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Study on impact of Non-Performing Assets on Commercial Bank

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Abstract: *Non-Performing Assets (NPAs) are loans or advances issued by banks or financial institutions that ceases to bring in money for the lender because the borrower is no longer making payments of both principal and interest of the loan for at least 90 days. "A bank assets becomes non-performing when it stops generating income for the bank," said RBI in a circular form 2007. A debt that has been past due and unpaid for a predetermined period (90 days) is known as a non-performing asset (NPA). Bank's income and profitability fall when the percentage of NPAs in a bank's loan portfolio rise also its capacity to lend falls, and the possibility of loan defaults and write-offs rises. To aware and to overcome with the problem, the government and the Reserve Bank of India have introduced various schemes, policies and methods to manage and cut the share of non-performing assets (NPAs) in the banking sector.*

Keywords: Non-Performing Assets, loan Defaults, financial institutions.

I. INTRODUCTION

Non-performing assets or Non-performing loans which appears on the balance sheet places different kind of burdens on lenders. It disturb the budget and also decreases the earning of the organization due to non-receipt of interest or principle amount.

The bank assets are classified in the three categorySub-Standard Assets, Doubtful Assets and Los Assets depending upon the months they are outstanding.

Sub-Standard Assets

If an assets remains Non Performing for the period less than or equal to 12 months, then it becomes Sub-Standard Assets

Doubtful Assets

If an assets remains Non Performing for the period of more than 12 months.

Loss Assets

If an assets becomes uncollectible or it has very less value which cannot be considered as assets, it is called as loss assets.

NPA Provisions

Provisioning means an amount of money the banks has to keep aside from their profits or income in a particular quarter or period of time for non-performing assets or assets that may turn into losses in the future. By this method by banks provide for bad assets and maintain a healthy book of accounts. Like, Tier-I banks and Tier-II banks have different provisioning norms.

In the previous time, many banks has Restructure loans to maintain cash inflow and avoid classifying loans as non-performing. Once defaulted loans are collateralized by assets of borrowers, lenders can take possession of the collateral and sell it to cover losses to the extent of its market value.

Lenders can also convert bad loans into options like equity shares, which may appreciate to the point of full recovery of principal lost in the defaulted loan. At the end the banks are left with no option than selling the bad debts at lower / discounts price to companies that are having specialization in loan collections.

Non Performing Assets is has been a problem for banks for a long time. There have been renewed and various efforts on part of the Government of Indian and Reserve Bank of India to tackle the problem of Non Performing Assets

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Difference between bank fraud and NPA:

Bank fraud is a deliberate and criminal offense while Non-Performing Assets is a default in payment of interest or installments of principal remain overdue for a period of 90 days.

As per the Reserve Bank of India (RBI), an asset becomes non-performing when it ceases to generate any further income for the bank. The Non Performing Assets in Public Banks are valued at approximately $ 62 Billion, which represents 90% of total NPA in India.

There were many reasons behind the rise of NPA in India. Introduction of LPG Reforms, Banning of many projects of different industries, etc.

After LPG Reforms i.e, in the period from 2004 to 2009, business has taking bank loans very aggressively.

Major investment was in infrastructure sectors like roads, power, aviation, steel industries etc.

Lack of strictness in lending norms by the banks, without analysing the financial health of the companies and their credit ratings.

One of the major problem was red-tapism (delay in different types of permits) to various big and heavy industries power, steel, and iron etc. Minning has also got banned as a precaution to protect the environment. All these factors together leads to reduction in the income of the industries which ultimately affect the loan payment capacity of the industries leading to NPA for the banks.

Measures to Overcome

TheGovernment of India along with the advisory of the Reserve Bank of India has come up with 4R's strategy / Solution. 1. Recognizing of NPA in honest and open manner, the amount should be recovered from stresses account, PSB reforms and PSB Recapitalizing. Prompt and holistic steps taken under 4R's.

Change in credit culture has been effected, with the Insolvency and Bankruptcy Code (IBC) fundamentally changing the creditor-borrower relationship, taking away control of the defaulting company from promoters/owners and debarring wilful defaulters from the resolution process and debarring them from raising funds from the market.

The PSB's has already started to recapitalize their NPA's. It has been continued by PSB in the continuous years.

Key reforms have been instituted in PSBs as part of the PSBs Reforms Agenda, including the following:

Board-approved Loan Policies of PSBs now mandate tying up necessary clearances/approvals and linkages before disbursement, scrutiny of group balance-sheet and ring-fencing of cash flows, non-fund and tail risk appraisal in project financing.

It has used the third party data to understand the NPA of the particular company and the reasons which are given is right or not.

To ensure timely and better realisation in one-time settlements (OTSs), online end-to-end OTS platforms have been set up.

It has started doing monitoring of the Bank Loan on time to time to make sure that prompt action has been taken by the Bank.

There has to be least NPA by the bank and bank should try to reduce as less as they can.

SARFAESI Act 2002- (Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act).

As per SARFAESI Act, the bank can auction the commercial and business assets of the organization for the recovery of the loan. It will reduce the overall liability of the bank. It will also prevent them from NPA and also make them stabilize profits.

Securitization involves bundling and selling various debt instruments, such as mortgages and consumer loans, to investors through bonds.

Asset Reconstruction - This process involves transforming non-performing or bad assets into productive assets with the assistance of asset reconstruction agencies.

