NON PERFORMING ASSETS (NPA) FROM 'A CRISIS' TO 'A CATALYST'

INTRODUCTION

The banking sector in an economy accounts for a major portion of financial intermediation and is considered to be the main channel of monetary policy transmission, credit delivery and payment systems. In a bank-based economy such as India, sound health of the banking system is imperative for efficient financial intermediation in the context of overall development and financial stability.

In the post- global financial crisis period, the Indian banking system, has suffered growing impairment of asset quality (observed through NPAs). The Non-Performing Assets (NPA) is an important indicator to assess the financial health of the banking sector. The NPA problem has been further compounded due to the COVID crisis. RBI has estimated that the level of NPAs could double in a span of merely one year from 2020 to 2021.

To understand the dynamics of why this has been happening and what can be done, it is important to answer the following questions- What are NPAs and why are they a concern? How has the NPA problem panned out in India? What are the primary reasons for emergence of the NPA problem? What steps have been taken to check these reasons and halt the growth of NPAs? Why the resolution of the NPA problem remains challenging? And can the effort for NPA resolution act as a catalyst for reformation of the Banking Sector?

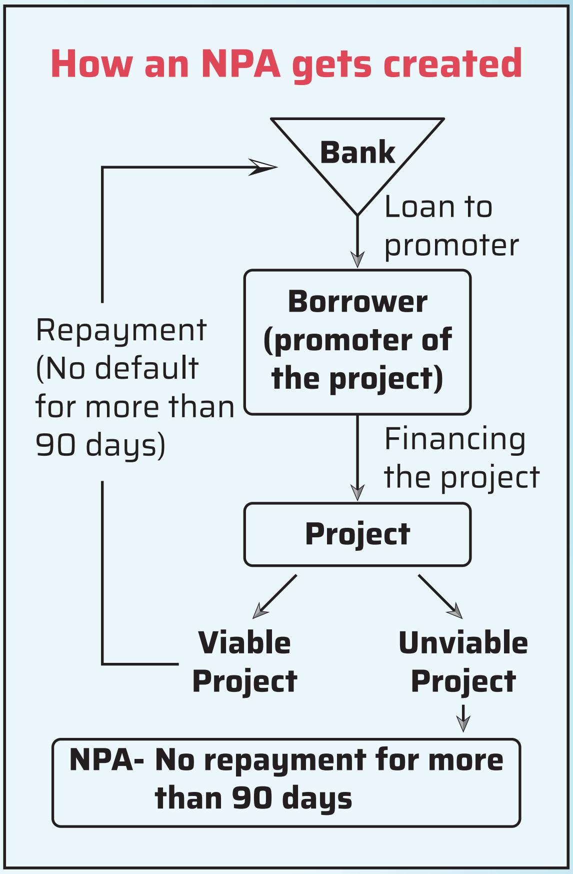
WHAT ARE NON-PERFORMING ASSETS (NPAS) AND WHY ARE THEY A CONCERN?

A non-performing asset (NPA) refers to a classification for **loans or advances of a bank that are in default or in arrears.**

The **period beyond the 'due date',** past which the **principal or interest payments are considered late or missed** has been accepted as **'90 days' in India.** The '90 days overdue' criteria is applicable on all major categories of advances including term loan, overdraft and cash credit. (Although for agricultural purposes,the discussed period is 'two harvest seasons'.)

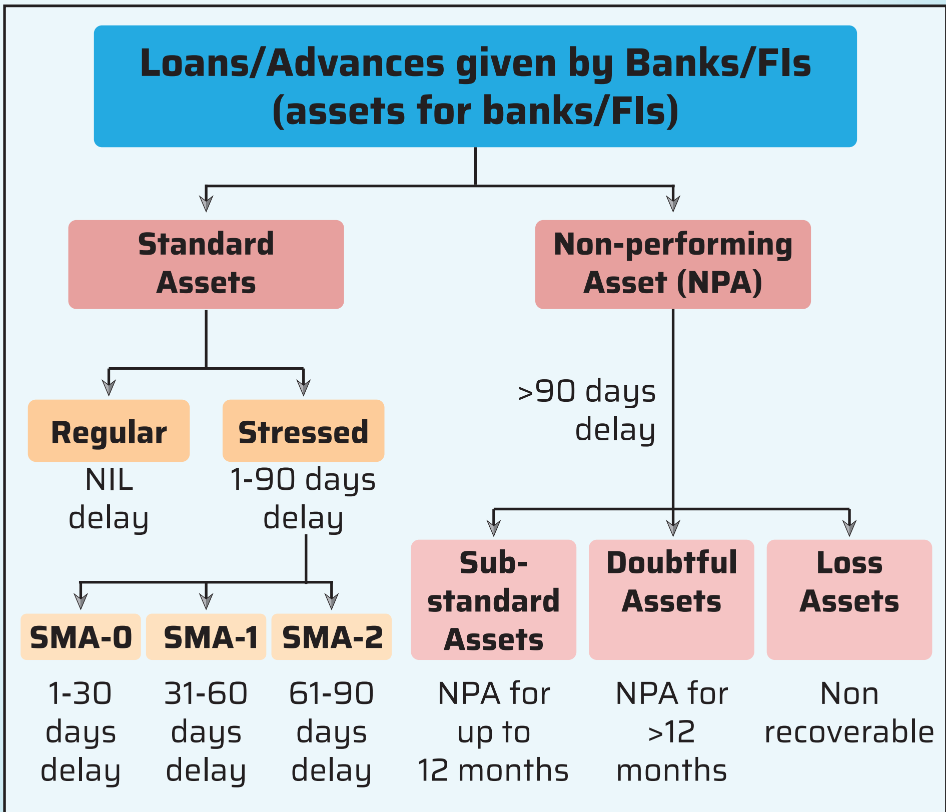
Banks are required to **classify non-performing assets** further into the following three categories-

- **Sub-standard Assets:** Asset which was classified as NPA for a period not exceeding 12 months.
- **Doubtful Assets:** An asset which has remained NPA for a period exceeding 12 months.
- **Loss Assets:** A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly.



