CHAPTER

7

ISSUE OF NON-PERFORMING ASSETS AND MANAGEMENT

INTRODUCTION

In recent times there has been extensive discussion on the accumulation of "huge" non-performing assets (NPAs) on the balance sheets of the Indian banks, more specifically, the public sector banks (PSBs). PSBs figure prominently in the debate not only because they dominate the banking industry, but also since they have much larger NPAs compared with the private and foreign banks operating in our country.[1] This raises a concern in the industry and academia because it is generally felt that NPAs reduce the profitability of a bank, weaken its financial health and erode its solvency.

The presence of large NPAs affects a bank's profit in a number of ways: *(a)* through reduced interest income, and *(b)* through the creation of reserves and provisions (to act as cushions against loan losses) at the expense of profits. This decline in profit has a bearing on variables like the capital to risk-weighted assets ratio (CRAR, or the capital adequacy ratio). With the dip in profit it becomes difficult for capital adequacy ratio). With the dip in profit it becomes difficult for the bank to raise Tier-I capital.[2]

According to the internationally accepted norms, NPAs in banks are those assets, which cease to generate income for the banks and remain irregular due to non-payment of interest and instalments generally for 90 days and above.

DEFINITION OF NPA

A 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 term loan.

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1. The PSBs accounted for 89.8 per cent of the gross non-performing assets of the banking industry during 1997-98 and 79.7 per cent of those assets as in 2001-02 (Reserve Bank of India, *Report on the trend and progress of banking in India*).
2. This is because Tier-I capital consists of statutory and capital reserves that are essentially built from profit.

(ii) The account remain "out of order" in respect of an overdraft/cash credit or the bill remain overdue for a period of more than 90 days.

(iii) The installment of interest remains overdue for two crop seasons in case of short dutation crops and for one crop season in case of long duration crops.

NORMS RELATED TO NPA IN INDIA **BOX: 7.1**

There are two concepts related to non-performing assets (NPAs) — gross and net. Gross NPA refers to all NPAs on a bank's balance sheet irrespective of the provisions made. It consists of all the non-standard assets, *viz.* sub-standard, doubtful, and loss assets. A loan asset is classified as "sub-standard" if it remains NPA up to a period of 18 months; "doubtful" if it remains NPA for more than 18 months; and "loss", without any waiting period, where the dues are considered not collectible or marginally collectible.

Net NPA is gross NPA less provisions. Since in India, bank balance sheets contain a huge amount of NPAs and the process of recovery and write-off of loans is very time consuming, the provisions the banks have to make against the NPAs according to the central bank guidelines, are quite significant. That is why the difference between gross and net NPA is quite high. While gross NPA reflects the quality of the loans made by banks, net NPA shows the actual burden of banks. The requirements for provisions are: 100% for loss assets; 100% of the unsecured portion plus by 20-50% of the secured portion, depending on the period for which the account has remained in the doubtful category; and 10% general provision on the outstanding balance under the sub-standard category.

CATEGORIES OF NPA

(i) Sub-standard Assets which has remained NPA for a period less than or equal to 12 months.

(ii) Doubtful Assets which has remained in the sub-standard category for a period of 12 months.

(iii) Loss Assets where loss has been identifed by the bank or internal or external auditors of the RBI inspection but the amount has not been written off.

CLASSIFICATION

The NPAs are broadly classified into two categories *viz.* Gross and Net. While gross NPA reflects the quality of the loans made by banks, net NPA shows the actual burden of banks.

QUANTUM OF NPA

Non-performance Assets affect all financial institutions like banks (commercial co-operative, development and other intermediaries). However, statistics are available for banks, development banks only. The quantum of Gross NPA for commercial banks aggregated to ` 97,922 crore in 2010-11. The quantum of NPA's is estimated to be over ` 1,80,000 crore for the financial institutions.

