International Journal of Engineering and Management Research
www.ijemr.net
e-ISSN: 2250-0758 | p-ISSN: 2394-6962
Volume- 9, Issue- 6 (December 2019)
https://doi.org/10.31033/ijemr.9.6.20

Non Performing Assets: A Burden on Banking Sector (An Assessment of Indian Commercial Banks' Profitability)

Dr. Naina Hasija
Associate Professor, Department of Commerce, Delhi University, INDIA

Corresponding Author: naina.hasija@gmail.com

ABSTRACT

After the evolution of new Industrial Policy 1991, banking system reforms became an important issue for the government. During this the reforms laid down by the Shri Narasimhan Rao Committee became quit important. It was at this time that the banking system was drastically transformed. These reforms adopted the international best practices to strengthen the functioning of banking industry. Many of these proposed reforms were implemented in the hopes of enhancing bank overall efficiency and lowering non-performing assets (NPA). The banks' profitability and financial efficiency would also improve as a result of this. For the purposes of this study, individual private sector banks, nationalised banks, and SBI and its affiliates were considered. The research is based on secondary data from the Reserve Bank of India's website for the years 2010 to 2017. The purpose of this research is to determine how banks have contributed to the growing threat and what the banking industry's trend has been in regards to these low-quality loans.

The author has also attempted to research and analyse RBI's proposal to implement Basel III norms in the banking sector beginning in January 2013, as formulated by the Bank for International Settlements (BIS) in consultation with central banks operating in a number of countries around the world in their respective economies and following sound financial and operational policies.

Keywords-- Asset Classification, Provisioning for NPAs, Capital Adequacy Norms, Basel III Standards, Regulatory and Supervisory Control by RBI Over

To give a famous, or notorious, example, consider Kingfisher Airlines. As the Indian government closed in on him for not repaying his loans, Mr Mallya quickly relocated to England.

I. INTRODUCTION

Every industry's performance may be assessed by its profitability, and the banking business is no exception. However, as the Reserve Bank of India (RBI) guidelines on Performing Assets state, "An asset or account of a borrower that has been classified by a bank or financial institution as sub-standard, doubtful, or non-performing has a direct impact on the profitability of banks because banks are legally not allowed to book income on such accounts while also being forced to make provision on such assets." When an amount due under a credit facility is not paid within 30 days of the due date, it is considered "past due." With effect from March 31, 2001, the word "past due" was dropped. The prudential criteria for revenue recognition, asset categorization, capital adequacy, and provisioning in commercial banks have been adopted, according to RBI guidelines released in line with international best practises, which highlight RBI's regulatory and supervisory oversight of banks. The move to Risk Based Supervision (RBS) in 2003-04 brought in CAMELS (Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, Systems and Controls approach) and Basel II regulations, and RBI assumed the position of supervisor.

II. PERFORMING AND NON-PERFORMING ASSESSMENTS (NPA)

The interest earned on loans and advances is the primary source of income for banks. These assets are classified as non-performing assets if they do not generate income (NPA). According to the Reserve Bank of India, a nonperforming asset (NPA) is a credit facility for which the interest and/or principal instalments are "past due" for a certain period. The asset is categorised as a non-performing asset if the loan payments have not been made for a period of 90 days. Banks are obligated to sort non-performing assets into one of the following groups based on how long they have been non-performing:

- *Sub-standard asset*: If an asset has been non-performing for less than 12 months, it is considered a sub-standard asset;
- *Doubtful asset*: If it has been non-performing for more than 12 months, it is considered a dubious asset; and
- *Loss assets*: If it has been non-performing for more than 12 months, it is considered a loss asset.

Poor loan production on bank balance sheets is not a good thing for the banking industry because it impacts the size and soundness of the balance sheet. There is also a

This work is licensed under Creative Commons Attribution 4.0 International License.

e-ISSN: 2250-0758 | p-ISSN: 2394-6962
Volume- 9, Issue- 6 (December 2019)
https://doi.org/10.31033/ijemr.9.6.20

negative influence on the rate of return on assets. Increasing NPAs necessitates setting aside a considerable portion of revenues to make provisions for questionable and bad loans, which decreases profitability. Profitability suffers as a result of this, as well as other concerns. In the case of banks, profitability is assessed by Return on Assets (ROA), which is determined by dividing Net Profits by Net Assets. A decrease in this ratio puts consumer money at risk. Banks are also burdened by the rising carrying costs of nonperforming assets (NPAs), which could have been put to better use. To strengthen their net worth, financial institutions must maintain a particular level of capital adequacy. Though this is terrible news for the banking business, it is clear from recent newspaper reports that this crisis has taken a significant toll on the banking business.

