CONSTITUENTS AND ESSENTIALS OF A ROBUST AUTONOMOUS FRAMEWORK TO MITIGATE NPA RISK: A STUDY OF THE INDIAN BANKING ENVIRONMENT

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Abstract

The rise of non-performing assets (NPAs) has been a major issue for the Indian banking industry. The increase in NPAs has a direct impact on banks' profitability. The economy as a whole is impacted by the NPA issue in addition to the banks. Actually, the high percentage of non-performing assets in Indian banks is just a reflection of business and commerce. While NPAs don't provide any revenue, the bank must make reserves for these kinds of assets. NPAs have a negative effect on the economy's ability to function in addition to reflecting poorly in a bank's account books. Numerous studies have been done on the subject of managing non-performing assets (NPAs), including those that focus on specific banks or compare public and private banks. The researcher is examining the components and requirements of a strong independent framework to reduce NPA risk in this paper: an examination of the financial landscape in India.

The health and performance of the banking system are critical to the development of the economy in a financial system-based economy since they act as financial intermediaries. Following the global financial crisis, nonperforming assets (NPAs) and nonperforming loans (NPLs) have become more and more problematic for the financial systems of developed and emerging nations. The goal of this article is to examine how NPA/NPL is currently managed in both developed and developing nations. The performance of the Indian banking sector was assessed in relation to the global level of non-performing assets (NPAs) in various countries.

Keywords: NPA, Economy, Indian banks, Financial system, Banking environment.

Introduction

There is a clear correlation between the quality and performance of advances and the profitability and viability of banks. A number of other direct and indirect factors may raise issues even in the case that banks have efficient credit appraisal and disbursement processes. Important elements of

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a robust/sound non-performing asset management system include prompt identification of non-performing assets, their containment at minimum or beginning levels, and making sure their impact on the financials is small or nonexistent. At different stages of the credit facility's life cycle, different strategies are needed for NPA management, which calls for a multidisciplinary approach. To reduce the amount of nonperforming assets (NPAs), none of the banks have put in place any kind of strategy, large or little. Field level players should prioritise finding a solution since they know that non-performing assets (NPAs) are currently a sore spot for the Indian economy. Why don't representatives of business and industry, along with the Indian Bankers Association, get together to assess the problem and devise a sustainable solution.

Financial institutions that specialise in handling money are called banks. Every commercial bank's primary functions are lending and accepting deposits. In order for an economy to grow and prosper, banks are essential to the mobilisation of capital and its distribution among priority and non-priority industries. Every commercial bank's primary functions are lending and accepting deposits. In order for an economy to grow and prosper, banks are essential to the mobilisation of capital and its distribution among priority and non-priority industries. Getting funds to high-quality assets (loans and advances) without failing is the main problem facing commercial banks, as it keeps them from going non-performing. A bank is deemed effective if it can effectively handle and surmount both internal and external variables and impediments, as well as stay abreast of emerging technologies. A nation's economic prosperity is greatly influenced by its sound financial system.

Getting client deposits in order to provide loans is the banking industry's main responsibility. Because of this, it raises money, which it subsequently lends to others, creating bank assets. As the primary activity of banking and the bank's most valuable asset, the money that has been mobilised is lent in the form of loans and advances. By way of loans or advances, the money is provided, and it helps the bank generate interest revenue. Furthermore, a part of the bank's total available money is allocated to real assets like buildings and land, office equipment, and other assets connected to banking, while a lesser fraction is invested in securities or instruments (both debt and equity).

Failure to produce revenue for the bank within the allotted period is what the Reserve Bank of India refers to as a non-performing asset. In other words, an asset will be classified as and treated as a nonperforming asset (NPA) if interest or principal installments are not paid for a period of time as stated in RBI rules and regulations.

Non-performing asset (NPA) revenue is only recorded as income when it is actually received; in other nations, it is not recognised on an accrual basis. In an attempt to bring about harmony, our nation decided to implement a comparable process. The bank is not to collect interest on any NPAs and is not to levy interest. Non-performing assets are those that no longer bring in money for the bank.