Table 1

Movement in Non-performing Assets of Scheduled Commercial Banks

(` Crore)

End March	*Gross NPA*	*Gross NPA as % Gross Advances*	*Net NPA*	*Net NBA as % of Net Advances*
1993	39,253	23.2	NA	NA
1994	41,041	24.8	NA	NA
1995	38,385	19.5	17,567	10.7
1996	41,661	18.0	18,297	8.9
1997	47,300	15.7	22,340	8.1
1998	50,815	14.4	23,761	7.3
1999	58,722	14.7	28,020	7.6
2000	60,408	12.7	30,073	6.8
2001	63,741	11.4	32,482	6.2
2002	70,561	10.4	35,554	5.5
2003	68,717	8.8	32,670	4.4
2004	64,787	7.2	24,617	2.8
2005	59,373	5.2	21,754	1.2
2006	51,097	3.3	18,543	1.2
2007	50,299	2.5	20,207	1.0
2008	56,435	2.3	24,733	1.0
2009	68,328	2.3	31,564	1.1
2010	84,798	2.4	38,723	1.0
2011	97,922	2.3	41,813	1.0

Source: RBI.

There has been a consistent decline in Non-Performing Asset (NPA) ratios over the years. The gross NPA ratio declined from 23.3 per cent in 1992-93 to 2.3 per cent in 2010-11, the net NPA ratio declined from 10.7 per cent to 1.0 per cent during this period.

During the year 2010-11 banks had fresh addition of NPAs of ` 70,410 crore recovered and written-off ` 48,091 crore and ` 8,299 crore. As a result, the gross NPAs of SCBs increased by ` 13,224 crore to ` 97,922 crore.

The fresh addition of NPA is mainly due to:

- Rapid credit growth.
- Hardening of interest rates

- Increase in housing loans at floating rates, notwithstanding increase in gross NPAs of the banking sector, gross NPAs as percentage of gross advances declined further to 2.3 per cent at end March, 2011.

Causes for NPA

The principle of causes for NPA's built up in the banks are:

1. The quality of the loans
2. The quality of the assets
3. Borrowers integrity
4. Intentions of the borrower and the bank management
5. Lapses in supervision and follow-up of loans
6. Laxiety in assessment
7. Political interference
8. Managerial incompetencies
9. Absence of will to recover loans
10. Lack of professionalism
11. Rapid Credit growth and slippage
12. Hardening of interest rates.
13. Defaulter friendly and complicated legal system
14. Low skills of personnel processing loan proposals
15. Lack of information of performance of the economy
16. Administrative defeciencies
17. End use of loans is not verified
18. Improper disbursement
19. Willful default
20. Business failures

Other Key Factors are:

- A lack of sponsorship and buy-in across the organisation;
- Inadequate education and communication efforts;
- Failure to manage expectations from the performance management system;
- Aspiring for implementation deadlines and timeliness that are too 'aggressive', the pressures of which may jeopardise the entire initiative;
- Inability to introduce effective 'incentive' and 'penalty' mechanisms. Some categories of Indian banks have a cultural legacy that hampers their ability to effectively influence performance through incentives or suitable penalties.

IMPLICATIONS

The growing NPAs affects the health of banks, profitability and efficiency. In the long run, it eats up the networth of the bank. A large number of co-operatives are being fallen prey to this. In short, NPA is not a healthy sign for financial institutions.

A closer look at the movement of NPAs may throw some light on the creation of new NPAs. Extending loans to enterprises for economic activity is the main function of a bank as a financial intermediary. But since there is always an element of judgement in projecting and valuing uncertain future receipts, there always remains some probability of every loan becoming non-performing. So elimination of NPAs is neither plausible, nor desirable[3] and bank balance sheets will always have some amount of NPAs. But at the same time, presence of large NPAs is detrimental to the bank's health. So the bank has to keep an eye constantly on the generation of fresh NPAs. For that, the bank may look at the incremental NPAs during a year, as given by the Reserve Bank of India (RBI). In Table 1, bank group-wise ratios of incremental NPAs to advance and assets are shown.

RISK MANAGEMENT

The globalisation of markets, the consolidation of industries, and the increased pressure from demanding stake holders led considerable competitive Pressures. All along the risks have also increased. In fact, risk is an inherent part of the business of financial organisation and effective risk management is critical for achieving financial soundness and profitability. DFIs have identified risk management as one of the core competencies for the next millennium and are taking effective steps to consolidate these competencies.

