Non Performing Assets and its issues

Why in news?

\n\n

The President has accorded his assent to an ordinance proposed by Cabinet giving more powers to RBI to solve the massive NPA mess.

\n\n

What is NPA?

\n\n

\n
- NPA is a loan or advance for which the principal or interest payment remained **overdue for a period of 90 days.**
\n
- Banks are required to classify NPAs further into Substandard, Doubtful and Loss assets.
\n
- **Substandard assets:** Assets which has remained NPA for a period less than or equal to 12 months.
\n
- **Doubtful assets:** An asset would be classified as doubtful if it has remained in the substandard category for a period of 12 months.
\n
- **Loss assets:** As per RBI, "Loss asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted, although there may be some salvage or recovery value."
\n

\n\n

What is the issue with NPA?

\n\n

\n
- The total size of the banking sector's NPAs is estimated at over **Rs 6.7 lakh crore,** of which no less than Rs 6 lakh crore is accounted for by state-owned banks or public sector banks (PSB).
\n

- Approximately 16% of loans and advances of banks are **stressed assets (NPA + restructured accounts + write offs).**
\n
- This is higher than BRICS partners except for Russia.
\n
- This is alarming given that capital adequacy ratio threshold for banks are prescribed at 12%.
\n
- Stressed assets for public sector banks are 17% while for private banks, it is 7% and for foreign lenders it is 6%.
\n
- The asset quality of PSU banks is the worst amongst the lot.
\n
- In the boom years, Indian companies took on significant loans to ramp up capacities.
\n
- But while debt galloped, underlying assets did not grow at the same pace.
\n

\n\n

What does the new ordinance offer?

\n\n

\n
- An ordinance to amend the Banking Regulation Act of 1949 has been issued.
\n
- The Presidential Ordinance empowers the Reserve Bank of India (RBI) to **enforce expeditious resolution of NPAs of banks.**
\n
- The Union government has now empowered itself to direct the RBI to take necessary steps to initiate the NPA resolution process once a default has been established.
\n
- The earlier provisions of the Banking Regulation Act did not allow the government to direct the RBI to enforce NPA resolution for cases of default.
\n
- On one hand this new provision is an intrusion into central banks sole authority, but on other hand projects the role of the political establishment as a proactive agent in bank NPA resolution.
\n
- NPA resolution under the amended law can take place on specific directives of the Union government.
\n
- The ordinance also links the Bankruptcy code to the Banking regulation act.

\n
- The Ordinance also allows the **RBI to set up oversight committees** for banks with NPAs that remain a matter of concern requiring early resolution.
\n
- This will certainly empower the central bank to enforce a closer supervision of banks with sticky loans.
\n
- The ordinance is likely to give flexibility to banks to resolve bad accounts and give immunity to bankers from taking legal action in future.
\n

\n\n

What does the ordinance does not offer?

\n\n

\n
- The ordinance doesn't address basic issue as to why NPAs arise.
\n
- It doesn't provide solutions to challenges faced by banks.
\n
- To ensure NPAs in future remain in control, a tectonic cultural shift and massive IT up-gradation is required.
\n
- The ordinance doesn’t propose making wilful default a criminal offence as publicised.
\n
- Instead of dealing with the issue of external constraints as envisioned by the PJ Nayak committee such as dual regulation by the finance ministry and the RBI, board constitution, etc, the Centre has taken a step back.
\n
- Divesting them of the autonomy to take commercial decisions does little to instil confidence in banks.
\n

\n\n

Why is there a need for such a move?

\n\n

\n
- Both the Insolvency and Bankruptcy Code 2016 and the Banks Board Bureau **have done little to improve governance at PSBs.**
\n
- The bank managements were shy of settling deals that would clean up their balance sheet.

\n
- That was because such decisions could also incur the wrath of the investigation and vigilance departments of the government for having entered into, what they would argue were, sweetheart deals.
\n
- At the same time, the bank managements showed no firmness in forcing the borrowers to take haircuts and lose equity in the troubled projects for which the sticky loans were obtained.
\n
- The policy as well as regulatory environment was such that asset reconstruction companies (ARCs) were unable to strike deals on buying sticky loans on which they hoped to make reasonable returns.
\n
- On the other hand, the bank managements were not bold enough to sell the sticky assets to ARCs at such discounts as would make the deal remunerative.
\n
- This called for regulatory reforms that, on the one hand, would have allowed ARCs to be floated by private equity firms that could take the risks.
\n
- And, on the other, would have allowed banks to take the financial hit on such loans in return for a more healthy-looking balance sheet.
\n
- Thus the ordinance is an attempt at tackling the growing problem of the economy’s twin balance-sheet problem (indebted borrowers and NPA-burdened lenders).
\n

\n\n

\n\n

Source: The Hindu & Business Standard

\n

