Chapter VI

Asset Quality Position of PSBs

6.1 Classification of Assets in Banks

> **An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank.**
>
> **NPA** is a loan or an advance where;
>
> i. interest and/ or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan,
> ii. the account remains 'out of order' in respect of an Overdraft/Cash Credit (OD/CC),
> iii. the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
> iv. the instalment of principal or interest thereon remains overdue for two crop seasons for short duration crops,
> v. the instalment of principal or interest thereon remains overdue for one crop season for long duration crops,
> vi. the amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitisation transaction undertaken in terms of guidelines on securitisation dated February 1, 2006.
> vii. in respect of derivative transactions, the overdue receivables representing positive mark-to-market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment.

In 1985, a system of classifying assets was introduced in the Indian banking system on the recommendations of the Ghosh Committee on Final Accounts. The system, (Health Code System) involved classification of bank advances into eight categories ranging from one (satisfactory) to eight (bad and doubtful debt). In 1991, the Narasimhan Committee on the financial system aligned the classification of bank assets to international standards and introduced four broad asset groups, viz. (i) standard assets; (ii) substandard assets; (iii) doubtful assets; (iv) loss assets. Following this, prudential norms relating to income recognition, asset classification and provisioning were introduced in 1992. In 1998, the Narasimhan Committee on Banking Sector Reforms recommended a further tightening of prudential standards in order to strengthen the prevailing norms and bring them at par with evolving international best practices. Subsequently, in 2001, the non-performing asset (NPA) guidelines were brought at par with international standards with the introduction of 90-days norm for classification of NPAs. NPAs can broadly be classified into Gross NPAs[21] and Net NPAs[22].

[21] **Gross NPAs: Gross NPAs are the sum total of all loan assets that are classified as NPAs as per RBI guidelines as on balance sheet date. It reflects the quality of loans made by banks.**

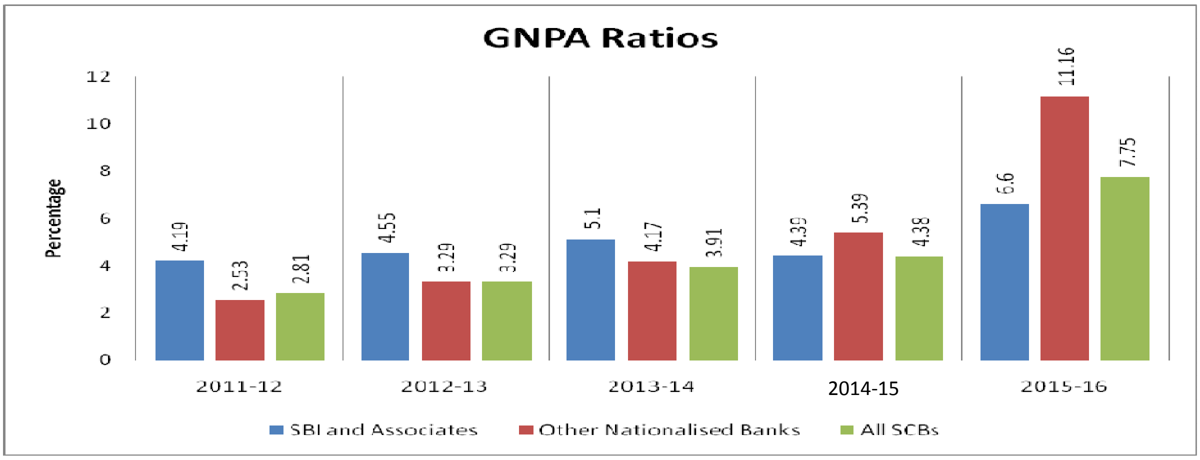
[22] **Net NPAs: Net NPAs are Gross NPAs less Provisions. It shows the actual burden of banks after deducting provisions**

