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UNDERLYING REASONS BEHIND STRESSED ASSETS IN BANKING SECTOR IN INDIA: AN OVERVIEW

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Abstract

In every country, stressed assets present numerous challenges for the banking sector regulator as well as the overall economy. The long-term stability of a bank can be jeopardised by stressed assets. Demands on the infusion of more capital, and support from the banking sector due to inadequate liquidity to revive the economy get affected. In this paper, the authors have dealt with the issue of stressed assets with specific reference to the banking sector in India. Gross NPAs of the Public Sector Banks (PSBs), and the underlying reasons behind these NPAs have been elaborated especially the role of financial frauds in the recent past.

Keywords: Banking Sector, Stressed Assets, NPA, RBI.

Introduction

Stressed assets pose challenges for financial stability of an economy. The Reserve Bank of India (RBI) released a Financial Stability Report (FSR) in January 2021, warning of a possible increase in bank NPAs (Non-Performing Assets) and stating that in a "severe stress scenario," the ratio of gross NPAs could rise from 7.5 percent in September 2020 to 14.8 percent in September 2021. This report also warned in January 2021 that four banks would not be able to meet the minimum capital requirement by September 2021. This has implications for 'Fiscal' and 'Monetary measures' to be undertaken by the government, to revive the economy. The semi-annual FSR also expressed concern about "hidden" NPAs because of regulatory forbearances like "moratorium," "ambiguity in asset classification," and "loan structuring mechanism."

Factors Responsible for Increased Level of Stressed Assets:

Various Macro-and Micro-Economic, industry-specific, and company-specific factors contribute to stressed assets. These are:

- Poor bank governance.
- Deficiencies in the supervisory role of the regulatory body (i.e., the Reserve Bank of India).
- Political interference.
- Lack of professional management.
- Lack of independence.
- Poor risk management.
- Lack of sound practices in the evaluation and monitoring of projects as well as borrowing entities.
- No timely reporting and action on bad loans.
- Appointment of senior functionaries and board members.
- Malpractices in loan disbursals.

Increased Non-Performing Assets (NPAs) and Stressed Assets in Public Sector Banks (PSBs): - As of September 30, 2019, Public Sector Banks (PSBs) had NPAs totaling Rs. 7,27,296 crores. (7.27 trillion rupees) NPAs totaled Rs. 6,09,129 crores as of September 30, 2020.

Table 1: Gross NPAs of Public Sector Banks (PSBs)

(Rs. Crore)

Year	Gross NPAs of PSBs
2015	2,79,016
2016	5,02,068
2017	6,84,732
2018	8,95,601
2019	8,06,412
September 30, 2020	6,09,129

Source: Gross NPAs of PSBs declined to Rs. 6.09 lakh cr in Sept 2020: Anurag Thakur (2021, February 9). *Economic Times*. PSBs gross NPA hits 9.83% in FY16; rises to 11.82% by September 2016 (2017, February 3). *Economic Times*. Gross NPAs of PSBs declines to Rs. 8.06 lakh crore end March 2019: FM (2019, June 25). *Business Standard*.

Underlying reasons for Non-Performing Assets (NPAs) and Stressed Assets: -

There are a number of reasons behind NPAs and Stressed Assets. A few prominent underlying causes may be elaborated as under:

Economic Crisis: - Bankruptcies, which result in NPAs, arise as a result of the economic downturn. Happenings in East Asia in 1997-98, and the United States and the United Kingdom in 2008-09, were examples cited in the Economic Survey of 2016-17. Continuous churning in the market results in changes in the fortunes of businesses. In the most recent case, COVID-19 has increased the ‘intensity’ and ‘speed’ of churning. New ‘sunrise’ businesses emerge and ‘sunset’ businesses have become extinct. In such a scenario, some businesses emerge or expand whereas others shrink or close. Resources, as well as jobs, move across firms and sectors. This necessitates the resolution of stressed assets.

