


Battle Against NPAs

Non-performing Assets (NPAs) have been a major challenge confronting Indian banking system. Various measures have been taken by the regulator and the government to tackle this NPA issue. This article discusses the recent steps taken by the government to address the NPA menace and its effectiveness.

The RBI has come up with schemes like Flexible Refinancing of Infrastructure (5/25 scheme), a scheme that permitted banks to extend the maturity of loans given to companies in the infrastructure sector, Asset Reconstruction Companies (ARC), Strategic Debt Restructuring (SDR) - the option of converting a part of the debt into equity and taking a controlling stake in overleveraged companies, Asset Quality Review (AQR) – a review by RBI with a view to clean up bank's assets, and Sustainable Structuring of Stressed Assets (S4A) where lenders are allowed to split the outstanding debt of a stressed company into sustainable debt and equity which will strengthen the lender's ability to deal with stressed assets.

RBI has also revised the Prompt Corrective Action (PCA) structure which was long overdue. The regulator has asked banks to make suitable disclosures in cases of heavy divergences and encouraged them to make provisions at higher rates. Despite this, banks have not been very successful in implementing these schemes due to lesser effectiveness of current legislative framework.

Further, the government has amended Banking Regulation (Amendment) Ordinance, 2017 and introduced new sections namely, section 35AA and 35AB in the Banking Regulation Act, 1949 (BR Act) that empower RBI in regards inspection of banking companies. Under these sections, RBI has been authorized to issue directions to the banking companies to initiate the insolvency resolution process under the Insolvency and Bankruptcy code, 2016 and specify authorities and form sector specific committees to advise banking companies on resolution of stressed assets.

With the release of the ordinance, the regulator has the power to provide sectoral guidelines associated with the provisioning and haircut for the banks. Therefore, banks may receive different guidelines for resolution of NPAs in different sectors. This ordinance is also expected to speed up the resolution process.

In its first step to implement the ordinance, RBI has decided to expand the panel set up on loan recast cases under the S4A Scheme. The panel would mostly comprise of independent board members to advise on the issue. The powers to examine would also include, filing cases in bankruptcy courts. However, the kind of cases to be taken to the bankruptcy courts is yet to be decided by RBI.

While this has been the story of efforts to deal with NPA issue, let us understand the sector-wise impact.

Currently, the amount of Gross NPAs (GNPAs) for banks is far more than INR 6 trillion. Within the industry, share of Infrastructure sector in NPAs is maximum followed by Basic metal and their products, Textiles, and Construction sectors. ***Infrastructure sector*** has been flooded with issues from land acquisition to project delays leading to cost overruns and hence economic viability of projects is at stake. There have been some signs of improvement in the ***steel sector***, where banks' exposure has been to the tune of around INR 3.3 trillion. Rising demand for the upcoming projects of Indian railways, the dedicated freight corridor, regional airports, smart cities, the mushrooming of affordable housing projects, and the increase in import duty, imposition of additional safeguard duty and the stipulation on minimum import price would help the producers in steel sector. With the approval of the National Steel Policy by the Cabinet, the dependence on imported coal would reduce, thereby boosting the country's annual steel production.

Also, as of June 2016, it was estimated that total advances given to the ***textile sector*** by the banks were more than INR 2 trillion and GNPAs were around INR 37000 crores. An "Amended Technology Up-gradation Fund Scheme" is expected to provide one time capital subsidy for investments in the employment and technology intensive segments of the textile value chain to deal with issues relating to textile industry. Looking at ***engineering, procurement and construction segment*** where over INR 1 trillion bank loans have been stuck is also not showing any signs of improvement.

The Cabinet Committee on Economic Affairs, headed by Prime Minister Narendra Modi, in August 2016 approved a series of initiatives to revive the ***construction sector***. As a part of those initiatives, the National Institution for Transforming India or NITI Aayog would address delayed payment or non-payment by the government departments and public sector undertakings after completion of projects, however progress is awaited.

The banks' exposure to the ***telecom sector*** is around INR 1 trillion whereas, the industry's overall indebtedness is close to INR 5 trillion. The ***power segment*** is equally in a bad shape. There are coal-based projects worth 15,200 megawatt (MW) which have been completed, but do not have the power purchase agreements (PPAs) and hence are not eligible for fuel-supply agreements. The cost of imported coal would hit their profitability. In this regard, UDAY Scheme (Ujwal DISCOM Assurance Yojna) announced in November 2015 by the central government for the stressed electricity distribution companies (DISCOMs) envisaged taking over 75% of the debt of the DISCOMs by Indian states. This would bring down the interest cost and push up the revenue by raising the tariff. The power plants are still suffering due to some regulatory hurdles. The excess thermal capacity with plants operating at around 60-65% capacity utilization can be a primary reason why even new power generation projects are not on the cards.

Thus, from the above, it is evident that every sector is strangled with considerable obstacles. However, the regulator hasn't specified the extent of higher provisioning for standard loans to the stressed sectors. The onus of deciding this lies with the individual bank boards.

Optimum capacity utilization in every sector would be the key to improve the performance of corporates. Increase in capacity utilization and minimal obstacles leading to enhanced cash flows and profitability is expected to improve recovery of NPAs. The hope is that the sectoral approach which the latest amendment in section 35 provides to deal with NPAs would prove constructive. Nevertheless, other judicial laws continue to prevail and are still available with borrowers to find a route to escape.