'Prevention is always better than post-mortems'

MA What should be the concerns of the banks relating to NPA management during this present scenario of economic downturn in India?

Prevention is always better than post-mortems. During an economic downturn, the focus should be on strict due diligence before selection of assets. One has to carefully analyse the outlooks of different sectors of the economy, which sectors are experiencing stressful conditions, which sectors remain comparatively unaffected.

In case of corporate lending, banks have to be quite selective in underwriting, focusing only on

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ARUN KAUL
Chairman and MD, UCO Bank

Arun Kaul, an MBA from Punjab University, joined the Indian Public Sector Banks (PSBs) as a probationary officer. He achieved remarkable feats in the banking sector, travelling through SBI and then PNB as CGM (Treasury, International Banking and Credit). He was then the Executive Director of Central Bank of India. His imaginative leadership of treasury management led to substantial improvement in bank's trading and profit. He took over as Chairman and MD of UCO Bank on 1st September, 2010 highly rated corporate.

Side by side, the Credit Monitoring department should diligently control and monitor the health of the loan assets and put out early warning signals wherever warranted.

As far as assets which have already turned bad, the root causes have to be identified and genuine defaulters may be provided hand-holding support to tide over the crisis while for others, Banks should vigorously pursue various recovery channels including taking recourse to legal remedies proactively.

In short, under the present situation prudent asset selection, monitoring of asset health and recovery of dues should be top priorities for banks.

MA Do you feel that 'big ticket' advances could be the major cause of burgeoning NPAs in banks, if yes what remedial measures would you suggest?

Smart lenders are selective about projects they finance even in boom times. But if the economy is under stress, then there will always be pressure on large corporate credit. As a result, deteriorating asset quality – caused by persistent inflation, slackening demand, and slowing down of economic activity - is now a major concern for the country's banks.

In the case of UCO Bank, NPAs in the category of Rs.5 crore and above constitute 77% of the GNPA involving 172 accounts. Similarly, top 50 NPAs of the bank has contributed around 42% of total NPA portfolio.

UCO Bank took several remedial measures to control NPAs. With a view to de-risk the business as also improve profitability, the bank embarked upon changing the mix of both its assets and liabilities. Bank's business model shifted from bulk to retail banking. The improvement in bank's profitability in the last couple of quarters is primarily because of the growth in low-cost CASA deposits and rebalancing of our asset portfolio. Three years back the share of CASA deposits (in total deposits) had declined to 21%, but now it is around 35%. This has helped us in reducing the cost of funds. On the asset side, our loans were skewed heavily in favour of large corporates and the infrastructure sector. Since there was stress on these segments, Bank decided to move away from large corporate credit to retail, SME and agricultural advances. In the process, the share of large corporate credit and infrastructure finance reduced from above 70% of our loan portfolio to below 50%. After rebalancing of portfolio Bank do not anticipate large slippages in the future.

As on 30.09.2013 the GNPA %age decreased to 5.32% from 5.42% as on 31.03.2013.

MA What is your view about credit to SME sector, how much of it could become NPA? Are there any guidelines from the government in this regard?

A) Credit to SME Sector

Worldwide, the Micro & Small Enterprises (MSEs) have been accepted as the engine of economic growth and for promoting equitable development. In India too, the MSEs play a pivotal role in the overall industrial economy of the Country. Further, in recent years the MSE Sector has consistently registered higher growth rate compared to the overall industrial sector.

B) Regarding NPA

• Under SME Sector, NPA percentage of our Bank stood at 2.50% as on September, 2013 as against 3.20% a year ago.

• Our Bank have been financing MSMEs which are covered by Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE). Hence we are very hopeful that percentage of NPA will further reduce to 2% or less within a short period.

C) Guidelines from Govt. regarding financing MSME

Govt. of India has enacted the Micro, Small & Medium Enterprises Development (MSMED) Act, 2006 which is in force from 2nd October, 2006 which is a turning point for the development of Indian Industry.

Some of the salient points in the main guidelines are:

- Banks are advised to achieve a minimum 20% YOY growth over the MSE advances.
- 40% of total advances to Small Enterprises should go to Micro (Manufacturing) Enterprises having investment in Plant and Machinery up to Rs.10.00 lakh and Micro (Service) Enterprises having investment in equipment up to Rs.4.00 lakh.
- 20% of total advances to Small Enterprises Sector should go to (a) Micro (Manufacturing) Enterprises having investments in Plant & Machinery between Rs.10.00 lakh to Rs.25.00 lakh, and (b) Micro (Service) Enterprises with investment in equipment between Rs.4.00 lakh and Rs.10.00 lakh.
- Annual growth in the number of Micro Enterprises Accounts should be at least 10%.
- Govt. has specified time limits for disposal of loan applications for different credit limits.
- Recently, RBI has stipulated that incremental bank loans to Medium Service Enterprises extended after November 13, 2013 up to the credit limit of Rs.10.00 crore, would quality as Priority Sector advances up to 31/03/2014, while for Micro and Small Service Enterprises similar incremental loans up to the credit limit of Rs.10.00 crore (as against the present ceiling of Rs.5.00 crore) shall be treated as Priority Sector advances up to 31/03/2014.