In 2018, the Standing Committee on Finance produced a report on India's banking system, noting that banks' ability to lend has been adversely harmed by rising nonperforming assets (NPAs).

During 2017-18, banks' financial performance was hampered by decreasing asset quality and treasury losses, which reduced non-interest earnings.

The aggregate gross advances of Public Sector Banks (PSBs) increased from Rs. 18,19,074 crore on 31.3.2008 to Rs. 52,15,920 crore on 31.3.2014, according to data from the Reserve Bank of India (RBI). Asset Quality Review (AQR) for clean and properly provisioned bank balance sheets, which began in 2015, indicated a high prevalence of Non-Performing Assets (NPAs) (NPAs). Stressed accounts were reclassified as NPAs as a result of AQR and subsequent transparent identification by banks, and predicted losses on stressed loans, which were not previously paid for under the flexibility allowed to restructured loans, were compensated for. Furthermore, all such loan restructuring schemes were cancelled. According to RBI data on global operations, gross NPAs of PSBs increased from Rs. 2,79,016 crore on 31.3.2015 to Rs. 6,84,732 crore on 31.3.2017 and Rs. 8,95,601 crore on 31.3.2018, mostly as a result of transparent recognition of stressed assets as NPAs. In India's SCBs, a rise in write-offs has coincided with a rise in nonperforming assets (NPAs). In four years, bad loans on all banks' portfolios have quadrupled, from Rs 3.2 trillion in 2014-15 to Rs 9.4 trillion in 2018-19.

Bank gross nonperforming assets (as a percentage of total loans) have risen steadily in recent years, from 2.3 percent in 2008 to 9.3 percent in 2017. This suggests that a growing share of a bank's assets is no longer generating income, decreasing the bank's profitability and ability to extend new loans.

Table 1: Classification of Loan Assets- Bank Group-wise (At end-March)

(Amount in Billion)

Bank Group	Year	Standard Assets		Sub Standard Assets		Double Assets		Loss Assets	
		Amount	Per cent*	Amount	Per cent*	Amount	Per cent*	Amount	Per cent*
PSBBs#	2017	45.012	87.5	1.641	3.2	4.603	9.0	167	0.3
	2018	46.021	84.5	2.053	3.8	5.936	10.9	465	0.9
PVBs	2017	20.310	96.5	244	1.2	429	2.0	65	0.3
	2018	24.506	96.0	272	1.1	700	2.7	52	0.2
FBs	2017	3.302	96.0	40	1.2	82	2.4	14	0.4
	2018	3.495	96.2	38	1.1	84	2.3	16	0.4
All	2017	68.624	90.4	1.925	2.5	5.114	6.7	247	0.3
SCBs**	2018	74.022	88.5	2.364	2.8	6.720	8.0	524	0.6

Notes: 1. Constituents items may not add up to the total due to rounding off.
2. *: As per cent to gross advance
3. #: Includes IDBI Bank Ltd.
4. ** : Data excludes SFBs
Source: off –site returns (domestic operation). RBI.

III. WRITING OFF BAD LOANS

A bank prefers to remove NPLs from its balance sheet in order to create a clean balance sheet with fewer liabilities and future losses. "Non-performing loans, including those for which full provisioning has been paid on completion of four years, are erased from the balance sheet of the bank concerned by way of write-off,"

This work is licensed under Creative Commons Attribution 4.0 International License.

e-ISSN: 2250-0758 | p-ISSN: 2394-6962
Volume- 9, Issue- 6 (December 2019)
https://doi.org/10.31033/ijemr.9.6.20

according to RBI guidelines. The quantity of bad loans removed from the balance sheets of the country's 21 public-sector banks (PSBs) has gradually increased over the years. These banks wiped down Rs 1.9 trillion in bad loans in 2018-19, accounting for nearly 90% of all SCB write-offs and four times their own write-offs in 2014-15. (From the Business Standard, November 29, 2019). According to numbers presented in Parliament by the finance ministry, India's 42 scheduled commercial banks (SCBs) wrote off Rs 2.12 trillion in loans in 2018-19. This was not only 42% greater than the Rs 1.5 trillion written off the previous year, but it also accounted for almost 20% of all non-performing assets (NPAs). (According to the Finance Ministry's report)

How NPAs Increased?