Creation of NPAs in a system is concerning because it can directly impact the banking and industrial sector, as well as have an indirect impact on the overall economy-

- **Impact on Banking sector:** NPAs put detrimental impact on the profitability of banks, as banks stop earning income on one hand and attract higher provisioning compared to standard assets on the other hand. This proportionally reduces the Bank's ability to provide credit to borrowers.
  - The NPA crisis also indirectly impacts the credibility of the banking system. The element of trust in depositors assumes prime importance in efficient functioning of any banking system.



- **Impact on Industrial Sector:** Poor profitability of banks and slower flow of money circulation decreases the availability of credit in the market. Lower credit availability creates a dearth of funds for the industrial sector.
  - Limited credit availability also makes the currently available credit expensive, thus driving up the financial costs and proportionately overall costs of the project.
- **Impact on overall Economy:** Banking system channels the savings of the public in investment. A struggling banking sector obstructs this flow, which can translate into a slowing economy. Also, since large NPAs result in poor performance of industrial projects, it indirectly discourages growth of entrepreneurship and private sector in the economy.
  - A large scale crisis in the Banking sector has the potential to snowball into a full-fledged economic crisis as was seen in the case of the Global Financial Crisis of 2008.

Relation of NPAs with macroeconomic parameters

- **NPAs and Credit Cycle:** In an economy, credit cycle generally follows the same pattern as the economic cycle i.e., expansion in credit during 'boom' phase and contraction of credit during 'recession' phase. As the financial institutions stretch their lending portfolio, they tend to lower their credit standards. This leads to creation of potential NPAs. As a result, NPAs generally follow an expansionary credit policy after a lag of about 2-3 years.
- **NPAs and Growth:** The NPAs growth is **inversely related to the GDP growth** i.e.,**Low GDP growth translates in to higher NPAs** after a lag of one to two quarters and **acceleration of GDP causes fall in NPA growth** with a lag of about four quarters.
- **NPAs and Interest Rate Cycles:** Increase in interest rates have a **direct relationship** with rising NPAs i.e., increase in market interest rates may result in rise of NPAs. This is because higher interest rates make credit more expensive and hence affect financial viability of projects.
- **NPAs and inflation:** Persistently high inflation erodes the real value of money and creates cost overruns for economic projects. As a result, **rising inflation indirectly aids creation of NPAs.**
  - Although, in certain cases higher inflation aids the borrowers, as the real value of debt gets eroded.
- **NPAs and Asset Prices:** Asset Prices and NPAs exhibit an **inverse relationship** i.e., as asset prices move upwards, the level of NPAs moves downwards and vice versa. As the asset prices move up, they tend to increase valuations of projects which in turn improves the collective financial viability of projects.
- **NPAs and Monetary Policy Transmission:** High incidence of non-performing assets (NPAs) in banks may weaken monetary policy transmission. This is because better asset quality improves the banks' lending channels and helps in smoothening the transmission of monetary policy.

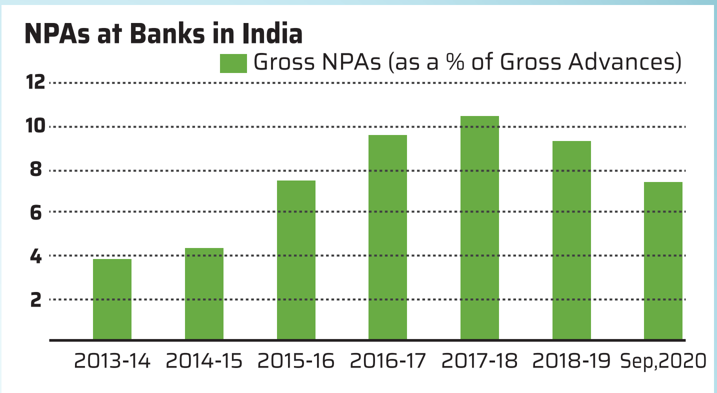
HOW HAS THE NPA PROBLEM PANNED OUT IN INDIA?

The problem of NPAs is not new for India's banking sector. Since the reforms of 1991, India has had two episodes of NPA problems, one during 1997-2002 and the current one after the global financial crisis of 2008.