The three critical risks identified are *(i)* Credit risk, *(ii)* Market risk, and *(iii)* Audit risk.

Credit risk is the risk that a borrower is unable to meet his financial obligations, and is the most significant risk faced by DFIs.

Market risk originates primarily due to asset-liability mismatches, foreign exchange positions and trading positions.

Audit risk is to ensure comprehensive coverage of all risk and efficient deployment of audit resources to determine the scope and frequency of the audit in various business areas.

Banks believe that sound methodologies, an extensive database, a sophisticated Credit Risk information system, dedicated industry portfolio analysis are the corner stones for effective risk management.

The goal of risk management of DFIs is to ensure that the entire organisation has the ability to understand, measure and monitor risk and to adhere with discipline to policies and procedures. This process has been facilitated by the development of critical technology which includes

3. Drastic reduction of NPAs or aiming at zero NPA will imply reduction to credit extension to areas where both the risk and expected return are high. Such policies not only impair economic growth, but also reduce bank profits, net of costs on account of NPAs.

analytical querying, data warehousing and on-line information on a firm-wide basis. The ultimate objective of risk management in bank's is to maximize potential for the most efficient allocation and management of financial capital.

The responsibility for managing bank's risk exposure lies with central Risk Management Group. The Risk Management Group also works closely with the Audit Committee of the Board of Directors. The Risk Management Group is also responsible for internal audit and corporate governance. The process of evolution and measurement of credit risk involves the assigning of a credit rating to each company using a mix of qualitative and quantitative factors and the determination of appropriate pricing. The credit rating assigned to the borrower form the basis of pricing for all products offered.

Banks are committed to the development of sophisticated technology and analytical tools to support market risk management processes that enable proactive risk management. Real time management reporting systems have been implemented through an entrant based Executive Information System for treasury operations. During the year, 2000-01, DFIs undertook several initiatives to minimize interest rate risk on its foreign currency loan through basis swaps and fixed to floating swaps. In addition, the Corporation also introduced a policy of warehousing in floating-rate Dollars linked to the 3-month LIBOR.

Risk management is critically important for banks and in the emerging economic scenario, there is a greater need for banks to implement risk-based practices. In view of the growing need for banks to be able to identify, measure, monitor and control risks, appropriate risk management guidelines have been issued from time to time by the Reserve Bank, including guidelines on asset-liability management (ALM). These guidelines are intended to serve as a benchmark for banks to establish an integrated risk management system. However, banks can also develop their own systems compatible with the type and size of their operations as well as risk perception and put in place a proper system for covering the existing deficiencies and requisite upgradation. Detailed guidance notes on the management of credit risk, market risk, operational risk, among others, have also been issued to banks by the Reserve Bank. The progress made by banks is monitored on a quarterly basis. With regard to risk management techniques, banks are at different stages of *(i)* drawing up a comprehensive credit rating system; *(ii)* undertaking a credit risk assessment on a half-yearly basis; *(iii)* pricing loans on the basis of risk rating; and *(iv)* adopting the Risk-Adjusted Return On Capital (RAROC) framework of pricing. Some banks stipulate a quantitative ceiling on aggregate exposures in specified risk categories and analyse rating-wise distribution of borrowers in various industries.

RECOVERY OF NPAs

A broad framework has evolved for the management of NPAs under which several options are provided for debt recovery and restructuring. Banks and FIs have the freedom to design and implement their own policies for recovery and write-off incorporating compromise and negotiated settlements.

WILFUL DEFAULTERS — CLASSIFICATION ON PROCESS

- The RBI has initiated certain steps in its Annual Policy statement of 2004-05. Accordingly, banks/FIs are required to form a committee of higher functionaries for classification of borrower accounts as wilful defaulters and create a redressal mechanism in the form a Committee headed by the Chairman and Managing Director for giving a hearing to borrowers who have grievance on their classification as 'wilful defaulters'.

LOK ADALATS

- The RBI issued guidelines to commercial banks and FIs to enable them to make increasing use of *Lok Adalats*. They were advised to participate in the *Lok Adalats* convened by various DRTs for resolving cases involving ` 1 million and above to reduce the stock of NPAs.

