



KHAN GLOBAL STUDIES

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Economics

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Non-Performing Assets (NPA)

- ❖ All the loans given by banks to their customers are c/a Assets for them. If the customer fails to pay the loan amount to the bank then they are c/a "Non-Performing Assets".

Standard/Performing Assets

- ❖ Not classified as NPA.
- ❖ The borrower pays the loan amount regularly.

Non-Standard/Stressed Assets

- ❖ Non-Performing Assets = SMA + NPA + RA + WOA.

1. Special Mention Account

Initially when the customer doesn't pay the loan amount on due date the bank started mentioning the outstanding amount in SMA.

It is of 3 types-

- (a) SMA - 0 - Principal or loan or interest amount - 0 to 30 days
- (b) SMA - 1 - Principal or interest amount - 31 to 60 days.
- (c) SMA - 2 - Principal or interest amount - 61-90

2. Non-Performing Assets

If the customer doesn't pay the interest or the principle or both upto 90 days then it is considered as NPA.

3. Restructured Assets/Loan

When the outstanding loan have been restructured by the Bank i.e. by taring the time period for reppayment, lowering the interest rate, etc.

4. Written Off Assets

Assets or loan which are not counted as due as they are compansated through other ways.

Note : Written of Assets are not counted as waving of loan.

- ❖ **Strategic Debt Reconstructing:** When the Bank convert the debt into the equity.
- ❖ **Assets (S4A):** Defaulting amount Rs. 500 cr. and more.
- ❖ Loan amount - Sustainable or non sustainable
- ❖ In Non-Sustainable amount convert into the equity.

NPA Problem of India Banks

- ❖ The NPA was on a declining trend from FY 2018 due to various initiatives by the Reserve Bank of India and the central government such as the **Insolvency and Bankruptcy Code**

- ❖ Due to the effects of the corona virus (COVID-19) epidemic and lockdown, the country was expected to see an increase in **bad loans**.

Measures to curb NPAs in India

1. Debt Recovery Tribunals (DRTs)

- ❖ The Debt Recovery Tribunals (DRTs) were established in 1993.

- ❖ To reduce the amount of time it takes to settle matters. The requirements of the Recovery of Debt Due to Banks and Financial Institutions Act, 1993, apply to them. However, because their numbers are insufficient, they face a time lag, with cases in many locations pending for more than two years.

2. Credit Information Bureau (CIB)

- ❖ In the year 2000, the Credit Information Bureau (CIB) was established.
- ❖ To avoid loans getting into the wrong hands and, as a result, NPAs, a good information system is essential. Individual defaulters and wilful defaulters are tracked and shared, which aids banks.

3. Lok Adalats - 2001

- ❖ They are useful in dealing with and recovering small loans, but the RBI guidelines established in 2001 limit them to loans of up to 5 lakh rupees. They are beneficial in that they prevent more cases from entering the legal system.

4. Wilful Defaulter

- ❖ Any entity is considered a wilful defaulter when:
 - ❖ The unit has failed to make its payment/repayment commitments to the lender, despite having the financial means to do so.
 - ❖ The unit has failed to meet its payment/repayment commitments to the lender and has not used the lender's funds for the specific objectives for which they were obtained, instead of diverting the money to other uses.
 - ❖ The unit has failed to meet its payment/repayment commitments to the lender and has syphoned off the funds, such that the funds have not been used for the precise purpose for which credit was obtained, nor are the funds available in the form of other assets with the unit.
- ❖ The Banks have to submit the names of the Wilful defaulters to the Reserve Bank of India (RBI) with outstanding loans of more than 25 Lakhs.

