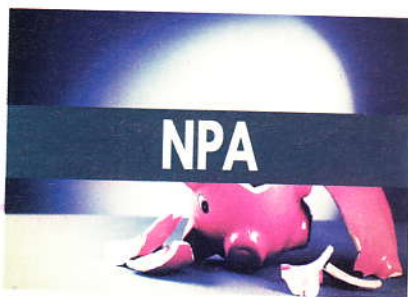


## Managing Non-Performing Assets: A Paradigm Shift

Deepak Narang



*Emerging scenario after Insolvency and Bankruptcy Code has kicked in, will change the borrowing culture and make lending, in future by the banks, much safer. Banks, undoubtedly, will heave a sigh of relief. Kudos to the Government for the paradigm shift. The mindset of borrowers will change for sure*

**F**inancial intermediation by banks is an engine of growth because they cause money to be circulated in the economy by seeking deposits from those who have surplus and lend for investment activity. It has a multiplier effect in the economy. Borrowing leads to creation of demand for productive resources and increases the income level of those who supply goods and services. Expenditure of one is income of the other. This leads to higher GDP and faster productive growth.

Contraction in lending has opposite effect and growth falters. One major reason for muted credit growth is fast accretion of Non Performing Assets (NPAs) on banks' balance sheets. Roughly 72 per cent of market share of outstanding credit of SCBs (Scheduled Commercial Banks) is of PSBs. The twin balance sheet problem is overleveraged and distress companies coupled with rising NPAs of PSBs is holding up investment in the economy.

Gross Non- Performing Assets (ie. Bad Loans) of banks in India as on September 30, 2017 are Rs 8.40 lakh crore showing a growth of 1.31 per cent from Rs 8.29 lakh crore as on June 30, 2017. Meteoric rise of NPAs from Sept 15 had its genesis in rapid credit growth of banks during

the preceding years say from 2008 onwards. During the period of 2008 to 2014 gross advances of public sector banks grew from 18 lakh crores to Rs 54 lakh crores and by September 17 this figure was Rs 55.01 lakh crores. No wonder that the share of sticky assets of government owned banks in this pile of bad loan is almost 90 per cent.

During the last quarter ie Q2 2017-18, the bad loans of PSBs have remained almost flat at Rs 7.33 crores vis-a-vis Q1 June 17 whereas those of 17 private sector banks increased by nearly 10.5 per cent to Rs 1.06 lakh crores.

Though the share of large borrowers, defined as those having limit of Rs 5 crores and above, in the advances of scheduled commercial banks is 56 percent but their share of NPAs is 86.5 percent. Maximum slippage to NPA has happened in the accounts (numbers as well as amount) having outstanding between Rs 20 crores to Rs 50 crores followed by those in the range of Rs 50 crores to Rs 100 crores. Top 100 large exposures (outstanding advances) account for nearly 15.2 per cent of gross advances but their share in top 100 Non-performing accounts is 25.6 per cent of GNPA of SCBs.

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The Stressed Advance Ratio of industries constitutes roughly 23 per cent as on March 17 of SCBs whereas this ratio for agriculture, services and retail was 6.3 per cent, 7 per cent and 2.1 per cent respectively. Of this PSBs as a group had Stressed Advance Ratio of Advance to industry as 28.8 per cent when Private Banks and Foreign Banks had 9.3 per cent and 7.1 per cent respectively. Across the broad spectrum of industries, those which are under stress include primarily basic metals and their products, cement and their products, textiles, infrastructure etc.

It would be desirable to discern the reason for this state of affairs which are quite a few-

- Exuberance in increasing balance sheet size by lending to borrowers unworthy of such loans on account of their past credit history.
- Funds were borrowed for creating excess capacities in anticipation of demand without factoring in the global capacities/demand supply position.
- Project completion was delayed for various reasons.
- Recovery of receivables was poor.