Poor Bank Governance especially in Public Sector Banks (PSBs): - Poor bank governance especially in PSBs as the Economic Survey of 2016-17 noted that more than four-fifths of the NPAs were in the PSBs. Among other issues, it raises the question of credit underwriting skills, monitoring the end-use of funds across lenders. Chief Economic Advisor, K V Subramanian said in an address (*Business Today*, dated January 31, 2021) that ‘resolution of bad assets with alacrity in decision-making often in the public sector is impacted because of fear of 3Cs, i.e., Central Bureau of Investigation (CBI), Central Vigilance Commission (CVC), and Comptroller and Auditor General of India (CAG). One can add other Cs such as ‘Courts’, ‘Chief Information Officer’.

Over-leveraging by Borrowers: - Over-leverage is a big factor on the borrower's side. In one report, Credit Suisse found that businesses with an interest coverage ratio of less than one owed a large portion of corporate debt, amounting to nearly 40% of total debt. In the event of a downturn in the economy, such businesses are more likely to default. There is a high degree of positive correlation between ‘Gross NPA Ratio' and the ‘Share of Debt Owed by Stressed Companies’.

Temporary Crisis: - Companies in some industries are experiencing temporary difficulties as a result of a variety of factors such as "overcapacity," "cheap imports," "weakening demand," and so on. If these problems persist, stressed assets will be the outcome.

RBI's Supervisory Role: - The Reserve Bank of India (RBI), for example, has had its supervisory position questioned on several occasions, especially in the wake of financial frauds. Many financial frauds have occurred in recent years. It can be observed from the following table: -

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Table 2: List of major Financial Frauds in India especially related to Banking Sector in recent years

Entity involved (Month/Year)	Quantum of fraud and Organizations Involved
Punjab and Maharashtra Co-operative (PMC) Bank (September 23, 2019)	About 75% of Rs. 8,383.33 crore loans given to one real-estate company, i.e., Housing Development and Infrastructure Ltd. (HDIL)
Punjab National Bank (PNB) (Jan./Feb. 2018)	Rs. 11,394 crore worth Letters of Credit (LoCs) and Letters of Undertaking (LoUs) issued to Nirav Modi Group, Gitanjali Group, and Chandri Paper & Allied Products Pvt. Ltd., among others
ICICI Bank (Sept. 2020)	Six high-value loans worth Rs. 1,575 crore given to various companies of the Videocon group between June 2009 and October 2011. On Sept. 9, 2009, Videocon received a Rs. 300 crore loan, and the next day, the borrower transferred Rs. 64 crore to Npower Renewables Pvt. Ltd. (NRPL), which is owned by Deepak Kochhar, the husband of ICICI Bank's MD.
Infrastructure Leasing & Financial Services Ltd. (IL&FS) (September 2018)	IL&FS and subsidiaries owed Rs. 99,354 crore by Sept. 2018. By December 2018, Gross NPAs stood at 90% as against 5.3% in March 2018. By January 2021, Rs. 32,000 crore debt was resolved.
YES Bank (March 2020)	Between April and June 2018, a total of Rs. 5,050 crore was diverted, with Rs. 3,700 crore invested in Dewan Housing Finance Limited (DHFL) group short-term debentures. Without appropriate collaterals, the promoters of DHFL gave a loan of Rs. 600 crore to a company owned by Rana Kapoor, a co-founder of YES Bank.
Laxmi Vilas Bank (LVB) (September 2019)	Religare Finvest Ltd alleged that LVB employees misappropriated Rs. 791 crore belonging to their company
Housing Development and Infrastructure Ltd. (HDIL) (October 2019)	The Punjab and Maharashtra Co-operative (PMC) Bank fraud cost HDIL Rs 4,355 crore. According to the RBI investigation, 44 suspect loan accounts were replaced with 20,149 fictitious bank accounts with low individual balances.
Dewan Housing Finance Limited (DHFL) (January 29, 2019)	On January 29, 2019 a media portal – Cobrapost – termed it the biggest financial scam in the history of India. By July 2019, DHFL owed Rs. 83,873 crore to mutual funds, state-run institutions, and retail bondholders. 2.6 lacs fake accounts were created in a 'non-existent branch' to divert Rs. 11,750 crore. A new fraudulent transaction of Rs. 6,182.11 crore was unearthed by auditors in February 2021. DHFL was the first financial services player sent to the National Company Law Tribunal (NCLT) for resolution