6.2 Implications of NPAs

High levels of NPAs in banks affect the economy as bank credit is a catalyst for economic growth. When loans are not repaid, funds go out of the financial system and the cycle of lending- repaying-borrowing is affected. The banks have an obligation to repay their depositors and other lenders to the bank. In absence of loan repayment, the banks have to borrow additional funds to repay the depositors and creditors. This leads to a situation where banks are reluctant to lend fresh funds to new projects or the on-going projects. Once the credit to various sectors of the economy slows down, the economy is adversely affected. NPAs also lead to credit risk management assuming priority over other aspects of bank's functioning. A bank with high levels of NPA would be forced to incur carrying costs on non-income yielding assets. Other consequences would be reduction in interest income, high level of provisioning (with higher NPAs the banks would need to provide for them which will reduce their net profits), stress on profitability and capital adequacy, gradual decline in ability to meet steady increase in cost, increased pressure on Net Interest Margin (NIM) thereby reducing competitiveness, steady erosion of capital resources and increased difficulty in augmenting capital resources. NPAs in Indian banks in general and PSBs in particular, have been increasing and stood at ₹6.83 lakh crore [gross NPAs of PSBs as of March 2017 (provisional)] necessitating a higher degree of provisioning which affected the profitability of the PSBs adversely and contributed to the additional requirement of capital.

6.3 Non-performing Assets in PSBs

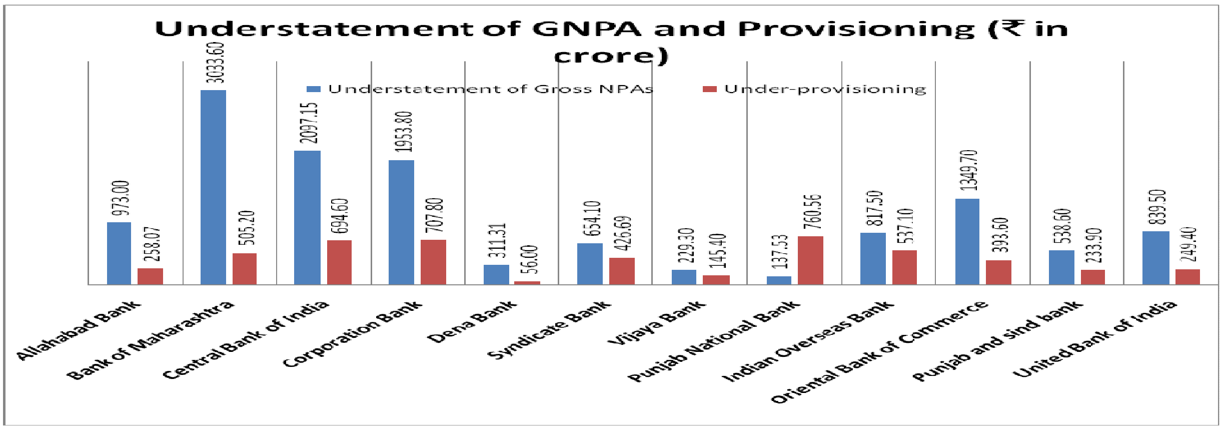
6.3.1 For SCBs, the Gross NPA ratio to advances was at 6.60 *per cent* in March 2016. Gross NPAs of PSBs surged from ₹ 2.27 lakh crore (31 March, 2014) to approximately ₹ 5.40 lakh crore (31 March, 2016), representing an increase of 138 *per cent*. They rose further to ₹ 6.83 lakh crore (provisional) at the end of March 2017. Paragraph 1.5.3.3 of Chapter I shows that PSBs account for the largest share of GNPAs in the banking sector. In fact, the gross NPA ratios of PSBs have risen sharply in the last few years though their ratios have, in general, remained higher than that of all SCBs, as shown in the chart on the next page:



(Source: RBI Database Statistical Tables Relating to Banks in India)

6.3.2 The above chart has been prepared from the database of the RBI. NPAs when recognized have to be provided for as per RBI norms. Instances of material differences between the NPAs recognized by banks and RBI and the provisioning made against them have been noticed. In April 2017, RBI directed[23] that banks make suitable disclosures wherever either (a)the additional provisioning requirements assessed by RBI exceed 15 *per cent* of the published net profits after tax for the reference period or (b)the additional Gross NPAs identified by RBI exceed 15 *per cent* of the published incremental Gross NPAs for the reference period, or both.

