

NPA Management in Banks : An Indian Perspective

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ABSTRACT

Non-performing Asset (NPA) has emerged since over a decade as an alarming threat to the banking industry in our country sending distressing signals on the sustainability and endurance of the affected banks. A high level of NPAs suggests high probability of a large number of credit defaults that affect the profitability and net-worth of banks and also erodes the value of the asset. The problem of NPAs is not only affecting the banks but also the whole economy. The paper deals with understanding the concept of NPAs, its magnitude and major causes for an account becoming non-performing and also strategies for reducing NPAs.

Keywords: NPA, credit defaults, net-worth

I. INTRODUCTION

The banking industry has undergone a sea change after the first phase of economic liberalization in 1991 and hence credit management. While the primary function of banks is to lend funds as loans to various sectors such as agriculture, industry, personal loans, housing loans etc., in recent times the banks have become very cautious in extending loans. The reason being mounting non-performing assets (NPAs). An NPA is defined as a loan asset, which has ceased to generate any income for a bank whether in the form of interest or principal repayment. As per the prudential norms suggested by the Reserve Bank of India (RBI), a bank cannot book interest on an NPA on accrual basis. In other words, such interests can be booked only when it has been actually received. Therefore, this has become what is called as a 'critical performance area' of the banking sector as the level of NPAs affects the profitability of a bank.

1. A NPA is a loan or an advance where;
2. Interest and/ or installment of principal remain overdue for a period of more than 90 days in respect of a term loan,
3. The account remains "out of order" in respect of an overdraft/ cash credit
4. The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.

5. The installment or interest remains overdue for two crop seasons in case of short duration crops and for one crop season in case of long duration crops.

II. IMPACT OF NPAS IN BANKS PROFITABILITY

An NPA account not only reduces profitability of banks by provisioning in the profit and loss account, but their carrying cost is also increased which results in excess & avoidable management attention. Apart from this, a high level of NPA also puts strain on a banks net worth because banks are under pressure to maintain a desired level of Capital Adequacy and in the absence of comfortable profit level, banks eventually look towards their internal financial strength to fulfill the norms thereby slowly eroding the net worth.

Today the Net NPAs of Indian PSBs (which account for around three-fourths of the total assets of Indian banking industry) are as low as 0.72 percent and gross NPAs are at 2.5 percent.

However, once there is a slowdown in private expenditure and corporate earnings growth, companies on these banks' books will not be in a position to service their debts on time and there is a strong likelihood of generation of new NPAs.

Moreover, he also suggests that with rising interest rates in the government bond market, the banks' treasury incomes have declined considerably. So banks will not have enough profits to make provisions for NPAs.

Under these circumstances, management of NPAs is a difficult task.

III. CATEGORIES OF NPA

- Substandard Assets–Which has remained NPA for a period less than or equal to 12 months.
- Doubtful Assets–Which has remained in the sub-standard category for a period of 12 months.
- Loss Assets–where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly.

Parameters which were selected for “Reasons of NPAs” are as follows:

- Market Failure
- Willful Defaults
- Poor follow-up and Supervision
- Non-cooperation from Banks
- Poor Legal framework
- Lack of Entrepreneurial Skills
- Diversion of funds

Preventive Measures for NPA

- Formation of the Credit Information Bureau (India) Limited (CIBIL).
- Release of Willful Defaulter’s List. RBI also releases a list of borrowers with aggregate outstanding of Rs.1 crore and above against whom banks have filed suits for recovery of their funds.
- Reporting of Frauds to RBI.
- Norms of Lender’s Liability–framing of Fair Practices Code with regard to lender’s liability to be followed by banks, which indirectly prevents accounts turning into NPAs on account of bank’s own failure • Risk assessment and Risk management.
- RBI has advised banks to examine all cases of willful default of Rs.1 crore and above and file suits in such cases. Board of Directors are required to review NPA accounts of Rs.1 crore and above with special reference to fixing of staff accountability.
- Reporting quick mortality cases.
- Special mention accounts for early identification of bad debts. Loans and advances overdue for less than one and two quarters would come under this category. However, these accounts do not need provisioning.

