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Resolutions undertaken for resolving non-performing assets of the Indian banking system

Nitu Jaiswal

Abstract
The issue of NPAs in the Indian Banking sector has become a matter of concern for the overall growth of the economy. NPA problem has far reaching effects not only on banks but also on the corporate sector, as companies are the main debtors which borrow to finance investment. This paper attempts to provide an overview of the prevailing NPA problem in India as well review the nature of prevailing NPAs while focusing on the key features of various resolution measures that has been taken to resolve the NPAs problem in India. A review of the past RBI and other regulators measures undertaken to handle the growing NPAs shows how the corrective efforts tackle the issue of NPA and are gradually yielding expected results and is also reversing the adverse trends. The asset quality of banks showed an improvement with the gross nonperforming assets (GNPA) ratio of SCBs declining. Introduction of IBC enables creditors to raise their default payment, thus shifting the recovery means from defaulter to creditors. This simply helps in solving the crisis instead of postponing it.

Keywords: Non-Performing Assets, Twin balance sheet problem, Debt Recovery Tribunal, Assets Quality classification, Bankruptcy code

Introduction

Banks form the backbone of an economy by ensuring timely and sufficient flow of credit which is essential for growth and development. Flow of credit is essential for economic activities and indeed Non-Performing Assets (NPAs) beyond a certain level affect the smooth flow of credit into the economy. According to the latest IMF Financial Soundness Indicator (FSI), April, 2019, India's NPA ratio (ratio of non-performing assets to total gross loans) stands at 9.5 per cent and is much higher than a median NPA ratio of 3.6 for all 132 countries covered under the database. NPA problem has far reaching effects on the whole economy not especially on banks but also on the corporate sector, as companies are the main debtors. Having too much unpaid debt create an inevitable stressed on the corporate sector balance sheet. On the other hand, rising NPA affected the ability of banks to lend. Thus, rising indebtedness in the corporate sector linked to the NPAs problems in banks. This is the Twin balance sheet problem which is becoming a major obstacle to investment and reviving growth. The problem of NPAs thus is not related to the lenders only but also to the policy makers who continuously worked for fast track economic growth (Rajeev and Mahesh, 2010).

The incidence of NPAs in Indian banking system was the result of the social banking motto along with many factors, including poor credit analysis skill and lending decisions, external shocks (heavy rainfall, droughts in case of agricultural loans, global slowdown, world economic crisis etc.) and short-comings in the legal and judicial system that prevent the timely preventions of creditors rights. Maintenance of few NPA is thus a desirable characteristic of a well-functioning financial system. From the early 1990s till date, the regulators in India have continuously provided guidelines and directives at reducing NPAs. Narasimham Committee, 1991 first reckon the concept of NPA in Indian banking system and thereon many accounting measures were put in place to resolve the growing NPA problems in Indian banking system.

The present paper attempts to provide an overview of the NPA problem in India and reviews the nature of NPAs as well discusses the key features of various resolution measures that has been taken to resolve the NPAs problem in India. With this background, the paper is arranged as follows. The next section presents a comparative picture of NPA in India with

Few other countries of the world, with special reference with BRICS countries. The third section of the study describes the trend and nature of the NPA in India. Section IV summaries the efforts that have been taken by the authorities and also discuss the key features of various directives that contribute to the successful management in NPAs. The paper ends with a concluding section V.

NPAs at the Global level

In order to get the picture at the global level, it is important to look at the NPAs in different countries of the world. As the absolute level of NPA does not reveal the true picture of the magnitude and intensity of NPA of a country, as a country with a large population or GDP may have large advances and in turn larger NPA, the study, thus, look at what proportion of the total loan has become non-performing. The NPA ratio of various countries as a percentage of total gross advances (TGA) of few countries, having highest and lowest NPA ratio are given in Table 1. One interesting feature of Table 1 reveals that the NPA/TGA varies substantially across countries. A country-wise break-up shows that Ukraine has the highest NPA ratio of 53.2 per cent while the lowest NPA ratio has been reported by China, P. R: Macao at 0.2 per cent. Examining countries-wise NPA ratio, it is seen that highest NPA as percentage of the gross advances are largely concentrated within developing and under developing countries. The magnitude of difference in NPA ratio between the highest and lowest is also very high.