Govt. guidelines have been implemented by our Bank in true spirit to increase our MSE Sector as well as Priority Sector.

MA How successful has the SARFAESI Act 2002 been in helping banks to manage NPA?

With a view to speed up the process of recovery from NPAs, The Securitization and Reconstruction of Financial Assets and

Enforcement of Security Interest (SARFAESI) Act was enacted in 2002 for regulation of securitization and reconstruction of financial assets and enforcement of security interest by secured creditors.

The SARFAESI Act empowers Banks / Financial Institutions to recover their non-performing assets without the intervention of the Court. The Act provides three alternative methods for recovery of non-performing assets, namely:

- Securitization
- Asset Reconstruction
- Enforcement of Security without intervention of the court

Despite enactment of a long overdue act like the SARFAESI Act to facilitate recovery of banks' money from defaulting borrowers, the ground level experience by the Banks/FIs tells a different story. Some major problems faced by the Banks/FIs are as follows:-

1) **Interference of Superior Courts in SARFAESI matters:** Although there is clear provision and procedure laid down under SARFAESI Act to challenge recovery actions of secured creditors, the Hon'ble Superior Courts are entertaining the recovery matters covered under SARFAESI Act by invoking writ jurisdiction vested upon them and granting stay/status quo which causes lot of delay in effecting recovery of banks' dues. This is despite the fact that ordinarily in SARFAESI matters, the borrower is not allowed to approach High Court invoking Article 226. In fact, the Hon'ble Supreme Court in the case of United Bank of India V/s Satyawati Tondon held that where an effective remedy was available to the aggrieved parties i.e. borrowers or guarantors, the High Court must insist that before availing the remedy under Article 226, the alternative remedies available to them under the relevant statute are exhausted.

2) **Delay in disposal by DRTs:** Now a days it is observed that DRTs are overburdened with SARFAESI Applications and DRT suits, which cause inordinate delay in disposal of cases, adversely affecting banks' recovery.

3) **Direction by the DMs./CMMs to the lenders:** It has been the experience of banks that whenever application is made by them under Sec 14 of the SARFAESI Act for police assistance to take physical possession of the secured property, the DMs/CMMs pass order directing the borrower to make repayment of the bank's dues by installments which is beyond the jurisdiction of the DMs/CMMs.

4) **Priority of Govt. Dues:** Though the SARFAESI Act has got overriding effect over other legislations, the claim of government prevails and often the amount realized though sale is claimed by the Government authorities. Due to the amendment in the Sale Tax Act of various States and decisions of Higher Courts, Banks are bound to honour sales tax claims etc.

5) **Registering FIR against Bank personnel:** Many a time, it is observed that influential borrowers/guarantors get criminal cases registered against the bank personnel thereby hindering the SARFAESI action of the Bank.

IN THESE CIRCUMSTANCES, THE ROLE OF FINANCE PROFESSIONALS CANNOT BE OVER-EMPHASIZED. THEY ARE THE BEST PERSONS TO PROPERLY GUIDE THE BORROWERS ON WHAT TO DO AND WHAT NOT TO DO

MA How is NPA presently affecting the profitability and efficiency of banks in India?

Impact of NPA

Profitability
Because of the money getting blocked, the profitability of bank decreases in proportion to NPAs. NPAs also lead to opportunity cost because otherwise if deployed in other assets/ investments the money could have earned income for the bank. So NPA does not only affect current profit but also future stream of profit. Reduction in profitability in turn results in lower ROI (return on investment).

Liquidity
With bank's money getting blocked, and decrease in generation of surplus, bank's liquidity gets affected forcing the bank to resort to short-term high-cost borrowing. This translates to additional cost.

Management Time
Since NPAs have become a burning issue, a lot of time and efforts of the top management are devoted towards this i.e. tackling and controlling the situation rather than to pursuing newer business opportunities which would have given good returns. Besides, banks have to bear substantial expenditure for legal and other related charges – like employing specialised recovery agents - to effect recovery from NPAs.

Reputation Loss
NPAs affect the repayment capacity of banks. Markets punish those with above-normal NPA levels as analysts and investors keep a hawk-eye on banks' asset health. High NPAs lead to loss of goodwill and affect brand image of the Bank.