Audit reviewed the annual reports of PSBs for the year 2016-17 and noticed that NPAs have been recognized at a lower quantum in some PSBs[24]. This has also led to under-provisioning by these banks and a consequent over-projection of net profits, as shown in the charts below:



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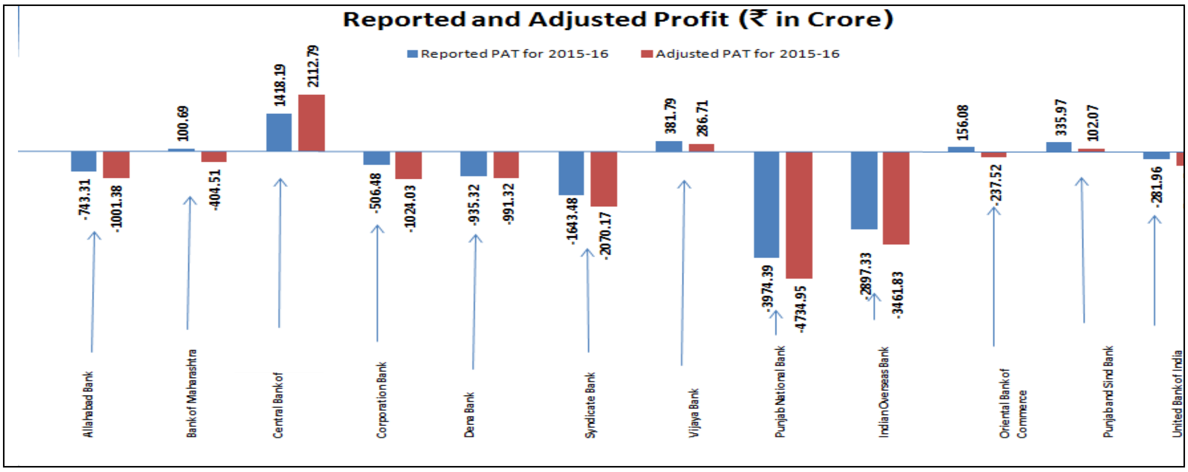
23 RBI instruction no. RBI/2016-17/283 DBR.BP.BC.no.63/21.04.018/2016-17 dated 18 April 2017

24 In case of five PSBs, there were differences in the classification of and provisioning for assets, as stated by the PSBs in their annual reports. However as the divergence did not fall within the criteria fixed by RBI, it has not been disclosed by these PSBs.

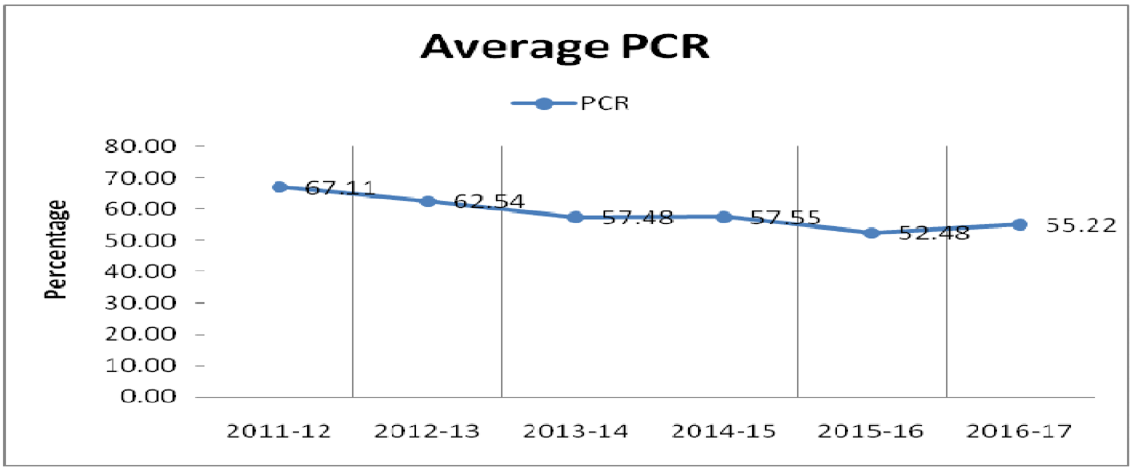


(Source : Annual Reports of PSBs for 2016-17) (PAT: Profit After Tax)