5. What is SARFAESI Act?

- ❖ SARFAESI Act of 2002 is “.. an act to regulate securitization and reconstruction of financial assets and enforcement of security interests, and to provide for a central database of security interests created on property rights, and for matters associated with or incidental thereto.”
 - ❖ SARFAESI is an acronym for Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest.
 - ❖ It permits banks and other financial institutions to recover loans by **auctioning off the defaulter’s residential or commercial assets**.
 - ❖ Under this act, India’s first **Asset Reconstruction Corporation (ARC)**, ARCIL, was established.
 - ❖ **Secured creditors** (banks or financial institutions) have rights to security interest enforcement under **section 13** of the SARFAESI Act, 2002.
 - ❖ The SARFAESI Act of 2002 will now **apply to all state and multi-state cooperative banks**, according to the Supreme Court of India. Banks can now seize and sell defaulters’ properties to recoup their debts, thanks to the Supreme Court’s momentous decision.
- SARFAESI Act - Provisions**
- ❖ If a borrower of financial assistance defaults on a loan or an instalment, and his **account is categorised as a non-performing asset (NPA) by a secured creditor**, the secured creditor may request written notice before the term of limitation expires.
 - ❖ Unsecured loans, **loans under Rs. 100,000 and debts that are less than 20% of the initial principle** are exempt from the statute.
 - ❖ This law permitted the formation of asset reconstruction companies (ARCs) and **the sale of non-performing assets by banks to ARCs** (which are regulated by the RBI).
 - ❖ Without the consent of a court, banks are authorised to take **ownership of collateral property and sell it**.
 - ❖ To conclude, the SARFAESI Act gives financial institutions the authority to “seize and desist.” They should send a notification to the delinquent borrower, requesting payment within 60 days.
 - ❖ If the debtor does not cooperate, the bank may take one of the following three actions:
 - (1) Take control of the loan security.
 - (2) Sell, lease, or assign the security’s right.
 - (3) Take care of the asset or appoint someone to do so.
- SARFAESI Act - Amendments**
- ❖ The Central Government passed a law in 2013 **bringing cooperative banks under the SARFAESI Act of 2002**.

- ❖ **The Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Bill, 2016**, altered the statute once again.
 - ❖ The Supreme Court also held that co-operative banks that engage in banking activities are subject to **Sections 5 (c) and 56 (a) of the Banking Regulation Act of 1949, which are laws related to List I Entry 45. (Union List)**.
- ## 6. What is the Insolvency and Bankruptcy Code?
- ❖ The Insolvency and Bankruptcy Code, 2016 (IBC) is India’s bankruptcy law, which aims to unify the existing framework by establishing a single insolvency and bankruptcy law.
 - ❖ Insolvency is a condition in which a debtor is unable to pay his/her debts.
 - ❖ Bankruptcy is a legal process that involves an insolvent person or company that is unable to pay its debts.
 - ❖ It establishes clearer and faster insolvency procedures to assist creditors, such as banks, in recovering debts and avoiding bad loans, which are a major drag on the economy.
 - ❖ It is an all-encompassing insolvency code that applies to all businesses, partnerships, and individuals (other than financial firms).
- Insolvency and Bankruptcy Code 2016**
- ❖ The code repealed all previous legislation and established a **standardised framework** for resolving insolvency and bankruptcy cases.
 - ❖ It enables creditors to **analyse a debtor’s viability** as a business decision. Furthermore, creditors might either agree to the plan for its resurrection or propose a **quick liquidation**.
 - ❖ The Code establishes a new legal structure. This framework aided in the **formalisation and liquidation of an insolvency resolution process** that was time-bound. The framework consists of the following elements:
 - ❖ **Insolvency Professionals:** They will be in charge of the resolution procedure. They also handle the debtor’s assets and provide information to creditors to help them make decisions.
 - ❖ **Insolvency Professional Agencies:** Insolvency practitioners will be registered with professional agencies for insolvency. Exams would be conducted to certify insolvency specialists, and a code of behaviour for their performance would be enforced by the agencies.
 - ❖ **Information utilities:** They will maintain track of debts owed to creditors, as well as repayments and debt defaults.

