Non-Performing Asset Management by Banks

Dr. Chandra shekhar Kumar

Research Scholar, Department of Commerce, B.R.A. Bihar University, Muzaffarpur, Bihar- 842001, India.

ABSTRACT

Over a decade Non-performing Asset (NPA) has emerged as an alarming threat to the banking industry in our country causing affliction on the endurability and sustainability of the affected banks. Not only the banks are affected but also the whole economy is severely affected. The issue of mounting non-performing assets is giving jitter to banking sector particularly in many a developing economy. In fact high level of NPAs in Indian Banks is nothing but a reflection of the state of health of the industry and trade. In Indian economy, Banking sector is not only for the purpose of achieving profitable banking business but also to reduce the magnitude of banking funds locked in the bad debt accounts.

A healthy banking system is essential for economy striving to achieve growth and remain stable in competitive global business environment. 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 erodes the value of the asset. Reserve Bank of India and Government of India has made some notable changes in policies and regulation to help strengthen the sector. These changes include strengthening prudential norms, enhancing the payments system and integrating regulation of commercial banks.

The best indicator to the health of the banking industry in a country is its level of Non-performing Assets (NPAs). NPAs are one of the major concerns for banks in India. It reflects the performance of banks. Reduced NPAs generally gives the impression that banks have strengthened their credit appraisal processes over the years and growth in NPAs involves the necessity of provision, which bring down the overall profitability of banks. The Indian banking system is facing a serious problem of NPA. The magnitude of NPA is comparatively higher in public sector banks. To improve the profitability and efficiency of banks the NPA need to be controlled and reduced.

The paper deals with understanding the concept of NPA, its magnitude and major cause for an account becoming non-performing, policy directives of Reserve Bank of India, initiatives of Indian Government and also strategies for reducing NPAs.

KEYWORDS: NPA, Banking sector, Prudential Norms, Credit defaults, Government Initiatives, Strategies.

INTRODUCTION

The banking sector reforms undertaken in India from 1992 onwards were designed for ensuring the safety and soundness of financial institutions and at the same time at making the banking system strong, efficient, functionally diverse and competitive. The reforms targets arresting the decline in productivity, efficiency and profitability of the banking sector. Banks in India have played a significant role in the development of the Indian economy.

The Indian banking sector is assorted into scheduled banks and non-scheduled banks. The scheduled banks are those included under the 2nd Schedule of the Reserve Bank of India Act, 1934. The scheduled banks are further classified into: nationalised banks; State Bank of India and its associates; Regional Rural Banks (RRBs); foreign banks; and other Indian private sector banks. The term commercial bank refers to both scheduled and non-scheduled commercial banks regulated under the Banking Regulation Act, 1949. The banking sector act as a catalyst for the country's economy playing a vital role in providing financial resources especially in infrastructure, automobile, iron and steel, pharmaceuticals, healthcare etc. The banking industry has undergone tremendous change after the 1st phase of economic liberalization in 1991 and hence credit management. Elementary function of bank is to lend funds, as loan to various sectors such as agriculture, industry, personal loan, housing loan etc., in recent time the bank have become very cautious in extending loans. The reason being mounting Non-performing assets (NPAs) and now a day these are one of major concern for banks in India. The banks, in their books have different kind of assets, such as Cash in hand, Balances with other banks, Investments, Loans and advances, Fixed asset and other assets.

The Non-Performing Asset (NPA) concept is restricted to loans, advances and investments. As long as an asset generates the income expected from it and does not disclose any unusual risk other than normal commercial risk, it is treated as performing asset and it fails to generate the expected income it becomes a "Non-Performing Asset".

In other words an account is declared as NPA based on the recovery of installments and interest on loans and advances and other aspects as per RBI norms. The updated norms to declare the account as NPA are as follows as per RBI guidelines:-

An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank.

A Non-performing asset (NPA) is a loan or an advance where;

(i) Interest and/ or installment 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' in respect of an Overdraft/Cash Credit (OD/CC).
Out of order status: If the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit / drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

(iii) The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,

(iv) The installment of principal or interest thereon remains overdue for two crop seasons for short duration crops,

(v) The installment of principal or interest thereon remains overdue for one crop season for long duration crops,

(vi) The amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitisation transaction undertaken in terms of guidelines on securitisation dated February 1, 2006.