Table 1: Countries-wise NPA Ratio*: 2019

Highest NPA Ratio Countries		Lowest NPA Ratio Countries	
Ukraine	53.2	China, P.R: Macao	0.2
San Marino	47.2	Canada	0.4
Greece	42	Korea, Republic of	0.5
Equatorial Guinea	30.8	Sweden	0.5
Chad	28.6	China, P.R: Hong Kong	0.5

Source: calculated from FSI, IMF, April, 2019

Note: NPA Ratio*= ratio of non-performing assets to total gross loans

Among the BRICS countries, India's NPA ratio is the second highest, less only to Russia. Table 2 shows NPA ratio of BRICS countries varies from 10.7 percent to mere 1.8 percent, only Russia and India have NPA as high as 10 per cent, whereas South Africa, Brazil and China have NPA as low as 3.9 percent, 3.1 percent and 1.8 per cent respectively.

Table 2: NPA Ratio of BRICS Countries: 2019

Country	Ratio of non-performing loans to total gross loans
Russia	10.7
India	9.5
South Africa	3.9
Brazil	3.1
China	1.8

Source: FSI, IMF, April, 2019

Note: NPA Ratio= ratio of non-performing assets to total gross loans

However, comparing country–wise NPA levels of different countries, it should be remembered that there is no uniform NPA evaluation mechanism across the countries. Low NPA may be because some countries losses are written off at an early stage. While some of the developing countries, a loan is classified as non-performing only after it is arrears for six months. In India, an outstanding amount is classified as NPA if it is not paid of more than 90 days. In addition, countries also do differ in various other aspects like classification of assets, varying definitions of NPA, longer and lengthy legal process to recover the loans. Hence, while comparing the NPA of India with other countries, it is needed to be considered that asset classification norms in India are more stringent than many other countries (Rajeev and Mahesh, 2010).

A closer look at the NPA in India: Trends and its nature

The issue of NPA in India was given importance after the Narasimham Committee Report (1991) highlighted the poor impact it has on the financial health of banks as well as on the overall economy. Subsequently, efforts are made on the NPA classifications, refinement of the accounting system and setting norms for assets quality began. Systematic availability of data on NPA in India is available from 1998 only (Rajeev and Mahesh, 2010). Though the total GNPA increased significantly between 1998 and 2002 owing to Asian financial crisis, it started to decline after that (Table 3). During 1998, the total gross NPA and Net NPA of the total schedule banking sector was 14.4 % and 7.3% respectively. However, the NPA levels started to improve over the next decade where NPA levels started to fall drastically, however, it marginally deteriorates during the Global crisis of 2008. Significant decline in the NPA shows some positive impact of the regulatory changes that has been undertaken to control the rising NPA in Indian banking sector.

Table 3: NPA of Total Banking Sector over the years (%)

Years	Gross NPA		Net NPA	
	As Percentage of Gross Advances	As Percentage of Total Assets	As Percentage of Net Advances	As Percentage of Total Assets
1996-97	15.7	7	8.1	3.3
2000-01	11.4	4.9	6.2	2.5
2005-06	3.3	1.8	1.2	0.7
2010-11	2.5	1.4	1.1	0.6
2015-16	7.5	4.7	4.4	2.7
2016-17	9.3	5.6	5.3	3.1
2017-18	11.2	6.8	6	3.4
2018-19	9.1		NA	

Source: RBI, Various Years

However, from 2010-12 onwards, the NPA again become to deteriorate and keep rising from 3.1 percent of gross advance in 2011-12 to 11.2 per cent by 2017-18. The entire decade shows a rising trend in the overall NPA, overall deterioration in the NPA may be because of the excess lending during the crisis period to keep the economy moving. Many new projects especially in infrastructure related areas were launched and investment through banks credit to medium and large industries increased. As the period was marked by moderate and slower growth, debt servicing capacity of the companies suffered and led to the problem of NPA. The situation worsens further when in 2016 RBI conducted the NPA ratio through Asset Quality Review (AQR).

