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A COMPARATIVE STUDY ON SECURITIZATION WITH REFERENCE TO INDIAN PUBLIC AND PRIVATE SECTOR BANKS

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ABSTRACT

Non-Performing Assets (NPAs). Like a canker worm, NPAs have been eating the banking industries from within, since nationalization of banks in 1969. NPAs have choked off quantum of credit, restriction the recycling of funds and leads to asset-liability mismatches. It also affected profitability, liquidity and solvency position of the Indian banking sector. One of the major reasons for NPAs in the banking sector is the 'Direct Lending System' by the RBI under social banking motto of the Government, under which scheduled commercial banks are required to lend 40% of their total credit to priority sector. The banks who have advanced to the priority sector and reached the target suffocated on account of raising NPAs, since long. The priority sector NPAs have registered higher growth both in percentage and in absolute terms year after year. The present paper is an attempt to study the priority sector advances by the public, private and foreign bank group-wise, target achieved by them and a comparative study on priority and non-priority sector NPAs over the period of 5years between 2010-11 and 2014-15.

Keywords: *Non Performing Assets, Priority Sector, Non-Priority Sector,*

INTRODUCTION:

In 1954 the All India Rural Credit Survey Committee found that not sufficient credit has been directed towards the rural sector of the economy. As a result of this, drives to nationalization of commercial banks were lunched in 1969 and 1981. Since nationalization of banks in 1969, Scheduled Commercial Banks have been asked to extend credit to priority sector, with a view to provide an opportunity to the poor and underprivileged section of Indian society to improve their standard of living. During the year 1985, the target of priority sector lending was fixed at 40% for domestic commercial banks and also sub-targets were fixed. Major parts of the loans lent to priority sector as per the RBI target guidelines were not recoverable and became Non Performing Loans. The first Narasimham Committee Report in 1991, pointed out many problems related to priority sector lending, the important being that a large part of NPAs comes from priority sector and recommended a fresh look into the subject of priority sector lending by banks and made concrete recommendation to phase out the priority sector slowly, to ensure growth of the banking industry on healthy lines

What is Non Performing Asset (NPA)?

Consequent upon liberalization and the efforts for integration of Indian financial system to the international level, the Reserve Bank of India adopted the Basle Norms in 1991-92 and brought in the first phase of banking sector reforms. RBI framed prudential income recognition norms and banks were asked to identify and provide for bad loans or non performing loans and were given one year to achieve the same. As per the RBI income recognition norms an asset becomes an NPA if principal or interest thereon is unpaid for two quarters. However, international rating agencies like Standard and Poor are of the view that the asset quality in the Indian banking system is far below. International Standard Institutions think that Indian banking practices are not up to international mark as laid down by Basle Norms which consider an account as NPA if principal or interest is not paid for a quarter.

With a view to moving towards international best practices and to ensure greater transparency, it has been decided to adopt the '90 days overdue' norm for identification of NPAs, form the year ending March 31, 2004. Accordingly, with effect from March 31, 2004 a Non Performing Asset (NPA) shall be a loan or an advance where;

a) Interest and/or installment of principal remains overdue for a period of more than 90 days in respect of a term loan,
b) The account remains 'out of order' for a period of more than 90 days, in respect of an Over Draft / Cash Credit.
c) The bill remains overdue for a period of more than 90 days in case of bills purchased and discounted,
d) Interest and/or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purpose, and
e) Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.

Advances against bank's term deposits, NSCs, IVPs, KVPs, and Life Policies will not be classified as NPAs if the outstanding balance is fully covered by such securities. These advances come under the exempted category for the purpose of income recognition and asset classification

Targets on Priority Sector Advances

Before the nationalization of banks, there was no target on the priority sector. After nationalization it was just emphasized that commercial banks should increase their involvement in financing of priority sector. By March 1979, banks were advised to raise the share of the priority sectors in their aggregate advances to the level of 33.33 percent. Later, it was increased to 40 percent at the end of 1985 and also sub-targets were fixed.

