3Rs – Recognition, Resolution and Recapitalization of PSBs in the last 5 years

In the Indian Banking system, Public sector banks(PSBs) control approximately 70% of the market share and despite that they have been plagued with several problems, the prominent of which include the rising NPAs and the impact of that on their capital position. NPA issue has been a worsening and is perpetual problem in the Indian banking system particularly for the PSBs over the past 4-5 years as evidenced by the fact that total Gross NPAs(GNPA) have risen from 2.52 lakh crore in 2013 to nearly 8.4 lakh crore towards the end of 2017. Furthermore, the GNPA ratio has increased from around 2.5% to nearly 9.6% in 2017. This has led to constrained credit growth of 6-7% during the year 2017 from the decent credit growth of 15-20% in the year 2013. The causes for these problems include but are not limited to concentration of large borrowers and underperformance of certain sectors such as construction, metals such as steel, power, telecom and mining, weak credit underwriting procedures, restructuring of the loans, poor provisioning, late recognition of bad loans, and excessive liberality and laxity in post sanction supervision.

To tackle the problem of credit growth in the banking system, since 2014 government has undertaken 2 initiatives- one was the Indra Dhanush scheme in 2015 that involved capital infusion of 70,000 crore INR in the PSBs. The second one was the recapitalization plan introduced in October 2017 that will involve capital infusion of 2,11,000 crore INR in the PSBs over the next one and a half years starting from the announcement. It is expected that the capital infusion will improve the capital adequacy of those PSBs ailing with high NPAs but sufficient if not proper credit mechanisms. Furthermore, to resolve the NPA problem in the banking system, government has introduced Insolvency and Bankruptcy Code(IBC) under which the defaulters can be taken to NCLT and be declared bankrupt to pay off the lenders within 180 days with maximum extension up to 270 days.

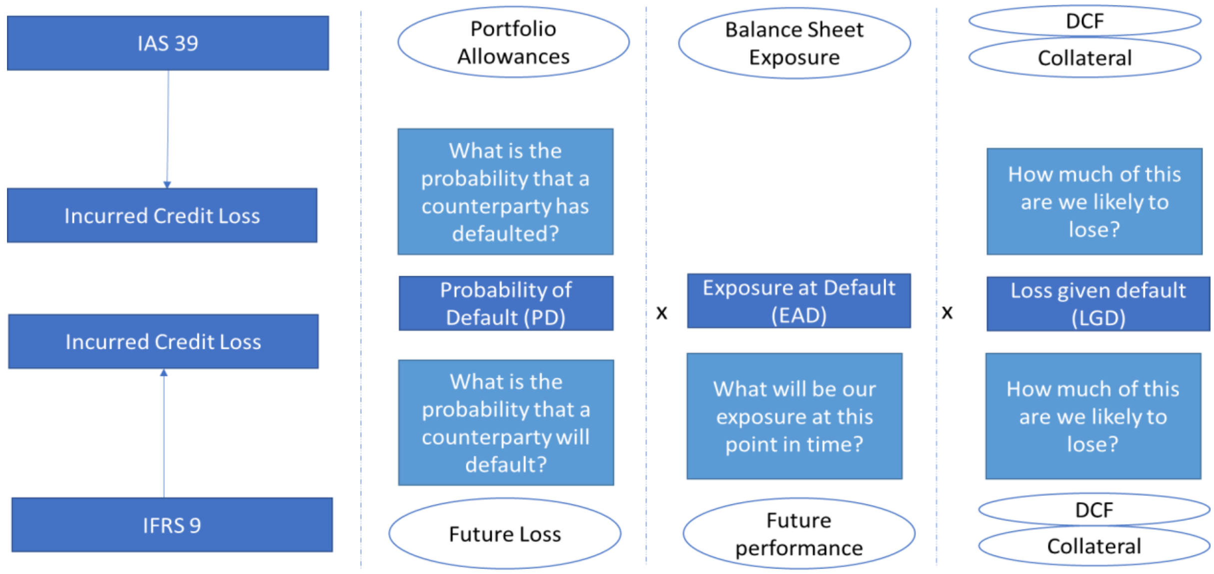
APAS BRT conducted a study to evaluate the performance of the PSBs in terms of market capitalization since 2014. Here are the results-

- Data shows that most of the PSBs experienced severe capital erosion in terms of market cap ranging from -2.78% to -98.11%.
- UCO Bank was the worst performer with a market cap decline of -98.11% since 2014 despite receiving a massive capital infusion of 9367 cr. INR in the said period.
- Indian Overseas Bank experienced the second highest decline in its market cap in the said period of -96.51% despite receiving a capital addition of 9354 cr. INR in the given period.
- 16 Banks experienced market cap decline by more than 50% since 2014 with major PSBs like Bank of Baroda, Canara Bank, Oriental Bank of Commerce, Dena Bank, and Punjab and Sind Bank featuring in the list along with some banks who have also been put under prompt corrective action.
- Although Vijaya Bank received the lowest capital during the period but it also experienced decline of -68.72% in its market cap. Indian Bank that received amongst the lowest capital infusion of 280 cr. INR has experienced one of the lowest market cap decline of -9.04%.

