N P A, P C A, etc., of Banks & Implications

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Abstract

The Objective of PCA is to facilitate the identified banks brought under this framework to take corrective measures, including those prescribed by the RBI in a time bound manner so as to restore the financial strength or for that matter the breached threshold parameters' limits. It is estimated that the out of the aggregate loan amount of Rs 70 lakhs crore, the Stressed Assets portfolio including those under restructure mode, is around Rs 13 lakhs crore and that nearly half of it, approximately Rs 7 lakhs crore (As good as nearly 10% of the total portfolio), are under Bad Loan category, with very remote chance of recovery.

Once taken into the PCA framework, restrictions on Dividend declaration, opening new branches, hiring, giving loans to companies with below Investment Grade, etc are duly applicable. Further, though the PCA framework would entail restrictions on risky advances and unsecured exposures, the regular lending activities, such as, Retail Loans, Agricultural loans, rated corporates, small / medium enterprises, etc., would definitely continue, of course without losing focus on the quality and viability aspects.

When there are TRAI & IRDA for Telecom companies and Insurance companies, why not introduce I B R A – Indian Banking Regulatory Authority, which will have a supervision and control over banks, presently done by RBI, which can focus on general economic aspects only.

INTRODUCTION

Recently Corporation Bank, Bank of India & Allahabad Bank were included to the list of Banks requiring Prompt Corrective Action (P C A) and the list has nearly 50 % of Public Sector Banks (PSBs) in India. In fact, some of the banks included in the list were Banks that were accredited with the title of Best Bank, by a popular business journal. This triggered the thought process of the author for a quick write up on the subject matter. In the financial and economic circle, the subject which occupies attention of print and also television media is the concerns about the growing Non- Performing Assets (NPA) of banks. Though till recently, it was confined to Public Sector Banks, slowly and steadily even private sector banks have not been spared and they have also joined the scenario to fight for their money lent and in fact and of late, their rate of growth in NPA appears to be faster than that of PSBs.

Though very many resolution exercises were taken, neither the banks nor the regulator accepted the ground realities almost ten years ago and they went for wholesale restructuring exercise of seemingly Bad Loans, without proper backing of the correct assessment of future cash flow generating capabilities of borrowers concerned. The authorities were on denial mode and simply postponed the recognition of bad loans in the past, while not stopping fresh Big Ticket Loans, involving huge exposure coupled with long gestation and repayment periods. Thus temporary resolution and schemes did not yield result and proved to be very elusive and suicidal. There can be no magic solution or magic wand, as stated by previous Governor of RBI. Very many past actions of RBI, such as Securitisation and Reconstruction of Financial Assets and Empowerment of Security Interest Act (Sarfaesi), Debt Recovery Tribunals (DRTs), Corporate Debt Restructuring (CDR)

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mechanism, Joint Lenders Recovery (JLR), S4A, 5/25, etc., have not yielded the desired results. Basically, it could be noticed that the prime reasons for the mounting NPAs are particularly in the field of Long Term Loan, scams relating to Telecom, Steel and Coal items, Delay in project approval, improper documentation / over valuations of security, undesirable political interference, banker Promoter Link, etc.

The PCA norms allow triggers of control points and allows the regulator RBI to impose some restrictions such as stopping payment of Dividend, halting Branch expansion, setting sector wise or even borrower / group wise exposure limits for Lending, etc. Besides, there can be Special Audit, Restructuring Operations, bringing in new management, etc. In fact, the PCA empowers RBI to supersede the Board decision of the respective banks. These are certain limits prefixed in the areas of Asset Quality, Profitability, Capital Adequacy, etc. The maximum tolerance limit for the NPA is 12%.

