



The Round Table on Management of Problem and Distressed Loans– Summary (IIBF Leadership Centre, Kurla, Mumbai on April 19, 2012)

NPAs were on the downward trend till about 2008. They started rising from 2009-10 due to global economic slowdown and related causes. It is now estimated that the Gross NPAs of the Indian Banking system is above 2.5% of gross advances and is likely to increase further to 3.0%. In addition to this, assets to the tune of Rs. 66,000 crores has been restructured. Incremental slippages and level of restructured advances being in the same range was a matter of concern, particularly since each of them annually topped Rs.100,000 crores for 2010-2011. The trend showed that incremental NPAs during the quarter ended September 2011 (15.8%) was highest in the last 14 years. Industry and Retail sectors are the largest contributors.

It is in this context that deliberations were held on the various measures which needed to be taken to manage problem loans in the Round Table held on April 19, 2012.

Prevention

There is a need for complete understanding of the customers' businesses as contrasted with merely understanding the customer alone. There are gaps in the processes and controls in banks and steps need to be taken to strengthen the appraisal and due diligence processes. Rigorous monitoring of customer operations is important for noticing the early signs of stress and taking corrective measures. Institutionalisation of processes for credit monitoring is essential for strong credit oversight.

Most of the banks follow Tandon Committee/Chore Committee method and concept for the credit assessments. There is a need to review it as cash flow is equally important. It needs to be examined whether entire reliance on these methods without doing much analysis of the cash flows is the best way to assess and monitor credit.

Pre-disbursement, during disbursement and post-disbursement inspections are must for booking good quality credit and identification of the early signs of stress. Due diligence process should be strengthened at the point of taking exposures, as well as monitoring

on an on-going basis. There has to be enhanced use of technology and data for capturing early signs of stress and taking corrective measures.

Takeover of an account is a high-risk area. The taking over banker should ask why the existing banker is willing to lose a good account. Without a proper answer to this, the banks are likely to be saddled with potential NPAs.

Banks also need to evolve methods to monitor bank guarantees issued by them, especially financial guarantees. Often time the operating functionaries do not realize the underlying liability and risk and enough attention is not given.

As a part of the Credit Risk Management the banks need to periodically review their credit acceptance criteria with respect to their risk appetite. They also need to review the portfolio exposure in the context of their performance.

There is a need to detect incipient sickness and take timely action for revival rather than deal with the accounts when it had slipped to NPA category. Standard operating procedure for taking definite early action where accounts display defined triggers should be put in place by banks.

Default and early identification

Repayment culture is not deep rooted in India and delinquency is yet to become a social stigma. Further there is no real reward for prompt repayment except farm loans. There is a need for maintaining credit history data and linkage of availability of credit and pricing to it.

There is delay in identification and declaration of NPAs by the banks which results in lowering the prospects of revival of the account and more losses. One of the reasons for it is the requirement of higher provisioning on declaration of an account as non-performing. This is self-defeating as it results in more losses for the banks, and there is tendency on the part of the lenders to delay declaration of an account as NPA.

Restructuring and Rehabilitation

For a capital starved country like India it is very important to preserve the productive assets by working with the promoters to find solutions to revive the weak accounts.

At present cases are referred to CDR without examining their prima-facie viability. There should be a fundamental thorough economic viability study of an exposure before referring to CDR. However, it will further delay making reference to CDR, if a viability

study is mandated at the stage of Flash Report itself. Further there would be an issue of co-ordination amongst the financing bank. This issue and other inherent rigidities in the CDR structure should be reviewed.

On the issue of promoters sacrifices and contribution, most of the time, the promoters want to bring bare minimum contribution mandated by CDR and do not contribute in the rehabilitation process whole heartedly. For CDR cases the general principle should be that the equity holders should take a hit first rather than the debt holders. However, there were cases of restructuring through CDR mechanism, where promoters willingly took a hit on their equity investment by writing them down (including the portion on non promoter equity holding), and were mostly successful. While one model does not fit all cases and each restructuring plan has to be specific to the case under consideration, it is necessary that the bank as well as promoters need to make sacrifice for the success of the restructuring.

In the Indian context, the CDR structure while not being a legal but a regulatory structure may not have served its full purpose; it cannot be denied that it is the only forum available today which has been able to bring promoters and all lenders together to find a solution. However, there is a need to strengthen the CDR forum.

For CDR the intrinsic value of underlying should be looked into. Viability of account must be assessed before allowing CDRs. Restructuring should preserve and enhance the value of the underlying economic value, thereby creating value for the investors and the economy as a whole.

In most of the cases of CDR, lenders are not willing to disburse additional funds. Package provides transient relief by just postponing the repayment of dues and servicing of interest, and saving the account from being classified as a NPA for the lender. In absence of additional funds to meet its working capital requirements, most of the restructured units continue to face shortage of funds. One solution to the problem could be to create a fund to meet further requirements of the rehabilitated units.

Provision of pooling of assets as security needs review. It should be taken as is where is basis for considering a CDR. That way, each lender would have an assessment of the collateral/ security available to them, and there will not be any conflict of interest by way of one lender getting a share in the others security.

