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NPA Management

Effective NPA Management

The need for improving the bottom line

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Abstract

India has a diversified financial sector undergoing rapid expansion, both in terms of strong growth of existing financial services firms and new entities entering the market. The sector comprises commercial banks, insurance companies, non-banking financial companies, co-operatives, pension funds, mutual funds and other smaller financial entities. The banking regulator has allowed new entities such as payments banks to be created recently thereby adding to the types of entities operating in the sector. However, the financial sector in India is predominantly a banking sector with commercial banks accounting for more than 64 per cent of the total assets held by the financial system.

The Government of India has introduced several reforms to liberalise, regulate and enhance this industry. The Government and Reserve Bank of India (RBI) have taken various measures to facilitate easy access to finance for Micro, Small and Medium Enterprises (MSMEs). These measures include launching Credit Guarantee Fund Scheme for Micro and Small Enterprises, issuing guideline to banks regarding collateral requirements and setting up a Micro Units Development and Refinance Agency (MUDRA). With a combined push by both government and private sector, India is undoubtedly one of the world's most vibrant capital markets.
With growth comes challenges: constant Technology change, consumer preference / expectation, Regulatory, political, Capital Adequacy, NPA etc., One of the major parameter that affects the performance of Banks are NPA (Non-Performing Assets).
These papers deals with understanding of various definition of NPA, the concept, management tools and suggest mechanism of effectively Managing of NPA for better bottom line.

Introduction

One of finance reforms done by the Government of India was Nationalisation of Banking sector; Banks were given opportunity to expand their presence across India and especially in rural sector. There by increasing the accessibility and reach to a wider market and population.

While many committees set-up by Government (viz., Narashiman Committee) recommended prudential norms on income recognition, assets classification and provisioning, there has been a sea change in Banking Industry and economy as a whole. The growing economy, the industrial bubbles, Job scarcity and with other challenges, increases the defaulter to the banks. It has become one of the great challenges

Financial Crisis

In 2008 financial crisis was a turning point in the Banking world for many reasons, the most important being the heighted awareness and concerns around assets quality. Every step of the lending process, from customer verification, profile risk assessment to collateral valuation came under the scanner. The financial world concluded that there exist a trade-off between assets growth and quality.

In the Indian context they are in a rapid growth, with Credit to Deposit ratio of 75% and an average annual credit growth of 15%

Non-performing Assets

Definition of NPA

NPA (Non-performing Assets) - All those assets which don't generate regular income are known as NPA.

Assets Classification:
Performing Assets

An Account does not disclose any problems and carry more than normal risk attached to the business. All loan facilities which are regular

Non-Performing Assets

Non-Performing Assets means a loan or an account of borrower, which has been classified by a bank or financial institutions as sub-standard, doubtful or loss assets, in accordance with the directions or guidelines relating to asset classification issued by RBI.

According to the RBI, an assets are declared as NPA if none of the instalment is paid till 180 days, ie., six months in respect of term loan

Standard assets :-

An assets which is generating regular income to the bank. Arears of interest and the principal amount of loan does not exceed 90days at the end of the financial year

Provisions: 0.25% of all type of Standard advances

Sub-standard assets :-

An asset which is overdue for a period of more than 90 days but less than 12 months

Provisions: 10% of all type of Standard advances

Causes of NPA

Doubtful assets: -

An asset which is overdue for a period of more than 12 months.

D1 i.e., up to 1 year: 20% provision is made by the bank
D2i.e., up to 2 year: 30% provision is made by the bank
D1 i.e., up to 3 year: 100% provision is made by the bank

Loss assets: -

Assets which are doubtful and considered as non-recoverable bybank, internal or external auditor or central bank inspectors

Provisions: 100% unsecured advances and 100% of secured advances

With effect from March 31, 2004 a non-performing asset (NPA) shall be a loan or an advance where:

- Interest and /or instalment of principal remain overdue for a period of more than 90 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 9o days in the case of bills purchased and discounted

- **Default: -**

One of the main reasons behind NPA is default by borrowers.

- **Economic conditions:** -

Economic condition of a region affected by natural calamities or any other reason may cause NPA.

- **No more proper risk management: -**

Speculation is one of the major reasons behind default. Sometimes banks provide loans to borrowers with bad credit history. There is high probability of default in these cases.
Mis-management - Often ill-minded borrowers bribe bank officials to get loans with an intention of default.