(vii) In respect of derivative transactions, the overdue receivables representing positive mark-to-market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment.

Non-performing assets are further classified into the following three categories based on the period for which the asset has remained non-performing and the realisability of the dues:

1. Sub-standard assets: a sub-standard asset is one which has remained NPA for a period less than or equal to 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 the RBI Inspection but the amount has not been written off, wholly.

REASON FOR AN ASSET BECOMING NPA

Several factors are responsible for increasing the size of NPAs in Banking sector. A few prominent reasons for assets becoming NPAs are as follows:-

- Lack of sincere corporate culture. Inadequate legal provision on foreclosure and bankruptcy.
- Criteria for classification of assets.
- Lack of proper monitoring and follow-up measures.
- Change in economic policies/environment.
- Non transparent accounting policy and poor auditing practices.
- Directed lending to certain sector.
- Lack of coordination between banks/FIs.
- Criteria for classification of asset.
- Willful defaults.
- Market failure.
- Classification of agricultural and non-agricultural loans is required to be done.
- Failure on part of the promoters to bring in their portion of equity from their own sources or public issue due to market turning unfavorable.

REASONS FOR NPA IN INDIA

Internal study conducted by RBI shows that in order of prominence, the following factors contribute to NPAs.

INTERNAL FACTORS

- Business Failure.
- Inefficiency in management.
- Slackness in credit management and monitoring.
- Lack of coordination among lenders.
- Inappropriate technology.
- Diversion of funds for
  - Expansion/diversification/ modernization.
  - Taking up new project.
  - Helping/promoting associate concerns time/ cost overrun during the project implementation stage.

EXTERNAL FACTORS

- Recession.
- Price escalation.
- Exchange rate fluctuation.
- Accidents and natural disasters.
- Change in government policies in excise/import duties, pollution control order, etc.

PRUDENTIAL NORMS ON INCOME RECOGNITION

1. Income Recognition Policy

1.1 The policy of income recognition has to be objective and based on the record of recovery. Internationally income from non-performing assets (NPA) is not recognised on accrual basis but is booked as income only when it is actually received. Therefore, the banks should not charge and take to income account interest on any NPA.

1.2 However, interest on advances against term deposits, NSCs, IVPs, KVPs and Life policies may be taken to income account on the due date, provided adequate margin is available in the accounts.

1.3 Fees and commissions earned by the banks as a result of renegotiations or rescheduling of outstanding debts should be recognised on an accrual basis over the period of time covered by the renegotiated or rescheduled extension of credit.

1.4 If Government guaranteed advances become NPA, the interest on such advances should not be taken to income account unless the interest has been realised.

2. Reversal of income

2.1 If any advance, including bills purchased and discounted, becomes NPA, the entire interest accrued and credited to income account in the past periods, should be reversed if the same is not realised. **This will apply to Government guaranteed accounts also.**

2.2 In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed with respect to past periods, if uncollected.

2.3 Leased Assets

The finance charge component of finance income [as defined in 'AS 19 Leases' issued by the Council of the Institute of Chartered Accountants of India (ICAI)] on the leased asset which has accrued and was credited to income account before the asset became nonperforming, and remaining unrealised, should be reversed or provided for in the current accounting period.

3. Appropriation of recovery in NPAs

3.1 Interest realised on NPAs may be taken to income account provided the credits in the accounts towards interest are not out of fresh/additional credit facilities sanctioned to the borrower concerned.

3.2 In the absence of a clear agreement between the bank and the borrower for the purpose of appropriation of recoveries in NPAs (i.e. towards principal or interest due), banks should adopt an accounting principle and exercise the right of appropriation of recoveries in a uniform and consistent manner.

4. Interest Application

On an account turning NPA, banks should reverse the interest already charged and not collected by debiting Profit and Loss account, and stop further application of interest. However, banks may continue to record such accrued interest in a Memorandum account in their books. For the purpose of computing Gross Advances, interest recorded in the Memorandum account should not be taken into account.