During 1989-90, the target of priority sector lending was fixed at 40% for domestic commercial banks. Within this there were sub-targets which included 18% to agriculture and 10% to weaker sections. For foreign banks the target was 32% within which the sub-targets were fixed at 10 % to small scale industries and 12% to export credit. With effect from April 2007, the priority sector lending target/ sub-targets have now been linked to Adjusted Net Bank Credit (ANBC) or Credit Equivalent of Off-Balance sheet Exposure (CEOBE), whichever is higher. The RBI had constituted a committee under the chairmanship of Shri M.V. Nair, Chairman, Union Bank of India on August 25, 2011 to re-examine the existing classification and suggest revised guidelines with regard to priority sector lending and related issues. The committee recommended that all the scheduled commercial banks including foreign banks have to lend 40% of ANBC or CEOBE, whichever is higher.

Categories of Priority Sector

The scope and extent of priority sector advances has undergone a significant change in the post-reform period with several new areas and sector being brought under its preview. On the basis of the recommendations made in September 2005 by the Internal Working Group, set up in Reserve Bank to examine, review and recommend changes, if any, in the existing policy on priority sector lending including the segments constituting the priority sector, targets and sub-targets, etc. and the comments/suggestions received thereon from banks, financial institutions, public and the Indian Banks' Association (IBA), RBI has decided to include only those sectors as part of the priority sector, which impact large segments of population & the weaker sections, and which are employment-intensive. Accordingly the broad categories of priority sector for all scheduled commercial banks as per Draft Guidelines of RBI (January 2007) on lending to Priority Sector are as under:

1. Agriculture and Allied Activities: Finance to agriculture shall include short, medium and long term loans given for agriculture and allied activities.
2. Micro & Small Enterprises: The micro and small enterprises shall include small road and water transport operators, small business, professional & self-employed persons.
3. Micro Credit: Credit and other financial services and products of amounts not exceeding Rs.50, 000 per borrower.
4. Education Loans: Loans and advances granted to only individuals up to Rs.10 lakh for studies in India and Rs.20 lakh for studies abroad.
5. Housing Loans: Loans up to Rs.25 lakh to individuals for purchase/ construction of dwelling unit and loans given for repairs to the damaged dwelling units of families up to Rs.1 lakh in rural and semi-urban areas and up to Rs.2 lakh in urban and metropolitan areas.
6. Loans to Self Help Groups (SHG) / Joint Liability Groups (JLGs): Loans to SHGs / JLGs up to Rs. 50,000 would be considered as Micro Credit and hence treated as priority Sector Advances.

Categories of Priority Sector	**Targets / Sub-targets**	
	Indian SCBs	**Foreign SCBs**
Total agricultural advances	18 percent of ANBC or CEOBE, whichever is higher	No target
SSI advances	Overall priority sector target of 40 percent of ANBC or CEOBE, whichever is higher	10 percent of ANBC or CEOBE, whichever is higher
Micro enterprises within SSI	60 per cent of SSI advances	Same as for domestic banks
Export credit	Export credit is not a part of priority	12 percent of ANBC or CEOBE, whichever is higher
Advances to weaker sections	10 percent of ANBC or CEOBE, whichever is higher	No target
Differential Rate of Interest Scheme	1 per cent of total advances outstanding as at the end of the previous year	No target
Total Priority Sector advances	40 percent of ANBC or CEOBE, whichever is higher	32 percent of ANBC or CEOBE, whichever is higher

Note: For the purpose of priority sector lending, Adjusted NBC (ANBC) or Credit Equivalent of Off-Balance Sheet Exposures (CEOBE) denotes NBC plus investments made by banks in non-SLR bonds held in HTM category

Early this year, India's Finance Minister, Pranab Mukherjee voiced his concern about the worsening quality of assets in the domestic banking sector – where Non-Performing Assets (NPAs) have outpaced credit growth over the last couple of years – and urged to industry to tighten its belt. As per leading rating agency CRISIL, Gross NPA levels in the Indian banking system will reach an unprecedented 3% in March 2012, a steep rise from 2.4% two years before.
Who can forget that the financial crisis of 2008-09 was triggered by the excessive buildup of sub- prime assets in the United States? Today, Indian banks would do well to recall this lesson, as they face this serious challenge of burgeoning NPAs on their home turf. What's worse, this comes on top of sluggish economic growth and growing competition within the industry.

The Government and the Reserve Bank of India (RBI) are taking many steps to alleviate the situation. One of these is to automate asset (and NPA) classification and reporting by banks, which continue to exercise manual control in this area.