Under the Insolvency and Bankruptcy Code (IBC) of Reserve Bank of India, banks need to resolve issues relating to Bad Loans within a stipulated timeframe failing which they would be asked to file Insolvency Proceedings against Defaulters. IBC is intended to improve the the Provision Coverage Ratio (P C R) of banks besides to ensure that the banks are fully protected against likely losses in the resolution process. Bankruptcy cases are to be filed with National Companies Law Tribunals (N C L T). The meter starts moving once a case is admitted, after which the IRP – Insolvency Resolution Professionals (IRPs) are put on the job to find a resolution process. In case no resolution is possible within six months, further three months extension can be considered. Even after this, if a resolution could not be arrived at, the bank would automatically progress to get it liquidated, without fail. Quickness and time bound settlement are the crux of the whole issue.

The fruitfulness of the Resolution process solely depends on the financial capability of banks to absorb the huge hair cuts through right sizing their exposures, as in case the resolution exercise fails, the Tangible Net Worth or for that matter, Capital Funds would take a heavy beating, thus throwing spanner in the wheels of operations of the banks concerned. On the one hand, speedy default resolution is a positive approach, what is required is structural changes and professionalisation combined with depoliticization of the governance aspects. If RBI, either on its own or at the dictate of government intervention power, need to step in and take it upon itself to issue very numerous directives every now and then, then the situation is quite a bad one. All banks need to address issues such as Credit Culture, Appraisal Mechanism, Decision Making process, etc., squarely so as to avoid repetition of recurrence of similar problem. Recent decision of Gujarat High Court in dismissing the plea of steel company paved way for Lenders to initiate Insolvency Petition and it is a path breaking move.

Investment Excesses and highly debt fuelled expansions beyond the financial capabilities or borrowing beyond the means or inability to bring in owned or non- repayment / non interest bearing money have all contributed heavily. The overstretched Debt Equity ratio would squarely extinguish an entity, if the borrowed money is not deployed for a superiorly profit oriented activities. With regulatory tacit approval restructure of big loans were made almost a decade ago and now the very same regulator prodded banks to come clean on NPAs, the skeletons are falling from the cupboard of Banks, with such speed and quantum, that the banks concerned are losing their face. It is very clear that PSBs reform should neither begin nor end with just privatisation.

At the time of nationalisation of banks in two tranches in 1969 and also in 1980, the Public Sector Banks have been identified for economic development of the country. While this agenda was getting fulfilled, some where down the line there were derailments along the track, resulting in some sort of conflict between Social Banking and Commercial Banking. This squarely paved way for escalation in Non Performing Assets. Hence, situation has graduated or for that matter deteriorated to the extent of saving banks, thereby economy and also people along with the nation, from overall perspective. Though Customers were to be treated as Kings in the past, now they appear to have been reduced to victim. In the process, while PSBs have become guilty and private banks have become more self styled efficient entity, without supporting or contributing to government's initiatives for Economic Development.

ESCALATING NPAs

According to the recent release of The Financial Stability Report of Reserve Bank of India, the Gross NPA in the Banking System as a whole as of Sept. 2017 has gone up from 9.6% to 10.2%, indicating the growth in NPA at the rate of nearly 0.1 percent every month and same is not a healthy sign, by any standard. The situation has assumed astronomical proportion and the financial health of banks has been deteriorating for the past few years that everyday some or the other news and directions are emanating from Centre or Reserve Bank of India. If one can draw parallel, then it is akin to the daily directions given to banks while demonetisation was in vogue, an year and odd ago.

The Gross Non Performing Assets (GNPA) of banks have grown steadily during the last 5 to six years, as could be made out from the following table:

No.	Year	Growth in GNPA
1	2011 - 12	2.83 %
2	12 - 13	3.38 %
3	13 - 14	3.96 %
4	14 - 15	4.41 %
5	15 - 16	8.06 %
6	16 - 17	11.00 %

During the last 4 years from 2013-14 to 2016-17, while the aggregate Gross Operating Profit of all banks put together improved significantly, the net profit after the provision for bad loans, has steeply deteriorated that it has become net loss to a significant extent. The chief contributor is actually the provision for Bad Loans, which steadily went up during the four years period, as could be noticed from the following data.