Related Concept of NPAs

NPAs are simply loans that fail and don't make money for the banks. Non-performing loans are ones that haven't expired yet, but it's not sure if the borrowers will be able to pay back their obligations. In addition to divergent definitions across nations, distinct definitions within a single nation also exist based on the industry. Regarding the contents, breadth, and classification scheme, the definitions differ. As per the guidelines set by the International Monetary Fund (IMF), a loan is deemed non-performing if the principal and interest payments are past due by more than ninety days, if interest payments have been agreed to be capitalised, refinanced, or delayed, or if payments are under 90 days past due but there are plausible reasons to question complete repayment.

Exempted Assets: Assets Classification, Income Recognition, Provisioning, and IVP Indira Vikas-Patras, KVP Kissan-Vikas-Patras, National-Saving-certificates, LIC policies surrender value, and advances against a bank's own term deposits/recurring deposits are all fully excluded and are hardly ever handled as "Standard Assets."

Downgrading of NPA: The RBI had instructed banks to treat accounts that pose a potential threat of recovery—regardless of how long they have been labelled as nonperforming assets—as assets as soon as possible. These accounts could be threatened by a decline in the value of security, an inability to obtain security, or other factors like borrower fraud.

Up gradation of NPAs: When non-performing assets turn into standard assets, or the account becomes regularised, it is when they are assessed for upgrade. Stated differently, if an NPA in question is upgraded from doubtful to sub-standard, no more recovery will occur unless the account is restored to good standing and taken off the NPA list.

Demand and Housing loans to staff: Staff accounts can be viewed as conventional assets since monthly due installments will be collected on a regular basis. Interest earned on these accounts can be reported as revenue for the year that ends.

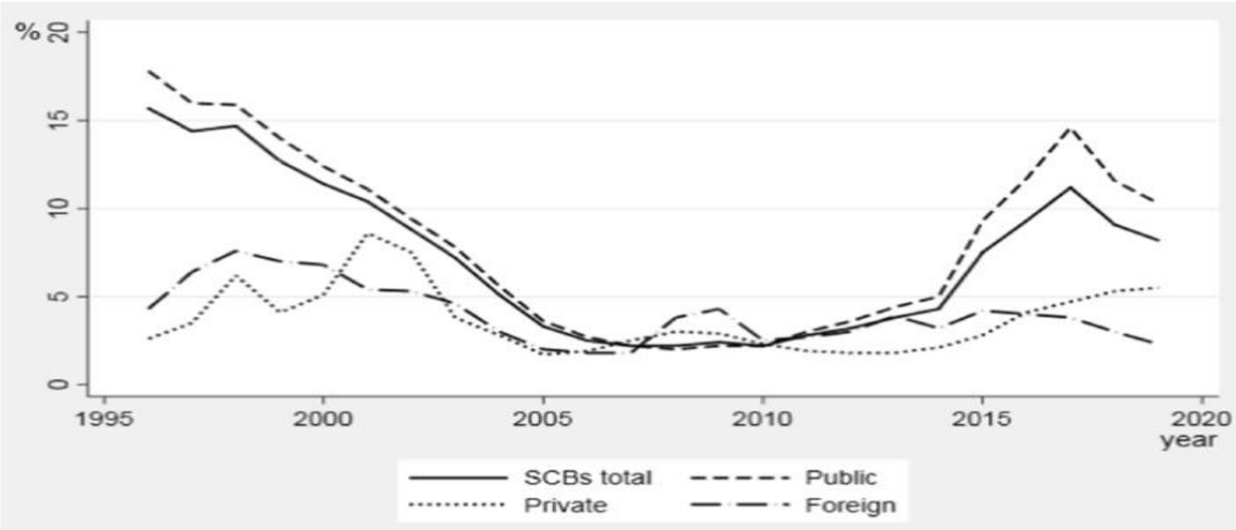
Consortium Advance: When multiple banks or financial institutions work together to advance a unit, this is known as a consortium advance. To ensure consistency in methodology when it comes to borrowing units, the consortium members ought to adhere to the classification that the leader has selected. The leading bank should notify other banks of the classification information.