- ❖ **Adjudicating authorities:** They will sanction the start of the resolution procedure, appoint the insolvency professional, and sign off on the creditors' ultimate judgement.
 - ❖ The **National Company Law Tribunal (NCLT)** is the deciding authority for corporations and limited liability firms.
 - ❖ Individuals and partnership firms have their debts adjudicated by the **Debt Recovery Tribunal (DRT)**.
 - ❖ The **Insolvency and Bankruptcy Board** will oversee insolvency experts, professional agencies, and information utilities established under the Code.
 - ❖ The goal of the code is to **address insolvencies in a timely way**; the evaluation and viability determination must be done **within 180 days**.
 - ❖ The Company is subject to a **180-day moratorium (which can be extended up to 270 days)**. The resolution time frame for startups and small businesses is 90 days, which can be extended by 45 days.
- 7. What is a Bad Bank?**
- ❖ A bad bank is a financial institution that was formed to **purchase the bad loans and other illiquid assets of another financial institution**.
 - ❖ The organization with a large number of nonperforming assets will sell them to the bad bank at market value.
 - ❖ The original institution may be able to clear its balance sheet by transferring such assets to the bad bank, albeit it will still be compelled to take write-downs.
 - ❖ Instead of a single bank, a bad bank structure may assume the risky assets of a consortium of financial organizations.
 - ❖ **Grant Street National Bank** is a well-known example of a bad bank. This entity was founded in 1988 to house Mellon Bank's bad assets.
 - ❖ Outside of the United States, the Republic of Ireland established the **National Asset Management Agency**, a bad bank, in 2009 in response to the country's own financial crisis.
 - ❖ The **Insolvency and Bankruptcy Code (IBC)** and other applicable resolution tools have been shown to be useful.
- Bad Bank in India**
- ❖ The government of India has established two new firms to acquire stressed assets from banks and then sell them in the market in order to resolve large NPAs (Non-Performing Assets) in the Indian banking sector.
 - ❖ **NARCL: National Asset Reconstruction Company Limited (NARCL)** was established under the **Companies Act** and has applied for an Asset Reconstruction Company license from the Reserve Bank of India (ARC).
- ❖ In phases, NARCL will buy stressed assets totaling roughly Rs 2 lakh crore from various commercial banks.
 - ❖ NARCL will be owned by **public sector banks (PSBs)** to the tune of 51 percent.
 - ❖ The NARCL will buy bad loans from banks first.
 - ❖ It will pay 15% of the agreed price in cash and the rest 85% in **"Security Receipts."**
 - ❖ The commercial banks will be paid back the remainder when the assets are sold with the help of IDRCL.
 - ❖ The government guarantee will be activated if the bad bank is unable to sell the bad loan or must sell it at a loss.
 - ❖ This guarantee is extended for a five-year period.
 - ❖ **IDRCL:** The stressed assets will subsequently be sold in the market by another firm, **India Debt Resolution Company Ltd (IDRCL)**.
 - ❖ IDRCL will be owned to a maximum of **49 percent by PSBs and Public Financial Institutes (FIs)**.
 - ❖ **Private-sector lenders** will own the remaining **51 percent of the company**.
 - ❖ The new bad bank structure is this framework of NARCL-IDRCL.
- 8. Recapitalisation of Banks**
- ❖ **Recapitalisation of Banks is injecting additional capital into state-owned banks to bring them up to capital adequacy standards.**
 - ❖ It entails **injecting more capital into state-owned banks** in order for them to achieve capital adequacy requirements.
 - ❖ The requirement for Indian public sector banks to maintain a **Capital Adequacy Ratio (CAR) of 12 percent** has been underlined by the Reserve Bank of India in line with **BASEL norms**.
 - ❖ The capital-to-risk-weighted-assets-and-current-liabilities ratio (CAR) is the ratio of a bank's capital to its risk-weighted assets and current liabilities.
 - ❖ The government injects capital into banks that are short on cash using a variety of instruments.
 - ❖ Because the government is the largest stakeholder in public sector banks, it is the government's responsibility to increase capital reserves.
 - ❖ The government injects capital into banks by issuing bonds or buying new shares.
 - ❖ In 2017, the government had announced an Rs. 2.11 Lakh crore recapitalisation package for the Public sector Banks
- 9. Prompt Corrective Action**
- ❖ The RBI uses the PCA framework to keep track of banks with poor financial performance.