- **Diversion of funds:** -

Many times borrowers divert the borrowed funds to purposes other than mentioned in loan documents. It is very hard to recover from these kinds of borrowers.

In case you have any query or you want to add anything then comment below. If I find any comment is adding value to the post then I will add that comment to the post.

- Loan sanctioned for agriculture purposes.
- Change in government policy leads to NPA

Effects of NPA on Banks & FI

- Restriction on flow of cash done by bank due to the provision of fund made against NPA
- Drain of profit
- Bad effect on goodwill
- Bad effect on equity value.

Types of NPA

- Gross NPA: Gross NPA are the sum total of all loan assets that are classified as NPAs as per RBI guidelines as on the Balance Sheet date. Gross NPA reflects the quality of the loans made by banks.
- Net NPAs are those type of NPAs in which the bank has deducted the provision regarding NPAs. Net NPA shows the actual burden of banks

  Net NPAs Gross = (NPA – Provisions) / (Gross Advances – Provisions)

Laws and Regulations helping recovery of NPAs

SARFAESI Act

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, allow banks and financial institutions to auction properties (residential and commercial) when borrowers fail to repay their loans. It enables banks to reduce their non-performing assets by adopting measure for recovery or reconstruction. The Act Provides three alternative methods for recovery of non-performing assets:

- Securitisation – This is a process where financial assets (dues from a borrower) are converted into marketable securities that can be sold to investors
- Asset Re-construction – The Act uses the term “asset rec-construction” for the acquisition of any right or interest, of any bank or financial institution, in any financial assistance, by any Securitisation company or Re-construction company, for the purpose of realization of such financial assistance
- Enforcement of Security Interest – In the normal course, court intervention is required for sale of property and realization of money due from a defaulter. SARFAESI Act has made provisions for banks and financial institutions to take possession of securities given from financial assistance and sell the same in the event of default

Process of Recovery:

- A borrower makes any default in repayment and his account is classified as NPA
- The secured creditor has to issue notice to the borrower giving him 60 days to pay his dues
- If the dues are not paid, the bank can take possession of the assets and can also give it on lease or sell it

Debt Recovery Tribunal (DRT)

The debts Recovery Tribunals have been established by the Government of India under an Act of Parliament (Act 51 of 1993) for expeditious adjudication and recovery of debts due to banks and financial institutions. Debts Recovery Tribunal is the appellate authority for appeals filed against the proceedings initiated by secured creditors under sub-section (4) of Section 13 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002

Appellate Tribunal

Any person aggrieved by an order of the DRT can appeal to the Appellate tribunal within 30 days of date of receipt of the order. The borrower has to deposit 50% of the amount claimed by the secured creditor, before filing an appeal. The Appellate Tribunal can reduce the deposit requirement to 25% of the amount claimed, after recording the reason for such a concession.

Implications of the NPAs on Banks:

The most important implication of the NPA is that a bank can neither credit the income nor debit to loss, unless either recovered or identified as loss. If a borrower has multiple accounts, all accounts would be considered NPA if one account becomes NPA.

Gross NPA and Net NPA

The NPA may be Gross NPA or Net NPA. In simple words, Gross NPA is the amount which is outstanding in the books, regardless of any interest recorded and debited. However, Net NPA is Gross NPA less interest debited to borrowable account and not recovered or recognized as income. RBI has prescribed a formula for deciding the Gross NPA and Net NPA.

NPA and SARFAESI Act

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act have provisions for the banks to take legal recourse to recover their dues. When a borrower makes any default in repayment and his account is classified as NPA; the secured creditor has to issue notice to the borrower giving him 60 days to pay his dues. If the dues are not paid, the bank can take possession of the assets and can also give it on lease or sell it; as per provisions of the SAFAESI Act.

Reselling of NPAs

If a bad loan remains NPA for at least two years, the bank can also resale the same to the Asset Reconstruction Companies such as Asset Reconstruction Company (India) (ARCIL). These sales are only on Cash Basis and the purchasing bank/ company would have to keep the accounts for at least 15 months before it sells to other bank. They purchase such loans on low amounts and try to recover as much as possible from the defaulters. Their revenue is difference between the purchased amount and recovered amount.