According to RBI data, the key causes of the increase in stressed assets include aggressive lending practises, wilful default / loan frauds / corruption in some circumstances, and economic recession. (According to the press)

Some of the external factors contributing to the rise in NPAs are external, such as weaker global commodity prices resulting in slower exports. Some are more inextricably linked to the Indian banking industry.

Many of the loans now classed as nonperforming loans were made in the mid-2000s, when the economy was flourishing and the economic outlook was bright. Loans for projects were given to large firms based on extrapolation of their current growth and performance. Corporations became heavily leveraged as loans became more readily available than before, suggesting that the majority of funding came from outside sources rather than internal promoter equity. However, as the economy slowed during the global financial crisis of 2008, these companies' ability to repay their debts shrank. This contributed to what is now known as India's Twin Balance Sheet Problem, in which both the banking sector (which lends money) and the corporate sector (which borrows money and must repay it) are experiencing financial difficulties.

Borrowers lost their ability to repay the bank when the project for which the loan was taken began to underperform. At the period, banks practised a technique known as "ever greening," in which new loans were issued to some promoters in order for them to pay down their debt. This effectively postponed the designation of these loans as non-performing, but it did not address the underlying causes of their insolvency.

Furthermore, there have been recent large-scale frauds that have contributed to increased NPAs. Despite the fact that frauds are tiny in comparison to the entire number of NPAs, they are becoming more common, and there have been no high-profile fraudsters punished. The amount of money lost as a result of bank fraud increased as the number of cases grew. According to the RBI's annual report for 2018-19, the sum lost to bank frauds in March 2013 was Rs. 10.2 thousand crore, but by March 2018 it had risen to a staggering Rs 71.5 thousand crore.

Lately, nonpayment of credit card dues has been cited as a contributing factor to increasing NPAs.

IV. STEPS TAKEN BY RBI

The Reserve Bank of India (RBI) has taken steps to address the problem of nonperforming loans (NPLs). Debt recovery tribunals (DRTs), the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, and the Insolvency and Bankruptcy Code (IBC, 2016) have all been established to help banks resolve their nonperforming assets.

In 2015, the Reserve Bank of India (RBI) launched an asset quality review (AQR) to clean up the bank's balance sheets. "As a result of AQR and subsequent transparent recognition by banks, stressed accounts were reclassified as NPAs, and expected losses on stressed loans, which were not previously provided for under the flexibility given to restructured loans, were provided for." comprehensive steps under its 4R's strategy of transparently recognising NPAs, resolving and recovering value from stressed accounts, and recapitalizing PSBs

i. PSBs have been recapitalized to the tune of Rs. 3.12 lakh crore during the last four financial years, with the government injecting Rs. 2.46 lakh crore and PSBs mobilising over Rs. 0.66 lakh crore. This has enabled PSBs to seek timely resolution of NPAs.
ii. As part of the PSB Changes Agenda, key reforms have been implemented in PSBs, including the following:
    a. In project financing, PSBs' Board-approved Loan Policies currently include tying up relevant clearances/approvals and connections prior to disbursement, monitoring of the group balance sheet and ring-fencing of cash flows, and non-fund and tail risk appraisal.
    b. Third-party data sources have been implemented for full due diligence across data sources, reducing the risk of misrepresentation and fraud.
    c. In high-value loans, monitoring and sanctioning functions have been rigorously separated, and specialised monitoring organisations with financial and domain experience have been deployed for effective monitoring of loans over Rs. 250 crore.
    d. Online end-to-end OTS platforms have been established to ensure faster and better realisation in one-time settlements (OTSs).