6.4 Providing for NPAs

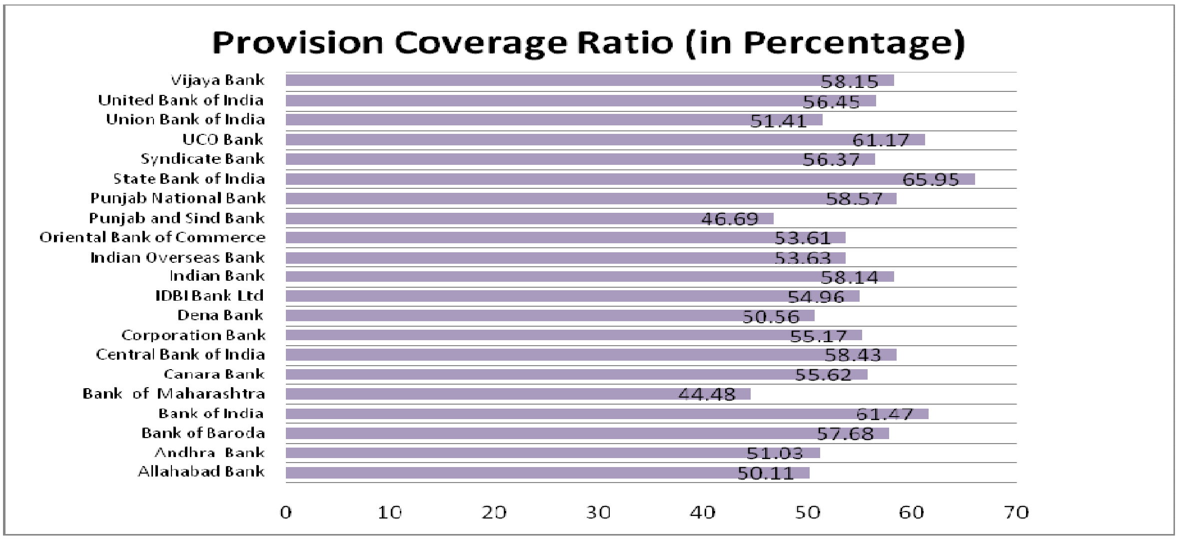
6.4.1 The primary responsibility for making adequate provisions for any diminution in the value of loan assets, investment or other assets is that of the bank managements and the statutory auditors. The assessment made by the inspecting officer of the RBI is furnished to the bank to assist the bank management and the statutory auditors in taking a decision in regard to making adequate and necessary provisions in terms of prudential guidelines. In conformity with the prudential norms, provisions should be made on the non-performing assets on the basis of classification of assets into prescribed categories.

6.4.2 Provision Coverage Ratio (PCR) is essentially the ratio of provisioning to gross non-performing assets and indicates the quantum of funds the bank has kept aside to cover losses on NPAs. The degree of provisioning required for NPAs is mandated by RBI. The PCR of the Bank should be disclosed in Notes to the Accounts to the Balance Sheet.



(Source : Annual Reports of PSBs from 2011-12 to 2016-17)

The chart above indicates that the average PCR of PSBs during 2011-12 to 2016-17 has been successively reducing, with the exception of 2014-15 and 2016-17. The PCR for the PSBs, as on 31 March 2017 is indicated in the chart below:



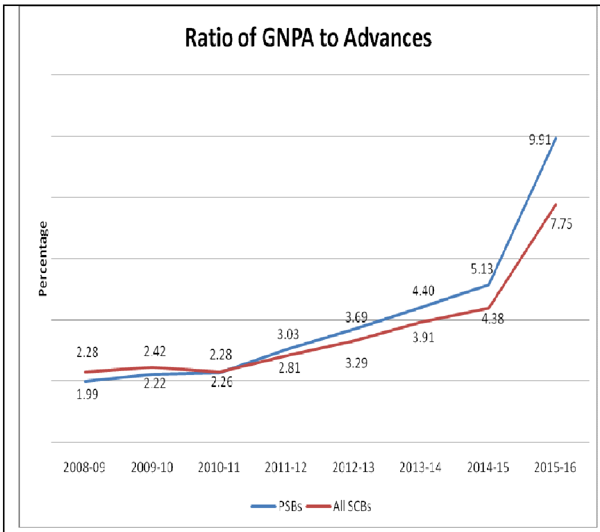
(Source : Annual Reports of PSBs for 2016-17)