Why Loan Accounts go Bad?

Borrower- Side

- Lack of planning
- Diversion of funds
- Disputes within
- No contributions
- No modernization
- Improper monitoring
- Industrial Relations
- Natural Calamities

Banker- Side

- Defective sanction
- No post-sanction supervision
- Delay in releases
- Directed lending
- Slow decision making process

The following points highlight the top seven types of non-performing assets. The types are:

- Term Loans
- Cash Credit and Overdrafts
- Agricultural Advances
- Exempted Assets
- Advances under Rehabilitation Packages
- Take-out Finance
- Advances Covered by the Guarantees of DICGC/ECGC.

Guidelines on preventing slippage of NPAs

The preventive and corrective measures are suggested measures in one form or the other for NPA management.

- Early Recognition of the problem
- Early Alert System
- Special Mention Accounts
- Identifying borrowers with genuine intent
- Timeliness and adequacy of response
- Focus on Cash Flows
- Management effectiveness
- Consortium/multiple financing
- Legal and related issues:
- Government relief:

The Problems caused by NPAs

NPAs do not just reflect badly in a bank's account books, they adversely impact the national economy. Following are some of the repercussions of NPAs:

- Depositors do not get rightful returns and many times may lose uninsured deposits. Banks may begin charging higher interest rates on some products to compensate Non-performing loan losses
- Bank shareholders are adversely affected
- Bad loans imply redirecting of funds from good projects to bad ones. Hence, the economy suffers due to loss of good projects and failure of bad investments.
- When bank do not get loan repayment or interest payments, liquidity problems may ensue.

Market Scenario

RISE & RISE OF STRESSED LOANS

The RBI's projections show the gross NPA of banking sector could go up to 8.5 % by March 2017

(in %)	Net NPA	Gross NPA	Stressed assets*
March 2013	-	3.4	9.2
September 2013	2.3	4.2	10.2
March 2014	2.2	4.1	10
September 2014	2.5	4.5	10.7
March 2015	2.5	4.6	11.1
September 2015	2.8	5.1	11.3
March 2016	4.6	7.6	11.5

"The stress in the banking sector, which mirrors in the corporate sector, has to be dealt with in order to revive credit growth
— RAGHURAM RAJAN, RBI Governor

Private sector banks

The net NPA of the banks also increased sharply to 4.6 per cent in March 2016, from 2.8 per cent in September 2015. Public sector banks' net NPA was 6.1 per cent, while the ratio for private sector banks was 4.6 per cent.

On the business side, the report noted that credit and deposit growth remained in single digits for the previous financial year. While credit growth was 8.8 per cent, deposit growth was 8.1 per cent.

There was a stark difference in the credit and deposit growth of public sector banks as compared with their private sector counterparts. According to RBI data, for public sector banks, loans grew at 4 per cent while it was 24.6 per cent for private banks. Deposits of state-run banks grew by 5.2 per cent, while for private banks it was 17.3 per cent.

"The relative performance of bank groups reflects their respective strengths amidst on-going industry-wise balance sheet repair and also sluggish growth in private capex," according to the report.

Banking sector gross NPA at 7.6%, highest in 12 years; Expected to rise further to 8.5% by March 2017

Gross bad loans at commercial banks could increase to 8.5 per cent of total advances by March 2017, from 7.6 per cent in March 2016, according to a baseline scenario projection by the Reserve Bank of India (RBI) in its Financial Stability Report released on Tuesday. "The macro stress test suggests that under the baseline scenario, the gross NPA may rise to 8.5 per cent by March 2017," the RBI noted in the report. "If the macro situation deteriorates in the future, the gross NPA ratio may increase further to 9.3 per cent by March 2017."

Economic Times: October 31, 2016


SINESS STANDARD BANKING ROUND TABLE 2016

Bad loans: Bankers shift focus to resolution from recognition

THE MOST GENEROUS

Top 10 banks in writing off bad debts in 2015 (in Rs crore):	
SBI	21,313
PNB	6,587
Indian Overseas Bank	3,131
Allahabad Bank	2,109
IDBI bank Ltd	1,609
Bank of Baroda	1,564
Syndicate Bank	1,527
Canara Bank	1,472
UCO Bank	1,401
Central Bank of India	1,386

Top 10 banks in writing off bad debts in last 3 financial years (in Rs crore):	
SBI	40,084
PNB	9,531
Indian Overseas bank	6,247
Bank of India	4,983
Bank of Baroda	4,884
Canara Bank	4,598
Central Bank of India	4,442
Allahabad Bank	4,243
Syndicate Bank	3,849
Oriental Bank of Commerce	3,593

Silver lining

The only silver lining is the housing sector, according to the financial stability report, which said with gross NPAs of the retail housing segment at 1.3 per cent, it does not pose any significant systemic risks in the Indian context.

