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Non-Performing Assets: The Cause of Concern for Banking Industry

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Abstract: ***This paper delves into the critical issue of Non - Performing Assets NPAs in the Indian banking sector, spotlighting the sluggish progress in managing problem loans that pose a significant challenge. It thoroughly examines the determinants of NPAs by reviewing existing studies and the impact of governmental initiatives aimed at mitigating these challenges, such as the establishment of the National Asset Reconstruction Company NARCL, the launch of UPI Lite, and the introduction of the Digital Rupee, among others. The discourse extends to the identification and comparison of NPA definitions across Asia, shedding light on the variance in regulatory and accounting perspectives. Additionally, the paper scrutinizes the exit criteria for NPAs and their implications on the reported levels of NPAs across jurisdictions. Concludingly, it emphasizes the detrimental effect of rising NPAs on the lending capacity of banks and underscores the importance of stringent capital adequacy norms, like the CRAR, to cushion against unexpected losses. Through an analysis of various strategies employed in loan recovery, the paper critiques the inconsistency in banks approaches and suggests a harmonized effort to bolster the financial health of the banking system, highlighting the pivotal role of regulatory norms and provisioning in curbing NPAs and fostering economic resilience.***

Keywords: Non - Performing Assets NPAs, Indian banking sector, capital adequacy norms, loan recovery strategies, governmental initiatives

1. Introduction

The discussion under this head has been made on the existing studies related to NPA determinants. The sluggish growth achieved by policymakers in the area of managing problem loans is becoming a major quandary for the Indian banking industry. In order to design appropriate management policies for NPA, it is important to identify and analyse the forces driving change in bad loans and the strength of the impact that these forces have on problem loans. In this regard, the study of factors exposing banks to vulnerability against non - repayment of loans has come under attention of many researchers (Demirgüç - Kunt and Detragiache, 1998; Beck et al., 2015; Tanasković and Jandrić, 2015). [1]

1) Government Initiatives

- National Asset reconstruction company (NARCL) will take over, 15 non - performing loans (NPLs) worth Rs.50, 000 crores (US$ 6.70 billion) from the banks.
- National payments corporation India (NPCI) has plans to launch UPI lite this will provide offline UPI services for digital payments. Payments of upto Rs.200 (US$ 2.67) can be made using this.
- In the Union budget of 2022 - 23 India has announced plans for a central bank digital currency (CBDC) which will be possibly know as Digital Rupee.
- National Asset reconstruction company (NARCL) will take over, 15 Non performing loans (NPLs) worth Rs.50, 000 crores (US$ 6.70 billion) from the banks.
- In November 2021, RBI launched the 'RBI Retail Direct Scheme' for retail investors to increase retail participation in government securities.
- The RBI introduced new auto debit rules with a mandatory additional factor of authentication (AFA), effective from October 01, 2021, to improve the safety and security of card transactions, as part of its risk mitigation measures.
- In September 2021, Central Banks of India and Singapore announced to link their digital payment systems by July 2022 to initiate instant and low - cost fund transfers.
- In August 2021, Prime Minister Mr. Narendra Modi launched e - RUPI, a person and purpose - specific digital payment solution. e - RUPI is a QR code or SMS string - based e - voucher that is sent to the beneficiary's cell phone. Users of this one - time payment mechanism will be able to redeem the voucher at the service provider without the usage of a card, digital payments app, or internet banking access.
- As per Union Budget 2021 - 22, the government will disinvest IDBI Bank and privatise two public sector banks.
- Government smoothly carried out consolidation, reducing the number of Public Sector Banks by eight.
- In May 2022, Unified Payments Interface (UPI) recorded 5.95 billion transactions worth Rs.10.41 trillion (US$ 133.46 billion).
- According to the RBI, India's foreign exchange reserves reached US$ 630.19 billion as of February 18, 2022.
- The number of transactions through immediate payment service (IMPS) reached 430.67 million and amounted to Rs.3.70 trillion (US$ 49.75 billion) in October 2021.
- Appointment of nodal officers in banks for recovery at their head offices/zonal offices/for each Debts Recovery Tribunal (DRT).
- Thrust on recovery of loss assets by banks and designating asset reconstruction companies (ARC) resolution agents of banks. Directing the state - level bankers' committees to be proactive in resolving issues with the state governments. Sanction of fresh loans on the basis of information sharing amongst banks. Conducting sector / activity - wise analysis of NPAs.
- Close watch on NPAs by picking up early warning signals and ensuring timely corrective steps by banks including early detection of sign of distress, amendments in recovery laws, and strengthening of credit appraisal and post credit monitoring.
- A strong banking sector is important for a flourishing economy. The failure of the banking system may have an adverse impact on other sectors thus, there is need to