Enforcement of Security without Court Intervention - The Act empowers banks and financial institutions to enforce security interests and initiate recovery proceedings without court intervention. This will increase the recovery of the loan.

The Act also provides a legal framework for securitization activities in India, ensuring transparency and regulation. Furthermore, it enables banks and financial institutions to auction off properties. It includes commercial and residential properties in the event of loan default by borrowers.

Latest situation of NPA in India

As per the Reserve Bank of India latest edition of its Financial Stability Report, Scheduled commercial banks' net non-performing assets (NPA) ratio has fell to 3.9 per cent in March 2023 which is 10 years low.

It further added that Macro stress tests for credit risk reveal that SCBs are well-capitalised and all banks would be able to comply with the minimum capital requirements even under adverse stress scenarios.

Non-Performing Assets (NPAs) have been a significant concern for Indian commercial banks for several years. An NPA, often referred to as a bad loan, is a loan where the borrower has not made interest or principal payments for a specific period. Here's an overall view of NPAs in Indian commercial banks:

NPAs in Indian banks have been a persistent issue, with the problem intensifying over the years. The magnitude of NPAs grew significantly from around 2014 to 2018, leading to concerns about the financial health of many banks.

Economic slowdown, global factors, and sector-specific issues have played a role in the rise of NPAs. In some cases, NPAs were a result of corporate governance issues, mismanagement, or even fraud. Inadequate credit risk assessment and lending practices also contributed to NPAs.

The Reserve Bank of India (RBI) has implemented various measures to address the issue, including Asset Quality Review (AQR), Prompt Corrective Action (PCA), and revised NPA recognition norms. These measures were aimed at improving the transparency in the banking system and reducing the divergence between reported and actual NPAs.

The Insolvency and Bankruptcy Code (IBC) was introduced to expedite the resolution of NPAs by providing a legal framework for the insolvency and bankruptcy of corporate entities. Additionally, various restructuring and resolution schemes, such as the Corporate Debt Restructuring (CDR) and Sustainable Structuring of Stressed Assets (S4A), have been introduced to address the issue.

The high level of NPAs has had several adverse effects on the banking sector, including capital erosion, reduced profitability, and constrained lending capacity. Some public sector banks have faced challenges in maintaining the minimum capital adequacy requirements.

Efforts have been made to recover NPAs through the Insolvency and Bankruptcy process. The government has also infused capital into public sector banks to bolster their financial health. The merger of several public sector banks was another step towards consolidation to create more robust entities.

Challenges remain, including the slow pace of resolution under the IBC, potential moral hazard, and the need for improved governance and risk management practices within banks.

While the situation has improved in recent years, addressing NPAs continues to be a priority for Indian banks. A more cautious approach to lending, stronger risk management, and enhanced corporate governance are essential for preventing the recurrence of a high NPA problem.

NPAs have been a significant issue for Indian commercial banks, impacting their financial health and ability to lend. Regulatory and legal measures have been introduced to address the problem, but challenges remain.

he ongoing resolution of NPAs and the adoption of prudent lending and risk management practices are crucial for the Indian Commercial Banks.

Changes in Non-Performing Assets (NPAs) can occur for various reasons and are an essential indicator of the financial health and risk management of banks. Here are some key factors that can lead to changes in NPAs.

The state of the economy plays a significant role in NPA changes. During economic downturns, businesses and individuals may struggle to meet their debt obligations, resulting in an increase in NPAs. Conversely, during economic upswings, NPAs may decrease as borrowers find it easier to service their loans.

Changes in the performance of specific sectors or industries can affect NPAs. For example, a sudden crisis in a particular industry, such as real estate or agriculture, can lead to a spike in NPAs within that sector.

Changes in a bank's lending practices can influence NPAs. If a bank relaxes its credit standards and lends to riskier borrowers, it may experience an increase in NPAs. Conversely, tighter lending standards can result in lower NPAs.

Changes in banking regulations, particularly those related to NPA recognition and classification, can impact how NPAs are reported. Regulatory authorities may periodically revise the norms for recognizing and provisioning for NPAs, which can lead to changes in their reported levels.

The implementation and effectiveness of resolution mechanisms, such as the Insolvency and Bankruptcy Code (IBC), can affect the pace of NPA resolution. Successful resolutions can reduce NPAs, while delays or failures can contribute to their persistence.

Improvements in corporate governance practices within banks, as well as better risk management, can lead to reduced NPAs over time. Conversely, lapses in these areas can contribute to an increase in NPAs.

The RBI conducts periodic stress tests to assess the health of Indian banks. These tests help identify potential vulnerabilities and assess how changes in economic conditions might affect NPA levels.

II. CONCLUSION

1. Indian Banks has suffered a lot in the previous years due to NPA.
2. Time to Time the government of India and Reserve Bank of India has taken various initiative to overcome with the problem of NPA in the Banks.
3. By keeping in view the interest of the bank and at the same time the development of the industries, the RBI and Government has regularly tried and kept the balance between both.
4. with the constant and regular effort by the RBI and Government of India, there has been a constant decline in the NPA of the banks.
5. The trust of the investors for the bank has been restored by the RBI.
6. The Introduction of various acts and precaution by the government has reduced the NPA for the banks.
7. In the long run its ultimately going to profit the business as they will get loan easily.

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