PROVISIONING NORMS

1. General

1.1 The primary responsibility for making adequate provisions for any diminution in the value of loan assets, investment or other assets is that of the bank managements and the statutory auditors.

1.2 In conformity with the prudential norms, provisions should be made on the non-performing assets on the basis of classification of assets. Taking into account the time lag between an account becoming doubtful of recovery, its recognition as such, the realisation of the security and the erosion over time in the value of security charged to the bank, the banks should make provision against substandard assets, doubtful assets and loss assets as below:

2. Loss assets

Loss assets should be written off. If loss assets are permitted to remain in the books for any reason, 100 percent of the outstanding should be provided for.

3. Doubtful assets

i. 100 percent of the extent to which the advance is not covered by the realisable value of the security to which the bank has a valid recourse and the realisable value is estimated on a realistic basis.
ii. In regard to the secured portion, provision may be made on the following basis, at the rates ranging from 25 percent to 100 percent of the secured portion depending upon the period for which the asset has remained doubtful:

Period for which the advance has remained in 'doubtful' category	Provision requirement (%)
Up to one year	25
One to three years	40
More than three years	100

Note: Valuation of Security for provisioning purposes

4. Substandard assets

(i) A general provision of 15 percent on total outstanding should be made without making any allowance for ECGC guarantee cover and securities available.

(ii) The 'unsecured exposures' which are identified as 'substandard' would attract additional provision of 10 per cent, i.e., a total of 25 per cent on the outstanding balance.

5. Standard assets

(i) The provisioning requirements for all types of standard assets stands as below. Banks should make general provision for standard assets at the following rates for the funded outstanding on global loan portfolio basis:

(a) Direct advances to agricultural and Small and Micro Enterprises (SMEs) sectors at 0.25 per cent;

(b) Advances to Commercial Real Estate (CRE) Sector at 1.00 per cent;

(c) Advances to Commercial Real Estate – Residential Housing Sector (CRE - RH) at 0.75 per cent

(d) All other loans and advances not included in (a) (b) and (c) above at 0.40 per cent.

INITIATIVES OF INDIAN GOVERNMENT

The Government and the Reserve Bank of India are close to finalising a number of changes in rules to reduce the proportion of bad loans in the banking sector, a prerequisite to kick-starting the investment cycle and pushing growth. Finance ministry told The Indian Express that the measures being finalised include tweaking the existing Joint Lenders Forum for faster resolution of NPAs (Non-performing assets), a scheme for one-time settlement of bad debts and penal action for defaulters who have siphoned off loans taken for business purposes. Sources said that state-owned banks have been asked to conduct a forensic audit of top 50 loan defaulters to separate genuine cases of business failure from those where funds have been diverted. "Over the last four years, the government has taken comprehensive steps under the 4r's strategy of recognizing NPAs transparently, resolving and recovering value from stressed accounts, recapitalizing PSBs and reforms in bank and financial ecosystem to ensure a responsible and clean system" Finance minister Nirmala Sitharaman said.

Comprehensive steps have been taken under the 4R's strategy to reduce NPAs of PSBs, including inter-alia, the following:

i. Change in credit culture has been effected, with the Insolvency and Bankruptcy Code (IBC) fundamentally changing the creditor-borrower relationship, taking away control of the defaulting company from promoters/owners and debarring willful defaulters from the resolution process and debarring them from raising funds from the market.

ii. SARFAESI Act has been amended to make it more effective, with provision for three month's imprisonment in case the borrower does not provide asset details, and for lender to get possession of mortgaged property within 30 days.

iii. Suits for recovery of dues are also filed by banks before DRTs. Six new DRTs have been established to expedite recovery.

iv. Over the last four financial years, PSBs have been recapitalised to the extent of Rs. 3.12 lakh crore, with infusion of Rs. 2.46 lakh crore by the Government and mobilisation of over Rs. 0.66 lakh crore by PSBs themselves enabling PSBs to pursue timely resolution of NPAs.

v. Key reforms have been instituted in PSBs as part of the PSBs Reforms Agenda, including the following:

a. Board-approved Loan Policies of PSBs now mandate trying up necessary clearances/approvals and linkages before disbursement, scrutiny of group balance-sheet and ring-fencing of cash flows, non-fund and tail risk appraisal in project financing.

b. Use of third-party data sources for comprehensive due diligence across data sources has been instituted, thus mitigating risk on account of misrepresentation and fraud.

c. Monitoring has been strictly segregated from sanctioning roles in high-value loans, and specialized monitoring agencies combining financial and domain knowledge have been deployed for effective monitoring of loans above Rs. 250 crore.

d. To ensure timely and better realization in one-time settlements (OTSs), online end-to-end OTS platforms have been set up.

