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Non-Performing Assets in India: An analysis over the years

BY NIKHIL PALLI

The origination of the ongoing crisis of Non-Performing Assets (NPA) in India cannot be attributed to a single event nor can it be confined to a particular timeline. It was only in the mid 1990's; post the economic liberalization when the country entered into the new millennium that the banks realized the sudden compounding of bad loans. The NPA situation essentially propelled in the mid 2000's following over-optimism in the economy specifically between 2006-2008, on the back of strong economic growth and pending infrastructure projects completing on time and within specified budgets, a thing largely unheard-of till then. This irrational exuberance was followed by number of bad loans being advanced by the banks often by compromising due diligences. Riding on this positive environment, corporations were being granted loans based on recent performances and growth. Loans were being advanced at an alarming rate, and these corporations grew highly leveraged which led to most of the financing through external borrowings rather than internal equity. However, though post the global financial crisis of 2008, the bubbled economic growth stagnated and the repayment capability of the same corporations substantially decreased causing unparalleled financial stress on the banking and the corporate sectors. The strong projections for various projects started seeming unrealistic and it became increasingly clear there was no set structure in place to recuperate these loan advancements.

The Reserve Bank of India (RBI) took a simple but holistic approach to empower the banks and reestablish the existing Corporate Debt Restructuring system. A large loan database (CRILC) was setup to share date for loans over INR 50 million with all banks. The CRILC data included the status of each loan; whether it was performing or had become an NPA or was heading in that direction. This system helped the banks identify warning signs and helped segregate the habitual offenders.

With the help of SEBI, in 2015 the RBI introduced the Strategic Debt Restructuring scheme helping financial institutions in recovering loans by taking over distressed companies. This gave banks substantial power in the management of companies, which defaulted in repaying the borrowings.

Consequently, the Insolvency and Bankruptcy Code (IBC) was introduced in 2016. Currently, more than 50% NPA matters are being resolved through the IBC. It laid down separate insolvency procedures for companies, individuals and partnership companies giving a maximum period of 180 days for resolution extendable by 90 days. The National Company Law Tribunal (NCLT), was set up under the IBC, 2016 and at pre-admission stage 4452 cases have been disposed which helped creditors obtain dues of INR 2 trillion; and various restructured post liquidation or adjudication .

In an attempt to bolster the reforms around NPA, the RBI in 2019 issued fresh guidelines, which have now replaced all the previous models, which state that defaults are to be recognized within 30 days. During this 30-day period, lenders may decide on the resolution strategy, including the nature of the resolution plan and its implementation. All lenders must put in place board approved policies for resolution of stressed assets and it is expected that the lenders initiate the process of implementing a resolution plan even before a default. Further, the lenders shall report credit information on all borrowings aggregating over INR 50 million and submit a weekly report on any default. If a Resolution plan is to be implemented, the lenders shall enter into an inter-creditor agreement. Further, previous instructions on resolution of stressed assets, corporate debt restructuring scheme, flexible structuring of existing long term project loans and strategic debt restructuring scheme have been withdrawn with immediate effect, and the RBI released the Financial Stability report in June 2019, which gave favorable projections claiming that bad loans are expected to fall to 9% in 2020, from the current standing of 9.3%. The gross non-performing ratio is set to decline to 12% from 12.6% and the Private sector banks too could see a fall in gross NPAs to 3.2% from 3.7%. Public sector banks, accounting for 80% of the NPAs in the economy are also projected to see their gross NPAs fall to 10.6% from 14.6% in March 2018.

However, inspite of these reforms led by the RBI, there is room for further headway. One of the primary reasons for stressed assets can be attributed to lethargic due diligence and an ineffective sanctioning process. Past records of borrowers should be available to banks to form

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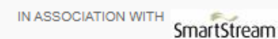

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Building a robust model

ineffective sanctioning process. Past records of borrowers should be available to banks to form an opinion and conduct financial background checks of prospective borrowers. The credit team of banks should also undergo periodic training to update their skills and industry benchmarks along with credit evaluation sheets, which should be upgraded regularly . Data analytics can also be a significant tool to conduct effective periodic review and audits.

Recently, the Finance Ministry declared to merge 10 Public Sector Banks into 4 banks reducing the Public Sector Banks to 12 from 27.She further stated that the profitability of public sector banks has improved and the total gross NPA's have drastically reduced and it can be sufficiently established that rigorous methods have been and shall continue to be adopted to address the situation surrounding Non Performing Assets in India.

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