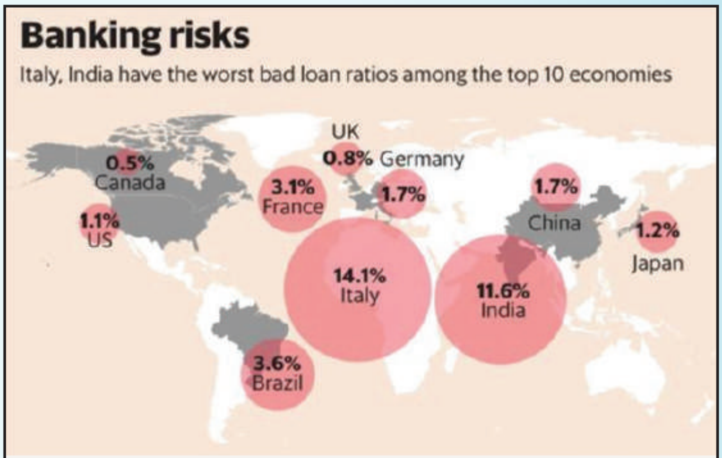
The problem of NPAs in the current episode started around 2010 and aggravated after 2013.The current crisis has following characteristics-

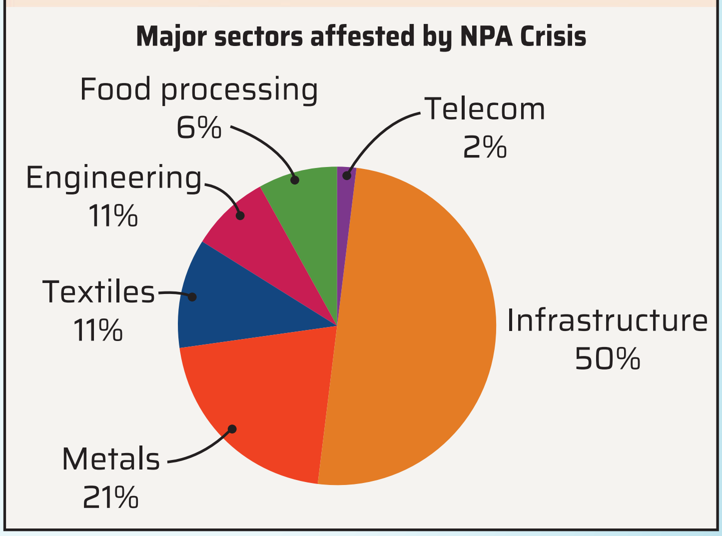
- **Crisis has been accompanied by other Macroeconomic problems:** The NPA problem this time has been broad based and has coincided with slowing economic growth, leading to generation of issues like Twin Balance Sheet Problem (TBS).

- **Larger and more broad based crisis:** The current NPA crisis facing banks in India is much larger than the previous one. GNPAs have ranged from 9.5% in 2017 to 7.5% in 2020 and **moving towards 13.5% in the wake of COVID-19 (as per RBI's Financial Stability Report).**
  - The significant increase observed after 2015 could be on account of the implementation of the **Asset Quality Review** which made banks recognize and report stressed assets.



- **Disproportionate share of Public Sector Banks:** About 9/10th of NPAs are from loans and advances of public sector banks. For instance, NPAs in the State Bank of India alone constitute close to 1/5th of the total NPAs in the Banking system.
- **Dominated by the infrastructure sector:** Close to half of the Gross NPAs (GNPAs) can be attributed to the infrastructure sector. Apart from infrastructure, other dominant sectors include Metals, Textiles, Engineering and Food Processing among others.
  - Large NPAs in the infrastructure sector has made banks apprehensive of the sector, drying up the funding to the sector and causing infrastructure deficiencies.
  - Also, majority of the NPA stricken sectors are employment intensive like infrastructure and textiles which has impacted their employment generation capacity.
- **Poor global standing:** Post the Global Financial Crisis (GFC) of 2008, all major economies faced some form of NPA crisis. Among the major economies that suffered, India has been one of the worst affected. (Although, the current situation cannot be completely attributed to the GFC.)





These characteristics clearly highlight the nature, extent and the depth of the NPA crisis that India is facing. Before we delve into what can we do to mitigate this crisis, it is important to understand how did we end up in such a situation.

WHAT ARE THE PRIMARY REASONS FOR EMERGENCE OF THE NPA PROBLEM?

The reasons for NPAs can be broadly divided into reasons based on the changing economic environment, systemic issues in the Banking sector and ethical issues in relation to the people involved:

Economic reasons:

- **Optimism regarding economic growth:** A large number of bad loans originated in the period 2006-2008 when economic growth was strong, and previous infrastructure projects had been completed on time. This prompted bankers to issue riskier credit to the sector without carrying out the necessary due diligence.
- **Global economic slowdown post the GFC of 2008:** The years of strong global growth before the GFC were followed by a slowdown, which extended even to India. Strong demand projections for various projects were shown to be increasingly unrealistic as domestic demand slowed down.
- **Structural issues in the Economy:** A significant section of the NPAs can be attributed to internal inefficiencies which result in poor Ease of Doing Business (EoDB). This results in time and cost overruns in projects resulting in generation of NPAs.

Writing-off loans and NPAs: Case in point- Farm loan waiver

Farm-loan waiver is a **collective write-off of agricultural loans of a certain segment.** Although a written-off account like farm loan-waiver is not reflected in the NPA statistics, it impacts the level of NPAs in following ways-

- **Reduces the overall assets:** Writing-off large assets reduces banks asset pile and affects its capital adequacy as well as its lending ability.
  - For instance, from 2015-2020, a total of 10 states have announced farm loan waivers totaling Rs 2.4 lakh crore, which amounts to 9% of the 2019-20 Union Budget. This has reduced the collective appetite of Banks to lend to agricultural sector.
- **Encourages Moral Hazard:** Writing-off loans creates a poor precedence in cases where borrowers had the ability to service these loans. For example, farm-loan waivers provided to prosperous farmers.