Enabled by the above steps, as per RBI data on global operations, the NPAs of SCBs, after reaching a peak of Rs.10,36,187 crore as on 31.3.2018, have declined by Rs. 1,02,562 crore to Rs. 9,33,625 crore as on 31.03.2019 (provisional data for the financial year ending March 2019), and SCBs have effected record recovery Rs. 4,01,424 crore over the last four financial years, including record recovery of Rs. 1,56,746 crore during 2018-19 (provisional data).

The Union Finance Minister held a meeting with top RBI officials and bankers, and a roadmap is being worked out to deal with the issue of NPAs in near and medium term. The government will also encourage banks to go for one-time settlement of loans with a haircut, and this process will be overseen by an oversight committee. The settlement will be done in a manner that it gives comfort to bankers against any regulatory backlash in future. The proportion of bad loans has been rising over the years, despite the government having announced the Indradhanush plan of reforms for the state-owned banks.

The core problem of bad debts is with very large corporates, predominantly in the steel, power, infrastructure and textile sectors. Members of the consultative committee suggested several measures to deal with the issue such as initiating criminal action against the big willful defaulters, creating a Special Bank where NPAs of all the state-owned banks are transferred, allowing the concerned state government to take part in the auction of stressed assets, fixing the gross NPA in the range of 9-10 per cent and not counting restructured assets as NPAs.

STRATEGIES FOR REDUCING NPA

The banks in India are adopting various strategies to reduce the non-performing assets in their banks and they are also adopting various methodologies by which further addition to NPA portfolio is minimized. In the real sense, in case there is a recovery in principal and installments due in respect of the loans granted to the banks are received 100%, the question of non-performing assets do not arise. However, there is no such ideal bank where the NPA is nil. Except banks which were originated recently, all banks are prone to have some portion of their loans and advances as non performing advances

The following are some strategies by which banks are trying to curtail non-performing assets to a great extent:

AMENDMENTS IN BANKING LAW TO GIVE RBI MORE POWERS: The Banking Regulation Act may be amended to give RBI more powers to monitor bank accounts of big defaulters. The amendment in the banking law will enable setting up of a committee to oversee companies that have been the biggest defaulters of loans. RBI wants stricter rules for joint lenders forum (JLF) and oversight committee (OC) to curb NPAs. While the present law allows the government to direct RBI to carry out inspection of a lender, there is no provision for setting up oversight committees. Also, there could be changes in the laws, which will bar a bank to extend loans to defaulting company that has failed to repay to other banks.

STRINGENT NPA RECOVERY RULES: The government has over the years enacted and tweaked stringent rules to recover assets of defaulters. The SARFAESI Act of 2002 was amended in 2016 as it took banks years to recover the assets. Experts have pointed out that the NPA problem has to be tackled before the time a company starts defaulting. This needs a risk assessment by the lenders and red-flagging the early signs of a possible default.

RBI'S LOAN RESTRUCTURING SCHEMS: RBI has over the past few decades come up with a number of schemes such as corporate debt restructuring (CDR), formation of joint lender's forum (JLF), flexible structuring for long-term project loans to infrastructure (or 5/25 scheme), strategic debt restructuring (SDR) scheme and sustainable structuring of stressed assets (S4A) to check the menace of NPAs. In many cases, the companies have to make profit and defaulted even after their loans were restructured.

BANKS MAY NEED TO TAKE A "HAIR CUT": In the past few quarters, most of the banks especially PSU lenders, have reported a sharp fall in profit as they set aside hefty amounts for losses on account of NPAs, which eroded their profits. Given the gravity of the problem, the government may ask banks to go for more "hair cut" or write offs for NPAs.

