Abstract

The Indian Banking industry has been reforming to meet the new developments ever since 1991. While it becomes absolutely essential, there are a few considerations that need to be tracked down minutely at all times. In an event of financial crisis in 2008, India and the world went through a major economic slowdown. As a result, concerns and awareness to maintain asset quality have taken a front seat. In other words, Non-Performing Assets (or the NPAs) have become an area of attention. The adverse effect of NPAs has aroused the need for authorities to regulate bank’s stability with a higher provision. The ebook focuses on past trends of NPAs and how banks must take serious actions in managing them.
Abstract

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**Introduction**

The economic growth of a country majorly depends on the role of banking sector to offer financial aids to industries like healthcare, automobiles, pharmaceuticals, iron and steel etc. Banks thus carry a scope beyond the responsibilities of just being financial institutions and contribute to attaining the government's social targets. However, over the past few years, the banks have been struggling to deal with the increase in the number of NPAs – where the principal and interest amount of loans or advances is not paid out and remains overdue. During the economic-high from years 2002 to 2008, the increase in credit growth was as high as 22%. On the contrary, past the financial crisis, there is a lack of credit demand and banking sector is facing challenges in extending credits. The increase in the number of NPAs has turned out to be a worry for RBI and Finance Ministry.

<table>
<thead>
<tr>
<th>FY01</th>
<th>FY02</th>
<th>FY03</th>
<th>FY04</th>
<th>FY05</th>
<th>FY06</th>
<th>FY07</th>
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<th>FY11</th>
<th>FY12</th>
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<tbody>
<tr>
<td>4.2%</td>
<td>5.4%</td>
<td>3.9%</td>
<td>8.0%</td>
<td>7.0%</td>
<td>9.5%</td>
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<td>6.5%</td>
<td>4.5%</td>
<td>4.9%</td>
<td>4.5%</td>
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Source: Trends in Indian banking sector, Reserve Bank of India
The Rise Of NPAs In Indian Banks

India – being one of the fastest growing economies is continuing to evolve as a result of developments in IT, infrastructure and agriculture. This further calls for an increase in credit flow across distinct sectors to back these developments. Banks have been facing challenges to complement GDP by monitoring credit flow, yet not compromising on the asset quality.

According to statistics suggested by RBI, in March 2016 – the gross NPAs in banking sector rose to 7.6% - being the highest in last 12 years. Projections are also indicative that this percentage may further increase to 8.5% by March 2017. However, it may reach a high of 9.3% in case of deterioration of macro-environment.

Here are a few statistics from the past few years reflecting the increase in Gross NPAs.

“The stress in the banking sector, which mirrors in the corporate sector, has to be dealt with in order to receive credit growth.”
Raghuram Rajan, RBI Governor
Considering the rise of NPAs over the years, banks have been given the power to recover the loan amounts in the desired ways as listed under the SARFAESI Act, 2002. According to this Act, banks may “seize and deceit” a property (commercial or residential, as applicable) by issuing a written notice to borrowers who default on their payments. This process is referred to as “recovery” and helps in minimising NPAs.

Listed below are the measures that banks may adopt in order to take action against the defaulters who fail to comply with the notice:

- Take charge to manage the security against loan or appoint an authority to manage it
- Sell/Lease the secured assets
- Take possession of the security against the loan
NPA Management

Non-Performing Assets (or NPAs) are an outcome of loosely monitored and controlled activities at the bank level. The loopholes at the levels of implementation strategy and management, directly impact the credit growth through an increase in the number of NPAs.

The NPA management initiates by obtaining customer data from various sources to conduct a predictive analysis based on their geographical and behavioural characteristics. This analysis helps rate a customer based on their capacity and will to repay, and accordingly decide the credit eligibility for the borrower. Credit Information Bureau India Limited’s (CIBIL) and High Mark have been helping banks to provide an indicator to customer sentiments/behaviour and take preventive measures to ensure they don’t turn into NPAs.
Loans and Advances – Repayment

While banks decide upon appraising the borrower’s credit limit, the biggest question that arises is whether or not the amount will be repaid. So, on what grounds do financial institutions analyse the borrower to assign them a relevant credit rating? Following are the criteria on which the decision is made:

- **Intention to Pay:** It is the willingness of the borrower to pay the loan amount within the stipulated time-frame and has mostly to do with the honesty and transparency of the payer.

- **Capacity to Repay:** The borrower must have a capacity to repay the loan by generating liquidity. The lender considers cash flow of operations that identifies the probability of loan repayment.