(Rs in crores)

Year.	Gross Profit	Bad Loans Provision	Net Profit after Provision
2013 – 14	1,27,653	90,633	37,019
2014 – 15	1,37,760	1,00,901	37,540
2015 – 16	1,36,275	1,53,967	(18,417)
2016 – 17	1,58,982	1,70370	(11,388)

It may not be out of place to mention that while the dues of 12 corporates initially identified for Insolvency Bankruptcy Proceedings aggregate to more than Rs 2.50 Lakhs crores, the total amount written off by P S Bs alone equals this sum during the last five years. It was in arithmetic progression basis from Rs 27,231 crores in 2012-13, to Rs 34,409 cr., to Rs 49018 cr., to Rs 57,586 cr., and finally to Rs 81,683 cr., in 2016-17, in all, totaling to Rs 2,49,927 crores.

The impact of Provisions towards Bad Loans during the last five years period ended 31.3.2017 can be very well gauged from the following table.

Year.	Op. Profit	Bad Loans Provisions	Net Profit / (Net Loss)
12-13.	1,21,839	71,256	50,583
13-14.	1,27,653	90,633	37,019
14-15.	1,37,760	1,00,901	37,540
15-16.	1,36,275	1,53,967	**(-)18,417**
16-17.	1,58,982	1,70,370	**(-)11,388**

The increasing status of net loss suffered by a good number of banks during the year 2017-18, as reflected in quarterly financials, also prompted the regulator to bring many banks under the framework of Prompt Corrective Action mode.

It is estimated that the **out of the aggregate loan amount of Rs 70 lakhs crore, the Stressed Assets portfolio including those under restructure mode, is around Rs 13 lakhs crore and that nearly half of it, approximately Rs 7 lakhs crore (As good as nearly 10% of the total portfolio), are under Bad Loan category**, with very remote chance of recovery. During the last four years from 2013-14 to 2016-17, while the aggregate Gross Operating Profit of all banks improved from Rs 1,27,653 crore to Rs 1,58,982 crore, the net profit after provision deteriorated steeply from Rs 37,019 crore to net loss of Rs 11, 388 cr. Thanks to the Chief contributor, Provisions for Bad Loans which steadily went up from Rs 90,633 cr., to Rs 1,00,901 cr., to Rs 1,53,697 cr., to Rs 1,70,370 cr., during the same four year period, with practically no sign of respite in sight in the near future. One Dy. Governor of RBI was categorical in his remark when he said that RBI was not responsible for banks' huge exposure to corporates, which are the biggest pain points in the Stressed Assets portfolio, now and that the regulator had no play in commercial banks decisions.

As far as SBI consolidation is concerned, as of June 17, the Percentage of NPA over advances has risen from 6.94 % to 9.97 %, to nearly one and a half times, of course only time would reveal whether the NPA status would improve. Further, out of 20 Public Sector Banks, excluding SBI, as many as nine appear to be having huge NPAs and a dozen banks have Common Equity Tier I Capital Adequacy Ratio of below 8%. Hence, **consolidation among Public Sector Banks, as a means of P C A, is a very tricky issue having multi dimensional impact, with wider ramifications.** With the government taking a call on Recapitalisation bond package of the value of more than Rs 2 Lakhs crore to banks, things are slated to be handled temporarily in a smooth manner by banks. As of March 2018, it is reported that a few banks under the PCA framework includes, Bank of Maharashtra, Bank of India, Central Bank of India, Corporation Bank, Dena Bank, IDBI Bank, Indian Overseas Bank, Oriental Bank of Commerce, UCO Bank, United Bank of India, Bank of India, Corporation Bank, Allahabad Bank, etc. It is not known as to how many are in the pipeline for further inclusion in 18-19.