Systemic reasons:

- **Absence of swift NPA identification mechanism:** Regulatory processes did not require continuous monitoring of assets. This resulted in a scenario where evergreening of loans was more viable for banks as compared to restructuring, in the immediate term.
  - Also, a prolonged policy of regulatory forbearance post 2008 GFC allowed banks to undertake higher restructuring and risky lending and caused a delay in recognition of actual NPAs.
- **Loss of Promoter and Banker Interest:** Once projects got delayed enough that the promoter had little equity left in the project, s/he lost interest.This resulted in delay in restructuring of the projects or abandoning of the projects by the banker altogether. Thus, stalled projects continued as **"zombie" projects,** neither dead nor alive.
- **Weak Corporate Governance:** Deterioration in the Quality of the Board and poor processes with regard to performance of due diligence, level of transparency and accountability mechanisms culminated to poor decision making and unproductive use of credit.
- **Government Permissions and Foot-Dragging:** A variety of governance problems such as the suspect allocation of coal mines coupled with the fear of investigation slowed down government decision making. Project cost overruns escalated for stalled projects and they became increasingly unable to service debt.

Ethical reasons:

- **Malfeasance by Bankers:** There have been several cases where bankers did not do due diligence or were outsourcing the analysis to agencies like IDBI. Although, it is hard to differentiate between banker exuberance, incompetence, and corruption.
  - Such behaviour on the part of bankers resulted in issues like unscrupulous promotors manipulating the system, limited monitoring of the health of the project and excessive issuing of loans to 'well-connected' promoters.

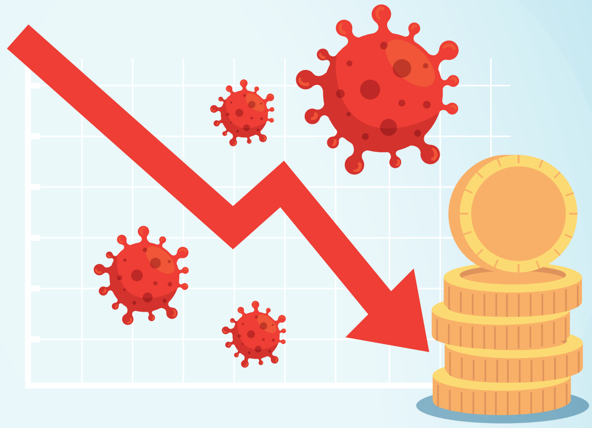
➢ **Fraud by promoters:** The size of frauds in the public sector banking system has been increasing, though still small relative to the overall volume of NPAs. Lack of appropriate action against culprits may have led to increase in fraudulent tendencies.

➢ **Manipulation of restructuring process by promoters:** Before the Insolvency and Bankruptcy Code was enacted, promoters enjoyed significant say in the restructuring process. For instance, promoters forced bank to convert their lending to equity.

- Such manipulation created a system where a promoter enjoys the upside in good times, and forces banks to absorb losses in bad times, even while s/he holds on to their equity.

How COVID-19 has further aggravated India's NPA problem?

The outbreak of the pandemic has had a devastating impact on the economy. Impact on NPAs, as part of the economy, has following attributes-

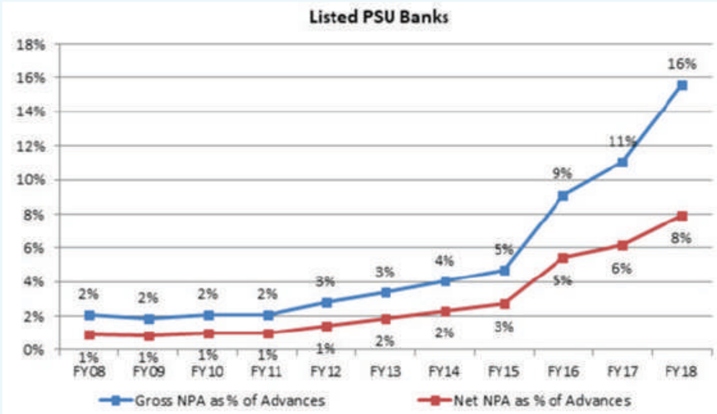


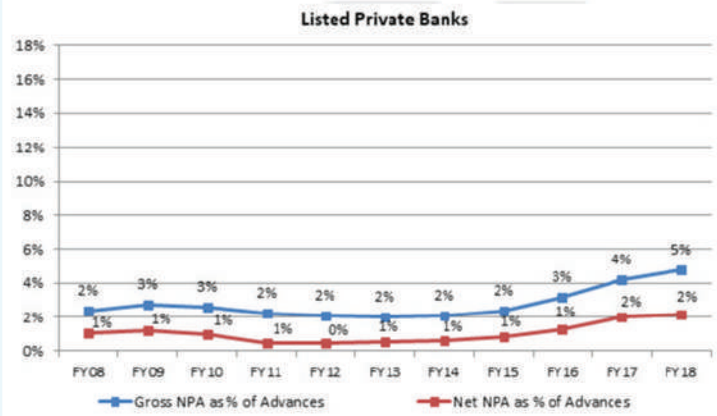
- **Overall increase in the level of NPAs:** The **RBI's Financial Stability Report (FSR) of 2020** has highlighted that **GNPAs may rise to 13.5%** of total assets (escalate to 14.8% in the worst-case scenario)in September 2021 from 7.5% in September 2020.
- **Prolonging of the NPA Crisis:** The economic halt created by the pandemic had to be accompanied with various loan moratoriums and one-time restructuring schemes. Majority of these stressed assets whose recognition has been deferred for the time being, are likely to emerge as NPAs in near future. The deferment (which was necessary to control the immediate crisis), has prolonged the crisis.
- **Disproportionate impact on certain sectors:** The pandemic has had a larger impact on some sectors and limited impact on some. For instance, construction sector has been drastically affected due to labour availability issues. As a result, stressed assets in some sectors are likely to rise at a faster rate.

