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A study of how Indian banks' big NPA problem evolved over years

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Introduction:

A **Non-performing asset** (NPA) is defined as a credit facility in respect of which the interest and/or installment of Bond finance principal has remained 'past due' for a specified period of time. NPA is used by financial institutions that refer to loans that are in jeopardy of default the so called NPL. Once the borrower has failed to make interest or principle payments for 90 days the loan is considered to be a non-performing asset. Non-performing assets are problematic for financial institutions since they depend on interest payments for income. Troublesome pressure from the economy can lead to a sharp increase in NPLs and often results in massive write-downs.

With a view to moving towards international best practices and to ensure greater transparency, it has been decided to adopt the '90 days' overdue' norm for identification of NPA, from the year ending March 31, 2004. Accordingly, with effect from March 31, 2004, a non-performing asset (NPA)is a loan or an advance where;

- Interest and/or installment of principal remain overdue for a period of more than 91 days in respect of a term loan,
- The account remains 'out of order' for a period of more than 90 days, in respect of an Overdraft/Cash Credit (OD/CC),
- The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
- Interest and/or installment 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
- Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.
- Non submission of Stock Statements for 3 Continuous Quarters in case of Cash Credit Facility.
- No active transactions in the account (Cash Credit/Over Draft/EPC/PCFC) for more than 91days

Further classify non-performing assets further into the following three categories based on the period for which the asset has remained non-performing and the reliability of the dues:

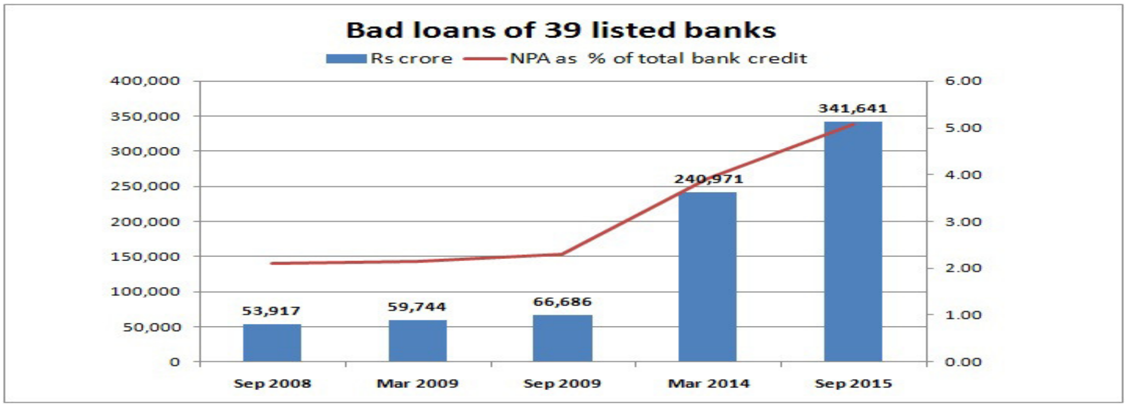
1. Sub-standard assets: a sub standard asset is one which has been classified as NPA for a period not exceeding 12 months.
2. Doubtful Assets: a doubtful asset is one which has remained NPA for a period exceeding 12 months.
3. Loss assets: where loss has been identified by the bank, internal or external auditor or central bank inspectors. But the amount has not been written off, wholly or partly.

The writing was on the wall; just that no one wanted to acknowledge it. The bad loan crisis that has gripped India's Rs 95 trillion banking sector didn't happen overnight.

For years, Indian lenders, especially state-run banks, were engaged in volume game to balloon their balance sheets and appease their promoter (the government). That has been so ever since nationalization of these banks happened in two stages (beginning 1969). Governments often treated these banks as their extended arms and used them for populist measures.