[1] Pacha Malyadri, S. Sirisha (2011). A Comparative Study of Non Performing Assets in Indian Banking Industry, International Journal of Economic Practices and Theories, Vol. 1, No. 2, pp. 2247-7225.

ensure that the banking system recognizes financial distress early, takes prompt steps.
- Ministry of Finance, Economic Survey 2013 - 14, to resolve it, and ensure fair recovery for lenders and investors so that banking sector start functioning without stress.

2) Identification of NPA around Asia

- The vast majority of Asian jurisdictions do not have a formal NPA definition. In the absence of an explicit regulatory NPA definition, market norms and supervisory practices have evolved to leverage off existing regulatory asset classification frameworks as a proxy for determining non - performing assets.
- Regulatory asset classification frameworks, which are widely used among surveyed jurisdictions in Asia, play a key role in the NPA identification process. Nearly all (10 of 11) jurisdictions require banks to use an asset classification system to classify credit exposures into various risk buckets (with the most common being: Normal, Watch, Substandard, Doubtful and Loss), generally based on quantitative and qualitative criteria developed by the prudential regulator.
- The three most severe asset classification categories (Substandard, Doubtful and Loss) are generally considered as NPAs. The Substandard category (or its equivalent) is generally the entry point of the NPA designation. The definition of Substandard is broadly consistent across surveyed jurisdictions and includes both qualitative and quantitative criteria, with the over 90 days past due threshold typically serving as the quantitative backstop. The links between regulatory asset classification categories and performing and non - performing designations under International Financial Reporting Standards (IFRS). [2]

3) Comparison of Regulatory Definition of NPA and Accounting Concept of Impaired

Regardless of the number of risk buckets used, the regulatory NPA identification frameworks adopted across surveyed jurisdictions are, in general, broader than the accounting concept of impaired. This is mainly due to the qualitative criteria ("well defined weakness") embedded in the Substandard (or equivalent) designation, which allows supervisors to place certain exposures in this category even if they are less than 90 days past due or may not be impaired under applicable accounting standards.

The majority of Asian jurisdictions have also adopted a uniform classification treatment of multiple loans granted to the same borrower, enabling authorities to classify certain exposures as NPAs that might not be captured as impaired under relevant accounting standards. Several Asian authorities (six of 11), as noted in Chart 3 below, specified that if one exposure to a borrower is classified as an NPA (or relevant classification category), then all exposures to the same borrower are automatically classified as NPA. Of the four jurisdictions that checked "other", two authorities require a uniform classification if the sources of cash flows are connected or if the collateral is supported by the same pool; another authority applies a uniform classification treatment for all wholesale exposures to the same borrower, but multiple retail exposures to one borrower can be assessed on a loan by loan basis.

The uniform classification treatment is, however, rarely extended to a group of connected borrowers belonging to the same group. Only two of 11 Asian authorities have introduced a uniform classification treatment of different borrowers belonging to the same group, and, only if certain conditions are met, such as if either the underlying cash flows of various entities within the group are connected.

The majority of surveyed jurisdictions allow an entity by entity classification, which is generally consistent with international norms.

On the other hand, there are certain features contained in the NPA identification frameworks in several jurisdictions that can result in a downward bias to the reported level of NPLs. [3]

First, seven of the 10 jurisdictions that use regulatory asset classification systems explicitly. The identification and measurement of non - performing assets in a cross - country comparison is estimated in order to value the collateral and determining whether a loan should be graded Substandard or worse. Second, some Asian authorities exclude certain asset classes, such as "accrued interest earned but not collected", "foreclosed collateral" and "equity interest received in a debt restructuring" from their regulatory NPA identification regime.

