 2015-16 mentioned that the contribution of five sub-sectors, namely mining, iron and steel, textiles, infrastructure and aviation together accounted for 24.2 per cent of the total advances of Scheduled Commercials Banks of India and 53 per cent of the total stressed advances as of June 2015. Stressed advances in the aviation sector increased to 61.0 per cent in June 2015 from 58.9 per cent in March 2015, while stressed advances of the infrastructure sector increased to 24.0 per cent from 22.9 per cent during the same period.

Bank Credit operation

8. Apart from interest rates, bank credit in India is regulated by using three major ratios - CRR (Cash Reserve Ratio), SLR (Statutory Liquidity Ratio) and the PSL (Priority Sector Lending) ratio. CRR is the fraction of customer deposits that banks have to maintain in cash in a current account with the RBI. SLR is the share of resources that banks have to hold in the form of liquid assets in the form of either cash, government bonds or gold or mix of all these so that prudential role can be performed by liquidating these assets should unexpected demand arises from depositors. The current levels of CRR is 4% and SLR is 21.5%. Priority sector lending ratio is the portion of bank credit that banks have to extend to specific priority sectors namely agriculture, micro and small enterprises, education, housing, export credit and others. As of now banks are required to lend 40% of their credit to these priority sectors. Further 45 per cent of all priority sector lending must be made to agriculture.

Causes for Rising NPAs in India

9. IMF Country Report No. 16/76 on “India: Selected Issues” released in the last week (March 2016) http://www.imf.org/external/pubs/ft/scr/2016/cr1676.pdf analyses build-up of corporate and banking sector vulnerabilities as one of the issues. The paper notes that the sizable rise in corporate investment needs in the mid to late 2000s in India was accompanied by an upsurge in corporate credit and the build-up of high leverage after the global financial crisis. Both debt levels and leverage in India are highly skewed toward large corporates and 2 key sectors namely infrastructure (including power, telecommunications and roads) and metals (including iron and steel) which witnessed a strong credit growth of 27 and 22 percent respectively during 2008-09 and 2012-13. The bottlenecks particularly in these sectors are largely structural in nature including delayed project approvals, land acquisition hurdles, coal supply disruptions etc. which negatively affected their profitability. The median return on assets of Indian corporates was lowest at 4.6 per cent in 2014-15, the lowest over the past decade.

10. The stress test conducted by IMF confirmed that Indian corporate balance sheets have high exposure to potential shocks like interest rates hike and currency volatility due to their dependence on external borrowings, trade credits and bonds. Such weaker position of domestic corporates has translated into a substantial deterioration of banks’ asset quality. IMF paper also indicated that due to these reasons as well as to fulfil Basel III norms of capital adequacy public sector banks in India need recapitalization.

Remedial Measures

11. Economic Survey 2015-16 highlighted that India does not have formal bankruptcy legislation and hence public sector banks have been struggling to recover much of the bad debt piling up on their balance sheets using available mechanisms.

12. In the latest Union Budget 2016-17, an allocation of Rs. 25,000 crore has been made to recapitalise public sector banks. The intention is to support banks to effect recoveries while continuing their credit growth and also help revive stalled projects. Other specific measures announced include (i) introduction of a comprehensive **Bill on Code on Resolution of Financial Firms** in the Parliament during 2016-17 to provide a specialised resolution mechanism to deal with bankruptcy situations in banks, insurance companies and financial sector entities; (ii) **Amending** the **Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002** that allows banks and financial institutions to auction properties (residential and commercial) when borrowers fail to repay their loans. The amendment would enable the sponsor of an Asset Reconstruction Company[1] (ARC) to hold up to 100% stake in the ARC and permit non-institutional investors to invest in Securitization Receipts; (iii) The **Bank Board Bureau[2]** will be operationalized during 2016-17 and a roadmap for consolidation of Public Sector Banks will be spelt out; and (iv) The **Debt Recovery Tribunals will be strengthened** for speedier recovery of assets by improving the tribunal's existing infrastructure and computerised processing of court cases that will reduce the number of hearings and faster disposal of cases. Finance Minister of India while

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[1] *An Asset Reconstruction Company (ARC) is a centralised agency for resolving bad loans created out of a systematic crisis. ARCs buy up distressed assets from banks/card companies and other financial institutions, re-package them and then sell them in the market. Non-performing assets (NPAs) can be assigned to ARCs by banks at a discounted price, enabling a one-time clearing of the balance sheet of banks of sticky loans. At the same time, the ARC can float bonds and recover dues from the borrowers directly. ARCs can either be publicly or privately owned or a combination of both, and can be either separately capitalised units or wholly-owned subsidiaries.*

[2] *Setting up of a Banks Board Bureau that would recommend appointment of directors in PSBs and advise on ways of raising funds and dealing with stressed assets was announced in August 2015. Vinod Rai has been named the first chairman of the Banks Board Bureau. The other members co-opted to the board are Anil K. Khandelwal, former Chair of Bank of Baroda, HN Sinor, former Joint Managing Director of ICICI Bank and Rupa Kudwa, former Managing Director and Chief Executive of Crisil.*

debating Union Budget 2016-17 in Lok Sabha on March 14, 2016 has clarified that the government would find a lasting solution to the banks' financial stress and that banks stress on account of fraud where defaulter have wilfully declined to repay loans would be dealt with legally.