To counter the impact of COVID-19 and pinpoint the sectors that need assistance, a **committee under the chairmanship of KV Kamath** was created. The **committee has identified 26 sectors for restructuring.** These 26 sectors collectively constitute about 60% of the loans that are at risk.

Why Public Sector Banks (PSBs) have a larger share of the NPAs?

Up till 2012, both **Public and Private Sector Banks had comparable proportions of GNPAs** in their assets. Since then, the share of **NPAs in the public sector has progressively increased** whereas that of the private sector has remained subdued.





Apart from the aforementioned reasons, PSBs have been facing additional challenges such as-

- **Obligation to fulfill social responsibilities:** PSBs have an obligation to lend to certain segments like infrastructure, iron and steel etc. as part of the Governmental agendas.
- **Procedural inefficiencies vis-à-vis the private sector:** The procedures followed in extending and monitoring credit in PSBs is significantly different from Private sector banks.
  - For instance, we can consider tractor financing. Generally, all private sector banks undertake a field inspection and telephonic check before disbursing a loan to the borrower. The same is not true for PSBs.
- **Political interference in decision making:** The management of the PSBs is subject to political interference which results in issues like inefficient lending practices, interference in financial decisions such as opening and closing of new branches etc.
  - Continuing the above-mentioned example of tractor financing, if the borrower fails to repay the loans, private sector banks would move the authorities to repossess the tractor.Unlike the private sector, PSBs are reluctant to repossess the tractor, often for political reasons.

WHAT STEPS HAVE BEEN TAKEN TO CHECK THESE REASONS AND HALT THE GROWTH OF NPAS?

Solving the NPA problem can be broadly divided into four major areas- Recognition, Recapitalization, Resolution and Reform. Following steps have been taken with regard to each area-

- **Recognition (and prevention if possible):** To recognize NPAs, a large-scale Asset Quality Review (AQR) was conducted in 2015 in addition to the regulatory oversight exercised by RBI via instruments like the SMA categorization. Other monitoring mechanisms added in the recent past include-
  - **Prompt Corrective Action (PCA) framework:** It is a framework under which banks with weak financial metrics are put under watch by the RBI. The PCA framework deems banks as risky (with three risk thresholds) if they slip below certain norms on three parameters — capital ratios, asset quality and profitability.

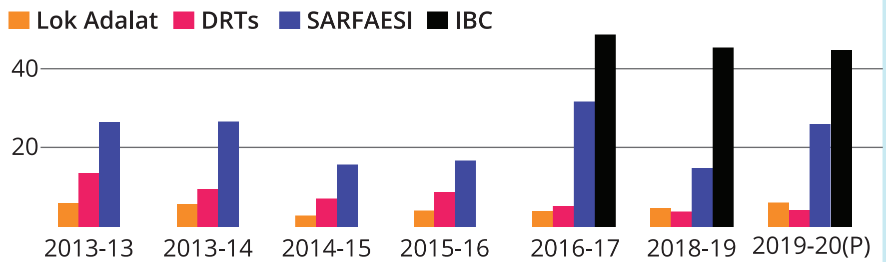
RISK THRESHOLDS & CORRECTIVE ACTIONS

RISK THRESHOLD 1	RISK THRESHOLD 2	RISK THRESHOLD 3
Restriction On Dividends More Capital For Foreign Banks Discretionary Actions by Regulator	Restriction On Dividends Restriction On Branch Expansian HIgher Provisions Discretionary Actions by Regulator	Restriction On Dividends Restriction On Branch Expansian Restriction On Management Compensation Restriction On Director Fee Discretionary Actions by Regulator

- **Creation of a large credit database:** A large credit database has been created with Central Repository of Information on Large Credits (CRILC) to identify early signs of distress in a borrower such as habitual late payments to a segment of lenders. It contains all loans over Rs. 5 crore and has been shared with the banks.
- **Recapitalization:** Following recapitalization measures have been taken to provide adequate capital to banks dealing with NPA crisis and increasing regulatory requirement in the form of BASEL-III norms-
  - **Budgetary allocations:** In 2017-18, the government had infused ₹ 90,000 crore in PSBs, followed by ₹ 1.06 lakh crore in 2018-19.For the year 2020-21, Government has pledged ₹ 20,000 crore to meet the regulatory requirements.
  - **Mission Indradhanush:** The mission was aimed at improving the overall functioning of the PSBs. Recapitalization of the 13 PSBs was one of the key elements of the mission.
- **Resolution:** Government and RBI have tried out various mechanisms such as creation of Debt Recovery Tribunals (DRTs), SARFAESI Act, Asset Reconstruction Companies (ARCs), Strategic Debt Restructuring (SDR) Scheme and Joint Lenders Forum (JLF) among others. These efforts have culminated into creation of-
  - **Insolvency and Bankruptcy Code (IBC):** The IBC was enacted in 2016 to provide a time-bound 180-day recovery process for insolvent accounts (where the borrowers are unable to pay their dues).
  - RBI data indicates that as a percentage of claims, **scheduled commercial banks have been able to recover 45.5% of the amount involved** through IBC for the financial year 2019-20, which is the **highest as compared to recovery under other modes.**