A similar trend is observed in the case of Net NPA (NNPA). The fall in the NNPA is sharper than gross NPA, mainly because of the increasing level of provisions, a seen in the second last row of Table 2. However, 2011-12 onwards, NNPA ratio keeps rising from 1.1 percent to as high as 6 per cent by the year 2017-18.

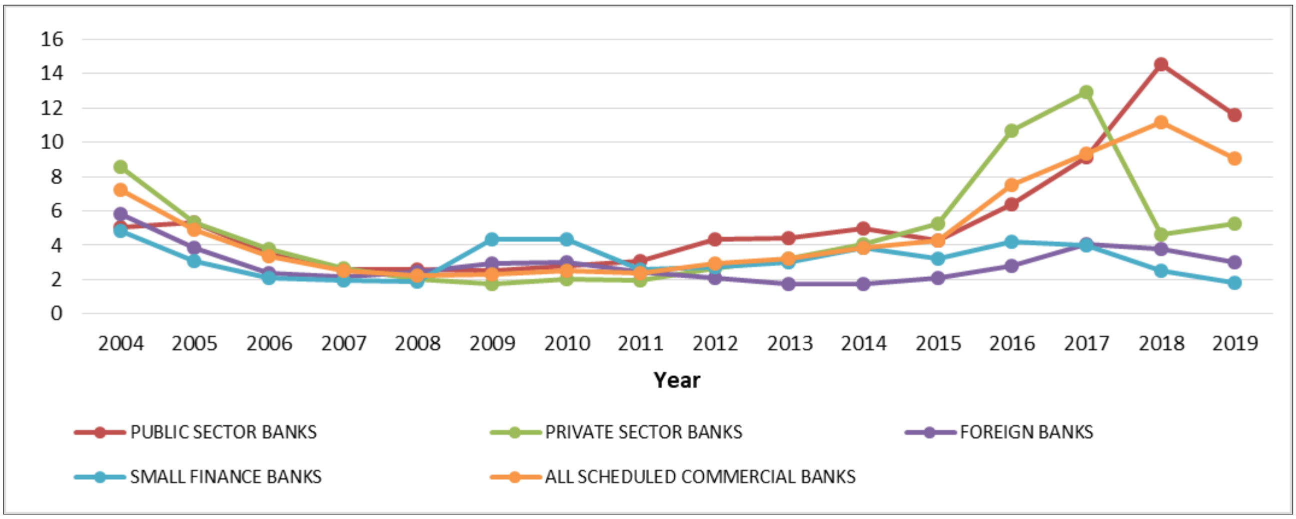
At the bank group level, foreign banks had the least level of NPA. Since, 2006 onwards, NPA in foreign banks is almost stagnant, however it rose sharply in 2017 only to decline in 2018. Private Banks were able to reduce their NPA at very low level, registered a sharp decline in the NPA ratio from 12.9 per cent in 2017 to 4.7 per cent in 2018. Public sector banks are doing as good as bad as their counterpart in the private sector. Though NPA of public sector has fallen significantly over the years, however, 2011 onwards, NPA started to increase significantly from 3.12 per cent in 2011 to 14.58 per cent by the year 2018. Priority sector lending that RBI keeps imposing on public sector banks may also considered as one of the reason for accumulating of NPA in the public sector banks, as the ability to earn and return for such sectors is very low.