The gross NPA ratio of the banking sector increased to 4.2% as at end September, 2013 from 3.4% of March, 2013. As on September 30, 2013, gross NPAs of banks stood at Rs 2,29,007 crore. The restructured standard advances also increased to 6% of total advances as at end September 2013 from 5.8% of March, 2013. Banks have to provide more for restructured assets, as per the RBI's revised guidelines.

All these factors would exert downward pressure on margins and squeeze profits for 2013-14 by around 30 percent according to a study.

MA Do Basel II and Basel III provide for sufficient provisions for management of NPA ?

Banks are required to maintain adequate capital against various risks faced by them for carrying out banking business. Capital requirement inter alia depends on the quality of assets of the bank. Basel II & III guidelines provide for allocation of higher risk weight for determining capital requirement on Non Performing Assets (NPAs). The salient points are:

- The unsecured portion of NPA (other than a qualifying residential mortgage loan), net of specific provisions, will be risk-weighted as follows:

I. 150 percent risk weight when specific provisions are less than 20 percent of the outstanding amount of the NPA;

II. 100 percent risk weight when specific provisions are at least 20 percent of the outstanding amount of the NPA;

III. 50 percent risk weight when specific provisions are at least 50 percent of the outstanding amount of the NPA.

- Where NPAs are secured by ineligible collaterals viz land, building., plant and machinery and provision reach 15% of the outstanding, risk weight is 100%.
- Claims secured by residential property, which are NPA will be risk weighted as under:

I. At 100 percent net of specific provisions.

II. If the specific provisions in such loans are at least 20 percent but less than 50 percent of the outstanding amount, the risk weight applicable to the loan net of specific provisions will be 75 percent.

III. If the specific provisions are 50 percent or more the applicable risk weight will be 50 percent.

The higher provisioning requirement for NPAs stipulated by Basel guidelines adversely affects the capital base of the bank which makes it all the more essential to ensure that assets do not turn bad.

MA In the present economic downturn, where borrowers are facing cash flow crunch and banks finding it difficult to provide for NPA accounts, how much do you feel the prudential guidelines are relevant to this scenario? Do you agree to the fact that stressing both the lenders and borrowers in an economic downturn scenario, as now, would simply impact the economy negatively and therefore the need of the hour is a situation based guideline that provide relief to genuine borrowers ? Do you feel that two sets of prudential guidelines be suitable for two different economic scenarios, one at the time of flourishing economy and one at the time of economic downturn ?

In order to reflect a bank's actual financial health in its balance sheet, the Reserve Bank has introduced prudential norms for income recognition, asset classification and provisioning for the advances portfolio of the banks. With a view to ensure that banks are not affected due to defaults, RBI has directed banks to make provisions or set aside money when an account turns bad.

It is true that in the present economic scenario, many bank borrowers are facing cash flow problems resulting in their failure to fulfill the repayment obligations to their lenders. For this reason asset quality of the banks has deteriorated substantially over the last 2-3 years requiring banks to make provision in all such accounts as per RBI prudential norms. This rise in provisioning for stressed assets is severely affecting the profitability of the banks.

Despite this, taking into account the time lag between an account becoming doubtful of recovery, its recognition as such, the realisation of the security and the erosion over time in the value of security charged to the bank, the banks should make provision against NPAs. This is also in line with the international standards and now, more than ever before, the prudential guidelines have become all the more relevant. Yes, during extra-ordinary situations, some special dispensations may be thought of - purely as a temporary measure - to help both bankers and genuine borrowers tide over the crisis.

For example, some relaxations may be thought of with regard to the delinquency period for classifying a genuinely distressed account as NPA. This will provide some breathing time to both bankers as well as borrowers to chalk out and implement a viable revival plan. However, this has to be sector-specific.

MA In the present scenario what roles professionals like Cost & Management Accountants play to help banking sector to check this problem? Please suggest in what way CMAs can offer their expertise in these situations?

In times of distress, the role of professionals like Cost & Management accountants is of paramount importance. They can render a yeomen's service to the banking sector by guiding the distressed borrowers properly. In such times people tend to take knee-jerk action like restructuring, over leveraging instead of proper study / analysis of the causative factors and then undertaking the correct long term sustainable remedial measures. In these circumstances, the role of finance professionals cannot be over-emphasized. They are the best persons to properly guide the borrowers on what to do and what not to do in a situation like the one obtaining today.

There cannot be one-formula-fits-all kind of suggestion across the board for all types of borrowers. This is where the expertise of professionals like CMAs would be required to diagnose the maladies and offer practical solutions to the bankers and borrowers.