The authorities had initially set a deadline of 30th September 2011 for Public Sector Banks to implement technology-based identification of NPAs, which has been extended until the end of March 2012, at the request of some banks running on legacy systems, which needed extra time to collate the data pertaining to the very large number of small loan accounts. Perhaps they also wanted to defer the impact of this move – which would most likely result in sharp upward revision of NPAs – on their financial results and bottom-line

Bank Group-Wise Classification Of Loan Assets Of Scheduled Commercial Banks

(As at March 31, in Rs. Crores)

Bank Groups / Years	As on 31st March		
	Total	Gross NPAs	
	Amount	Amount	Per cent
Public Sector Banks			
2011	1070872	41378	3.9
2013	2103763	44039	2.1
2015	3079804	71047	2.3
Private Sector Banks			
2011	30379	7774	2.6
2013	51965	16888	3.2
2015	73231	17972	2.5
Foreign Banks			
2011	9886	2090	2.1
2013	16971	7294	4.3
2015	19932	5065	2.5
Source : Off-site returns (domestic) of banks, Department of Banking Supervision, RBI.			

NPAs of SCBs Recovered through Various Channels

(Amount in ` Billion)

Year	No.	Recovery Channel	Lok Adalats	DRTs	SARFAESI Act	Total
2012-13	1	No. of cases referred	840,691	13,408	190,537	1,044,636
	2	Amount involved	66	310	681	1,058
	3	Amount recovered*	4	44	185	232
	4	3 as per cent of 2	6.1	14.1	27.1	21.9
2013-14	1	No. of cases referred	1,636,957	28,258	194,707	1,859,922
	2	Amount involved	232	553	946	1,731
	3	Amount recovered*	14	53	244	311
	4	3 as per cent of 2	6.2	9.5	25.8	18

Notes : 1. * : Refers to amount recovered during the given year, which could be with reference to cases referred during the given year as well as during the earlier years.
2. DRTs : Debt Recovery Tribunals.

Causes of rising NPAs

In a published report, the RBI attributes the rise in the NPAs of both Public and Private Sector Banks to diversion of funds away from the original purpose for which they were granted, as well as wilful default (or misappropriation of funds) by borrowers. That apart, adverse economic and market factors, ranging from recessionary conditions, regulatory changes and resource shortages to inefficient management and strained labour relations have impacted the health of businesses, and driven them to default on their loan repayments. Sometimes the banks themselves are to blame – delay in loan disbursement can throw a project off track, and have a cascading effect on its viability and capacity to repay. Banks have also been known to take comfort in collateral, and hence not follow up diligently enough on loan dues. Were the market value of the collateral to drop, there is an immediate impact on the quality of the related loan asset.

There are also other, less transparent reasons why NPAs are on rise. For one, the process of (non performing) asset disposal is riddled with legal impediments and delay. Secondly, highly connected corporate debtors have been known to use political pressure to get banks to waive their dues or restructure terms in their favor. Come election time, political parties make populist promises – such as the offer of easy credit to the Small Scale and Rural Sectors which may not yield the expected results – which commercial banks are forced to honor

Impact of rising NPAs

The health of a bank is reflected not only by the size of its balance sheet but also the return on its assets. NPAs generate no interest income for the bank; the bank is required by law to provide for future loan losses arising from its bad assets (at a coverage of 70%), out of current profits. Banks can no longer account the interest on NPA loans as income unless and until it is actually paid by the borrower. This not only affects profitability but also

liquidity because now, the bank has fewer funds to lend out or recycle.
High NPAs degrade a bank's credit rating, lowering its credibility as well as its ability to raise fresh capital. Today, the incidence of high NPAs in the Indian banking industry points to a deteriorating credit market.

As per law, every bank must maintain a Capital Adequacy Ratio (CAR), which is the ratio of total capital to risk weighted assets, of 9% (10% for new Private Banks) or higher. As NPAs go up, so do the aggregated risk weighted assets, forcing the bank to allocate further capital in order to maintain the ratio. Today, commercial banks in India are struggling to meet CAR norms.

Measures to control NPAs

Regulatory measures

As India's banking regulator, the RBI defines a framework to monitor and regulate the increase of non-performing loans in the country. In this, it is guided by international practice as well as the recommendations of the Narasimham Committee.