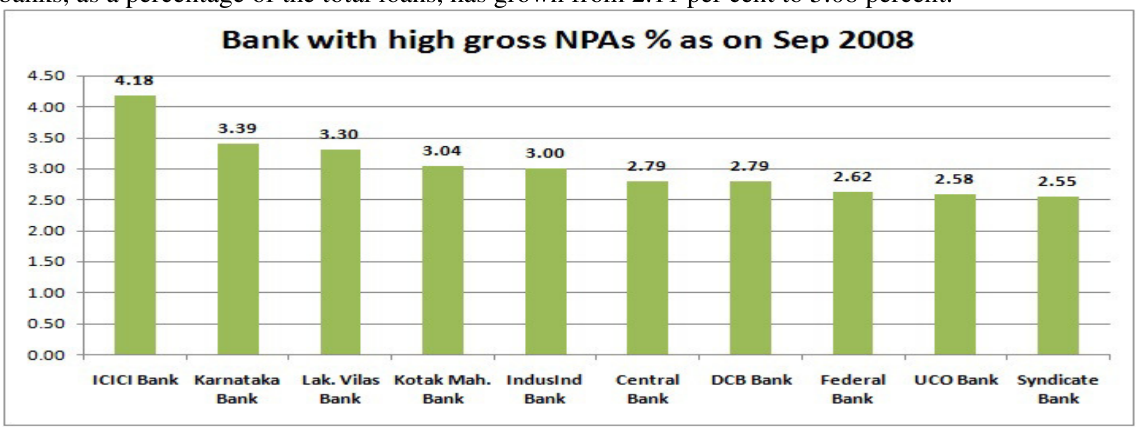
There used to be competition among sarkari banks to flag their total business number on front-pages of national newspapers but very little attention was paid to the quality of assets. Every outgoing chairman passed the buck to his successor.

"That was a time (2011-2013) when everyone rushed to give money to corporations, no matter what the credit perception was. Everyone expected a miraculous pick-up in the economy," recalled a former banker with a nationalized bank who now works as a consultant.



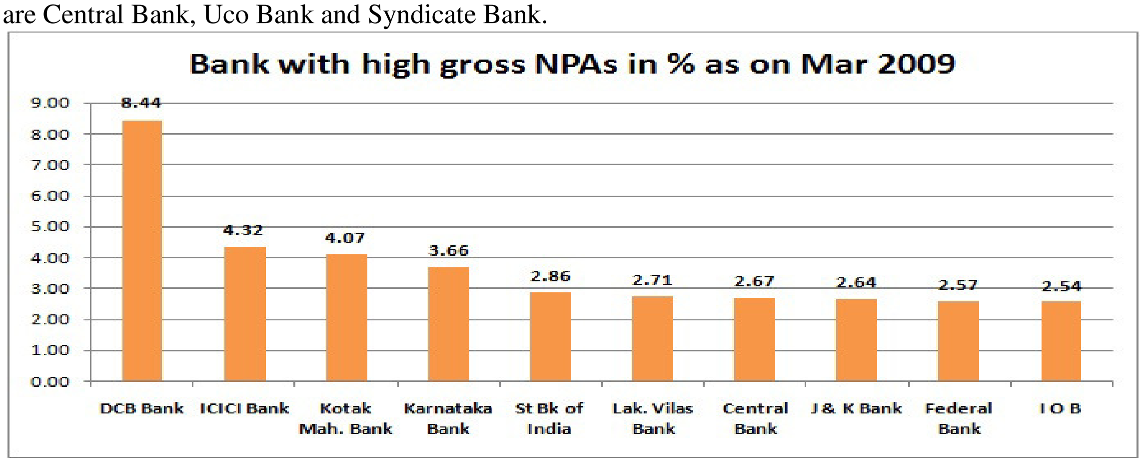
First post

From Rs 53,917 Crore, Indian banks gross non-performing assets (GNPAs) in September 2008 (just before the 2008 global financial crisis broke out following the collapse of Lehman Brothers), the bad loans have now grown to Rs 3,41,641 Crore in September 2015. In other words, the total GNPAs of banks, as a percentage of the total loans, has grown from 2.11 per cent to 5.08 percent.