- The concerned corporate was not able to raise capital through the issue of equity or other debt instruments from capital markets and used borrowed money as equity leading to double leveraging. Banks did not look at the color of an equity.
- Business failure because of over optimistic projections.
- Diversion of funds meant for expansion/modernization. Borrowed funds were not used for the purpose for which they were lent.
- Willful defaults, siphoning of funds, fraud, mis-appropriation etc.
- Lack of skill on the part of the banks to monitor end use of funds and diversion by the borrower through web of shell companies etc.
- Deficiency in credit appraisal and improper due diligence.

There is a lag of nearly 3 to 4 years before NPAs out of the fresh lending appear. Fresh creation of NPAs during the phase of growth get masked by the high growth of advances and ever greening. Gross NPA ratio does not show alarming rise as denominator

(Advances) increase much faster than the numerator (NPA).

Banks should have been alert about the emerging situation by effectively monitoring the cause of delinquency (for reasons as stated above) coupled with prompt corrective action to deny fresh loans to willful defaulters and for sum optimal projects. They should have taken the intent of RBI circular to monitor/pickup early warning signals (EWS) with all seriousness and declare the errant borrower as non cooperative or willful defaulter.

The provisions of company law as detailed below provide ammunition to bankers to initiate action and refer such cases to the Serious Fraud Investigation Office (SFIO):

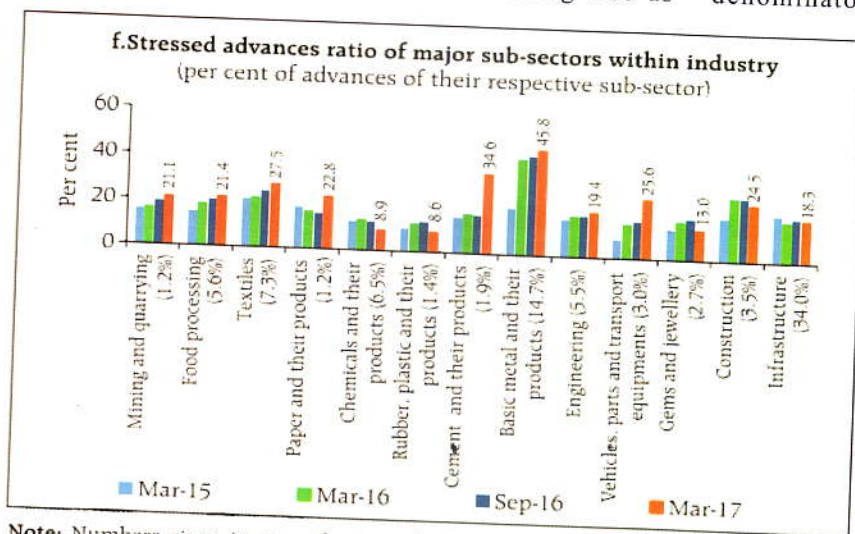
As per section 447 of the Companies Act, 2013, a new offence of fraud in relation to the affairs of a company is as under:

Any act or omission, concealment of any fact or abuse of position committed by any person with intent to deceive or to injure the interest of the company or its shareholders or creditors, whether or not there is a wrongful gain or loss, can be investigated by Serious Fraud Investigation Office (SFIO)

Cases of wilful defaults can, therefore, be entrusted to the SFIO to investigate whether such default amounts to serious fraud under Section 447 of the Companies Act.

Unless the banks are in a position to establish dishonest intention and false representations on the part of borrowers, it is difficult to initiate criminal proceedings against borrowers for wilful defaults.

Any person who is found to be guilty of fraud- imprisonment for a term which shall not be less than 6 months but which may extend to 10 years and fine – Not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.



Note: Numbers given in parenthesis with the legend is share of the respective sub-sector's credit in total credit to industry.

Source: Financial Stability Report 20, June 2017.