NPAs of Scheduled Commercial Banks Recovered

Through various channels (%)

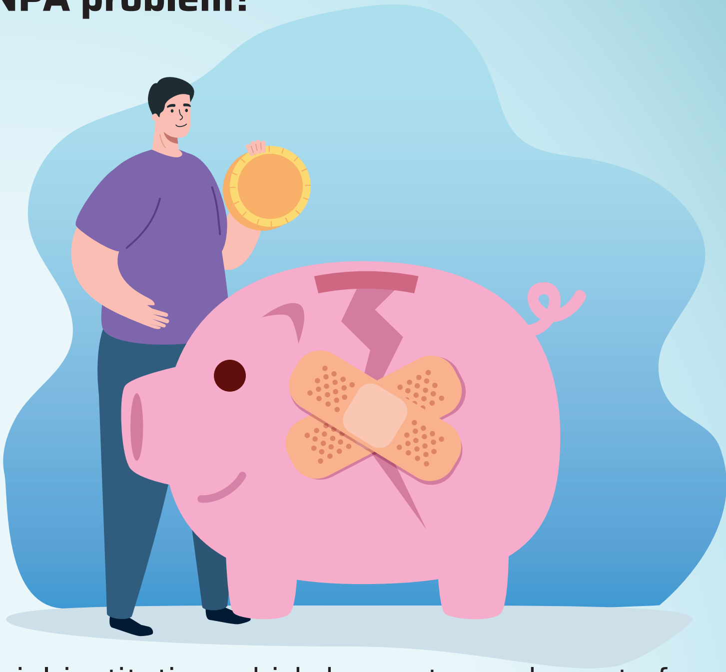


  - **Project Sashakt:** The project aims at resolution of assets with larger value on a higher priority. Under the project, bad loans of up to ₹ 50 crore will be managed at the bank level, bad loans of ₹ 50-500 crore, banks will enter an inter-creditor agreement and for loans above ₹ 500 crore, it aims to create an independent Asset Management Company (AMC).
  - **RBI's framework for COVID-19 related stress:** Under the framework, eligible borrowers (vulnerable and distressed sectors such as MSME borrowers, Farm credit, housing finance companies etc.) can invoke the resolution framework by merely submitting a request to the lending institutions.
  - **Other sector specific schemes:** like MSME SAMADHAN Scheme etc.
- **Reform:** To ensure that structural deficiencies in the credit lending and monitoring procedure are rectified, following reforms have been undertaken-
  - **More robust Credit Risk Management:** through regulatory reforms like higher provisioning for stressed assets, detailed sectoral as well as individual analysis of the profit and loss statements and financial safeguards against external factors.
  - **Widening of powers of RBI:** through a series of legislations and executive orders. For example, punitive measures introduced as part of the PCA framework.
  - **Key reforms undertaken for PSBs:** such as incorporating usage of third-party data sources for due diligence, creation of online end-to-end One Time Settlement (OTS) platforms and strict segregation of monitoring and sanctioning of high-value loans.

Can Bad Bank be a solution to India's NPA problem?

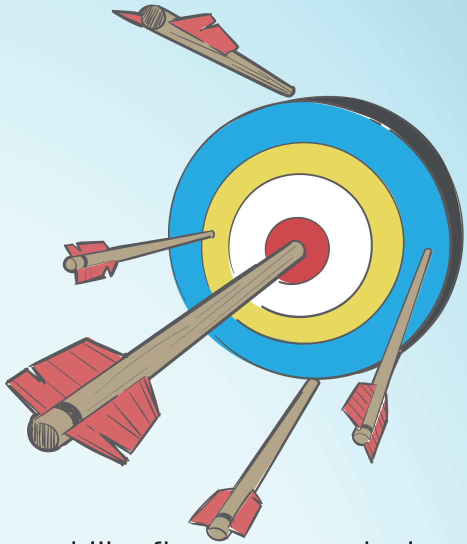
The idea of a Bad Bank is not new in the economic parlance. The **first Bank** to use the Bad Bank strategy was the **Mellon Bank of United States.** In India, a Bad Bank-like entity was first created in 2004, namely Stressed Asset Stabilization Fund (SASF), for a temporary period. Further, in 2017, the Economic Survey mooted creation of a **Bad Bank in the form of a Public Sector Asset Rehabilitation Agency (PARA).**

With COVID-19 further aggravating the NPA problem, the Budget 2021-22 has announced setting up of a **Bad Bank in the form of an Asset Reconstruction Company (ARC).**