Though initially the Public Sector Banks only featured in the list of banks with huge NPAs, slowly and steadily a few private sector banks such as ICICI Bank, Axis Bank besides relatively new banks like Yes Bank, RBL Bank, etc., have joined the list, thereby indicating that the NPA woes are not restricted to PSBs. Further, if one can glance through the list of major NPAs, it is dominated by private sector big ticket loan borrowers whose ambitious and larger than life expansion plans have contributed the downfall of banks. In fact, Public Sector Units in similarly placed sector of private corporate entities, have done reasonably well to retain the financial strength. This aspect negated the feeling that PSBs are at fault as the faulty private sector banks as well as corporates go scot free, in the eyes of general public. This is a misplaced belief, which should not be encouraged. Portraying PSBs alone are inefficient or corrupt or wrong decision maker, etc., is contrary to the facts borne out of NPAs statistics. Just holding on to the belief that private sector alone would lead to better performance is not totally true.

THE " HAIR CUTS "

The outcome of a recent study of Top Stressed Loan accounts carried out by CRISIL, the top financial Rating Agency, reveals a dangerous situation. In nutshell, banks may have to accept an alarming level of hair cuts! To the extent of 60% of the total bad debts of around Rs 4 lakhs crore from these 50 borrowers. It means, banks need to accommodate a loss of nearly Rs 2.40 lakhs crore in their books. This is a very huge sum, in the light of few thousands of crores of Capital the government is planning to infuse to banks in a staggering manner. The rating agency found that the 50 top stressed accounts consists of Metals – 30%, Construction – 25%, Power – 15%. CRISIL classified the " Hair Cuts " (implying the financial sacrifice that banks need to suffer to get some money out of the amount outstanding in Stressed Accounts) into four categories as follows:-

No.	Category	Extent of sacrifice
1	Marginal	Less than 25%
2	Moderate	25 to less than 50%
3	Aggressive	50 to less than 75 %
4	Deep	Above 75%

PROMPT CORRECTIVE ACTIONS

Objectives of PCA is to facilitate the identified banks to take corrective measures, including those prescribed by the RBI in a time bound manner so as to restore the financial strength or for that matter the breached threshold parameters' limit. Hence, the notion that the banks under PCA mode are on the verge of collapse due to Asset Quality issue or Capital Adequacy requirement is to be dispelled squarely, according to one of the Dy. Governors of RBI. He also said PCA is one among many tools involving close monitoring of bank's performance indicators, as an early warning signal and is initiated once the thresholds relating to Capital, Asset Quality, etc., are breached. It is similar to taking an injured sportsman to bed rest for treatment and by no stretch of imagination suggests that the bank would cease to carry out normal banking operations. In this regard, the RBI has categorically said that there is no closure of any lender placed under the PCA purview / framework. It may actually, reduce the moral hazard associated with "Lender of Last Resort" and makes banks liable to improve their overall financial health.

The Prompt Corrective Actions, the PCA norms, are applicable with reference to the status of cut-off date financials of the bank as at 31st March 2017 and the framework would be reviewed after three years, unless the situation worsens to warrant an earlier revision. Actually the PCA framework was introduced long time back in 2002, as a fallout of serious shortcomings thrown out of Annual Financial Inspection (AFI) exercise carried out on banks by the Reserve Bank of India. in April 2017, it was reviewed by RBI to assess the situation in a better manner and PCA is a fresh initiation by RBI.

The sanctions or conditions imposed can be broadly classified into two, viz. Mandatory and Discretionary. While Mandatory sanctions are in the areas of Dividend payment, branch expansion, Directors' compensation, etc., Discretionary one may include curbs on the basic activities of banks such as acceptance of Deposits and deployment of Funds.