In addition, the extent to which supervisors rely on qualitative or past - due criteria to place exposures in the Substandard category have significant implications for both the timing and stock of reported NPAs. The survey results indicate that the vast majority of jurisdictions utilise past - due indicators to place retail exposures in the Substandard or worse category; this is an expected outcome and consistent with international norms, given the small balance and homogenous nature of most retail credit portfolios. A sizeable number of respondents also noted that they relied primarily on past - due indicators to place wholesale exposures in the Substandard or worse category.

These practices can affect the timing of when exposures are placed on NPA status, resulting in commensurate delays in the recognition of requisite credit loss provisions. [4]

4) NPA Exit Criteria

NPA exit criteria vary considerably across Asian jurisdictions and can materially impact the stock of reported NPAs. Some jurisdictions allow an exit once there is repayment of past - due principal and interest (P&I), while others require

[2] Batra, S (2003), "Maximizing Value of Non Performing Assets", *Forum for Asian Insolvency Reform*, Korea, 2003.
[3] Dhanda, Neelam and Rani, Shalu (2009), "An empirical study on the position, causes and remedial measures for non-performing assets in public sector banks," KAIM journal of management and research, Vol.1 No.2, November-April, pp33-40.
[4] Prasad M., Sinha, K.K. and Prasad, K.M. (2004). Post-reform Performance of Public Sector Banks with Special Reference to Non-performance Assets, Edited Book Banking in the New Millennium, New Delhi.

repayment of P&I and the remaining debt is expected to be repaid. One jurisdiction allows an exit when it does not meet the accounting definition of impaired or the regulatory definition of NPA. Even in cases where the criteria appear broadly similar across a number of jurisdictions – for example, some demonstrated repayment history (quantitative) and an expectation of full debt repayment (qualitative) – the demonstrated repayment history varies from P&I payments received for at least six months, to full repayment of all past - due P&I, to repayment such that P&I is less than three months past due.

Similar variations across jurisdictions were noted for restructured (forborne) exposures to exit the NPA category. As Chart 5 illustrates, for restructured NPAs, the repayment period varies from One of these authorities only recognises cash collateral or loans secured by government bonds for purposes of determining credit classification.

Immediate upgrades upon debt restructuring to continued repayments for a period of time (ranging from one–three payments to one year). In one case, the decision to upgrade a restructured NPA is left solely to the bank. These differences can also impact the reported level of NPAs.

2. Conclusion

Nowadays the serious problem faced by banks all over the world is the growth of NPAs. The value of loan - disbursement process is harmed because of non - recovery of loan instalment and the interest on the loan which in turn is the consequence of growth of NPAs which adversely affect the lending activity of the banks. As a result significant importance has been given, to make stronger the capital adequacy requirements like the measure of CRAR to measure the capacity of banks to absorb losses occurring from non - performing assets. Public sector banks in India have been able to manage high level of CRAR to provide sufficient cushion for any unexpected losses, in relation to capital adequacy requirements. Despite the fact, rise of NPAs in recent years remains an area of concern and should be tackled with sincere efforts during the periods of disbursement of loans and recovery of the same. In recent times, the use of the method, in which compromise settlements has been effected by banks; certain serious concerns have been articulated from different sections and by the Debt Recovery Tribunals. It was examined that the banks take up different parameter to different borrowers, and agreed for a lesser amount as against claimed amount, regardless of availability of plentiful securities and thus ignoring RBI guidelines. The study finally observes that the prudential and provisioning norms and other initiatives taken by the regulatory bodies has pressurized banks to improve their performance, and consequently resulted into trim down of NPA as well as improvement in the financial health of the Indian banking system. In the nutshell, we can say that, however during the periods of economic slowdown, public sector banks in India have shown flexibility, management of NPAs through better quality of advances and recovery procedures is essential for banks to maintain their continued existence and expansion.

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