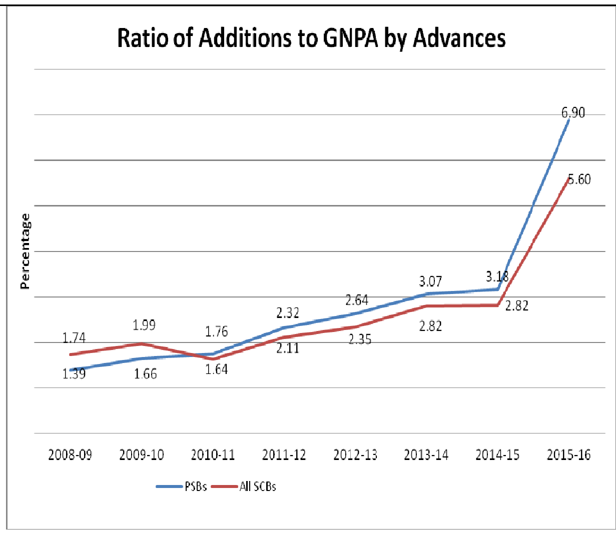
State Bank of India had the highest PCR at 65.95 *per cent* while Bank of Maharashtra had the lowest at 44.48 *per cent*.

6.5 Deteriorating Asset Quality in PSBs over 2008-16

6.5.1 The asset quality of commercial banks in general and PSBs in particular has been deteriorating significantly since 2012-13 onwards. The GNPA ratio in PSBs increased from 1.99 *per cent* (2008-09) to 9.91 *per cent* (2015-16). It is noticed that while the GNPA ratio of PSBs has been lower than that of all SCBs, indicating better performance by PSBs, by 2011-12, GNPA ratio has been higher for PSBs and has remained so. The trend of fresh slippage ratio[25] for PSBs also indicates an increase in fresh slippage (from 1.39 *per cent* in 2008-09 to 6.90 *per cent* in 2015-16) and consequent increase of NPAs in PSBs. The charts on the next page depict the same:

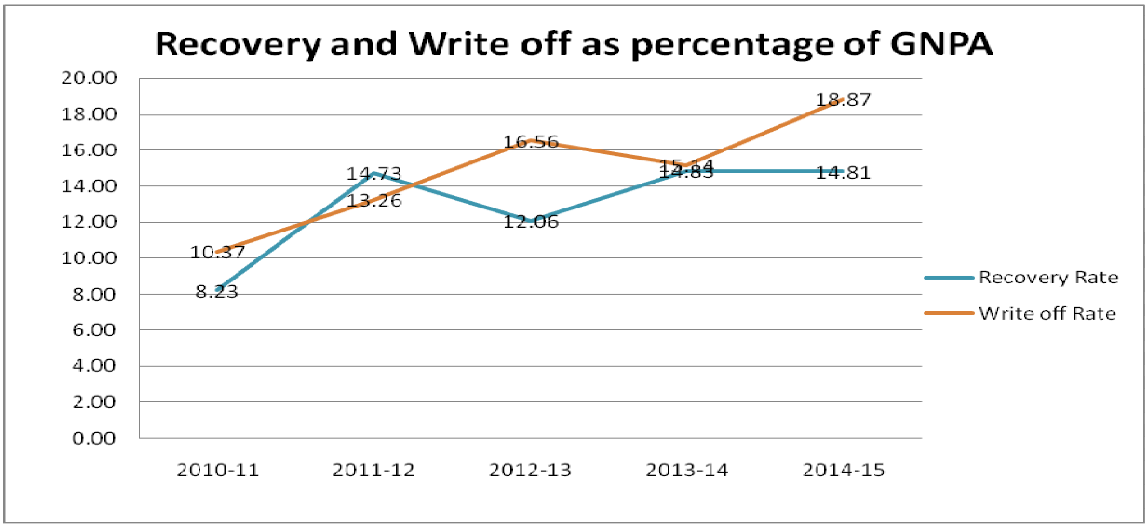
[25] **Fresh Slippage ratio: ratio between additions to Gross NPA in a financial year and Advances in that year, expressed as a percentage**





(Source: RBI Database : Statistical Tables Relating to Banks in India)

To appreciate the efforts made by PSBs to recover the NPAs, Audit reviewed the gross NPA recovery rates[26] and the write off rates[27] of PSBs over 2010-11 to 2014-15 as can be seen in the chart below:



(Source : RBI Database : Statistical Tables Relating to Banks in India and O.M of DFS to the Lok Sabha Secretariat, dated 21April 2016)

As can be seen from the chart above, the GNPA recovery rate has, in general, been lower than the write-off rate (except for 2011-12) which implies that a larger component of the gross NPAs have been written off compared to being recovered.