This work is licensed under Creative Commons Attribution 4.0 International License.

e-ISSN: 2250-0758 | p-ISSN: 2394-6962
Volume- 9, Issue- 6 (December 2019)

https://doi.org/10.31033/ijemr.9.6.20

In addition, the regulator has placed restrictions on eleven public sector banks by ordering them to take quick corrective action (PCA).

With effect from April 1, 2017, the Reserve Bank amended the Prompt Corrective Action (PCA) framework (which was established by RBI in 2002 to sanction banks when they report poor and risky financial performance). As part of the framework, the Reserve Bank monitors banks' key performance indicators as an early warning system, and PCA is triggered once capital, asset quality, and profitability thresholds are crossed.

Up until the end of September 2018, 11 PSBs had been placed under PCA, including five in the quarter ending June 2017, five in the quarter ending December 2017, and one in the quarter ending March 2018.

In May 2016, the Insolvency and Bankruptcy Code (IBC) was passed, establishing a time-limited 180-day recovery process for insolvent accounts (where the borrowers are unable to pay their dues). The creditors of these bankrupt accounts determine whether to restructure the loan or liquidate the defaulter's assets to reclaim the due amount under the IBC, which is presided over by an insolvency professional. If a decision is not made in a timely manner, the defaulter's assets are liquidated. Personal insolvencies are judged by the Debt Recovery Tribunal, and corporate insolvencies are handled by the National Company Law Tribunal (NCLT). As of March 2018, 701 cases had been registered and 176 had been resolved under the IBC.

V. RECOVERIES

As a result of the government's 4R policy of recognition, resolution, recapitalization, and reforms, have fallen by Rs. 1,06,032 crore to Rs. 7,89,569 crore as of the 31st of March 2019. (provisional data reported by RBI on 2.7.2019).

As a result of the above steps, according to RBI data on global operations, PSBs' NPAs have decreased by Rs. 1,06,032 crore to Rs. 7,89,569 crore as of 31.3.2019 (provisional data for the financial year ending March 2019), and PSBs have effected record recovery of Rs. 3,16,479 crore over the last four financial years, including record recovery of Rs. The bad debts held by Indian banks reached at $10.36 trillion on March 31, 2018. As of March 31, 2019, bad loans totaled $9.4 trillion, thanks to recoveries and write-offs.

PCA banks have seen an increase in the share of CASA (current account and savings account) deposits while decreasing the share of bulk deposits, lowering deposit costs. They've also enhanced NPA recoveries while limiting advances and deposits growth, lowering asset riskiness, and focusing on better-rated assets, as seen by lower RWAs. They've also proven that GNPAs grow slower than non-PCA PSBs.

The IBC of 2016 and the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests (SARFAESI) Act of 2002 helped to boost the recovery of stressed assets in 2017-18. Apart from banks' aggressive efforts to speed up recovery, changing the SARFAESI Act to include a provision for three months in prison if the borrower fails to give asset details and for the lender to take control of mortgaged property within 30 days may have aided recovery. Recovery through LokAdalats and Debt Recovery Tribunals (DRTs) has decreased in tandem with the number of cases referred, indicating the IBC mechanism's rising influence in the resolution of stressed assets.

According to an RBI study, banks were able to recover Rs 74,500 crore from corporations in the resolution process in 2018-19, representing a 43 percent recovery rate. Other venues such as LokAdalats, debt resolution tribunals (DRTs), and processes initiated under the Securitization and Reconstruction of Financial Assets and Enforcement of Securities Interest Act had much lower recovery rates (SARFAESI).

This work is licensed under Creative Commons Attribution 4.0 International License.

e-ISSN: 2250-0758 | p-ISSN: 2394-6962
Volume- 9, Issue- 6 (December 2019)
https://doi.org/10.31033/ijemr.9.6.20

Table 2: NPAs of SCBs Recovered through Various Channels (At end-March)

(Amount in ☐Billion)

