Non-Performing Assets of Banking Sector in India – Extent and RBI guidelines

Extent:

We present below a table showing the extent of NPA in India for the period 2013-17.

Percentage of gross NPA of All SCB's (Excluding Foreign Banks) by Priority and Non-Priority Sectors

(Rs. billion)

All Scheduled Commercial Banks (Excluding Foreign Banks)						
	Priority Sector			Non-Priority Sector		
Year	Gross Advances	Gross NPAs	Percentage	Gross Advances	Gross NPAs	Percentage
2017	26,119.19	1,675.69	6%	46,351.85	5,473.29	12%
2016	24,357.25	1,382.55	6%	44,381.11	4,121.93	9%
2015	21,287.16	1,008.96	5%	41,538.92	1,934.25	5%
2014	19,023.53	852.47	4%	38,998.36	1,542.36	4%
2013	15,947.00	721.00	5%	35,078.00	1,038.00	3%

The rise in NPA is very pronounced and alarming for the non-priority sector which has quadrupled in four years from 3% to 12%. NPA for the priority sector is also quite high at 6% of gross advances. The figures have further increased in recent times causing a major strain on the banking sector's health.

Remedial measures

In line with the international practices and as per the recommendations made by the Committee on the Financial System (Chairman Shri M. Narasimham), the Reserve Bank of India introduced in the 1990s, a number of ***prudential norms*** for **income recognition**, **asset classification** and **provisioning** for the loan portfolio of the banks. This was done to move towards greater consistency and transparency in the published accounts, as well as to improve the functioning of the banks. ***Thus, it can be said that Banking Sector Reforms to tackle the problem of NPA started from this very initiative of identifying and isolating the non-performing assets periodically.***

The RBI approach towards classification of bank assets is to design a set of **objective** criteria. This would ensure a uniform and consistent application of the norms. Also, according to RBI guidelines, provisioning should be made on the basis of the classification of assets which would depend on the period for which the asset has remained non-performing and the availability of security and the realisable value thereof.

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 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'** 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. The instalment of principal or interest thereon remains overdue for two crop seasons for short duration crops,

v. The instalment 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.

Categories of NPAs: Banks are required to classify NPAs further into the following three categories:

i. Substandard Assets
ii. Doubtful Assets
iii. Loss Assets

A **Substandard asset** is one, which has remained NPA for a period less than or equal to 12 months. Such assets are characterised by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.

A **Doubtful asset** is an asset which has remained in the Substandard category for a period less than or equal to 12 months. A loan classified as **Doubtful** generally implies that **collection or liquidation in full** – on the basis of currently known facts -is highly unlikely.

A **Loss asset** is one where loss has been identified by the bank or auditors or the RBI inspection team but the amount has not been written off wholly. In other words, such an asset is considered quite uncollectible and its continuance as a asset is not warranted, though there may yet be some recovery value.

The accounts which do not belong to the above classes are **'Standard Accounts',** i.e. 'good accounts'.

Steps taken to tackle the problem of NPA

Managing asset quality is always very important. Recognising the importance of effective asset quality management, RBI has issued various guidelines to banks, from time to time, on various aspects of such management.

Preventive Management

Reserve Bank has advised banks that the management of credit risk should receive the top management's attention and the process should encompass:

(a) Measurement of risk through credit rating / scoring;
(b) Quantifying the risk through estimating expected loan losses and unexpected loan losses
(c) Risk pricing on a scientific basis; and
(d) Controlling the risk through effective Loan Review Mechanism and portfolio management.

The guidelines stipulate involvement of top Management, including the Board of Directors in actively managing the credit risk of the banks. Banks are required to follow proactive credit risk management practices like

(i) annual / half-yearly industry studies,
(ii) credit audit including periodic credit calls,

(iii) periodic visits of plant and business site, and
(iv) at least quarterly management reviews of troubled exposures / weak accounts.

Recent Regulatory Initiatives

In January 2014, the Reserve Bank of India had released a comprehensive **'Framework for Revitalising Distressed Assets in the Economy'**. The Framework emphasises (i) early identification of problem cases, (ii) timely restructuring of accounts, and (iii) taking prompt steps by banks for recovery or sale of unviable accounts. In addition, a **Central Repository of Information on Large Credit *(CRILC)*** to collect, store, and disseminate credit data to lenders, was set up. Under this arrangement, banks are reporting credit information to **CRILC** on all their borrowers having aggregate fund-based and non-fund based exposure of Rs. 50 million and above.

The RBI has also introduced a **standby credit facility** for long term project loans to tackle 'cost overruns', in case there is any unavoidable cost overruns in such projects. Also, it has advised banks **not** to adopt a 'One-size-fits-all' approach while determining repayment schedules. Instead, banks should carefully assess the type of project, likely future cash flows and so on.

Restructuring/Rehabilitation

It is well known that despite all kinds of preventive measures, there will be some NPAs. Once an account is identified as NPA, there is first the need to see whether rehabilitation is possible, and if it is considered to be unviable, the process of recovery should be smooth and prompt. Banks have been advised to distinguish between wilful defaulters on the one hand and borrowers who have defaulted due to circumstances beyond their control on the other. Assistance should not be withdrawn merely because an account has been identified as NPA. Effective restructuring may make a project viable again and minimise losses to the creditors and other stakeholders.

Recovery/Exit

Finally, if the account is considered beyond redemption, the process of recovery should be set in motion. There are different routes of doing so, like Debt Recovery Tribunals, Lok Adalats and **SARFAESI Act.** The relatively recent initiatives taken by the Govt are as follows:

Purchasing/Trading of NPAs: In April 2005, the RBI issued guidelines for trading of NPAs of banks and other non-banking financial institutions. However, a healthy secondary market for NPAs does not exist in India as yet.
Asset Reconstruction Corporation of India Limited: This Corporation was established with a view to provide a platform through which sellers and investors in NPAs will function. The ARCIL floated its first ever issue of Rs. 2000 cr. The proceeds collected through the issues were to be utilised to lay the assets of selected firms.
Securitization and Re-Promulgation of Financial Assets and Enforcement of Security Interest Ordinance (SARFAESI): The recovery mechanism of NPAs in India was time consuming and cumbersome. Therefore, it was required to give more powers to banks and other financial institutions so that they can sell securities to recover their dues. This Act permits the secured

creditors to enforce security interest in relation to the underlying security without reference to the court after giving a 60 days’ notice to the defaulting borrower. This Act gives sweeping powers to the secured creditors such as taking over the possession of secured assets of the borrower including the right to transfer by ways of lease, assignment or sale, takeover the management of secured assets. This legal enactment will remove legal hurdles and help in resolving a large number of NPAs quickly.

SARFAESI Act remains the most important channel for NPA recovery**.** In 2012-13, among the three channels for NPA recovery (SARFAESI Act, Debt recovery Tribunals and Lok Adalats), the largest amount was recovered through the SARFAESI Act. NPAs recovered through this Act accounted for about 80 percentage of the total amount of NPAs.