

NON-PERFORMING ASSETS AND THEIR EFFECTS ON THE INDIAN ECONOMY

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Abstract: An asset of a bank turns into a non-performing asset when it ceases to generate regular income such as interest for the bank. These NPAs have serious economic repercussions on the bank in terms of loss of profits, capital and inability to lend as well as on the national economy on a macro level. Therefore, it becomes very important to reduce such NPAs. Once a borrower faces problems in repaying the principal amount or the interest due on a loan amount, the bank may indulge in debt restructuring methods. The legislature has also enacted various laws in order to tackle the rising problem of NPAs for e.g. the SARFAESI Act, the IBC and the RDDBFI. Recently, a Financial Resolution and Deposit Insurance (FRDI) Bill was presented before the Parliament for its approval. Despite such parliamentary measures, a large amount of NPAs still subsists in India, which has an adverse impact on its economic growth. Hence, a robust mechanism needs to be implemented by the Government of India to minimize the loss caused by NPAs to banks and the Indian economy.

Keywords: Assets, bank, banking, Non-performing assets, NPAs, debt restructuring, SARFAESI Act, IBC, FDRI Bill, RBI

1. INTRODUCTION

An asset of a bank (such as a loan given by the bank) turns into a non-performing asset (NPA) when it ceases to generate regular income such as interest for the bank. In simpler terms, when a bank which lends a loan and does not get back its principal and interest on time, the loan is said to have turned into an NPA. While NPAs are a natural fall-out of undertaking banking business and hence cannot be completely avoided, high level of NPAs can severely erode the bank's profits, its capital and ultimately its ability to lend further funds to potential borrowers. It may also have an impact on the national economy. Therefore, it becomes extremely important for the banks to have a vigorous appraisal of loans, which can reduce the chances of a loan turning into an NPA.

The main function of the Reserve Bank of India (RBI) is to regulate the supply of money in the economy. For this end, they use tools like Cash Reserve Ratio (CRR), the Statutory Liquidity Ratio (SLR), the repo rate, and the reverse repo rate. Bad loans are generally the outcome of poor lending decisions on the part of banks.

CRR is the money that banks are required to deposit with the RBI. Currently, the RBI has fixed this at 4%. In addition to this, banks have to deposit a portion of their money in relatively safe assets, which are liquid in nature, for e.g. government bonds, securities or gold. This is referred to as the SLR, which at present is 19.5%¹

As an example, out of every Rs. 1000 deposited in a bank, Rs. 40 is parked with the RBI in the form of CRR, and Rs. 195 in assets like government bonds. The bank is free to lend the remaining Rs. 765 to the interested borrowers. The interest earned from such loans is used to compensate the bank's customers as interest payment and whatever amount is left after that constitute the profit earned by the bank. NPAs arise when banks lend to clients who default on their repayment.

2. CLASSIFICATION OF NON-PERFORMING ASSETS

Banks have to classify their assets as performing and non-performing in accordance with RBI's guidelines. Under these guidelines, an asset is classified as non-performing if any amounts of interest or principal instalments remain overdue for more than 90 days, in respect of term loans. In respect of overdraft or cash credit, an asset is classified as non-performing if the account remains out of order for a period of 90 days in respect of bills purchases and discounted account, if the bill remains overdue for a period of more than 90 days.

However, it must be noted here that all assets do not perform uniformly. In some cases, assets perform really well and the recovery of the principal and interest happen on time, while in other cases, there may be delays in recovery or no recovery at all because of one reason or the other. Also, there may be difference in the performance of assets at different times, and asset may exhibit good performance at one point of time and poor performance at some other point of time.

¹ <http://www.thehindu.com/business/Economy/all-you-need-to-know-about-indias-npa-crisis-and-the-frdi-bill/article21379531.ece>

As per the RBI Guidelines, banks are required to classify their assets on an on-going basis into the following four categories²:

1. Standard assets: Standard Assets service their interest and principal instalments on time; although they occasionally default up to a period of 90 days. They may be also referred to as performing assets. They yield regular interest to the banks and return the due principal on time and thereby held the banks earn profit and recycle the repaid part of the loans for further lending.
2. Sub-standard assets: Sub-standard assets are those, which have remained NPAs for a period of 12 months.
3. Doubtful assets: as asset becomes doubtful if it remains a sub-standard asset for a period of 12 months and recovery of bank dues is doubtful.
4. Loss assets: Loss assets comprise assets where loss has been identified by the bank or the RBI. These are generally considered uncollectible.