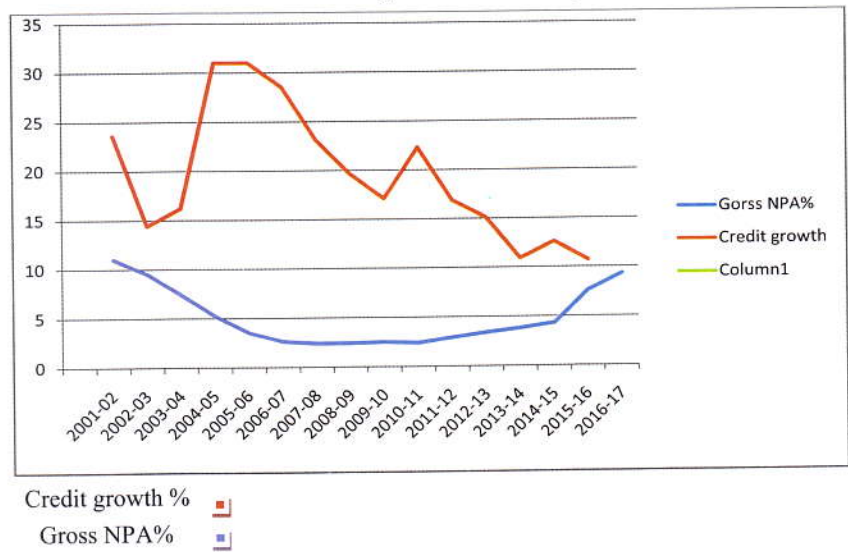
	GNPAs Ratios	Credit Growth
2001-02	11	23.6
2002-03	9.5	14.4
2003-04	7.4	16.2
2004-05	5.2	31
2005-06	3.5	31
2006-07	2.6	28.5
2007-08	2.4	23.1
2008-09	2.4	19.6
2009-10	2.5	17.1
2010-11	2.4	22.3
2011-12	2.9	16.9
2012-13	3.4	15.1
2013-14	3.8	10.9
2014-15	4.3	12.6
2015-16	7.6	10.7
2016-17	9.3	5.08

If the fraud in question involves public interest – Term of imprisonment shall not be less than 3 years .

There are enabling laws which are specifically meant for banks to recover default amount from borrowers viz RDDBFI Act, SARFAESI Act -02 and recent legislation of Insolvency and Bankruptcy Code 2016.

SARFAESI Act allows bankers to take possession of the assets charged to the bank and auction these without intervention of the court. No doubt it is a powerful tool and with proper planning and perfect execution the assets can be sold. As is the wont, the defaulters use all means to brow beat the bankers in not allowing them to auction assets. False allegation/cases of criminal trespass are filed against authorised officers while management of the banks in few cases proactively come to the rescue of such harassed executives. This leads to demoralization of work force and recovery going for a toss. In a decided case of Deepak Narang vs State of Haryana And Anr. on September 14, 2006 the Hon'ble Justice of Punjab and Haryana court not only came to the rescue of the harassed AGM (ie the author) of Allahabad bank, who was

% Credit growth vs GNPA per cent



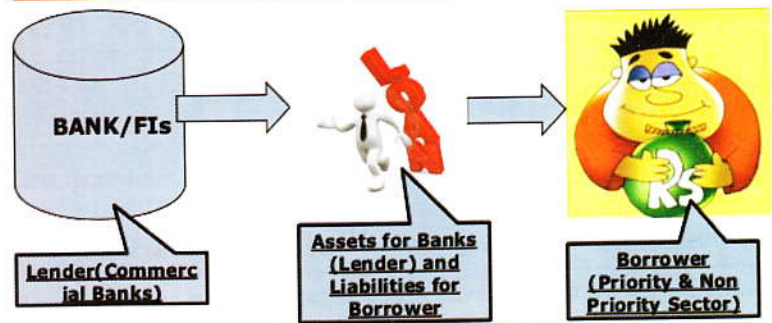
the authorised officer, but castigated the magistrate who admitted the FIR and ordered prosecution based on concocted facts. Hon'ble Justice R S Madan held that.