PROGRESS IN DEBT RECOVERY TRIBUNALS

- The Recovery of Debts Due to Bank and Financial Institutions Act was enacted in 1993 to provide for the establishment of Tribunals for expeditious adjudication and recovery of debts due to banks and FIs. As at end-December 2003, out of 61,301 cases (` 888.76 bn) filed with DRTs by the banks, 25,510 cases (` 232.73 bn) have been adjudicated by them. The amount recovered so far through the adjudicated cases by is ` 68.74 bn.
- On the basis of an internal review on the functioning of DRTs and in order to consider further improvements in this regard RBI has asked the Government to set up a Working Group.

ASSET RECONSTRUCTION COMPANY (ARC)

- The enactment of "Securitisation, Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002" marks a watershed in the process of on-going economic reforms. This Act enables the setting up of asset management companies for addressing the problems of NPAs of banks and financial institutions.
- Under the Act, an asset management company is authorised to acquire assets of any bank or financial institution by issuing a debenture or bond or any other security for consideration agreed upon with such company and the bank or the financial institution.
- On a pilot basis an asset reconstruction company has been set up by ICICI Bank jointly with other FIs and banks.

Banks should also initiate the following actions to recover the NPAs:

- Bank should set the targets for recovery from NPAs and also for prevention of potential NPAs. A separate Recovery Department/Cell should be set up in the banks to by co-ordinate recovery efforts.
- Send a reminder to the defaulters on timely basis, pay a visit to their business premise/ residence.

- Entertain a compromise proposal as per the broad policy guidelines of the bank.
- Recall the advance.
- File suit against the borrowers in the court/DRT.
- Serve a notice of 60 days under the SARFAESI Act.
- Initiate action under Transfer of Property Act by entrusting the work to the private auctioneers.
- Organise 'recovery competition' and reward those recovering the highest amount.
- Initiate any other steps to strengthen recovery efforts and upgrade the quality of potential NPAs.

MANAGEMENT OF NON-PERFORMING ASSETS ("NPAS")

As the Indian economy continues to feel the impact of trends in the global marketplace particularly in the commodities markets, its operating environment has undergone a significant shift. Indian industry has been subjected to very focused domestic and international competition and corporates are coming to terms with the new competitive reality through a process of restructuring and repositioning. This restructuring process is taking place in several industries, primarily in sectors where uneconomic fragmented capacities were set up in the erstwhile licensing period. While this phase of restructuring may show some signs of stress in certain industries, it is a process that corporate India has to pass through.

The quality of loan assets is the most important factor for the basic viability of the banks. Spiralling non-performing assets are hurting banks profitability by way of both non-recognition of interest income and loan loss provisioning. In addition to the time tested measures for stepping up the recoveries, several other measures were also taken in the recent past, *viz.,* micro level budgeting, review of top NPA accounts, opening of recovery branches, creation of recovery cells, mergers and acquisitions, etc. Loan assets are classified into *(i)* Standard assets, *(ii)* Sub-standard assets, *(iii)* Doubtful assets, and *(iv)* Loss assets.

Banks are dealing with this situation in various ways. These include facilitating the integration of fragmented capacities, catalyzing the merger of weak and unviable units with strong and viable ones, encouraging modernization of existing plants through technology upgradation, enabling financial restructuring and taking early steps for legal action where necessary.

NPA MANAGEMENT BY BANKS

Keeping in view the fact that the chances as well as the extent of recovery of NPAs reduce overtime, the Reserve Bank tool several measures in recent years to expedite recovery of NPAs by banks by strengthening the various channels of NPA recovery such as debt recovery tribunals (DRTs), *Lok Adalats*, corporate debt restructuring (CDR) mechanism and the SARF AESI by Act, 2002.

With a view to providing an additional option and developing a healthy secondary market for NPAs, guidelines on sale/purchase of NPAs were issued in July 2005 covering the procedure for purchase/sale of non-performing assets (NPAs) by banks, including valuation and pricing aspects; and prudential norms relating to asset classification, provisioning, accounting of recoveries, capital adequacy, exposure norms, and disclosure requirements. The guidelines were partially modified in May 2007, whereby it was stipulated that at least 10 per cent of the estimated cash flows should be realised in the first year and at least 5 per cent in each half year thereafter, subject to full recovery within three years.