However, one of the significant observations from Table 4 is that GNPA as per cent of gross advances has been declining over time across all bank groups till 2010. It is during the present decade, the NPA across all bank groups started to increase after the Asset Quality Review conducted by RBI, slowdown in the economy, poor performance by mid-size and SMEs, lower profitability and struggled to service sectors.

Table 4: Gross NPA as percentage of gross advance of SCBs

Year (March end)	Public sector banks	Old private sector banks	New private sector banks	Foreign banks in India
2018-19	11.59		5.25	2.11
2017-18	14.58		4.62	3.81
2016-17	11.7		4.1	4
2015-16	9.3		2.8	4.2
2005-06	3.7	4.4	2.4	2.1
2000-01	12.4	0.1	5.1	6.8
1999-00	14	0.1	4.1	7
1996-97	17.8	0.1	2.6	4.3

Source: RBI, Various Years



Source: Computed using RBI data

Fig 1: GNPA as to gross advances ratio (%) for different SCBs

Table 3 and Table 4 give a picture of an aggregate level of NPA in India. In order to tackle the problem of NPA, a disaggregate analysis is necessary to examine what type of loans lead to more NPAs. A sector-wise NPA loans has been examined, broadly segregated it into priority and non-priority sector loans. Table 4 reveals that the NPA of the priority sector is indeed higher than the non-priority sector loans and the trend has been continuing over the years. However, 2011 onwards, the trend reverse from priority sector to that of non-priority sector. Since 2012, more than 50 per cent of NPA comprises from non-priority sector which keep rising to as high as to 75 per cent in the year 2017. Thus, the last decade recorded a reversal trend of high priority sector NPA to non-priority sector NPAs resulting from the policy of waiving off many infrastructural and corporate sector loans.

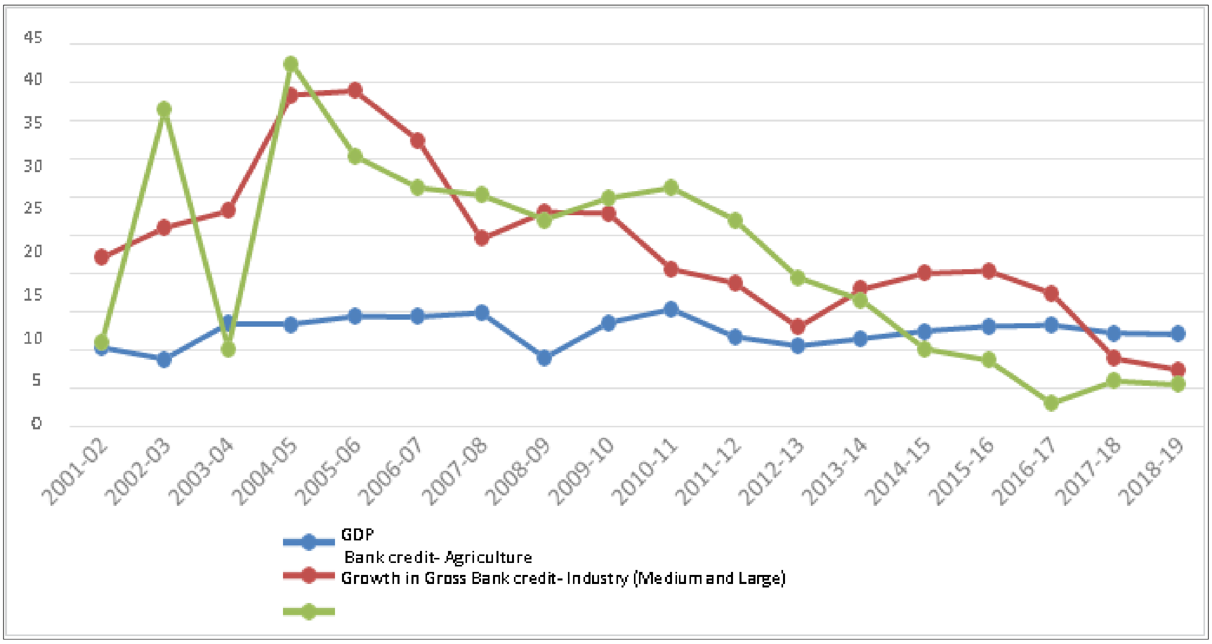
Table 5: % Sector-wise NPAs of scheduled commercial banks (Rs. Cr.)