The RBI mandates that banks must follow an objective policy of income recognition, based on actual recovery, i.e. they must only recognize income when it is received as payment from the customer, and conversely, must reverse (or derecognize) any entries that are not backed by actual payment. It is worth mentioning that under manual classification, income de- recognition happens rarely, which will change once automated processing comes into play.

Banks are also advised to fix realistic repayment schedules – based on the borrowers' actual cash flow – at the time of sanctioning loans. At times banks pressurize customers into accepting terms that are obviously not feasible and only end up increasing their non-performing loans.

The RBI is also keen that banking institutions establish appropriate internal systems, which will eliminate the tendency to defer NPA recognition, especially in the case of high value defaults.

Operational measures

Besides adhering to the above, banks must establish an appropriate Credit Assessment and Risk Management mechanism to ensure proper assessment of credit prior to the sanctioning of loans.

It is also important for banks to diversify their revenue stream in favor of fee-based income. Indian banks – unlike their developed world counterparts – are excessively dependent on interest income, which accounts for about 86% of their total income.
There is a need to monitor potential and borderline loan accounts closely and take early remedial measures to prevent them from turning delinquent.
Banking institutions must also maximize recovery from NPAs to release locked up

funds. They are required to examine all cases of willful default of Rs.1 Crore and above at the Board level, after which they may file criminal charges against the offenders and also affix accountability on the concerned staff.

Re-engineering structure for NPA recovery:
There are several institutions, offering different types of services towards the recovery of NPAs.

Debt Recovery Tribunals are empowered to attach the property of the defaulters' dependents before the delivery of judgment. Disobedience of a tribunal's order attracts penalties.

Asset Reconstruction Companies (ARC) specialize in the recovery and liquidation of assets. Banks, which wish to clean their balance sheet at one go, may divest their NPAs to an ARC at a discounted value, after which it is the latter's responsibility to recover the outstanding dues from the borrowers directly. Although this option doesn't seem to have worked in the case of Public Sector Banks, Private Banks have transferred sizeable NPAs to ARCs. In western markets, asset reconstruction companies have been very successful as they buy loans outright, whereas in India ARCs pay only 5% of the agreed price and the remaining based on recovery.

Corporate Debt Restructuring (CDR) Consortia comprising multiple banks can put together a timely and transparent mechanism to restructure the debts of viable corporate entities. They typically work on exposures exceeding Rs.20 Crores.

CIBIL (Credit Information Bureau of India Limited) maintains a database of borrowers that banks and financial institutions may easily access.

The RBI also plays its part by circulating lists of willful defaulters of banks and financial institutions and of borrowers facing lawsuits for recovery, to caution the industry against issuing fresh loans to the concerned companies, their promoters or directors

The role of technology in NPA management

The RBI has made it clear to all banks that they must automate data management and record keeping as far as possible, and complete periodic regulatory reporting of NPAs without intervening manually. The regulator is also exploring the creation of a central server to store the data of different banks.

The use of technology will bring about a fundamental shift in the way Indian banks manage their NPAs. Implementing automated solutions not just helps in finer analysis of data but more importantly enables early warning indicators before the situations worsens, thus giving banks more time to take appropriate measures. A core banking application is a pre-requisite for this. But most of all, it can put a stop to the manipulation of NPAs, a common practice in the manual system.

Besides improving compliance, a core banking solution can add value by aggregating data across the organization and its touch points, making it easily accessible to the bank as a single unified view of each customer. That being said, not all technology solutions are alike, and banks must choose carefully to pick one with strong credentials as well as comprehensive functionality

CONCLUSION

The problem of NPAs is a live danger to the Indian Scheduled Commercial Banks, because it destroys the healthy financial conditions of them. The people would not keep trust on the banks any more if the banks have higher NPAs. So, the problem of NPAs must be handled in such a manner that would not ruin the financial conditions and affect the image of the SCBs. The RBI and the Government of India have taken number steps to reduce NPAs of the SCBs. The remedial measures taken by Government of India, Reserve Bank of India and Bank management in recent years, helped to reduce NPAs below 3% of total advances (average 2.5%) as recommended by Shri M. Narasimham. To improve the efficiency and profitability, the NPA has to be reduced further. The bank management may speed up recovery of good loans and bad loans through various modes to decelerated growth of NPAs from the present level and also to prevent re-emergence of NPAs over the minimum level.

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