To ensure improvement in performance of PSBs, RBI has a critical role to play to ensure that banks take necessary steps towards recognition of stress in their accounts as well as towards implementation of resolution practices. Since 2015, RBI has been amending the provisioning norms in a strict manner so that there is minimal divergence in the accounting of the recognition and provisioning of bad loans. RBI is doing as best as it can to make sure that the provisioning norms are as objective as possible and these can be summarized as below-

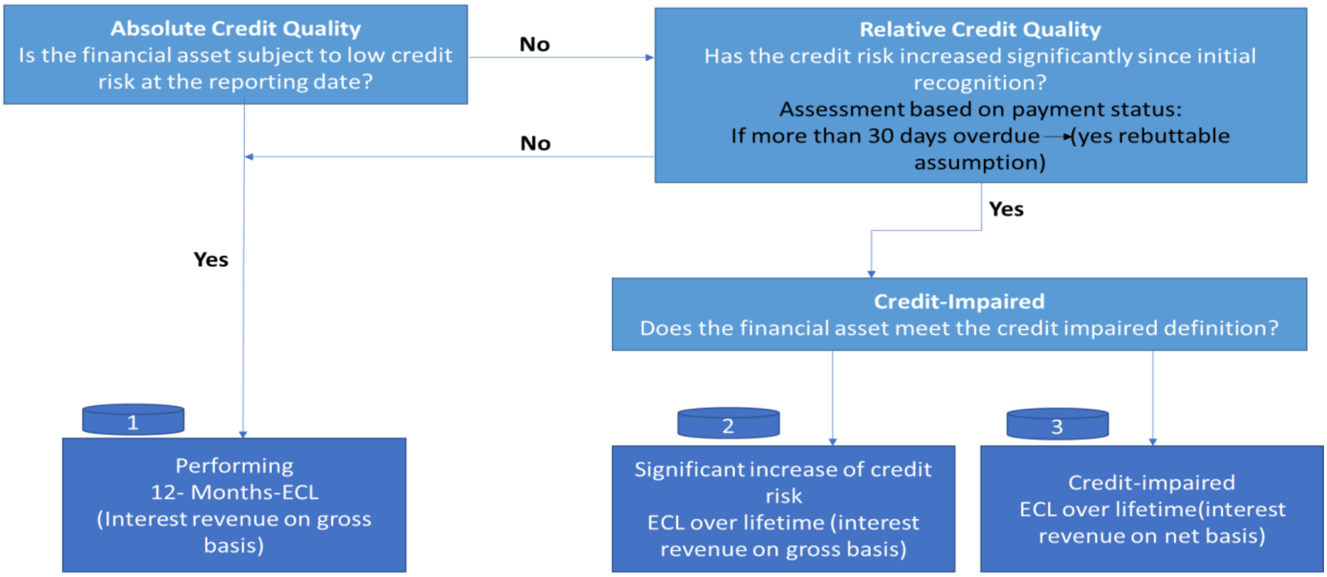
Type of Asset	Secured	Unsecured	Time Period
Standard Asset	0.40%	0.40%	
Sub Standard Asset	15%	25%	between 3-12 months
Doubtful			
D1	25%	100%	1 year
D2	40%	100%	1-3 years
D3	100%	100%	>3 years
Loss	100%	100%	

Furthermore, the banking system’s transition from Basel 2 norms towards Basel 3 norms which would include adoption of expected loss model from the current incurred loss model would do a great benefit towards early recognition in the stressed accounts under the special mention accounts category SMA0(Non-payment up to 30 days), SMA1(Non-Payment up to 60 days), and SMA2(Non-Payment up to 90 days) and until it becomes NPA(Non-payment for more than 90 days).



Source: PwC

The three stages- Decision Tree



Source: PwC

Although recognition problems are likely to reduce with these changes but the resolution problems still lie at the end of the tunnel. Recent RBI circular on February 12th, 2018 shook things up and dictated subsuming the stressed asset schemes such as Corporate Debt

Restructuring Scheme, Flexible structuring of existing long-term project loans, Strategic Debt Restructuring (SDR) Scheme, Change in ownership outside SDR, Scheme for Sustainable Structuring of Stressed Assets (S4A) and even the Joint Lenders Forum(JLF) also stands discontinued. This seems a step in the right direction as these schemes had several issues such as timelines getting extended, lack of agreement among lenders in consortium among other issues and in that aspect IBC, which is timebound and relatively strict might prove to be a good resolution tactic, however, there are still some legal loopholes that need to be mended in it to prevent creditors and ensuring development of structured mechanism under it to ensure resolution.

Finally, it would be interesting to see with these measures as well as evolving credit mechanism that will unravel in the coming months, whether RBI and government would be able to maintain a tricky balance between spurring growth and regulating PSBs to ensure reduction in NPAs.

-APAS