Bank group/years	Priority sector		Non priority sector		Public sector		Total
	Amount	Percentage	Amount	Percentage	Amount	Percentage	Amount
2017	1257.29	24.80	3811.93	75.20	147.20	2.90	5069.22

2016	969.03	23.18	3210.85	76.82	17.63	0.42	4179.88
2015	709.34	34.61	1337.67	65.26	2.59	0.13	2049.59
2014	537.50	36.45	935.67	63.46	1.30	0.09	1474.48
2013	408.34	40.16	599.01	58.91	9.48	0.93	1016.83
2012	324.24	46.96	355.55	51.49	10.68	1.55	690.48
2011	246.20	55.61	194.10	43.84	2.42	0.55	442.72
2010	195.67	53.76	165.23	45.40	3.05	0.84	363.95
2009	157.54	59.35	106.68	40.19	1.21	0.46	265.43
2008	159.72	63.96	85.63	34.29	4.38	1.76	249.74
2007	153.44	58.63	103.40	39.51	4.87	1.86	261.72
2006	149.22	51.78	132.27	45.90	6.68	2.32	288.17
2005	153.36	46.75	170.62	52.01	4.06	1.24	328.04
2004	167.05	47.74	178.95	51.14	3.90	1.11	349.90
2003	168.86	47.10	184.02	51.33	5.61	1.56	358.49

Source: RBI

GDP growth surged from 2003 onwards and at this time corporate profitability was amongst the highest in the world, which made them raise loans easily and excessively. Heavy projects worth lakhs of crores especially in infrastructure related areas (power generation, steel, telecom) were launched and investment through bank credit to medium to large industries increased by 36 per cent points in the year 2003 reaching 44 per cent by 2005-06. As the boom period was followed by the long period of moderated and slower growth, debt servicing capacity of the companies suffered and led to the problem of NPA. At the same time, bank credit to agriculture sector has always been comparatively slower, however, with rapid GDP growth and the priority sector lending policy, bank credit to agriculture registered a growth of 8.3 per cent in the year 2003-04 which further increased to 10.2 per cent in 2010. However, the credit growth both in agriculture and industry showcased a slowdown from 2010 onwards with as low as 5.4 per cent to 6 per cent in 2018- 19.



Source: MoSPI, RBI

Fig 2: Growth in deployment of bank credit and GDP

Resolutions undertaken to solve NPA in India

This section of the study reviews the key features of the important resolutions undertaken to resolve the growing NPAs across the countries with focus on Indian banking sector.

Different Countries opt for different solutions to resolve the problem of NPA depending upon various factors such as macroeconomic factors, structural issues related to banking system, legal and judiciary constraint, extent and types of assets in NPA.

"London Approach" was extensively used during the Asian crisis on 1997-98. It was a voluntary approach where the majority vote of creditors was sought rather than unanimity to pass the restructuring plan of assets. Supervisory authorities were set up to provide recommendations and guidance during the process. A "Hybrid Approach" of Pre-packaged program is another option where lenders submit the resolution plan of the corporate debtor in court. In USA, bankruptcy code allows for such prepackages whereas European Commission provides recommendations to simplify the process. Most of the countries have centralized Asset Management Companies (AMC) wherein banks' bad loans or assets are transferred to these AMCs. These companies used methods such as direct sales, court process for insolvency process, and auction abroad for recovery.

