Asset Resolution & Managing NPAs – What, Why and How?

S. S. Mundra
Deputy Governor

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What?

- Extent of the problem

<table>
<thead>
<tr>
<th></th>
<th>All Banks</th>
<th></th>
<th>Public Sector Banks</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mar 13</td>
<td>Mar 14</td>
<td>Mar 15</td>
<td>Sep 15</td>
</tr>
<tr>
<td>Gross NPA (%)</td>
<td>3.42</td>
<td>4.1</td>
<td>4.6</td>
<td>5.1</td>
</tr>
<tr>
<td>Net NPA (%)</td>
<td>1.7</td>
<td>2.2</td>
<td>2.5</td>
<td>2.8</td>
</tr>
<tr>
<td>Restd. Assets (%)</td>
<td>5.8</td>
<td>5.9</td>
<td>6.4</td>
<td>6.2</td>
</tr>
<tr>
<td>Gross +Restd. Assets (%)</td>
<td>9.2</td>
<td>10.0</td>
<td><strong>11.1</strong></td>
<td><strong>11.3</strong></td>
</tr>
<tr>
<td>Gross+ Restd.+ W/off Assets(%)</td>
<td>11.5</td>
<td>12.1</td>
<td><strong>13.6</strong></td>
<td><strong>14.1</strong></td>
</tr>
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But……. the problem is not uniform… either across bank groups  or across sectors

Restd.: Restructured, W/off : Written off
## Divergent NPA trends

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<th>Foreign Banks</th>
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<tr>
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Contrary to popular perception, stress relatively much less in priority sector
Restructuring mostly in larger accounts
What NPA means?

- Assets/project not generating cash flow to the extent and in the period originally envisaged.
- By translation, banks may not be able to timely recover the entire amount lent and hence, provisioning

However, in real world, NPAs arise due to:
- Genuine reasons
- Wrong assumptions/inefficiencies
- Misdemeanour
Why?

- **External Environment** - Global slowdown, Fall in domestic demand, Policy logjam & Disputed Contracts

- **Internal environment**
  - **Banks:** Governance deficit, Poor credit appraisal; Weak risk management; All debt-no equity; Infra financing particularly highways-‘gold plated’ contracts; Power – Faulty FSAs, Pass through arrangement, termination payments; Chasing quick growth; Pretend and Extend
  - **Corporate India:** Complex web- hold co, step down entities; High leverage; Overseas acquisitions; Unhedged exposures; siphoning, diversion and so on
  - **Value sale v/s distress sale:** Minsky’s Financial Instability Hypothesis- 3 types of borrowers (Hedge, Speculative and Ponzi)
  - **Beyond Corporate Universe:**
    - KCC/Agri distress vis-a-vis crop insurance
    - Small/ medium enterprises…. lack of timely support and delayed payments

  **Promoters must recognize their failure and cooperate**

FSAs- Fuel Supply Agreements; KCC- Kisan Credit Card
INNOVATION IS IMPORTANT IN BANKING
BUT NOT OF THE FOLLOWING TYPES……..
AQR Insights

- DP manipulations, EPBG abuse, funding satellite entities, devolved L/Cs .. late adjustments etc.
- Round tripping- last week to first week – 50 cr to 500 cr
- Short term O/D to repay.. then O/D paid by fresh sanctions
- Sale of assets within groups inflated.. same lenders
- CDR ..equity upfront/security creation/personal guarantees
- Interchanges…NFB to FB
- DCCO- not achieved/cosmetic/very small capacity
- Restructuring- incomplete TEV study

Asset Resolution: How?

- **Acknowledge**: Shift the balance—borrowers to lenders

- **Redress or recover**
  - Need to preserve economic value of assets where cash flow potential exists (Under construction projects, lower capacity utilization)
  - Don’t prolong the agony…both for the patient and the caretaker

- **Enablements**:
  - Forbearance ended, CRILC and Monitoring of SMA, JLF, 5/25 scheme, SDR

CRILC: Central Repository of Information on Large Credits, SMA: Special Mention Accounts, JLF: Joint Lenders Forum, SDR: Strategic Debt Restructuring
Last Words

To err is human but to keep on repeating the errors is foolish...learn from past

- Not ownership but governance issue – Improve credit origination / administration standards
- (Re) Defining risk appetite at banks
- Early cleansing better- IFRS beckons
- Bankruptcy framework - SDR subsumed
- Strengthening ARCs- Capital an issue
- Handholding support to SMEs - make TReDS compulsory for PSUs/Large corporates/ Govt. Depts.
- Capital planning (exercising all possibilities)
- Borrowers should ‘cooperate’ in their own long term interest
- Retail Loan - guard against adverse selection

IFRS: International Financial Reporting Standards, ARC: Asset Reconstruction Companies, TReDS: Trade Receivables Discounting System
Our broad sense is …

Prevention is better than cure!

- Present ailment is well within cure and that ‘cure’ is being administered
- Willingness of the affected persons is as important as the medicine… happy to see that such will power is being shown
- Recent signs indicate that the preventive measures are also being embraced

All should be optimistic about a sustained recovery and continuous well being thereafter….
THANKS