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[26] **Recovery rate = recoveries made/ Gross NPAs**

[27] **Write off rates = write offs done / Gross NPAs**

6.6 Quality of Assets in Stressed Sectors

6.6.1 The Financial Stability Report (December 2016) of RBI points to a high concentration of GNPAs in large borrower accounts. The Report indicates that nearly 88.4 *per cent* of GNPAs of SCBs relate to large borrowers. As of 30 June, 2016, while the GNPA ratio (GNPA divided by Gross Advances, expressed as a percentage) in the Corporate Sector was 8.78 *per cent*, it was 7.70 *per cent* in the Infrastructure Sector[28] and 7.03 *per cent* in the Agriculture Sector.

DFS agreed (May 2017) that Corporate lending had contributed the maximum in GNPAs.

6.6.2 For PSBs, a significant component of the GNPAs are advances made to the infrastructure, iron and steel and textile sectors, as can be seen in the table below :

Table 6.1: Sectors under Stress

Industry		31 March 2016	31 March 2017
Mining and Quarrying	Share in Gross Advances	0.59	0.54
	Stressed Adv Ratio	16.52	23.45
Coal	Share in Gross Advances	0.08	0.06
	Stressed Adv Ratio	40.13	43.14
Basic Metal and Metal Products – Iron and Steel	Share in Gross Advances	5.12	5.42
	Stressed Adv Ratio	53.19	60.03
Textiles	Share in Gross Advances	2.92	3.18
	Stressed Adv Ratio	25.39	33.16
Infrastructure	Share in Gross Advances	15.5	14.61
	Stressed Adv Ratio	18.91	21.17
Energy	Share in Gross Advances	9.06	8.98
	Stressed Adv Ratio	17.21	18.21
Aviation	Share in Gross Advances	0.33	0.48
	Stressed Adv Ratio	16.86	5.59

(Source : Data from the RBI) Figures for 2016-17 are provisional

In its reply (May 2017), DFS accepted that Iron & Steel, Power and Textile had been the most stressed sectors.

[28] **Infrastructure sector includes educational institution, power, roads, real estate, ports, shipping, etc.**

6.7 Industry-wise Asset Quality in Systemically Large PSBs

The industry-wise asset quality and credit growth positions of systemically large PSBs in India as on 31 December 2016, provides insights into the performance of 18 specific industries. The industry portfolio risk information has been compiled using data of six systemically large PSBs (SBI, BOB, BOI, Canara Bank, PNB and Union Bank of India) and is placed in the table below.

Table 6.2: Asset Quality and Credit Growth Positions of Systemically large PSBs

Industry Name	Total Credit (₹ in crore)	Industry[29] Credit Growth (*Per cent*)	Exposure Share[30]	Closing GNPAs (₹ in crore)	GNPA Ratio (*Per cent*)
Mining and Quarrying	18677.10	4.42	1.23	1699.11	9.10
Food Processing	69731.79	-21.67	4.60	10218.92	14.65
Beverages (excluding Tea & Coffee) and Tobacco	8135.84	14.65	0.54	1260.38	15.49
Textiles	113066.14	-6.03	7.46	19709.08	17.43
Leather and Leather products	5798.96	-3.75	0.38	232.58	4.01
Wood and Wood Products	4348.33	-1.26	0.29	663.85	15.27
Paper and Paper Products	14729.48	-63.77	0.97	2690.38	18.27
Petroleum, Coal (non-mining) & Nuclear Fuels	40949.46	-10.36	2.70	3769.15	9.20
Chemicals and Chemical Products	82514.23	-17.35	5.45	8480.29	10.28
Rubber, Plastic and their Products	46229.19	95.90	3.05	1700.31	3.68
Glass & Glassware	4927.63	-13.75	0.33	1446.25	29.35
Cement & Cement Products	17134.32	8.79	1.13	3363.46	19.63
Basic Metal and Metal Products	249371.31	1.17	16.46	81417.81	32.65
All Engineering	94615.70	-5.05	6.25	7967.69	8.42
Vehicles, Vehicle Parts & Transport Equipments	27027.72	2.52	1.78	4850.93	17.95
Gems and Jewellery	42436.02	-33.63	2.80	5089.25	11.99
Construction	51511.65	2.04	3.40	6183.08	12.00
Infrastructure	494492.10	6.09	32.64	31097.53	6.29
Other Industries	129230.16	-12.42	8.53	20474.17	15.84
Total	**1514927.1**		**100.00**	**212314.22**	**14.01**