Bank Group/Years	PRIORITY SECTOR		NON PRIORITY SECTOR		PUBLIC SECTOR		TOTAL
	Amount	Percentage	Amount	Percentage	Amount	Percentage	Amount
Nationalised Banks							
2015	709.34	34.61	1337.67	65.26	2.59	0.13	2049.59
2014	537.50	36.45	935.67	63.46	1.30	0.09	1474.48
2013	408.34	40.16	599.01	58.91	9.48	0.93	1016.83
2012	324.24	46.96	355.55	51.49	10.68	1.55	690.48
2011	246.20	55.61	194.10	43.84	2.42	0.55	442.72
2010	195.67	53.76	165.23	45.40	3.05	0.84	363.95
2009	157.54	59.35	106.68	40.19	1.21	0.46	265.43
2008	159.72	63.96	85.63	34.29	4.38	1.76	249.74
2007	153.44	58.63	103.40	39.51	4.87	1.86	261.72
2006	149.22	51.78	132.27	45.90	6.68	2.32	288.17
2005	153.36	46.75	170.62	52.01	4.06	1.24	328.04
State Bank of India &its Associates							
2015	256.76	34.93	478.32	65.07	0.00	0.00	735.08
2014	261.49	32.76	536.68	67.24	0.00	0.00	798.17
2013	264.42	42.12	361.30	57.55	2.06	0.33	627.79
2012	233.56	48.44	232.71	48.27	15.88	3.29	482.15
2011	155.67	51.22	148.26	48.78	0.00	0.00	303.93
2010	109.29	46.45	125.91	53.51	0.09	0.04	235.29
2009	84.47	45.70	98.60	53.35	1.76	0.95	184.83
2008	89.02	57.50	64.44	41.62	1.36	0.88	154.82
2007	71.75	56.57	52.63	41.49	2.45	1.93	126.83
2006	73.14	58.27	50.52	40.25	1.87	1.49	125.52
2005	62.00	41.84	84.31	56.90	1.86	1.26	148.18

Public Sector							
2015	966.11	34.69	1815.98	65.21	2.59	0.09	2784.68
2014	798.99	35.16	1472.35	64.79	1.30	0.06	2272.64
2013	672.76	40.91	960.31	58.39	11.55	0.70	1644.61
2012	557.80	47.57	588.26	50.17	26.56	2.27	1172.62
2011	401.86	53.82	342.35	45.85	2.43	0.32	746.64
2010	304.96	50.89	291.14	48.58	3.14	0.52	599.24
2009	242.01	53.75	205.28	45.59	2.97	0.66	450.26
2008	248.74	61.48	150.07	37.10	5.74	1.42	404.56
2007	225.19	57.96	156.03	40.16	7.32	1.88	388.54
2006	222.36	53.75	182.79	44.18	8.55	2.07	413.70
2005	215.36	45.22	254.94	53.53	5.92	1.24	476.2

Conclusion:

NPA management in itself is major process every bank needs to undertake and put stringent process and monitoring of the assets on a regular basis to avoid increasing the NPA. The credit policy and lending process should be effective to reduce the bad loans. Some solutions for effective NPA Management:

- Don't Eliminate – Manage:
  - Studies have shown that management of NPAs rather than elimination is prudent
- Securitization:
  - Though the concept in India is in nascent stage but has the potential in arears like mortgage backed securitisation
- Capital Norm tightening:
  - There is a fear that disposal through he provision of excessive reserves may result in a deflationary spiral. A thorough provision of reserves will have no negative impact on the longer term dividends paid to shareholders. It will help restore credibility and by adjust mechanism create capital gains and future profits that will result from the disposal of NPAs will pass back to creditors and tax payers who have incurred the loss today.

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