RECOVERY CAMPS: These recovery camps are more suited to small loans. Normally the borrowers who had availed small loans will be more in number in rural and semi urban areas rather than urban and metro centers. As such, the banks instead of conducting the recovery camps at their branches, they usually conduct such recovery camps in centers like panchayat board offices, court buildings, government department buildings etc. such recovery camps so that the borrowers find it convenient to attend the recovery camps.

PREFERENCE OF CLAIMS: Banks should expeditiously and properly claim indemnity from organizations like Deposit Insurance and Credit Guarantee Corporation called DICGC, Export Credit Guarantee Corporation called ECGC, Credit Guarantee Fund Trust for small scale industries, Insurance Companies etc. and invokes Government/other personal guarantees to recover loan dues and reduce non-performing assets.

COMPROMISE PROPOSALS: Compromise routes are adopted by banks, where borrowers experience certain genuine difficulties and where normal recovery is not possible. It involves certain sacrifices on the part of the banks on the principle of "one bird at hand is worth two in the bush". Such proposals can be taken up considering the history of the borrowal account, security available, net worth of the borrower/guarantor, time value of offer made etc.

TECHNICAL WRITE OFF: Normally banks decide writing off small loans which have become bad and the recovery is not at all possible in those accounts under any circumstances on account of the facts that the borrower might have been expired; he has no means to repay the loan at any cost and there may be huge losses in respect of the properties etc. This is for the sole purpose of servicing such non performing accounts.

ONE TIME SETTLEMENT SCHEME: To reduce the absolute amount of non-performing assets, Government of India along with Reserve Bank of India is announcing one time settlement schemes periodically for the past few years. When the borrowers are alive and when the borrowers are farmers, small entrepreneurs etc and they find it very difficult to pay their dues for various reasons like bad health and fall in their business ventures, however, they have the inclination to repay their debts to the banks, this type of practice is very much helpful to the borrowers and the lending institutions.

SUIT FILING: Filing of suit is taken up as a last resort when all other remedies to recover Non-performing assets fail. Banks can initiate recovery proceedings with or without intervention of the courts of law. To expedite the process, banks should be alert and proactive in all stages of the proceedings. i.e. preparation of plaint, service of summons, written statements, trial of the suit, obtaining decree copy, praying for interim relief, execution of decrees, attachment of the property, arrest of the defendants, if needed etc.

DEBT RECOVERY TRIBUNALS: The debt recovery tribunal act was passed by Indian Parliament in 1993 with the objective of facilitating the banks and financial institutions for speedy recovery of dues in cases where the loan amount is Rs. 10 lakhs and above.

LOK ADALATS: It is a legal forum for expeditious settlement of loan dues on consensus arrived between the bank and the borrowers mediated by the Lok Adalat.

SECURITISATION ACT: The securitisation and financial assets and enforcement of security interest – SARFAESI act 2002 aims to empower banks as secured creditors to take possession, manage and sell the securities without the intervention of court/tribunal. It also aims at Asset Reconstruction by securitization or Reconstruction Company. However, loan with balance below Rs. 1 lakh unsecured loans and loans against collateral of agricultural land are exempted from the purview of this act.

CONCLUSION

Although the government and the regulator have taken several initiative for creating an effective NPA management regime, but the success story is not very encouraging. NPA level of Indian banks are still high as compared to the foreign banks. The government should also make more provisions for faster settlement of pending cases and also it should reduce the mandatory lending to priority sector as this is the major problem creating area. It is not at all possible to have zero NPAs. The bank management should speed up the recovery process. The problem of NPA can be achieved only with proper credit assessment and risk management mechanism. It is necessary that the banking system is to be equipped with prudential norms to minimize if not completely to avoid the problem of NPA. This will necessitates organizational restructuring improvement and the managerial efficiency and skill up gradation for proper assessment of credit worthiness. It is always to better to nip the problem at the bud stage.

With the robust system in place the growing NPAs can be managed effectively which would help in unlocking of good money blocked into unproductive assets and give a much needed boost to the sagging economy in general and the banking sector in particular.

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