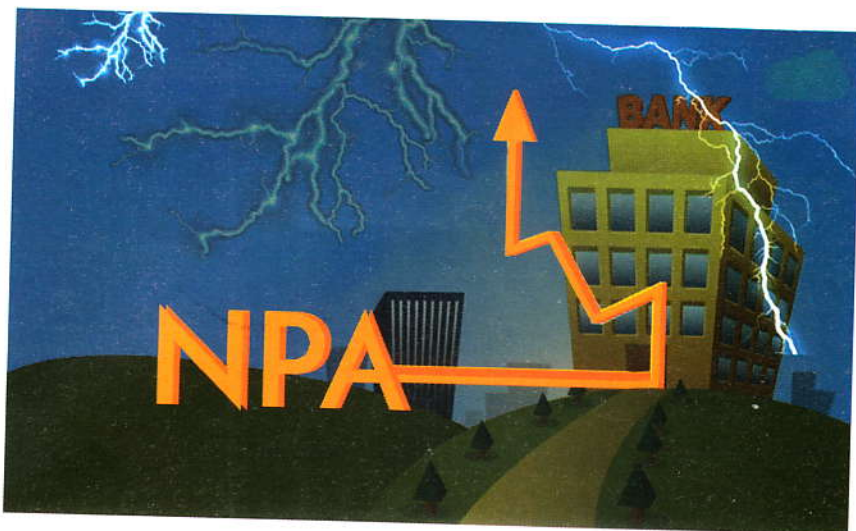
- It is a case where the petitioners are not only protected under Section 197 of the Code of Criminal Procedure but under Section 32 of 2002 Act, which are reproduced as under:
- Sanction for prosecution of public servant is required for any offence alleged to have been committed by him while acting or purporting to act in the discharge of his official duty. Official duty implies that the act or omission must have been

done by the public servant in course of his service and such act or omission must have been performed as part of duty which further must have been official in nature. Section 197, Cr.P.C will apply to those acts which are discharged in course of duty.”

- “Securitization Act, 2002-Section 32-Protection of action taken in good faith-No suit, prosecution or other legal proceedings shall lie against any secured creditor or any of his officers or manager exercising any of the rights of the secured creditor or borrower for anything done or omitted to be done in good faith under this Act.

## About Non Performing Assets (NPAs)





- Admittedly, respondent No. 2 had no cause of action to sue the petitioners as he was not available in the house at the relevant time. Therefore, the present complaint is an act of revenge on the part of defaulters to get the present complaint filed through his son by concocting a false version in the complaint, which has never seen the light of the day. Therefore, the present complaint is an act of an abuse of the process of the Court which cannot be allowed to proceed.

Despite various judicial pronouncements related to this act being in favor of the bank's authorized officer the process lost its sheen and banks are not so bullish in making recovery under this act.

Under this Act, 64,519 properties were seized or taken possession of by the banks in the year 2015-16; as of June 17 the figure is 33928. This ought to have been much more.

Government amended the law to make it mandatory for the district collector /district magistrate to hand over the physical possession to the bank when application is made under the act by the authorized officer. There are other impediments which borrowers create to thwart the efforts of Bankers. Borrowers have been gaming the system for far too long.

As a banker, one can understand the predicament of an honest borrower. Evaluate this: An industrialist from Ludhiana said that he was manufacturing those very goods which other industries are making in Ludhiana. While he is paying interest at documented rate, installment in time, all taxes etc in an honest manner but banks do not consider his request for reduction in rate of interest and rewarding him for his past excellent conduct which signals very low credit and default risk. He lamented that dishonest borrowers after having diverted money and running their business aground could manage to readily get, under various restructuring schemes, the concession in rate of interest and moratorium in repayment of installment. He obviously was at a disadvantage while marketing his product vis a vis the dishonest borrower. He questioned whether there is a premium on dishonesty. Are honest borrowers to suffer? This was the time the words of Hon'ble Prime Minister echoed in my mind. He said in an interview that he would give a taste of law to willful loan defaulters.