The Credit Information Companies (Regulation) Act, 2005 passed in Parliament in May 2005 was passed in Parliament in May 2005. The rules and regulations for the implementation of the Act were notified on December 14, 2006. The Act was enacted with a view to strengthening the legal mechanism and enabling the credit information companies to collect, process and share credit information on the borrowers of banks and financial institutions. The Act also covers, inter alia, responsibilities of credit information companies, rights and obligations of the member credit institutions and safeguarding of privacy rights. The salient features of Credit Information Companies Rules and Regulations are set out below:

- An efficient system of credit information on borrowers is, thus, an important first step in improving the credit risk management.
- To develop a healthy secondary market for NPAs.
- Streamling the processes and introducing transparency in lending practices.
- Training the banking personnel in appraisal processes and providing clear guidelines.

Among the various channels of recovery available to banks for dealing with bad loans, the SARFAESI Act and the Debt Recovery Tribunals (DRTs) have been the most effective in terms of amount recovered.

The Reserve Bank has so far issued Certificate of Registration (CoR) to eleven securitisation companies/reconstruction companies (SCs/RCs), of which six have commenced their operations. At end-June 2008, the book value of total amount of assets acquired by SCs/RCs registered with the Reserve Bank stood at ` 41,414 crore. The security receipts subscribed to by banks amounted to ` 1,299 crore. The security receipts redeemed amounted to ` 1,299 crore.

NPA STRATEGY

Banks set in place a process involving a detailed and periodic analysis of its performing assets portfolio, to determine on an on-going basis, the health of every borrower account in the loan portfolio. DFIs used the interest cover approach to determine stress levels in the performing assets portfolio as it believes that this approach is the most effective in gauging the real quality of the asset portfolio. Conceptually this approach involves assessing the underlying cash flows of the borrower and then determining adequacy of interest cover after allowing for all expenses required to maintain the corporate as a going concern. For projections, typically a worst case scenario is used for product and input prices and capacity utilization levels. This analysis provided a much deeper understanding of potential stress in the asset portfolio thereby enabling DFIs to initiate more stringent monitoring and control mechanisms and to develop a proactive strategy for early stage solutions.

Banks have placed great emphasis on recovery and settlements in respect of bad assets and this focus has been institutionalized across the organization. This has resulted in a significant mindset shift towards NPAs. Asset quality targets are today a key parameter for employee performance evaluation. As mentioned earlier, the effort in this direction has been based on a proactive approach towards identification of stress case and early stage solutions to incipient problems. An aggressive approach has been adopted towards defaulters with a focus on early stage recall and the use of collateral to enforce settlements. A clear exist strategy is being followed in the case of intrinsically unviable and historical NPAs with emphasis on the time value of recovery and a pragmatic approach towards settlements.

ENHANCED TRANSPARENCY AND DISCLOSURES

Transparency is a key element of an effectively supervised, sage and robust financial system. The complementary interaction of prudential supervision and market discipline promotes the stability of both individual institutions and financial systems. It may be mentioned that the absence of prudential supervision and market discipline is cited as one of the primary reasons for the systemic crisis in the east Asian financial systems.

The lack of transparency gives rise to systematic concerns related to the concentration of exposures within specific markets and linkages across markets. Without adequate information, it is difficult to know where in the financial system risks and vulnerabilities might be concentrated. So financial disclosure and transparency are fundamental for effective market discipline.

Market discipline can work only if participants have access to timely and reliable information that enables them to make an accurate assessment about a player's business activities, performance, financial condition and risk profile. Improved public disclosures encourage safe and sound banking practices by strengthening the incentives to banks to behave in a prudent and efficient manner. Public disclosures also help limit the systemic effects of market disruptions by increasing the ability of the market, in times of stress, to distinguish between banks that are vulnerable and those that are not.