- **Intention to Default:** When the borrower depicts possible intentions to default i.e. a high tendency of not repaying the loan amount for a long time and turn into a bad debt.
RBI Initiatives to Deal with NPAs

Reserve Bank of India (RBI), as a regulatory body has introduced several reforms which may help in keeping control over the rising trend of NPAs in financial institutions and Non-Banking Financial Companies (NBFCs). Here’s a list...

- RBI, in order to recognise stressed assets, presented Special Mention Accounts (SMAs) concept to identify borrowers before they move towards delinquency and become NPAs.

- Central Registry of Information on Large Credits (CRILC) is set up to identify those in stress and have borrowed large amounts (500 crores and more).

- To promote FDI in Asset Reconstruction Companies (ARCs), the cap is increased from 49% to 74% which promoted Foreign Institutional Investors (FIIs) to invest in the equity of ARCs.
The Need for Automation in Banks to manage NPAs

Reserve Bank of India (RBI) has been working to strengthen banks and other financial institutions for managing NPAs – setting policies in place, defining the recovery measures etc. Automation – to decide and follow the remedial course of action is the key. However, banks struggle to achieve NPA automation due to lack of enough facilities that can aid them in NPA calculations, have unified customer data, manage huge chunks of relevant information etc.

NPA management is crucial to set up a regulatory framework that can effectively evaluate credit ratings of borrowers. Banks need to invest more into ways like NPA automation that can help maintain the asset quality and increase overall profitability.

NPA automation can give **Early Warning Signals (EWS)** that can identify assets who have become delinquent or are on the verge of delinquency. Based on this, the assets can be made to fall under 4 broad categories:

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standard assets:</td>
<td>When the dues are paid regularly and on time</td>
</tr>
<tr>
<td>Sub-standard assets:</td>
<td>When the dues remain unpaid for less than or up to 12 months</td>
</tr>
<tr>
<td>Doubtful assets:</td>
<td>When an asset remains to be an NPA for more than 12 months</td>
</tr>
<tr>
<td>Loss assets:</td>
<td>Where loss has been incurred and amount is not written off in full or half</td>
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NPA management is crucial to set up a regulatory framework that can effectively evaluate credit ratings of borrowers. Banks need to invest more into ways like NPA automation that can help maintain the asset quality and increase overall profitability.
Life Cycle Management

Digitisation is popularising and financial institutions are realising the influential role of technology. As a result, efforts to invest in technology that streamlines operations, have become a major consideration. Financial institutions must leverage the capabilities of automated banking software to manage customer data, their banking patterns, loan requirements, repayment capacity and thus effectively manage Non-Performing Assets (NPAs).

Few vendors have been offering a complete suite for NPA management in banks. Life cycle management of these automated software can ideally be divided into three steps:

**Analytics**
This package provides a single-window dashboard that helps view data, create reports, track workflows and make business decisions.

**Investigation**
This module gives reminders and alerts to follow-up, escalate and contact customers, as required.

**Recovery**
This module helps financial institutions take necessary actions as per the SARFAESI act, send a legal notice, set reminders for court hearings etc.

Financial institutions can choose to deploy individual modules, specific to their needs – for Analytics, Contact Process or Recovery.
Conclusion

Indian Economy has taken a downturn since the financial crisis hit in 2008. Banks have been striving to deal with high NPAs and low credit growth. Though macro-economic environment is one factor behind the cause, inefficient decisions taken during the economic-high has contributed largely to this effect. Not only banks but borrowers, regulators and other authorities need to be held responsible. It is high time they must take corrective actions and follow a holistic approach towards formulating a rational credit assessment strategy.
About Sesame

Sesame, a Speridian company, is a provider of complete banking solutions to financial institutions. It has been serving 200+ clients for over 23 years with Core Banking, Business Intelligence, Business Correspondents, Mobile and Internet Banking solutions.

The quality, innovation, integrity and support that Sesame has been extending to its customers becomes a primary reason for its success. Being completely compliant with the latest standards, trends, and advancements in the banking sector, Sesame has built and delivered new dimensions to cater to specific needs of financial institutions.

Identified as a market leader in co-operative banks sector, Sesame is aiming to provide its world-class services to scheduled and nationalised banks. Its objective is to empower financial institutions with the finest banking solutions that add on to their profitability and efficiency.
About Delinkure

Sesame has developed one-of-a-kind product for banks to manage NPAs – Delinkure. It is a comprehensive package for NPA management which offers an analytical workbench along with systematic contact and recovery processes to address delinquencies. The beauty of it lies in its ability to plug-in to an existing CBS in banks and perform as an individual entity to manage NPAs and make profitable business decisions.

Delinkure is developed considering SMAC – Social Mobile Analytics and Cloud, and comes with capabilities of Predictive Analysis for NPAs. It can integrate with Big Data Analytics algorithms such as Sentiment Analysis and Text Mining.