- ❖ The PCA framework was introduced by the **RBI in 2002** as a structured early intervention mechanism for banks that have become undercapitalized or fragile due to a loss of profitability.
 - ❖ Its goal is to **address the issue of non-performing assets (NPAs)** in India's banking system.
 - ❖ Based on the recommendations of the **Financial Stability and Development Council's** working group on Resolution Regimes for Financial Institutions in India and the **Financial Sector Legislative Reforms Commission**, the framework was reviewed in 2017.
 - ❖ If a bank is in crisis, PCA is supposed to inform the regulator, as well as investors and depositors.
 - ❖ The goal is to prevent problems from reaching crisis proportions.
 - ❖ Essentially, PCA assists RBI in monitoring banks' key performance indicators and taking corrective action to restore a bank's financial health.
- 10. Indradhanush Framework – 2015**
- ❖ Since banking nationalization in 1970, the Indradhanush framework for changing PSBs has been the most comprehensive reform effort undertaken by ABCDEFG to remodel the PSBs and improve their overall performance.
 - ❖ **Appointments:** Based on worldwide best practices and guidelines in the Companies Act, a distinct post of Chairman and Managing Director will be created, with the CEO receiving the designation of MD & CEO, and a non-executive Chairman of PSBs would be appointed.
 - ❖ **Bank Board Bureau:** will replace the Appointments Board in the selection of Wholetime Directors and non-Executive Chairman of PSBs.
 - ❖ **Capitalization:** According to the finance ministry, the capital requirement for the next four years up to FY 2019 is estimated to be around Rs.1,80,000 crore, of which the government will pay 70000 crores and PSBs will have to raise the remainder from the market.
 - ❖ **Destressing:** De-stressing entails resolving concerns in the infrastructure sector in order to keep stressed assets out of banks by bolstering asset reconstruction firms. The creation of a thriving debt market for PSBs.
 - ❖ **Empowerment:** PSBs should be given more flexibility and autonomy when it comes to employing staff.
 - ❖ **A framework of Accountability:** The banks will be evaluated based on a few key performance indicators. It would include everything.
 - ❖ Non-performing asset management, growth, diversification, return on capital, financial inclusion, and other quantitative indicators
- ❖ Steps done to improve asset quality, human resource initiatives, and so on are examples of qualitative parameters.
 - ❖ **Governance Reforms:** Banker's Retreats or Gyan Sangam talks between bankers and government officials to resolve banking sector concerns and determine the future course of action.
- What are Basel Norms?**
- ❖ The Basel accord refers to a set of agreements by the BCBS that primarily address risks to banks and the financial system.
 - ❖ The agreement's goal is to ensure that financial institutions have sufficient capital on hand to meet obligations and absorb unexpected losses.
 - ❖ The Basel accords for the banking system have been accepted by India. In fact, the RBI has imposed more stringent standards on a few parameters than the BCBS has.
- The Basel Committee on Banking Supervision (BCBS) issues Basel Norms for international banking regulations.** The goal of these norms is to strengthen the international banking system by coordinating banking regulations around the world. BCBS is made up of 27 representatives from various countries around the world, including India. The Basel Committee has currently issued three guidelines to achieve its goal: **Basel I, II, and III.**
- ❖ In India, the deadline for implementing Basel-III was **March 2019**. It was pushed back to **March 2020**.
 - ❖ **Basel is a city in Switzerland.**
 - ❖ **It is the headquarters of the Bureau of International Settlements (BIS),** which promotes cooperation among central banks with a common goal of financial stability and banking regulatory standards.
 - ❖ Every two months, the BIS hosts a meeting of the governors and senior officials of member countries' central banks.
- BASEL I**
- ❖ **BCBS introduced the capital measurement system called Basel capital accord in 1988.**
 - ❖ It was almost entirely concerned with **credit risk**.
 - ❖ The required **minimum capital** was set at **8% of risk-weighted assets (RWA).**
 - ❖ RWA refers to assets with varying risk profiles. For example, an asset backed by collateral would be less risky than a personal loan with no collateral.
 - ❖ Capital is divided into two categories: Tier 1 capital and Tier 2 capital.
 - **Tier 1 capital** is the bank's **core capital** because it is the primary measure of the bank's financial strength.

- The majority of core capital is made up of disclosed reserves (also known as retained earnings) and paid-up capital.
- It also includes non-cumulative and non-redeemable preferred stock.

❖ **Tier 2 capital** – It is used as supplemental funding since it is less reliable than the first tier.

- It consists of undisclosed reserves, preference shares, and subordinate debt.
- **In 1999, India adopted the Basel 1 guidelines.**

BASEL II

❖ BCBS published **Basel II guidelines** in **June 2004**, which were considered to be refined and reformed versions of the Basel I accord.

❖ The guidelines were founded on **three pillars**, as the committee refers to them:

- **Capital Adequacy Requirements:** Banks should keep a minimum capital adequacy requirement of 8% of risk assets.
- **Supervisory Review:** According to this, banks were required to develop and implement better risk

management techniques for monitoring and managing all three types of risks that a bank faces: credit, market, and operational risks.

- **Market Discipline:** This necessitates stricter disclosure requirements. Banks must report their CAR, risk exposure, and other information to the central bank on a regular basis.

BASEL III

- ❖ The **Basel III** guidelines were published in **2010**.
- ❖ These guidelines were put in place in response to the **2008 financial crisis**.
- ❖ There was a need to further strengthen the system because banks in developed economies were undercapitalized, over-leveraged, and relied more on short-term funding.
- ❖ **The guidelines are intended to promote a more resilient banking system by focusing on four critical banking parameters: capital, leverage, funding, and liquidity.**
- ❖ The **capital adequacy ratio** should be kept at **12.9 percent**.