Recovery Channel	2016				2017-18 (P)			
	No. of Cases Referred	Amount Involved	Amount Recovered*	Col. (4) as % of Col. (3)	No. of Cases Referred	Amount Involved	Amount Recovered	Col. (8) as % of Col. (7)
1	2	3	4	5	6	7	8	9
i) LokAdalats	3.555.678	361	23	6.3	3.317,897	457	18*	4.0
ii) DRTs	32.418	1.008	103	10.2	29.551	1.333	72*	5.4
iii) SARFAESI Act	199.352	1.414	259	18.3	91.330	1.067	265*	24.8
iv) IBC	37@	-	-	-	701@	99#	49 ^	49.6
Total	3,787,485	2.783	385	385	3,439,477	2.956	404	13.7

Notes:
P: Provisional
*: Refers to amount recovered during the given year, which could be with reference to cases referred during the given year as well as during the earlier years.
DRTs: - Debit Recovery Tribunals
@ : Cases admitted by National Company Law Tribunals (NCLTs).
#: Claims admitted of financial creditors (FCs) on 21 companies for which resolution plans were approved
^ : Realisation by FCs from 21 companies for which resolution plans were approved
Sources RBI and Insolvency and Bankruptcy Board of India

Banks are also cleaning up their balance books by selling doubtful/loss assets to assets reconstruction companies (ARCs) and other banks/NBFCs/financial institutions by taking haircuts, in addition to recovery through various resolution methods. The purchase cost of ARCs as a percentage of the book value of assets increased in 2017-18, reflecting better bank realisations on stressed asset sales. PSBs have been the most proactive on asset sales among bank groups. PSBs struggled to sell assets, owing to hefty haircuts and a variety of management.

VI. CONCLUSION

Despite various measures by the Indian government and the Reserve Bank of India, the problem of non-performing assets (NPAs) in the banking system remains unsolved. Overall, the data hint to a concerning position for the financial industry. An examination of the increase rate in the number of nonperforming assets (NPAs) reveals that the problem affects both small and large banks. As a result, the entire industry is in a state of flux. Poor asset quality for banks is a concern since, according to RBI norms, banks are obligated to hold a certain amount as provision based on their asset quality, resulting in deteriorating bank profitability. As a result, it has an impact not only on the profitability of these banks, but also on the wealth of their shareholders. As a result, the RBI has been issuing increasingly rigorous regulations in order to rein in the expansion of these assets. The Insolvency and Bankruptcy Code of 2016 is playing a critical role in the recovery of assets for creditors who have filed a case with the National Company Law Tribunal. In reality, the RBI's numbers show that the rate of growth of nonperforming assets (NPAs) is dropping, which is a good sign. However, there is still more work to be done. Only time will tell how successful the RBI has been in limiting the sector's NPA expansion. It is vital to pull the trigger hard since these bad loans are wreaking havoc on banks' liquidity positions, and even banks have been told to take it easy on lending, which has a negative influence on economic development, which has been lacklustre in recent quarters.

Although purposeful defaulters and defaulters owing to unforeseen circumstances should be distinguished, banks' previous freedom to restructure loans through a variety of schemes failed to get the desired results. Banks aren't altruistic organisations by any stretch of the imagination. Their lending policies should be urged to cater solely to legitimate borrowers; otherwise, they will be hampered by a substantial accumulation of nonperforming assets (NPAs).

REFERENCES

[1] *Reserve Bank of India*- Master Circulars 2014-15, 2015-16, 2016-17.
[2] *Standing Committee On Finance (2017-18).*

This work is licensed under Creative Commons Attribution 4.0 International License.

e-ISSN: 2250-0758 | p-ISSN: 2394-6962
Volume- 9, Issue- 6 (December 2019)

https://doi.org/10.31033/ijemr.9.6.20

[3] *Report On Trend And Progress Of Banking In India* 2014-15, 2015-16,2017-18.
[4] *Economic Survey.*
[5] *Stressed Account Management & Financial Stability-July –September 2016*, Bank-Quest.
[6] *Asset Quality Review and its impact on banks*. July 16, 2016, Manojit Saha, 'The Hindu"
[7] *Examining the rise of Non-Performing Assets in India***.** (2018). Ahita Paul.
[8] *PSU banks account for over 90% of total bad loans in FY'*. (2014). The Economic Times.
[9] *Annual Reports of Reserve Bank of India, Various Issues.*
[10] RBI Working Papers Series.

This work is licensed under Creative Commons Attribution 4.0 International License.