(Source: Compiled by authors from various newspaper/ other sources acknowledged in references**)**

6. **Political interference: -** Political interference is also cited as a contributor to NPAs. And further, due to political interference, recovering money remained a challenge. P J Nayak Committee appointed by the RBI to improve corporate governance in PSBs asked for doing away 'dual regulation', i.e., government being a majority stakeholder in PSBs and the RBI as the banking sector regulator. It also asked for reducing the government stake in PSBs below 51 percent. Since PSBs hold a significant share in deposits and have a significant presence in terms of branches so such interference is justified by the political parties as well.

The Role of the RBI, and Viewpoint of former RBI heads on the resolution of stressed assets: - The role of the RBI regarding the resolution of Stressed Assets, can be judged from the different angles. Urjit Patel, Ex-RBI Governor, published a book entitled "Overdraft: Saving the Indian Saver" in December 2018. The government was blamed for diluting the IBC by undermining the RBI's regulatory powers over-stressed asset resolution. On February 12, 2018, a revised structure was released, directing banks to begin the resolution process after just one day of default. On April 2, 2019, the Supreme Court of India ruled that the Reserve Bank of India (RBI) cannot direct banking institutions to move under the Insolvency Code in all circumstances. The RBI can only issue directions if the central government has granted it permission and if there are specific defaults.

Ex-RBI Governor, Raghuram Rajan and Ex-Deputy Governor Viral Acharya shared in their paper titled "Indian Banks: A Time to Reform" the case of the IDBI Bank, which in 2004 shifted bad loans totaling over Rs. 9,000 crore to a wholly-owned Special Purpose Vehicle (SPV). They concluded that the IDBI failed to recover substantial amounts through this mechanism, and at the same time, there was no improvement in the lending record of IDBI Bank.

Expectations from the ARC-AMC model: - It is expected that the new ARC will not be just an addition to the existing number of ARCs in India. ARC-AMC model has two tiers. Tier-1, i.e., ARC as an entity, is expected to have a public structure and Tier-2, i.e., AMC is expected to be a private sector entity. It is expected to be a bigger entity in comparison to earlier AMCs so that it is in a position to aggregate NPAs and stressed assets of all PSBs. Resolution of stressed assets will remain a challenge.

Structure and functioning of the 'Bad' Bank: - According to the Financial Services Secretary, the ARC will be formed by both public and private banks. The Indian government will not own any equity capital in the proposed bank. Banks must transfer stressed assets to the ARC at net book value, which is the asset's value less asset provisioning. AMC is expected to be run by experienced professionals. AMC will acquire bad loans from banks including PSBs at a negotiated price, and make payments in the form of cash and Security Receipts (SRs). Cash for making payment for bad loans is likely to come from sponsors (government, PSBs, private banks, etc.) and Alternative Investment Funds (AIF).

Concluding Remarks: - To conclude, it may be remarked that among others, underlying reasons for these NPAs are numerous, such as political interference, poor governance of PSBs, financial frauds, temporary economic and business conditions, economic crisis, over-leveraging by borrowers, and supervisory role of the regulatory agency. Govt. should try to adopt some measures like AMC to operate the asset for some time, restructure and turnaround the bad loans, find an investor or an Alternative Investment Fund (AIF), and then dispose of assets through a market price discovery mechanism. Lessons learned from SDR, S4A, IBC and other schemes need to be incorporated while implementing the idea of 'bad' bank. At the same time, learning from those countries such as the USA, Sweden, Finland, and Germany, will be of utmost importance as they have implemented the ARC-AMC model. Belgium, Ireland, Indonesia, and other countries have also implemented this model to deal with stressed assets due to economic crisis.

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