At first, the PCA actions were triggered in two banks viz. IDBI Bank and UCO Bank, having their Head Office in Mumbai and Kolkatta respectively. Both the banks appear to have breached the threshold of Asset Quality / Profitability. A few more banks also joined the stream for initiation of PCA, when profitability worsened and poor asset quality deepened. It is seen that though some banks have breached on NPA and profitability parameters, their capital adequacy is comfortable, giving some cushions and comforts for some more time for PCA triggers**. These banks need to thank the government for their support in providing Capital Fund. However, fiscal discipline to be maintained by the government comes in the way for the continuance of such financial support for a longer time, though recently Government announced their plan for further infusion of nearly Rs 2 lakhs crores.**

On the one hand, nearly 12 business group are likely to face the music of Insolvency and Bankruptcy Code - IBC, on the other hand and not relating to these portfolio, it looks like that many banks are under the watch list of R B I. PCA action would be invoked or triggered, when the Capital to Risk Weighted Asset Ratio is below 7.75 % and in case it touches 3.625 %, perhaps the only alternative left to the regulator is to give a green signal for its merger and closure. The financial year 18-19 is very crucial to these banks, in the days to come. **Once taken into the PCA framework, restrictions on Dividend declaration, opening new branches, hiring, giving loans to companies with below Investment Grade, etc are duly applicable.** Further, though the PCA framework would entail restrictions on risky advances and unsecured exposures, the regular lending activities, such as, Retail Loans, Agricultural loans, rated corporates, small / medium enterprises, etc., would definitely continue, of course without losing focus on the quality and viability aspects.

ALTERNATE MECHANISM

As part of PCA, recently, the Union Government has approved the formation of an Alternate Mechanism or a Panel of Ministers to decide on consolidation proposals emanating from the Public Sector Banks. If the Panel finds that the merger between banks is likely to create a strong bank, it will not lose the opportunity merely for want of Capital, which the government would find its way to provide. According to the government, the merger proposal should come suo motto from the bank or banks. There is no target set for the consolidation / merge. Apart from State Bank of India, there are 20 state owned banks (PSBs) and collectively the PSBs are grappling with the Non Performing Assets of around Rs 6.00 Lakhs crores, consisting of nearly 75% of the quantum of Total Stressed Assets in the banking system, as a whole. Depending on the synergy level, the consolidation may take shape. After the in-principle clearance for consolidation by the Alternate Mechanism Panel, banks would take steps in accordance with the due process of Law and the requirements of Security Exchange Board of India (SEBI) as all the PSBs are listed entities with stock exchanges. The final stamp of approval for the scheme of merger / consolidation is with the Alternate Mechanism Panel. **It is u dear this Alternate mechanism, the government has prompted three banks viz., Bank of Baroda, Vijaya Bank and Dena Bank, to consider amalgamation, to form a new entity of banking and the Board of these banks have already cleared the same for formal clearance by the government. It is expected to complete the process probably by 31st March 2019, well before the general elections some time in May 2019. However, overstepping this date cannot be ruled out.**

THE WAY FORWARD

Though consolidation and merger plans are on the anvil, it is seen that the status of N PAs in SBI at the pre merger and post consolidation exercises with its associate banks is quite disturbing and perhaps one fears whether from the identified level of Too Big To Fall (TBTF), the SBI may be graduating into Too Big To Rescue (TBTR) status. Provisions of the Competition Corporation of India are not applicable for Public Sector Banks as far as getting consent for the consolidation or merger, for the time being.

Notwithstanding the alarming situation of going through the motion of PCA, some of the banks can monetise their investments in notable non - core investments in their associates, joint ventures, non-banking subsidiaries such as Housing Finance companies, Asset Management Companies, Insurance outfits, etc to raise funds, thus fending for themselves, instead of waiting for Capital from the government. With deteriorating asset quality, escalating provisioning, poor credit growth, time is not too late to explore the possibilities on these lines, depending on the market status, with reference to the cost of investments in these diversified portfolios.

Reacting to the decision of the government on the likely merger of some of the PSU banks, the former Governor of RBI, Dr. Y V Reddy made an interesting and pointed remark " **In general, if a strong bank is merged with another strong bank, I am not sure it will become stronger; If a weak bank is merged with weak bank, I am not sure it will become strong; And if a strong bank is merged with a weak one, there is an equal chance that it will be stronger or weaker than before**." What a practical perception, from all the possible Permutations and Combinations !.

