

Manage NPAs through a multi-facet approach

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Parliamentary Standing Committee (PSC) on Finance has done well to advise Reserve Bank of India (RBI) to review the entire gamut of non-performing assets (NPAs), which have been growing incessantly for last five years.

In its report on NPAs submitted to Parliament on 24th February, PSC recommended:

"The Committee would also like the RBI to conduct an objective evaluation of the efficacy of different instruments / schemes implemented by banks to deal with their NPAs / Stressed assets like OTS, CDR, SDR, 5 by 25 scheme, ARC sale etc., so that pitfalls can be identified and plugged with a view to making these efforts more purposeful."

Gross NPAs of scheduled commercial banks especially public sector banks (PSBs) have risen to an estimated Rs 4 lakh crore by 31 March 2016 from Rs 71,080 crore as on 31st March 2011. This is a telling commentary on the quality of entrepreneurship, banks' capability to assess projects' viability and recover loans, policy flaws, tardy implementation of projects and NGOs-judicial activism that results in delays or abandonment of projects.

Put simply, NPAs prove that reforms are not working well. There are serious problems in the economy especially in certain sectors such as infrastructure. Moreover, several industries lack the cushion to withstand impact of global downturn, which invariably results in dumping of products by foreign competitors.

The PSC-recommended study should thus also analyze all underlying causes for rise in NPAs and suggest ways to address them. After all, prevention is better than cure that RBI offers as guidelines for one-time settlement (OTS) with loan defaulters, corporate debt restructuring (CDR), etc. Both lenders and borrowers consider all debt restructuring instruments as de facto normal business transactions. This mindset must change.

Lending has no doubt become a highly risky business in an economy subjected to too many pulls and pressures emanating from within the country and abroad. In such a dynamic situation, some borrowers fail to generate adequate cash flow to repay loans in time. Many find their projects becoming unviable due to changed business environment such as duty-free imports from a country with which India signs a free trade agreement. Such developments, in turn, forces banks to classify un-serviced loans into NPAs in keeping with RBI accounting norms.

Setting aside NPAs that crop up in normal course of business difficulties or failures, the study should focus on many other avoidable factors that contribute to NPAs.

A major factor is the regulators' and banks' inability or lack of willingness to track misuse of loans. Certain promoters use them as equity for other projects to raise more loans. Some of them also deploy or siphon off a part of loan to other activities through a web of companies, subsidiaries and step-down subsidiaries.

The Banks need to step up vigil in sensing the build-up of stress on its loan portfolio and take swift action to safeguard its assets. The pathetic state of affairs in certain PSBs on this count can be gauged by a shocking disclosure made by P.J. Nayak Committee on Banks Governance Boards that submitted its report to RBI in May 2014.

The Committee observed: ***"In one bank the taxi fare reimbursement policy gets the same coverage as the NPA recovery policy."***

Simultaneously, the study should look into the pattern of rise in NPAs and their management by the Government with infusion of fresh capital into PSBs.

The Government should disclose how much money it has so far invested in recapitalization of PSBs since 1993-94 when RBI issued its maiden guidelines for managing NPAs, which were earlier known as sticky advances. And how long it would continue to sustain this cycle of rise in NPAs, recapitalization and growth in NPAs with public money?

Finance Ministry has rationalized repeated infusion of money from national exchequer into PSBs. In a statement issued in December 2013, the then Finance Minister P. Chidambaram, contended:

"The capital infusion by the Government in PSBs is done with the twin objective of adequately meeting the credit requirement of the productive sectors of economy as well as to maintain regulatory capital adequacy ratios in PSBs. The Government of India, as the majority shareholder, is committed to keep all PSBs adequately capitalized."

The Government has already resolved to pump in Rs 70,000 crore in PSBs over four years ending 2018-19 ostensibly to enable them to meet global operational standards called BASEL-III norms. Had PSBs been allowed to operate professionally and autonomously, they might have recapitalized themselves to meet BASEL norms in the same fashion as private sector banks do.

The Government should take this as last recapitalization initiative, which should be accompanied by dilution of its stake in PSBs below 51 percent. Even with 26% equity stake, the Government can have say in the management of PSBs.

More importantly, the Government should lift the veil of end-to-end secrecy in the NPA business. The Government should stipulate transparency in all transactions with promoters/owners of stressed assets.

It should pay heed to recommendations of PSC and all RBI Committees and unveil a comprehensive time-bound package for banking reforms. The proposed Insolvency and Bankruptcy (I&B) Code is important initiative for prompt recovery of credit from defaulters. It is, however, one element of reforms. So is the case with PSBs' revamp plan named Indradhanush announced in August 2015.

As put by Nayak Committee,

"The onus of remedying this situation through radical reform lies primarily with the Central Government. In the absence of such reform, or if reform is piecemeal and non-substantive, it is unlikely that there will be material improvement in the governance of these banks. This could impede the Government's objective of fiscal consolidation. The fiscal cost of inadequate reform will therefore be steep."