Reschedulement of Advances: As per RBI guidelines, if an account hasn't turned bad yet, it can be rescheduled prior to production starting or before an installment is due based on the initial terms. In these cases, the rescheduled periods must be taken into consideration while evaluating the NPA status.

Causes for Non-Performing Assets

Public concern has been raised by the high percentage of nonperforming assets (NPAs) in both public and private sector banking institutions. This is because bank lending is the engine of the nation's economic growth, and rising NPAs are one reason for this, which will unavoidably have a negative impact on the economy. There could be repercussions in other businesses from the banking industry's collapse. The challenges of operating in a free market now face the Indian banking industry, which has traditionally operated in a closed economy. While social banking and directed financing combined to push competition and profitability to the background, a safe environment ensured that banks would never need to acquire sophisticated treasury or asset liability management capabilities. Unsustainable nonperforming assets (NPAs) were the ultimate result, which raised the effective cost of banking services. When the government and the RBI are charged with adopting a lax approach or neglecting to take further measures with banks that fall short of targets for lending to priority sectors, particularly small and agriculture, that's a different matter. Recovering non-performing assets (NPAs) under priority sector advances may be challenging due to externalities, particularly in small and rural enterprises.

Practical challenges have arisen in Indian banks, especially in public sector banks. For instance, in 1989–1990, the Indian government waived a sizable amount of rural debt of fifteen thousand crores during the tenure of Mr. V.P. Singh as prime minister. This was not an uncommon incident in India, and the loan recipient was not pleased with what they saw. Programmes to reduce poverty like IRDP SUME, SEPUP, JRY, PMRY, and others have not been able to achieve their objectives and have had negative effects. The enormous quantity of loans made under these schemes was entirely unrecoverable by banks due to political influence, financial pressure or abuse, and the unreliability of the target consumers in these locations. Their assets are bank loans, the quality of which has been steadily declining because some of them were not repaid on time. Credit allocation became referred to as the "Loan Mela." There was inadequate evaluation of the loan proposal, which led to poor repayment.



Source: Database on Indian Economy, RBI

Management of non-performing assets (NPAs) has so gained importance following the 1991 and 1998 recommendations of the Narasimham Committee I and II on Financial Sector Reforms, respectively. Adhering to the global benchmarks established by BASEL regulations, the committees suggested several micro-prudential actions, including as implementing risk-based capital guidelines and standardising accounting procedures for income recognition and provisioning against problematic and dubious assets. Prudent standards for best practices in banking were developed by the Reserve Bank of India (RBI) as a progressive measure. From a high of 15.7 percent in 1996 to a low of 2.2 percent by 2010, the non-performing asset (NPA) ratio for scheduled commercial banks (SCBs) has decreased dramatically.

The surge in investments throughout the latter part of the 2000s encouraged banks to provide credit to the private industry. But during the global financial crisis, India saw a decline in output as well as significant inflation and depreciation of the currency. Both the corporate and financial sectors have been damaged by these events and the ensuing monetary recession. However, as the economy slowed down, the banks continued to provide more loan facilities, and new initiatives failed to gain traction. Finally, that resulted in a new wave of non-performing assets, particularly in the infrastructure sector. Since 2010, PSBs' and FBs' non-performing assets (NPAs) ratios have steadily increased, with the exception of private banks. Moreover, there has been a notable rise in non-performing assets (NPAs) since 2014, with a peak of 11.2 percent in 2017. The RBI has been