- **How it works?** An ARC is a specialized financial institution which buys stressed assets from banks and financial institutions.Thereafter, it is the responsibility of the ARC to recover the bad debts or associated securities in a market-led process.
- **How is the Bad Bank different from the existing ARC?** The new ARC or 'Bad Bank' is different on two accounts-
  - **Well capitalized:** The Bad Bank would be provided with adequate capital by the Government and hence will have a better chance at resolution of the assets.
  - **Higher trust element:** Largely, all major ARCs are in private sector, which makes PSBs skeptical due to a potential fear of investigation. A Government backed ARC may see more participation of the PSBs.
- **What are benefits a Bad Bank will bring?** A Bad Bank could bring following to the table-
  - A new ARC for addressing the NPAs of PSBs **may also shape the operations of the existing ARCs.**
  - A large ARC will have the **ability to buy out the 'big' accounts and free up the banks.** These accounts currently get stuck due to limited capacity of private ARCs.
  - Being a government initiative, the **RBI may extend certain rule relaxations to the Bad Bank** which can likely provide a push to resolution of NPAs.
- **What are the challenges in realization of the above objectives?** The primary problem with ARCs has been the limited participation of Banks. This is because Banks have to sell their assets to ARCs at a devalued price taking into account the status of NPA. Most of the times, the extent of this devaluation becomes the bone of contention.
  - Also, some economists have argued that creation of a bad bank primarily caters to Willful Defaulters and as a result encourages defaults and does not penalize fraudulent practices.

WHY THE RESOLUTION OF THE NPA PROBLEM REMAINS CHALLENGING?



Despite several steps taken by the Government from Resolution to reform, the recovery rates in India have not been up to the mark. Following structural challenges can be cited as key bottlenecks in achieving the desired level of resolution-

- **Apathy in decision making:** Risk-averse bankers, seeing the arrests of some of their colleagues, are simply not willing to take the write-downs and push a restructuring to conclusion, without the process being certified by the courts or eminent individuals. Taking every restructuring to an eminent persons group or court delays the process significantly.
- **Lack of clarity in accountability flow:** Absence of clear accountability flows creates the issue of moral hazard and inadequate due diligence. For example, lower-level executives are often made accountable for implications of decisions made by senior executives.
- **Corporate Governance Issues:** Banks, especially PSBs, have not undertaken necessary changes from financial decision making to appointment of senior level positions to ensure more efficient and sound lending practices and hence smaller NPAs.
- **Absence of integrated approach towards asset quality in the financial sector:** The liquidity crisis created by the NPA problem affects not only Banking sector but also other financial sectors such as the NBFC sector (evidently seen in the IL&FS Crisis). In this context, NPA resolution approaches which are limited to the banking sector are not able to structurally address the issue.
- **Inadequate growth in ARCs:** According to a Reserve Bank of India (RBI) report on ARCs, the growth of the ARC industry has not been consistent over time and not always been synchronous with the trends in non-performing assets (NPAs) of banks and non-banking financial companies (NBFCs).

Apart from these, some emerging challenges like unaccounted growth of FinTech Industry can also halt the progress of NPA resolution. For instance, absence of adequate regulation of the emerging P2P lending platforms can potentially create a new wave of NPAs for the system.

CAN THE EFFORTS FOR NPA RESOLUTION ACT AS A CATALYST FOR REFORMATION OF THE BANKING SECTOR?

The **level of NPAs of a banking system serve as a symptom for the overall health of financial sector.** Therefore, to mitigate the symptom (i.e., NPAs) in the long-term, it becomes imperative to address all major issues in the financial sector as a whole.

In this context, the **focus on resolution and prevention of NPAs in the long-term could catalyse large scale reforms in the Banking sector.** For instance, recapitalization of PSBs for better NPA resolution has indirectly strengthened the financial stability and capital availability for these banks. Similarly, NPA resolution can **act as a catalyst in reforming following areas-**

- **Strengthening the core banking function:** Prevention of NPAs requires better credit monitoring mechanisms. These capacities directly translate to more efficient lending practices in the long run, which is the essence for functioning of any banking system.
- **Enhancing the level of governance:** Solving the problem of NPA requires that there should be clarity on who is accountable for which decision.Evolving such a system requires **transparency in the system, clear communication channels** and a sense of responsibility among all the stakeholders which can translate into enhanced levels of governance in all areas of the Banking system.
- **Attitudinal change among all stakeholders:** Discouraging emergence of fresh NPAs demands that **regulatory forbearance should be an exception and not a staple diet.** This approach would address the 'taken for granted' attitude among bankers as well as promoters.
- **Accelerating use of technology:** Monitoring of NPAs requires collection of large datasets, use of analytics to assess the viability of projects and use of tools like Blockchain, Artificial intelligence, encryption technology etc.Adoption of these technologies spills to other areas, thus accelerating adoption in the overall banking system.
- **Driving integration within the financial system:** As can be seen from the aforementioned challenges, NPA resolution is not possible if connected issues related to sectors like NBFC sector and FinTech sector are not accounted. This collective approach to NPA resolution indirectly creates links between the sub-sectors which aid in overall integration of the sector.
- **Developing linkages between the industrial sector and the financial sector:** Restructuring of NPAs requires participation from industrial partners of the project as well as banks. Development of a connection can be further used to create better products for industries and increase participation of industries in the sector, which is in line with the Bank Licensing Framework proposed by RBI.

CONCLUSION

Stress in the banking sector causes less money to be available to fund other projects, and therefore, has a negative impact on the national economy. Banks begin to charge higher interest rates to maintain profit margins. As investments get stuck, unemployment begins. Investors do not get rightful returns. And with the trigger of this vicious circle, the biggest casualty is the economy.