In India, from the early nineties till date, the regulators have provided various guidelines and directives at reducing

NPAs. Various policy reforms that has been undertaken to solve the rising NPA problems are briefly analysed below:
Narasimham committee-I (1991) advised for higher norms for capital adequacy, a cut in liquidity and cash reserve ratio for providing banks a better autonomy as credit provider. Asset Reconstruction Fund (ARF) was also created under Narasimham Committee-I to take over a portion of banks' bad loans on a discounted rate. Subsequently, Narasimham Committee-II was formed in 1997. This Committee recommended that an asset be classified as doubtful, substandard category. Banks have to follow prudential norms and avoid making fresh advances to the defaulters. One of the major introductions based on this committee was the setting up of Asset Reconstruction Company (ARC) on a pilot basis. However, M.S. Verma Committee in 1999 suggested Debt Recovery Tribunals (DRTs) taking charge of resolving NPAs as well suggested Asset Reconstruction Funds (ARFs) should continue help weak banks in NPA management. As the regulator of banking system, RBI took the necessary steps to avoid banks to fail by tightening the rules under its Prompt Corrective Action (PCA) framework which was introduced in 2002-03. Under this framework, RBI sets some benchmark such as minimum capital requirement measured through CRAR, NPA and Return on Assets to assess, monitor, control and take corrective actions on banks which are weak and troubled. Table 6 shows the GNPA to Gross Advances ratio for the 11 banks that are now under PCA is more than 10 percent.

Table 6: Gross NPA for 11 banks under prompt corrective action (PCA) as on March, 2018 (Amount in Rs. million)

Banks	Gross NPAs	Gross advances	Gross NPAs to gross advances ratio (%)
Allahabad Bank	265627.88	1664358.58	15.96
Corporation Bank	222134.39	1280052.6	17.35
IDBI Bank Limited	555882.64	1988530.85	27.95
UCO Bank	305499.2	1239895.35	24.64
Bank of India	623284.64	3759954.94	16.58
Central Bank of India	381307	1774840.4	21.48
Indian Overseas Bank	381801.51	1509992.9	25.28
Oriental Bank of Commerce	261336.4	1482060.1	17.63
Bank of Maharashtra	184332.3	946452	19.48
Dena Bank	163614.38	742385.81	22.04
United Bank of India	165521.1	686917.7	24.10

Source: Bank Wise And Bank Group-Wise Gross Non-Performing Assets, Gross Advances And Gross NPA Ratios Of Scheduled Commercial Banks, RBI.

Laws relating to NPA and bankruptcy

There are various legal measures available to help banks recover their loans. These include:
The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act: which allows banks to realize money from a lender‘s assets without going through Courts.
Recovery of Debts due to Banks (DRT) Act: Debt Recovery Tribunals, help banks resolve cases of seizure of property and assets for defaulters above Rs. 10 lakhs expeditiously.
Lok Adalats: Section 89 of the Civil Procedure Code provides resolution of disputes through ADR methods such as Arbitration, Conciliation, Lok Adalats and Mediation. Lok Adalat mechanism offers expeditious, in-expensive and mutually acceptable way of settlement of dispute.
Table 6 shows that total of 46.54 lakh cases to recover NPAs were filed in Lok Adalats, Debt Recovery Tribunals and under the SARFAESI Act. Of this, 44.56 lakh cases were taken up by Lok Adalats during fiscal March 2016. Public sector banks, which are burdened with a high proportion of the banking sector‘s NPAs, could recover only Rs. 19,757 crore as against Rs. 27,849 crore during the previous years.
The deceleration in recovery was largely due to a reduction in recovery through the SARFAESI channel by 74% from Rs. 19,0537 crore in 2012-13 to Rs. 80076 crore in 2016-17. On the other hand, recovery through Lok Adalats and DRTs has registered a sharp increased (Table 7). According to the RBI data, the rate of recovery through DRTs has been increased from mere 14% in 2012-13 to 24% by the year 2016-17, surging a record of 71% increase in recovery rate through DRTs.
The rate of recovery of NPAs was 10.3%, or Rs. 22,800 crore, out of the total NPAs of Rs 285,937 crore during fiscal ended March 2016-17, against Rs. 30,800 crore (12.4%) of the total amount of Rs. 248,200 crore reported in March 2015.