(Source: Data from the RBI : Domestic Operations)

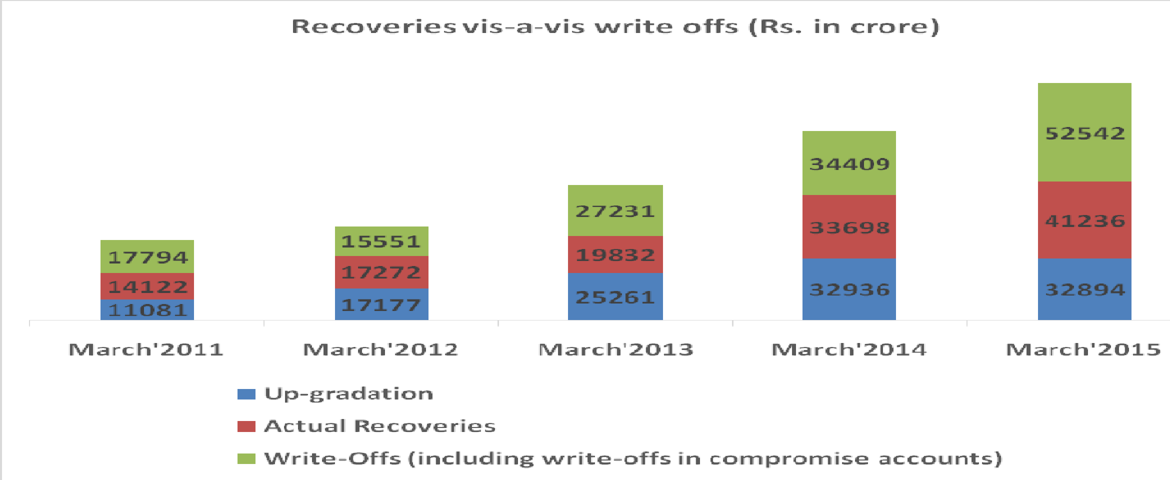
6.8 Recoveries and Write-Offs

6.8.1 Management of the NPAs include their recoveries and write-offs. An account classified as NPA may also be up-graded when the arrears of interest and principal are paid by the borrower. The following chart shows the break-up

[29] **Industry credit growth for 9 months from April to December 2016**

[30] **Exposure share reflects exposure of systemically large PSBs in the particular industry to total industry credit in respect of these PSBs**

of GNPA reduction across three categories (i)up-gradation (ii)actual recoveries and (iii)write offs (including write-offs in compromise accounts) during 2010-15.



(Source : O.M. of DFS to the Lok Sabha Secretariat, dated 21 April 2016)

It is noticed that the actual recoveries were lower than the write-offs in all years except 2011-12. The quantum of write-off in 2014-15 was in fact ₹ 52,542 crore, significantly higher than the recovery of ₹ 41,236 crore which goes against the principle of DFS to ensure that recoveries match amounts written off.

DFS stated (May 2017) that they were in agreement with the principle that written off amount should match with the recovery in accounts but the stressed asset situation in PSBs had become grim during the last few years and while special measures had been taken, it might take some time for normalcy to be restored in terms of asset quality.

6.9 Measures Taken by GOI and RBI to Address NPAs

GOI and RBI have taken several initiatives to address the problem of burgeoning NPAs. Some of the significant measures are summarized below:

6.9.1 Debt Recovery Tribunals (DRT)

Debt Recovery Tribunals (DRTs) had been constituted under an Act of Parliament (1993) for recovering NPAs of banks. At present, there are 39 DRTs and 5 Debt Recovery Appellate Tribunals (DRATs) functioning in different states. The amount recovered[31] through DRTs (including compromise) was ₹ 3,484 crore and ₹ 5,590 crore in 2014-15 and 2015-16 respectively.