A laudable effort made by the present government in implementing Insolvency and Bankruptcy Code on December 1, 16 is a game changer. Twice the government has brought an ordinance to plug the loophole and make a stringent law for recovery. Insolvency and Bankruptcy Code now is a potent weapon like a Brahmastra

to be used to destroy the demon of NPAs. Its efficacy will depend on the will power and honest intent of the user to find a just and equitable solution. It is utmost necessary to discern and destroy the ill motive and bad intent of anyone to defeat the real purpose of the law. Resolution under IBC has to be based on intelligence through discrimination.

The recent ordinance which debars willful defaulters from buying back their companies after diverting loan amount and /or making their accounts NPA has taken wind out of the sails of such promoters. The alacrity with which government has acted is remarkable and makes the intent amply clear i.e to rid the system of the menace of NPA and disallow any one to game the system. This, coupled with the provision of section 447 of Companies Act 2013 has unnerved these willful defaulters. The time is right to make willful default, as per definition of RBI, a serious crime as is the case in some countries, thus putting the final nail in the coffin of such willful defaulters. These measures are going to have salutary impact on the behavior of those who borrow money from banks and consider it as their birth right not to pay. The day of reckoning for errant borrowers has come at last.

Going forward, banks need to do forensic audit for ascertaining the end use of funds. They should use Big Data Analytics and other IT based solutions for doing proper due diligence about the borrower and his businesses like fintech companies are doing. Artificial Intelligence(AI) can be leveraged to predict default at least one year in advance with confidence of 80 per cent. A fintech company like D2K technology of Navi Mumbai has developed such a software and results have been remarkable. Banks have to fine tune their HR policies to train the young work force, which at present lacks experience, and upgrade their skills.

The government on its part has to appoint professionals on the Board of

Banks having domain knowledge and sufficient experience of Bank's functioning. Selecting retired executives like MD and ED having impeccable track record on the bank Board is worth examining. To expedite recovery government will do well to have a few more NCLTs and large number of DRTs as present benches are woefully short to achieve this objective. Strength of judges can be increased to cope up with the workload. With the coming in of insolvency of individuals, proprietors and partnership firms the need will be acutely felt.

Emerging scenario after Insolvency and Bankruptcy Code has kicked in, will change the borrowing culture and make lending, in future by the banks, much safer. Banks, undoubtedly, will heave a sigh of relief. Kudos to the Government for the paradigm shift. The mindset of borrowers will change for sure. □

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### **Cabinet approves Subsidizing MDR Charges on Debit Card/BHIM UPI/AePS Transactions**

The Union Cabinet chaired by Prime Minister has approved that the Merchant Discount Rate (MDR) applicable on all debit card/BHIM UPI/Aadhaar enabled Payment System (AePS) transactions upto and including a value of Rs. 2000 will be borne by the Government for a period of two years with effect from 1st January, 2018 by reimbursing the same to the banks.

A Committee comprising of Secretary, Department of Financial Services, Secretary, Ministry of Electronics & I.T. and the CEO, National Payment Corporation of India (NPCI) will look into the industry cost structure of such transactions which will form the basis to determine the levels of reimbursement.

As a result of this approval, for all transactions less than Rs. 2000 in value, the consumer and the merchant will not suffer any additional burden in the form of MDR thereby leading to greater adoption of digital payment modes for such transactions. Since such transactions account for sizeable percentage of transaction volume, it will help to move towards a less cash economy.

It is estimated that the MDR to be reimbursed to the banks in respect of transactions less than Rs.2000 in value would be Rs.1,050 crore in FY 2018-19 and Rs.1,462 crore in FY 2019-20.

When payment is made at a merchant point of sale, MDR is payable by the merchant to the bank. Citing this, many people make cash payments inspite of having debit cards. Similarly, MDR is charged on payments made to merchants through BHIM UPI platform and AePS.

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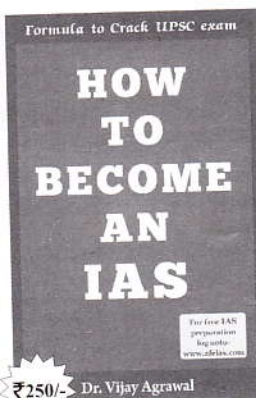
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