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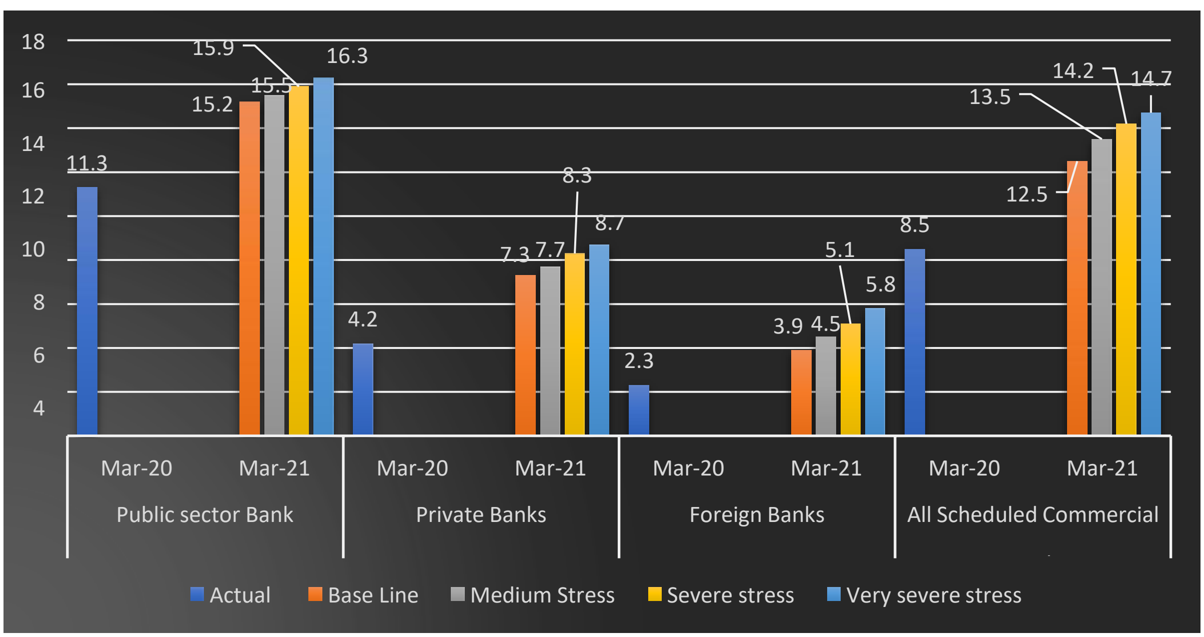
forced to implement crucial steps, such as the Asset Quality Review (AQR), to manage the NPA levels due to the alarmingly high levels of non-performing assets.

Nevertheless, the net present account (NPA) ratio saw a two-year downward trend, dropping from 8.2 percent in 2019–20 to 7.3 percent in 2020–21. It is mainly write-offs and fewer slippages that have caused the current decrease in NPAs (RBI, 2021). With 9.1% of overall non-performing assets (NPAs) in their portfolio, public sector banks (PSBs) have the biggest share of NPAs. This is not shocking considering that, in comparison to other banks, PSBs lend mostly to priority industries and rural communities. When comparing Indian private sector banks (PVBs) to foreign banks, the NPA ratio for PVBs has been the highest since 2016. In 2020–21, the NPA ratio for PVBs is 4.9 percent, while FBs have 3.6 percent.

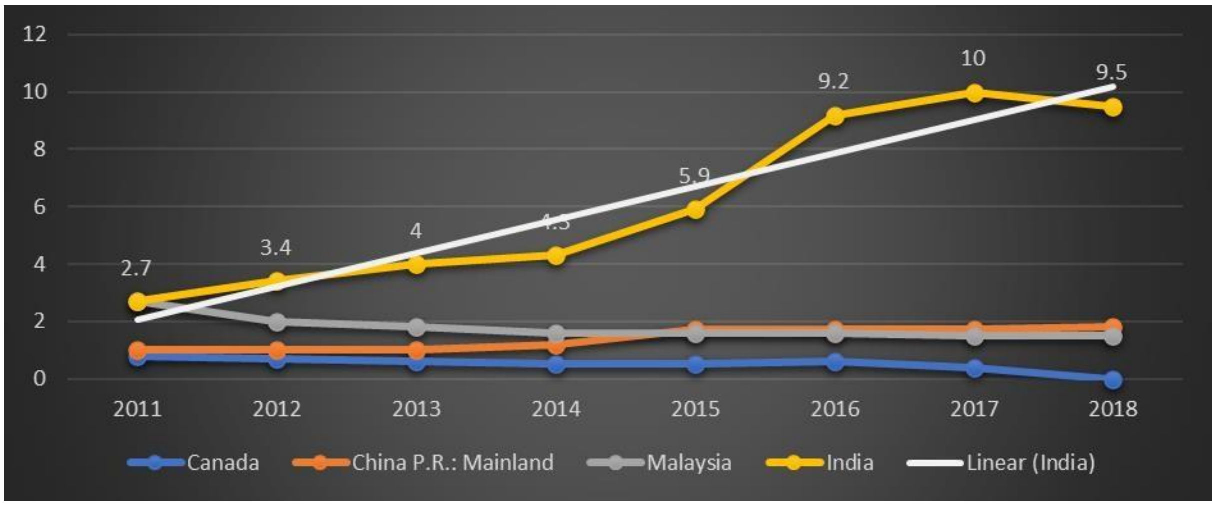
Non-performing assets (NPAs) are a crippling burden on the Indian banking sector. Their current percentage of all assets is 10.2 percent, according to the Reserve Bank of India's Financial Stability Report from December 2022. In contrast, stressed assets, or what are essentially considered non-performing assets, make up 12.8% of all assets. The banking system is beset by governance flaws stemming from concerns of competence and integrity, which have led to related frauds totaling INR 612.6 billion in the last five fiscal years.