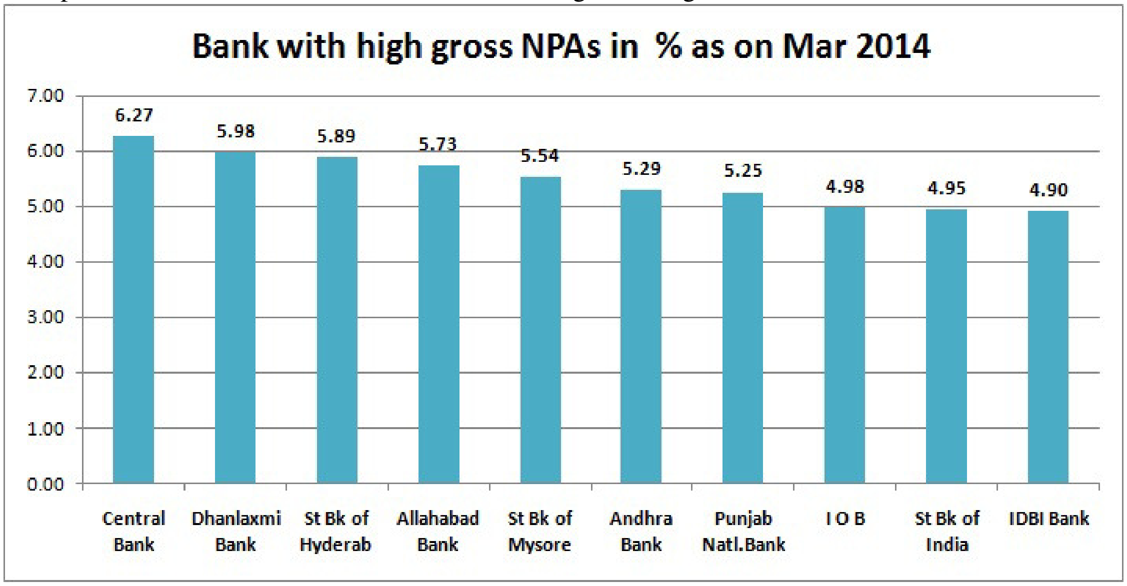
First post

Surprisingly, in the pre-crisis period, private banks topped the list of banks with highest NPAs (see the chart). A quick look at the top ten NPA scorers in September 2008 shows ICICI Bank at the top. This was followed by small and medium-sized private sector banks such as Karnataka Bank, Lakshmi Vilas Bank, Kotak Mahindra and IndusInd Bank. Among the few sarkari banks that figure in the list are Central Bank, Uco Bank and Syndicate Bank.



First post

By March 2009, a few months before the Congress-led UPA II assumed power, the scene began changing gradually. More state-run banks began appearing in the picture. The country’s largest lender by assets, State Bank of India (SBI) and Indian Overseas Bank found place in the list of top NPA scorers. Still private sector lenders figured prominently in the list with ICICI and DCB Bank leading the pack. To be sure, there is no direct link between the ascension of UPA-II and the increase in the NPA picture, but this is when the state-run banks began feeling the heat of NPAs.



First post

Twenty months into the Modi government rule, it wouldn't be an exaggeration to say that state-run banks are on the verge of a crisis due to their high NPAs, which constitute over 90 percent of the total bad loans of the industry. Many of them have reported losses on account of huge NPAs in the December quarter, surprising analysts. Investors are dumping shares of these banks while there is a sense of uncertainty prevailing on the extent of troubles in the banking sector.

"Provisions made by banks for bad loans are not treated as expenditure," said Abhishek Bhattacharya, director and co-head, banks at India Ratings & Research. "Previously, banks would have to pay income tax on these provisions, less 7.5 percent. This reduction has now been increased to 8.5 percent."

The government also proposes to bring non-scheduled cooperative banks on a par with scheduled banks with respect to taxation on interest receivable on non-performing accounts. Now, non-scheduled cooperative banks will have to pay taxes on actual receipt of interest on NPAs, rather than on accrual basis.

Bad loans across banks, and especially for government-owned lenders, surged after the Reserve Bank of India conducted an asset quality review in the second half of 2015. The central bank, in its Financial Stability Report, expects gross NPAs to rise to 9.8 percent by March 2017 from 9.1 percent at the end of September. By March next year, this number could rise even further to 10.1 percent.

Capital Infusion

As part of its Indradhanush programme, in Budget 2017, the government proposed to allocate Rs 10,000 crore towards recapitalization of public sector banks. The government had committed to invest a total of Rs 70,000 crore over four years ending March 2019.

The government has committed to provide additional allocation when required. "Our expectation was that the government would not provide growth capital, but would instead focus on giving banks bail-out capital. In terms of a planned road map, it is clear that nothing more is forthcoming. This is good because, good money should not chase bad," said Bhattacharya.

India Ratings expects demand for additional tier-1 bonds to rise as banks look to raise funds to meet capital requirements.

The RBI has given a deadline of March 2017 for all banks to clean up their balance sheets, which also require these lenders to set aside huge chunk of capital in the form of provisions. RBI governor Raghuram Rajan has given a clear message to banks to deal with the NPA problem upfront, instead of postponing it and worsening it.

But, there is also huge capital implication on these banks on account of high NPAs too. Banks need to set aside money (known as provisions) to cover their bad loans. The onus to keep government banks stay afloat lies with the government, which is the owner of these banks that control 70 per cent of the banking industry assets. Experts have opined that the government's promised capital infusion in these banks is inadequate. Finance minister, Arun Jaitley, has to work out ways to bring in solutions in the long term. For now, all eyes are on the Union budget a road map.