RECOMMENDATIONS OF THE NARASIMHAM COMMITTEE (1998) — BOX: 7.2

- The committee recommended that the capital adequacy ratio be increased to 9 per cent by 2000 and further to 10 per cent by 2002.
- It also suggested that measures of capital adequacy should take into account the marker risk of the banks' assets along with the credit risk. In this context, bank were encouraged to undertake risk management practices by adopting Value at Risk (VaR) Modeling that takes care of market price fluctuations, foreign exchange rate volatility and interest rate changes, Further, it proposed that the entire portfolio of government securities with banks be marked to market within a three-year period.
- Regarding prudential norms, the committee suggested that an asset be classified as "doubtful" if it is in the substandard category for 18 months to begin with, and that this period be reduced to 12 months gradually. The Committee suggested that banks be asked to adopt the international standard with respect to income recognition, thereby reducing the relevant time period from 180 days to 90 days.

- As for NPAs, the Committee proposed that the average level of net NPAs as a fraction of credit outstanding for all banks be reduced to 5 per cent or less by 2000 and to 3 per cent by 2002. For banks with international presence, the corresponding targets for gross and net NPAs were proposed to be 5 per cent and 3 per cent, and 3 per cent, and 3 per cent and by 0 per cent, respectively.
- The committee expressed concern over the financial health of banks and recommended two criteria for identifying a weak bank. These were: *(a)* accumulated losses and net NPAs exceed the net worth of the bank, and *(b)* operating profits less than the income on recapitalization bonds have been negative for three consecutive years.
- For banks with high NPA portfolio, the Committee proposed the establishment of an Asset Reconstruction Company (ARC) to tide over the backlog of NPAs.[#] ARCs would issue bonds guaranteed by government and the proceeds from these would be used to buy the bad assets of banks at a discount.
- The Committee, however, discouraged recapitalization of banks using government funds. A suggestion has been made towards a reduction in the minimum stipulated holdings of government in the equity of PSBs to 33 per cent.[*]
- To bring about efficiency, the Committee prescribed measures to improve customer servicing through extensive application of information and communication technology, employment of competent and skilled labour, reduction of overstaffing, especially in PSBs, simplification of documentation systems, introduction of computer audit, etc.

The ARC will either issue NPA Swap Bonds worth the realizable value of NPA or banks should issue bonds which would form their Tier-II capital. These instruments should be government guaranteed to make them eligible for SLR investments by banks or approved instruments of LIC and GIC.

* The Central Government is attempting to effect such a reduction with the of appropriate legislation, but the proposal has met with significant resistance from the opposition parties.

Various international bodies including the Basle Committee on Banking Supervision have recommended progress in accounting and disclosure practices for banks. In this respect, the Basle Committee has issued a report “Enhancing Bank Transparency” — September 1998) that discusses the role of transparency and disclosure of information in effective market discipline and effective market supervision. It has called for efforts by all banking supervisors to improve the standards of transparency and disclosures in the financial system while recognizing that the goal of achieving transparency has become increasingly challenging in recent years as financial systems have become more complex and dynamic.

In line with the recommendations of these Committees, a number of steps have been taken to resolve the problem of NPAs in our country. Whatever attempts have been made to reduce the old NPAs, have been made entirely by the banks themselves, mainly with the help of Debt Recovery Tribunals (DRTs). DRTs were set up in 1993 to speed up the recovery proceedings initiated by banks. But the performance of these DRTs has been far from satisfactory. Till September 2001, DRTs could decide on only 9,814 cases involving ` 6,264.71 crore and helped to recover a meagre ` 1,864.30 crore, while as many as 33,049 cases involving ` 42,988.84 crore remained pending (Muniappan, 2002). The legal recovery process is further prolonged in cases under the Sick Industrial Companies Act (SICA) and with the Board for Industrial and Financial Reconstruction (BIFR).[4]

RECOMMENDATIONS OF THE VERMA COMMITTEE (1999) **BOX: 7.3**

The committee concluded that the PSBs were under pressure because of the prudential norms regarding asset classification and provisioning for NPAs, and because of the intensification of competition subsequent to the first phase of banking sector reforms. The Committee pointed out that the dismal performance of the weak PSBs was not merely on account of exogenous shocks, but also attributable to internal problems like limited number of products, poor risk management systems and mediocre service.