NPA in banking System



Governor of the Reserve Bank of India (RBI) Shaktikanta Das acknowledged that the actual burden on Indian banks was muted by the loan prohibition regime. He cautioned that banks will continue to be extremely watchful and attentive, at least in the near future, in his preface to the FSR report, which presents a very negative picture of the Indian banking sector. According to the report, in a "very bad stress scenario," the total non-performing assets of the banking system would increase to 14.7 percent of all loans by March 2021 following a stress test of 53 scheduled commercial banks. He said that, in the base case as well, the total NPA ratio might rise to 12.5%. The total NPA figure reached a peak of 8.5% in March 2020.

Comparing India in NPL



Source: Financial Soundness Indicators

The figure presents a comparative comparison of India and other nations, highlighting the potential for improving the Indian banking industry through a decrease in the percentage of nonperforming assets. It is possible to infer the rise in nonperforming loans in Indian economies from the linear line, which shows a rising trend in nonperforming assets in India. The nation as a whole will benefit from the banking sector reforms that are prompted by this data.

Conclusion

An appropriate credit evaluation and risk management system can the issue of non-performing assets (NPAs) be resolved. Concerns regarding adverse selection and the risk of adding to the pool of non-performing assets (NPAs) arise when the banking system's eagerness to expand lending compromises asset quality in an environment of excess liquidity. The implementation of prudential regulations inside the banking system is necessary in order to mitigate, if not entirely prevent, the issue of non-performing assets. It is the responsibility of the banks themselves to limit the conditions that result in non-performing assets. For a proper evaluation of creditworthiness, this will require skill upgrades, organisational restructuring, and an increase in management efficiency. Establishing thorough and suitable credit appraisal processes is the best way to prevent non-performing assets (NPAs) in the early stages of credit consideration.

It was discovered that the circumstances surrounding non-performing assets (NPA) in Indian banks are quite dire following the completion of the investigation and data analysis. NPA not only indicates a negative outlook for the banks but also highlights a different aspect of the economy, which makes it a serious problem. Reforms in the financial industry are therefore imperative. India had to take note of how other countries have implemented policies to control their non-performing assets (NPAs) as they have been unable to contain the growth in NPLs.

In addition to being the main conduit for monetary policy, loans, and payments, India's banking sector is a crucial component of the country's economic structure. An essential precondition for the stability and growth of the economy is the complete asset quality of the banking system. A crucial metric for assessing the efficiency and effectiveness of the banking industry is the number of non-performing assets (NPAs) or non-performing loans (NPLs). The handling of NPAs involves investigating asset quality, credit risk management, and sensible finance resource use.

Banks need to perform very well on a range of criteria in today's fiercely competitive global marketplace. To sum up, public sector banks in India are still far behind private sector banks despite both having experienced significant development as a result of the banking sector reforms. It could be claimed that PSBs in India should be more effective in their entire asset management strategy, employee performance, cost control, and customer-friendly banking operations in order to compete with global competitors and meet the high standards set by India's private sector banks. In addition, they have to regularly assess non-performing accounts and keep a careful eye on asset quality.

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