Growth in NPAs is India is a amalgamation of several weaknesses such as poor credit monitoring, governance issues in PSBs, limited capital availability etc. The solution of this problem, similarly, has to be an amalgamation of several steps which can be expressed as the '4RStrategy'- Recognition, Recapitalization, Resolution and Reform.

The broad based nature of solution of the NPA problem acts as a catalyst for the overall banking reforms. The indicator 'level of NPA' can act as an appropriate anchor for monitoring and progressing towards better overall health of the financial system.

GLOSSARY	
Default	A loan is in default when the lender considers the loan agreement to be broken and the debtor is unable to meet his obligations.
Arrears	A loan is in arrears when principal or interest payments are late or missed.
Provisioning of loans	For every loan given out, the banks have to keep aside some extra funds to cover up losses, in case the asset does not perform well. The provisioning of loan is variable in nature i.e., it depends on the probable risk of the project.
Twin Balance Sheet Problem (TBS)	A balance sheet summarizes the asset and liabilities of any individual/institution at any time. The Twin Balance sheet (TBS) problem is a twofold problem faced by overleveraged companies and bad loan-encumbered banks.
Loan Write off	Writing-off a loan implies reducing its value to zero and removing the asset from the Banks's balance sheet. For example, loans from bankrupt businesses have to be written-off.
Evergreening of loans	Evergreening of loans is a scenario in which banks revive a loan on the verge of default by granting further loans to the same firm.
Regulatory forbearance	Regulatory forbearance for banks generally involves relaxing the norms for restructuring assets, where restructured assets are no longer required to be classified as Non-Performing Assets (NPAs) and therefore do not require the levels of provisioning that NPAs attract.

TOPIC AT A GLANCE

Non-Performing Assets (NPA)

A non-performing asset (NPA) refers to a classification for loans or advances of a bank that are in default or in arrears.They are further sub-classified into sub-standard (NPA < 12 months), doubtful (NPA > 12 months) and loss assets. Development of an NPA crisis creates an impact on following areas-

- **Banking Sector:** It directly impacts the profitability and credibility of the Banking system.
- **Industrial Sector:** It decreases the availability of credit and consequently makes credit expensive.
- **Overall Economy:** Creation of NPAs obstructs the flow of money leading to slowdown in the economy and at times snowballing into a full-fledged economic crisis.

Characteristics of India's NPA problem

- The NPA crisis has been **accompanied with other macroeconomic problems** like slowing economic growth and twin balance sheet issue.
- The crisis is **larger and more broad-based** than India's Banking Sector has ever experienced before.
- **Disproportionate share of Public Sector Banks (PSBs)** i.e., about 9/10th of NPAs are from advances of PSBs.
- The **sectoral share of the NPAs is dominated by the infrastructure** sector followed by Metals and Textiles among others.
- **India's NPA crisis has been one of the worst among affected economies** from the Global Financial Crisis of 2008.

Reasons for emergence of the India's NPA problem

- **Economic Reasons:**
  - **Overoptimism** in relation to the growth experienced in 2006-08 period.
  - **Global Economic Slowdown** post the GFC of 2008.
  - **Structural issues** in the economy such as poor Ease of Doing Business (EoDB).
- **Systemic Reasons:**
  - **Absence of a swift NPA identification** mechanism accompanied with a prolonged policy of **regulatory forbearance.**
  - **Abandoning of projects** due to loss of promoter and banker interest in the project.
  - **Governance issues** such as weak corporate governance and foot-dragging with respect to permissions by government.
- **Ethical Reasons:**
  - **Malfeasance by Bankers** in the form of limited due diligence or outsourcing of analysis.
  - **Fraud by promoters** increases fraudulent tendencies.
  - **Manipulation of the restructuring process** by the promoters.

Steps taken to halt the growth of NPAs

- **Recognition:** Post the Asset Quality Review of 2015, NPA recognition steps include Prompt Corrective Action Framework and Creation of a large credit database among others.
- **Recapitalization** includes Budgetary allocations and schemes like Mission Indradhanush.
- **Resolution:** These include Insolvency and Bankruptcy Code (IBC), Project Sashakt, RBI's framework for COVID-19 related stress and other specific schemes like MSME SAMADHAN.
- **Reform:** Long-term steps for sectoral reformation have been taken such as implying a more robust Credit Risk Management system, widening of powers of RBI and key reforms undertaken for PSBs.

Challenges that still remain

- **Apathy in decision making process** due to risk-averse nature of bankers.
- **Absence of clear accountability** flows creates the issue of moral hazard and inadequate due diligence.
- **Corporate Governance Issues,** especially with PSBs in the form of appointment delays, interference etc.
- **Absence of integrated approach** towards asset quality in the financial sector as the Banking sector, NBFC sector and other elements of financial sector are not viewed together.
- **Growth of the ARCs has not been consistent** and not always been synchronous with the trends in NPAs of banks.

NPA resolution as a catalyst for reformation of the Banking Sector

- **Strengthening the core banking function** by making lending practices more efficient.
- **Enhancing the level of governance** through transparency and creation of clear communication channels.
- **Attitudinal change among all stakeholders** by clearly highlighting that **regulatory forbearance should be an exception and not a staple diet.**
- **Accelerating the use of technology** through tools like Blockchain, Artificial Intelligence etc.
- **Driving integration in the financial system** by addressing the connected issues in the NBFC and FinTech sector.
- **Development of linkages between the industrial sector and the financial sector.**