The Committee identified three weak PSBs, *viz.* Indian Bank, UCO Bank of India, on the basis of seven parameters related to solvency, earning capacity and profitability. The Committee considered capital adequacy and coverage ratios for solvency; return on assets and net interest margin for earning capacity and operating profit to average working funds, cost-income ratio and the ratio of staff cost to net interest and all other income, for profitability. However, the Committee concluded that mergers and narrow banking are unlikely to resole the problem of weak banks, and while privatization is perhaps the best course of action it would be difficult to attract private bids for PSBs, the cost of restructuring of which would be prohibitively high. Hence, the Committee prescribed operational and organizational restructuring. Importantly, the Committee categorically stated that the weak banks would have to bring down their cost of operations by reducing their staff strength. It proposed that the staff strength of weak PSBs be reduced by 25 per cent. If a Voluntary Retirement Scheme (VRS) failed, the Committee suggested that across-the-board wage cuts for employees be effected to reduce the operations cost of these bank. It also proposed that the branch network of the weak banks be rationalized.

Following the recommendations of the Committee on Banking Sector Reforms, India is moving in the direction of building a resilient banking sector. Strengthening of prudential norms and installation of Asset Liability Management systems are significant measures introduced by the regulations, aimed at building a robust financial system. The Reserve Bank of India is playing a dynamic role in the transformation of the financial sector as is evident from its proactive setting up of the Khan Working Group to redefine the role of financial institutions and banks. The Reserve Bank of India has also initiated a nationwide debate on the recommendations of the Group, which revolves around the issue of universal banking and the development of an enabling regulatory framework. The dialogue between the regulator, the banks and the institutions has provided the country with an opportunity to view the relevant issues in a holistic manner.

4. It is extremely difficult for a bank to initiate any proceeding or file a suit for recovery of money smoothly and quickly against an industrial entity registered as sick under the Sick Industrial Companies Act (SICA), 1985, since finding the consent of the Board or the Appellate authority at every step acts as an impediment. Defaulting companies can use this law to their advantage. Moreover the BIFR takes very long time to decide any case (RBI Bulletin, 1999b).

CONCLUSION

The asset quality of credit reflects on prevailing credit risks, management capability and corporate governance. In turn, it influences productivity and profitability of banks. Good quality assets improves profitability as well as the image of the bank/financial institutions.

Although improvement in the credit appraisal process, new legal initiatives aimed at faster NPA resolution and greater provisions and write-offs enabled by greater profitability contributed to the decline in NPAs. Yet, NPA continue to be an issue with the increase in retail loan portfolio. Hence, there is a need among other things to improve credit risk assessment as well as collection of credit information, particularly with respect to real assets, relationship banking and professional management.

The accumulation of huge non-performance assets (NPAs) in banks/financial institution has assumed great importance. The depth of the problem of bad debts was first realised only in early 1990s. The magnitude of NPA's in banks and financial institution is over ` 1,50,000 crore. While gross NPA reflects the quality of the loans made by banks, net NPA shows the actual burden of banks. Now it is increasingly evident that the major defaulters are the big borrowers coming from the non-priority sector. The banks/financial institutions have to take the initiative to reduce NPAs in a time bound strategic approach. The government has empowered the banks to take over the management of business of a borrower merely by publishing a notice in a newspaper.

In India, it is observed that the probability of success of such a strategy is much higher compared with the policy of debt transfer to AMCs. So it is suggested that India should opt for the decentralised creditor-led strategy and adopt policies to create an amicably environment for the success of such a strategy. However, in some bank-specific cases, a time-bound AMC can be conceived after meeting all the pre-conditions of AMC-based restructuring, if the need arises.

SELL ASSESSMENT QUESTIONS

(1) Define Non-performing assets (NPA) and discuss in implication to financial institutions.

(2) Do you think that the non-performing assets affect the economy?

(3) What are the Causes of non-performing assets. How to overcome them?

(4) Analyse the NPA management in banks.