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The stressed assets problem plaguing Indian banking system is well documented. Gross non-performing asset (NPA) ratio for banks is at their peak and the problem seems to show no signs of abating. The question to ask in such a scenario is how big the actual problem is and what does it entail for the banks? To give an estimate, there are nearly Rs 12 lakh crore of stressed assets in the country's banking system.

These constitute nearly 15 per cent of the outstanding loan books of these banks. Of this, banks have already sold around Rs 2 lakh crore worth of such loans to asset reconstruction companies (ARCs), leaving about Rs 10 lakh crore on their own books. Taking the past experience into account, nearly 35 per cent or Rs 3.5 lakh crore of the Rs 10 lakh crore will eventually need to be marked down by banks in the form of provisions and write-offs.

These numbers reflect a massive problem which requires a concerted and strong response. The Reserve Bank of India (RBI) and the government have gone about solving this in a very phased and planned manner. They have identified that the problem is of gigantic proportions and a one-shot resolution would serve no purpose and could potentially yield disastrous consequences. The response has evolved over the couple of years through a variety of steps, each designated to further push towards a clean-up in the banking system.

Asset quality review

The process started in 2015, with the AQR undertaken by the RBI. This pushed the banks towards transparency in recognition and classification of NPAs across the board. While this resulted in significant provisioning by banks and decline in profitability, it also established a clear picture of the nature of problem faced by the banks. The good news is that banks have already provisioned Rs 2 lakh crore of the Rs 3.5 lakh crore mark down they are expected to take on their stressed loans. Effectively, more than half the markdown is already over. Additionally, banks are now providing around Rs 35,000-40,000 crore every quarter. Usually, it takes 3-5 years for the provisioning and 'real value' to catch up. So, the required provisioning should be complete in another 4-5 quarters. This will effectively complete Phase-I where the mark to market for these stressed loans will be accomplished.

Restructuring and NCLT

With the provisioning requirements almost taken care of, the time is now opportune for banks to aggressively get into restructuring mode. The economy, global as well as Indian, is also on an uptick, creating an amenable environment for promoters to agree to reasonable restructuring terms. This is because promoters also now see the potential of an upside in case the restructuring works out. This is in contrast to a couple of years ago when the relatively weaker growth meant that the promoters could afford to wait and drive a harder bargain as restructuring presented no viable benefits for them.

In such a scenario, the RBI direction on referring companies to the National Companies Law Tribunal (NCLT) could push the NPA clean-up process into its end-game. Assuming most cases will be referred to the NCLT by October 2017, we could expect most resolutions/ restructurings to be in place by June 2018.

What next?

According to our estimates, more than 70 per cent of these cases will be restructuring and resolutions wherein the debt will be written down to sustainable levels. Banks will take equity positions in these companies and new investors will provide additional capital. These companies would be then run with higher governance oversight and stricter loan covenants. As banks will take debt haircuts, promoters will take significant equity haircuts and new investors will ensure better management of these companies going forward. Capital allocation and efficiency will be the key for these companies as they try to tread back the path to normalcy. We estimate that around Rs 40,000-50,000 crore of new additional capital will have to be infused to make these companies perform efficiently again. This will be infused by a mixture of existing promoters, ARCs, stressed asset funds and private equity (PE) investors. These investors will also drive the turnaround for these companies through stronger oversight.

Starting afresh

Driven by the strengthening economy and pushed by the government, regulators, banks and capital providers, we expect the bad loan situation to be significantly mitigated by 2019. The economy can then look forward to a fresh capital expenditure cycle. Coupled with strong consumption & savings, continued seminal reforms like the goods and services tax and aided by the continued trend of global capital flows, we can expect to see the Indian economy firing on all cylinders in the next few years.

Conclusion:-

A study of NPA (Non Performing Assets) its seriousness in financial sector is having great effect on government policies and also in development of a nation. Due to time constraint a study is made through the journals, newspaper and internet and through it the conclusion is drawn that NPA is not grown overnight but it gradually increases due to various changing reforms of Globalization and Government Policies. But know the Governor has given a deadline to all private or public sector banks to take harsh action against NPA.

Twenty months into the Modi government rule, it wouldn't be an exaggeration to say that state-run banks are on the verge of a crisis due to their high NPAs, which constitute over 90 percent of the total bad loans of the industry. Through capital Infusion committed to invest a total of Rs 70,000 Crore over four years ending March 2019. Government is trying to control Banks in terms of NPA concern but what next every bank should try at his own level that they should go for Quality assets and do constant review of it Quarterly instead of Number of Crore disbursement of Loans for better tomorrow for sustainability in Globalization. ARC and NCLT should be given major Right to take action on NPA. So that shareholders of bank will not get affected.

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