3. DEBT RESTRUCTURING

Once a borrower faces difficulty in repaying loans or paying interest, the bank should initially address the problem by trying to verify whether the finances company is viable in the long run. If the bank is satisfied that the company/project is viable, then rehabilitation is possible by restructuring the credit facilities. By adopting a restructuring exercise, the bank can change the repayment or interest payment schedule to improve the chances of recovery or even make some sacrifices in terms of waiving interest, etc.

To augment the institutional mechanism for the restructuring of corporate debt, RBI has devised a Corporate Debt Restructuring (CDR) system. The main purpose of this system is to ensure a timely and transparent mechanism for the restructuring of corporate debts of viable entities facing problems.

4. OTHER RECOVERY OPTIONS

If rehabilitation of debt through restructuring is not possible, banks themselves make efforts to recover. For example, banks set up special asset recovery branches that concentrate on the recovery of loans, which have become bad or irrecoverable.

It is a common practice that the banks engage external recovery agents who collect the past dues; they get in contact with the borrowers and make visits to them.

The past due debt collection policy of banks generally emphasizes on the following at the time of recovery:

- Respect to customers
- Appropriate letter authorizing agents to collect
- Due notice to customers
- Confidentiality of customers' dues
- Use of simple language in communication and maintenance of records of communication

In difficult cases, banks have to option to resort to courts, Lok Adalats, Debt Recovery Tribunals, One Time Settlement Schemes, etc. The banks may also utilize the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) as an effective tool for NPA recovery. It is also possible where NPAs are backed by securities charged to the Bank by way of hypothecation or mortgage or assignment. Upon such default, the banks can seize the securities without the intervention of the court.

5. STATUS OF NPAs IN INDIA IN COMPARISON WITH OTHER COUNTRIES

A careful perusal of the Financial Stability Report 2017³, released by the RBI, shows that India's gross NPAs stands at 9.6%. India has the second highest ratio of NPAs among the major economies of the world. Only Italy, with 16.4% NPAs has more stressed assets than India. However, despite the large quantum of stressed assets, India still fares better than countries like Greece and Ukraine which have NPAs over 30% NPAs.

It can be also observed that basic metals and cement industries are the most indebted, with 45.8% and 34.6% stressed assets respectively. As stated by the Finance Minister, Mr. Arun Jaitley in the Lok Sabha, the gross NPAs of public sector banks increased by 311.22% from Rs.1,55,890 crores in 2013 to Rs. 6,41,057 crores in 2017. Likewise, the gross NPAs of private banks saw an increase of 269.47% from Rs. 19,986 crores in 2013 to Rs. 73,842 crores in 2017.⁴

As of June 2017, State Bank of India leads the list of scheduled banks with the highest NPAs with Rs. 1,88,068 crores of stressed assets. Punjab National Bank and IDBI Bank follow suit with Rs. 57,721 crores and Rs. 50,173 crores of gross NPAs respectively.

² <http://www.aspirantszone.com/non-performing-asset-types-causes/>

³ https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/0FSR_30061794092D8D036447928A4B45880863B33E.PDF

⁴ <http://www.thehindu.com/business/Economy/all-you-need-to-know-about-indias-mpa-crisis-and-the-frdi-bill/article21379531.ece>

6. IMPACT OF NPAs ON THE NATIONAL ECONOMY

It has been observed that NPAs have a detrimental effect on the economic growth of a country. Data collected by the Ministry of Statistics and Programme Implementation (MOSPI) and compiled by the World Bank reveals that economic growth tapers off with a spike in the bad loan ratio. The gross NPA ratio has risen from 5.88% in 2015 to 9.6% in 2017 while economic growth has slumped in the same period.

The Financial Resolution and Deposit Insurance (FRDI) Bill is one such endeavour of the Government of India to help the banks cope with bad loans. To recover outstanding loans, legislations like the IBC (Insolvency and Bankruptcy Code), the SARFAESI (Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest) Act, and the RDBFI (Recovery of Debts due to Banks and Financial Institutions) have already been enacted in this sphere.

7. CONCLUSION

A number of initiatives have been taken by the Government of India to combat the problem of NPAs. However, it still remains a big challenge to bring down the percentage of bad loans being faced by the banking sector of India. The Indian economy would not be in a position to achieve a greater level of economic growth until and unless this impediment of NPAs is tackled with. The need of the hour is a robust mechanism to be developed by the Legislature, which is supported by the Reserve Bank of India to successfully curb down the bad performance of stressed debts.