Table 7: NPAs of SCBs recovered through various channels (in cr.)

	Recovery channel	Lok adalats	DRTs	SARFAESI act	Total
2012-13	No. of cases referred	840691	13408	190537	1044636
	Amount involved	6600	31000	68100	105700
	Amount recovered*	400	4400	18500	23300
	3 as per cent of 2	6	14	27	22
2013-14	No. of cases referred	1636957	28258	194,707#	1859922
	Amount involved	1400	5300	25300	32000
	Amount recovered* 3 as per cent of 2	6	10	27	18
2014-15	No. of cases referred	2958313	22004	175355	3155672
	Amount involved	31000	60400	156800	248200
	Amount recovered*	1000	4200	25600	30800
	3 as per cent of 2	3	7	16	12
2015-16	No. of cases referred	4456634	24537	173582	4654753

	Amount involved	72000	69300	80100	221400
	Amount recovered*	3200	6400	13200	22800
	3 as per cent of 2	4	9	17	10
2016-17	No. of cases referred	2152895	28902	80076	2261873
	Amount involved	105787	67089	113100	285976
	Amount recovered*	3803	16393	7758	27954
	3 as per cent of 2	4	24	7	10

Source: RBI

Insolvency and Bankruptcy code, 2016

To improve the financial health of the banks, reforms in the banking related rules and regulations requires, however it is equally important to look upon the twin balance sheet problem. To this cause, the Insolvency and Bankruptcy Code, 2016 (IBC) was introduced on 28th May, 2016 and commenced from 1st December, 2016.

Under IBC, any corporate debtor commits a default, a financial creditor, an operational creditor or the corporate debtor itself may initiate corporate insolvency resolution process with the Adjudicating Authority. To start the Resolution process to start either creditors or corporate debtor has to apply to the National Company Law Tribunal ("NCLT") into the corporate insolvency resolution process ("CIRP").

Once a corporate debtor is admitted into the CIRP, its board of directors is suspended and its management is placed under an independent "interim resolution professional". Within 30 days of the admission into CIRP, Committee of Creditors ("COC") is formed, comprising all the financial creditors of the corporate debtor. To enact the process of resolution, the Committee has to reviews and approves the resolution plan.

Maximum period for insolvency resolution is 180 days extendable by 90 days. The Adjudicating Authority may extend the Corporate Insolvency Resolution Process duration by 90 days on application of Resolution Professional instructed by CoC with 66% of the voting shares. As presented in Table 8, nearly 1966 Corporate Debtors have been admitted into CIRP by the end of March, 2020. Of these, 23 have been closed on appeal or review or settled; 21 have been withdrawn; 121 have ended in liquidation and 2 have ended in approval of resolution plans.