[31] Recovery figures through DRTs, Lok Adalats and SARFEASI are taken from the RBI Report on Trend and Progress of Banking in India 2015-16

6.9.2 Lok Adalat

The RBI had issued guidelines (May 2001) with a view to making increasing use of the forum of Lok Adalats to settle banking disputes involving smaller amounts. The amounts recovered through Lok Adalat were ₹ 931 crore and ₹ 3,134 crore in 2014-15 and 2015-16 respectively.

6.9.3 SARFAESI Act, 2002

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 empowers banks/financial institutions to recover their NPAs without the intervention of the Court. The Act provides three alternative methods for recovery of non-performing asset, namely securitization, asset reconstruction and enforcement of security without the intervention of the Court. The amounts recovered through implementation of SARFAESI Act were ₹ 23,434 crore and ₹ 11,033 crore in 2014-15 and 2015-16 respectively.

6.9.4 Schemes for Restructuring

Corporate Debt Restructuring (CDR) mechanism was introduced by RBI in August 2001 and is a voluntary non-statutory system based on Debtor-Creditor Agreement (DCA) and Inter-Creditor Agreement and the principle of approvals by super-majority of 75 *per cent* creditors (by value) which makes it binding on the remaining 25 *per cent* to fall in line with the majority decision.

The 5/25 Scheme was introduced (July 2014) to enable long term debt financing of projects in infrastructure and core industries and provides for longer amortization period for loans in these sectors of upto 25 years (based on the economic life or concession period of the project) with periodic refinancing every five years to ensure long term viability. **Strategic Debt Restructuring (SDR)** was introduced (June 2015) with a view to ensuring more stake of promoters in reviving stressed accounts and provide banks with enhanced capabilities to initiate change of ownership in accounts which fail to achieve the projected viability milestones, whereby RBI had directed (June 2015) that banks may, at their discretion undertake a Strategic Debt Restructuring (SDR) by converting loan dues to equity shares. **The scheme for Sustainable Structuring of Stressed Assets (S4A)** was formulated (June 2016) by the RBI as an optional framework for the resolution of large stressed accounts. The S4A envisages determination of the sustainable debt level for a stressed borrower, and bifurcation of the outstanding debt into sustainable debt and equity/quasi-equity instruments which are expected to provide upside to the lenders when the borrower turns around.

6.9.5 Prompt Corrective Action framework

The Reserve Bank of India has introduced a policy action guideline in the form of revised Prompt Corrective Action (PCA) framework for banks on April 13, 2017. Capital, asset quality, and profitability to be the key areas for monitoring the banks in the revised framework. RBI will track CRAR or CET1 ratio, Net NPA ratio and Return on Assets respectively. Leverage would also be monitored additionally as part of PCA. Certain trigger points have been specified and breach of any defined risk threshold would result in invocation of PCA. This has become effective from April 1, 2017. The RBI has initiated (May 2017 and June 2017) PCA on four PSBs, i.e. IDBI Bank Ltd, UCO Bank, Dena Bank and Central Bank of India in view of their high net NPA and negative ROA.

6.9.6 Ordinance

The Banking Regulation (Amendment) Ordinance, 2017 has been promulgated (May 2017), inserting two new Sections (viz. 35AA and 35AB) after Section 35A of the Banking Regulation Act, 1949, to enable the Union Government to authorize the Reserve Bank of India (RBI) to direct banking companies to resolve specific stressed assets by initiating insolvency resolution process, where required. The RBI has also been empowered to issue other directions for resolution, and appoint or approve for appointment, authorities or committees to advise banking companies for stressed asset resolution.

6.9.7 Other measures

Specific measures have been taken to address NPAs specific sectors, primarily in Infrastructure (Power, Roads etc.), Steel and Textiles. In the Steel Sector, Minimum Import Price (MIP) has been introduced on import of specific steel products in December 2016 while coal mines have been auctioned to manufacturers in the sector, which would boost domestic production and may help combat the mounting NPAs in that sector. In the power sector, the Ujwal Discom Assurance Yojna (UDAY) has been launched (September 2015) under which the State Governments would take over 75 *per cent* of the debt in the DISCOMs over 2015-17 which would improve the NPA, for unlocking capital in PSBs. Discoms have accumulated losses of approx. ₹ 3.8 lakh crore and outstanding debt of approximately ₹ 4.3 lakh crore as of March 2015.