Recommendations for Reducing NPAs

- Effective and regular follow-up of the end use of the funds sanctioned is required to ascertain any embezzlement or diversion of funds. This process can be undertaken every quarter so that any account converting to NPA can be properly accounted for.
- Combining traditional wisdom with modern statistical tools like Value-at-risk analysis and Markov Chain Analysis should be employed to assess the borrowers. This is to be supplemented by information sharing among the bankers about the credit history of the borrower. In case of new borrowers, especially corporate borrowers, proper analysis of the cash flow statement of last five years is to be done carefully.
- A healthy Banker-Borrower relationship should be developed. Many instances have been reported about forceful recovery by the banks, which is against corporate ethics. Debt recovery will be much easier in a congenial environment.
- Assisting the borrowers in developing his entrepreneurial skills will not only establish a good relation between the borrowers but also help the bankers to keep a track of their funds.
- Countries such as Korea, China, Japan, Taiwan have a well functioning Asset Reconstruction/ Recovery mechanism wherein the bad assets are sold to an Asset Reconstruction Company (ARC) at an agreed upon price. In India, there is an absence of such mechanism and whatever exists, it is still in nascent stage. One problem that can be accorded is the pricing of such loans. Therefore, there is a need to develop a common prescription for pricing of distressed assets so that they can be easily and quickly disposed. The ARCs should have clear ‘financial acquisition policy’ and guidelines relating to proper diligence and valuation of NPA portfolio.
- Some tax incentives like capital gain tax exemption, carry forward the losses to set off the same with other income of the Qualified Institutional Borrowers (QIBs) should be granted so as to ensure their active participation by way of investing sizeable amount in distressed assets of banks and financial institutions.
- So far the Public Sector Banks have done well as far as lending to the priority sector is concerned. However, it is not enough to make lending to this sector mandatory; it must be made profitable by sharply reducing the transaction costs. This entails faster embracing of technology and minimizing documentation.
- Commercial Banks should be allowed to come up with their own measures to address the problem of NPAs. This may include waiving and reducing the principal and interest on such loans, or extending the loans, or

settling the loan accounts. They should be fully authorized and they should be able to apply all the preferential policies granted to the asset management companies.

- Another way to manage the NPAs by the banks is Compromise Settlement Schemes or One Time Settlement Schemes. However, under such schemes the banks keep the actual amount recovered secret. Under these circumstances, it is necessary to bring more transparency in such deals so that any flaw could be removed.

- Cash recovery—Banks, instead of organizing a recovery drive based on overdue, must short list those accounts, the recovery of which would provide impetus to the system in reducing the pressure on profitability by reduced provisioning burden. Vigorous efforts need to be made for recovery of critical amount (overdue interest and installment) that can save an account from NPA classification:

- In case of a term loan, the banker gets 90 days after the date of default to take appropriate action and to persuade the borrower to pay interest or installment whichever is due.

- In case of a cash credit account, the banker gets 90 days for ensuring that the irregularity in the account is rectified.

- In case of direct agricultural loans, the account is classified NPA only after two crop seasons (from sowing to harvesting) from the due date in case of short duration loans and one crop season from the due date in case of long duration loans.

IV. TOOLS FOR RECOVERING NPAS

Lok Adalats

- To settle disputes involving account in “doubtful” and “loss” category.

- Outstanding balance of Rs. 5 lacs for compromise settlement.

- Proved to be quite effective for speedy justice and recovery of small loans.

Debt Recovery Tribunals (DRT)

- To recover bad debt quickly and efficiently.

- DRT has powers to grant injunctions against the disposal, transfer or creation of third party interest by debtors in the properties charged to creditor and to pass attachment orders in respect of charged properties

- In case of non-realization of the decreed amount by way of sale of the charged properties, the personal

properties if the guarantors can also be attached and sold.

- It is the special court established by Central Government for the purpose of bank or any financial institutions recovery.

- The judges of the court are the retired judges of high court.

SARFAESI act, 2002

- The Act provides three alternative methods for recovery of non-performing assets, namely Securitization

- o Asset reconstruction

- o Enforcement of security without the intervention of the court.

- NPA loans with outstanding above Rs. 1. Lac.

- NPA loan accounts where the amount is less than 20% of the principal and the interest are not eligible to be dealt with this act.

This act empowers the bank:

- To issue demand notice to the defaulting borrower and guarantor, calling upon them to discharge their dues in full within 60 days from the day of the notice.

- To give notice to any person who has acquired any of the secured assets from the borrower to surrender the same to the bank.

- To ask the debtor of the borrower to pay any sum due or becoming due the borrower.

- Any security interest created over agricultural land cannot be proceeded with.

Asset Recovery Construction Industry Limited

(ARCIL)

- A company which is set up with the objective of taking over distressed assets from banks or financial institutions and to reconstruct or re-pack these assets to make those assets saleable.

- To buy out troubled loan from banks and make special efforts at recovering value from the assets, if necessary by special legislation, with special powers for recovery.

- Restructuring of weak banks to divest the bad loan portfolio.

BIFR and AIFR

- BIFR has been given the power to consider revival and rehabilitation of companies under the Sick Industrial Companies (Special Provisions) Act of 1985 (SICA), which has been repealed by passing of the Sick

Industrial Companies (Special Provisions) Repeal Bill of 2001.

- The Board of Directors shall make a reference to BIFR within sixty days from the date of finalization of the duly audited accounts for the financial year at the end of which the company becomes sick.
- The company making reference to BIFR to prepare a scheme for its revival and rehabilitation and submit the same to BIFR the procedure is same as laid down under the CPC.
- The shelter of BIFR misused by defaulting and dishonest borrowers

V. CONCLUSION

Management of NPA is need of the hour. To be effective, NPA management has to be an exercise pervading the entire bank from the Board down the last level. Time is of prime essence in NPA management. The course open to the banker is to ensure that an asset does not become NPA. If it does, he should take steps for early recovery failing which the profitability of the bank will be eroded. That can trigger other problems to undermine the bank's financial condition.

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