Table 8: Corporate insolvency resolution process

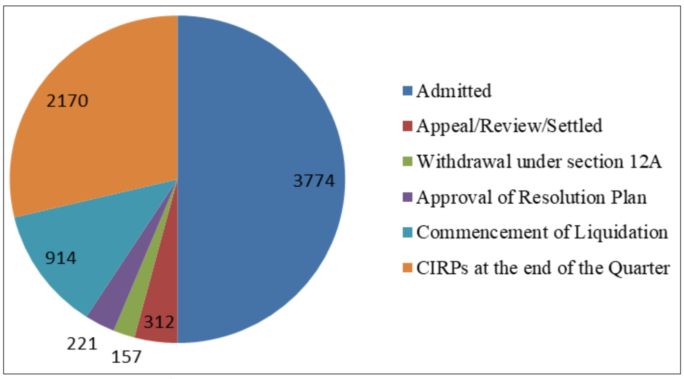
Quarter	CIRPs at the beginning of the quarter	Admitted	Closure by				CIRPs at the end of the quarter
			Appeal/Review/ Settled	Withdrawal under section 12A	Approval of resolution plan*	Commencement of liquidation	
Jan - Mar, 2017	0	37	1	0	0	0	36
Apr -Jun, 2017	36	130	8	0	0	0	158
Jul - Sep, 2017	158	235	18	0	2	8	365
Oct - Dec, 2017	365	144	40	0	7	24	438
Jan - Mar, 2018	438	196	23	0	11	59	541
Apr - Jun 2018	541	249	22	1	14	51	702
Jul - Sep, 2018	702	242	33	27	29	86	769
Oct - Dec, 2018	769	276	13	38	18	82	894
Jan - Mar, 2019	894	382	50	21	20	86	1099
Apr - Jun, 2019	1099	301	26	26	26	95	1227
Jul - Sep, 2019	1227	582	28	21	32	153	1575
Oct - Dec, 2019	1575	613	27	11	35	149	1966
Jan - Mar, 2020	1966	387	23	12	27	121	2170
Total	NA	3774*	312	157	221**	914	2170

Source: IBBI Newsletter March 2020

*These CIRPs are in respect of 3706 CDs

**This excludes 1 CD which has moved directly from BIFR to resolution

As shown in Figure 3, as on March, 2020, out of total 3774 cases, 8.26 per cent cases were closed on appeal/review /settled, 4.16 per cent cases were closed on withdrawal under section 12A, 5.85 per cent cases were closed on resolution, 20 per cent cases were closed on liquidation and 57 per cent cases are still ongoing.



Source: Computed from IBBI, March 2020

Fig 3: Status of CIRPs as on 31 March, 2020

IBC has proved to be far superior to the tools used earlier for the resolution of bad assets and given the significance of the Code for the overall economy. Large amounts are also being recovered because defaulters cleared dues before the adjudicating authority admitted the creditor's plea due to the fear that if IBC was invoked they would lose control over their firms. The increasing application of the IBC shifts in the power in favor of creditors, instead of defaulter's vis-à-vis all the earlier means for insolvency resolution.

Conclusion

It is next to impossible to eliminate NPAs from the books of the banks, but high levels of NPAs can pose a big threat to the viability of the banks and can lead to bank failures. Bank failures in turn, through interconnectedness can threaten the stability of the financial system of an economy. Moderated growth can lead to reduced dynamism and investments thus worsening NPAs and further reduced growth. To break this vicious cycle, it is crucial that correct and timely measures are taken for structural transformation of the banking sector and the economy.

RBI has announced a host of measures to rein this problem. A review of the past measures NPA handling by the banks and the regulators shows how the corrective efforts tackle the issue of NPA and are gradually yielding expected results and is also reversing the adverse trends. The asset quality of banks showed an improvement with the gross nonperforming assets (GNPA) ratio of SCBs declining from 11.5 per cent in March 2018 to 10.8 per cent in September 2018. Henceforth, the credit disbursal of SCBs (driven largely by private sector banks) has improved between the same periods. Implementation of Special Mention Accounts (SMA) norms have helped in early identification of stress assets in the system. Joint Lender Forum is also created to expedite the process for resolving NPAs. Tagging individuals and companies as wilful defaulter would help in creating a strong deterrent.

RBI also allowed the banks to sell even the loans where the principal or interest was overdue by 60 days rather than 90 days, earlier. In essence, it allowed banks to start selling assets early if they felt the loan was non-redeemable. Banks can sell their NPAs to professionally managed ARCs, who in turn resolve the no-performing assets into assets. A maximum of two years' time period is given to banks to spread the loss from sale of assets to ARCs. Till March 2016, this benefit has resulted in surge in efforts from banks to clean their balance sheets. However, until the bankruptcy code was enacted bankers had little ability to threaten incompetent promoters for failing projects. Introduction of IBC enables creditors to raise their default payment within a limited period of time. This simply helps in solving the crisis instead of postponing it.

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