A quick recap and travel back to almost a century reveal that quite a good number of banks were closed down during the period from mid 20s in the 20th century till 1960, (when at the instance of the banks Union the Deposit Insurance coverage was brought in place) and mostly Depositors lost their money kept in these banks. However after the amendment in Banking Regulations Act for embracing Deposit Insurance, many banks were merged into other banks without the Depositors losing their money. A few example in the recent past is – Lakshmi Commercial Bank, Hindustan Commercial Bank, New Bank of India, United Western Bank, Global Trust Bank, etc. Under the protection in Banking Regulation Act, none of the Depositors of the erstwhile banks lost their money, though these banks were merged with some other better run banks.

If only one decisive mistake is to be identified for the N P A problems of banks, then, the genesis of the present problem can be traced to and pointed at the unwise closure of Development Financial Institutions (DFIs) such as ICICI, IDBI, etc., nearly two decades ago, as this single move paved way for commercial bankers to take exposures through Project Loan, Infrastructure Loan, etc., much beyond their capabilities and comprehension. The mix match in Asset Liability Management and the related Risk in the areas of Market Risk, Liquidity Risk, etc., were having huge ramifications.

Steps such as Bad Debt Resolution, Bankruptcy Code, Recapitalisation or for that matter, the recent inclusion of " Bail-In " clause in the FRDI Bill, etc., are just surface level remedy, while the actual solution lies in improving Credit Appraisal skills of the bankers and in freeing RBI to regulate on its own in an empowered manner and banks to function on its own, with least interference from the Government. Such structural reforms can only bring in some sort of long term solution to banks, for at least not to deteriorate any further, which if deterioration escalates, there may be a systemic problems in the economy of India.

Whether Prompt Corrective Action on recovery of Bad Loan from Big Ticket Loan is taken or not, the government, in power, is very quick and prompt in laying their hands on the benign savings of small customers, through the proposed "Bail-in" concept in the Financial Resolution and Deposit Insurance Bill. With no funds of their own left to bail out the Stressed Loan Borrowers, government has unjustifiably turned their focus on Depositors to pitch in. The unrevised amount of Rs one lakh cover for nearly 25 years since 1993 needs an urgent look for revision, reckoning more than the inflation rate and real interest rate concept.

When the interest rate charged on the loans taken by borrowers is inclusive of RISK PREMIUM – say 0.5 or 1 or 2 percent or so, why can't banks carve out that money so collected periodically from borrowers, earmark it to be credited as RISK PREMIUM FUND and park the same in some liquid treasury bill or government securities to be used later when the bank deteriorates to the brink of closure

or such eventualities. The purpose of Risk Premium is this only and nothing else. But in reality, this risk premium amount collected as part of income by banks, gets credited as Interest Income, consequently shown as Profit and gets distributed as Dividend or so. Ideally this Risk Premium Fund amount should be available only for adjustment of defaulted amounts of borrowers and not for distribution to shareholders.

In the matter of functions of banks, one thing is clear that every one is scared of some one and all are doing things, with a pinch of reluctance and hesitation. Bankers are reluctant to lend for the fear of vigilance action, lower official is unable to either oppose or accept fully the orders of higher ups, regulator is unwilling to relax rules Ministers / politicians make speeches but hesitant to be specific and logical in their instructions, Bureaucrats caught in between the government and functional authorities are hesitant to mediate between the two. These things are very difficult to handle, by the respective people.

The recent difference of opinion between the government and Reserve Bank of India actually stemmed from a number of issues and relaxing the P C A norms is also one of the important one. While the government is bent up on not to push many banks to be sheltered and parked down under the P C A umbrella so that business growth do not gets impacted much, the R B I wants to ensure that the banks are not pushed to the brim of N P A issues, which are menacingly increasing, in an un abated manner.

When there are TRAI & IRDA for Telecom companies and Insurance companies, why not introduce I B R A – Indian Banking Regulatory Authority, which will have a supervision and control over banks, presently done by RBI, which can focus on general economic aspects only.