Regulator must look at one year stand still clause for deferring provisioning in restructured accounts. Recompense procedure must be made simpler for the lender as well as borrower to know the specific liability to avoid disputes and ambiguity at a later date.

Recovery and sale of NPAs

The problem of tackling NPAs is compounded due to tardy legal system though SARFEASI and credit information have brought about some improvement in bargaining power of lenders.

Many a times when accounts become NPA, it is found that the documentation is not complete. When the account is identified for early warning signals, documentation should immediately be reviewed for completeness.

In several cases, there is sudden sharp decline in the value of assets, particularly current assets declared by the borrowers. To give a strong message to the borrowers such cases should be investigated in depth. Such cases should immediately be declared as fraud and circulated among all banks. This will help in controlling the tendency of the borrower to overstate inventory and receivables, which will result in timely action in case of need.

There has been a slowdown in recoveries through compromise settlements and sale of NPAs to ARCs, resulting in deterioration of the productive assets. Valuation of NPAs needed to be resolved by both banks and ARCs. For this it is necessary to have a system of proper valuation of current assets.

Asset Reconstruction Companies

The total amount sold by the banks to ARCs has remained static over the period of the last few years despite substantial increase in the level of NPAs. Public sector banks in particular face several issues while selling assets to ARCs and also while settling with borrowers. The most important issue is valuation of the account. There is always a gap between the banks' expectations and borrowers/ARCs offer. There was a need to bridge the gap between the value expectations on sale of stressed assets by banks and the amount offered by participants including ARCs.

Issues of accountability and fear of CVC/ CBI were some of the factors which have also slowed down decision making in this space. More specific guidelines from the regulator will help in this regard.

Price offered by ARCs does not meet the banker's expectation because the ARCs are given information on tangible assets while the banks have additional information on intangibles which could yield value. Providing complete detailed information on the assets by the banks to ARCs is likely to result in better valuations. Price determination mechanism should be transparent and should be determined in consultation.

Reserve price should be announced while auctioning assets to Asset Reconstruction Companies; this is considered a feasible solution as banks are already fixing such reserve price in terms of law whenever initiating action under Section 13(4) of SARFAESI Act.

ARCs should be construed as a supportive system. They should not be the last resort for bankers to dispose of NPAs. Sale of assets should be considered at an early stage when the assets have good chance of revival and fair amount of realizable value. At what point of time the assets are to be transferred to ARCs is the real concern.

ARCs are necessary to take care of NPAs and banks should be freed of that task. It should be kept in mind that ARCs are not trading unit. ARCs should take over bigger assets rather than smaller ones as the viability is more reasonable. Need for partnership among banks and ARCs is important. For this the information sharing has to be enhanced. This will provide a better price offer from ARCs.

Use of the FIMMDA interest curve (the lowest investment grade plus a markup) for the concerned tenor for benchmarking discount rate to be used by banks will bridge the valuation gap between banks and the ARCs.

Another area of difficulty being faced by the public sector banks was valuation of individual account assets in case of basket accounts. ARCs at times assign zero value to some of the accounts. PSBs find it difficult to justify sale of asset at zero value. It was clarified that selling banks should either ask a value quote for a portfolio or ask for individual asset prices but not both.

The value of an asset sold to ARC, over the net book value cannot be taken by a bank to the P&L but has to be parked in sundry liability account. How long should the amount be held in the account is not clear. The question arises that why the treatment should not be the same as OTS where it can be booked to P&L A/c. Diminution in fair value of

restructured assets should be provided for at the year end and proportionately. This needs to be looked into and clarified by the regulators.

The recommendations of the high powered advisory committee for reforms in the ARC space need to be looked in to. Bankers should look at investment in Security Receipts (SRs) so that they can participate in the up side realised on resolution of accounts.

Approach of most of the ARCs in the past has been on realization of the assets. They should focus on restructuring and revival rather than on asset stripping.

Sector specific understanding is required. ARCs must have an understanding of the industry where they want to do restructuring otherwise it will not succeed. Any business should be looked at using a 5P approach – People, Purpose, Potential, (fundamental business) Proposition, Past performance. It is worth considering whether separate NBFC for restructuring is essential as it requires sector specific expertise to effectively understand the problems of the businesses.

Other Issues

At present banks are not allowed to take to their profit and loss account the amount of surplus on sale of NPLs and/or realization of NPLs, they are required to keep it in a separate reserve. The rationale for the provision is that it is expected that there would be some cases where banks would have surpluses and some cases where banks could have shortfall on realization of NPLs. The purpose of the provision was to provide a cushion for banks so that cases where there is a shortfall do not hit the banks operating results. Nevertheless RBI will review the provision.

Lack of resources is a major constraint for ARCs. ARCs need to enhance their fund raising capabilities. Minimum net worth threshold for ARCs may be considered to be increased to Rs.200 crores FII investment limit in ARCs should also be raised beyond 10% individual and from 49% to 74% overall ceiling.

There was a need for clarity on taxation approach to assets in pass through vehicles (Trusts). It was suggested that SRs should be revived to work with ARCs.

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