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NPAS and Written off Accounts in India

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ABSTRACT *Directed lending has created recovery problems to the commercial banks in India. Leading to high level of NPAs that has resulted in negative impact on their profitability due to the necessity of provisions, recoveries and write offs as per RBI guidelines. NPAs also negatively impact the capital adequacy ratio, net worth and credibility of banks. Rising NPAs have direct impact on the bottom line as legally banks cannot book income on such accounts. Indian banks have to play more proactive role in minimising the level of NPAs. Foreign banks and private banks are more effective in recovering the due amount from the defaulters compared to Public sector banks. Write off of NPAs may not be a solution for the problem. The success of lending and recovery is possible only through the proper attention and concerted efforts by all stakeholders like regulators, policy makers, banks and bank customers.*

KEYWORDS : Commercial Banks, NPAs, write-offs, slippage and Recovery.

Introduction:

Target oriented approach in Indian banks has eroded the quality of lending, leading to high level of NPAs that has resulted in negative impact on their profitability due to the necessity of provisions, recoveries and write offs as per RBI guidelines. NPAs also negatively impact the capital adequacy ratio, net worth and credibility of banks. Rising NPAs have direct impact on the bottom line as legally banks cannot book income on such accounts. Indian banks need to be more proactive in all their operations, particularly risk identification and management, to operate profitably in the prevailing milieu (Talwar 2013)[1]. The problem of NPAs can be achieved only with proper credit assessment and risk management mechanism. In a situation of liquidity overhang, the enthusiasm of the banking system to increase lending may compromise on asset quality, raising concern about their adverse selection and potential danger of addition to the stock of NPAs. It is necessary that the banking system is to be equipped with prudential norms to minimize if not completely to avoid the problem of NPAs. The onus for containing the factors leading to NPAs rests with banks themselves. This will necessitates organizational restructuring, improvement in the managerial efficiency and skill up gradation for proper assessment of credit worthiness. It is better to avoid NPAs at the nascent stage of credit consideration by putting in place of rigorous and appropriate credit appraisal mechanisms (Prasad and Veena 2011)[2].

In India the tax law allows 100% tax deductibility for the calculation of taxable income for banks in the case of loans written off. However, provisions for sub-standard assets are permitted as deduction only to the extent of 7.5% of the bank's total income. Because of this special tax law, Indian banks prefer to write-off the doubtful and bad assets rather than make provisions. This is shown in the reduction of gross NPLs instead of an increase in loan loss reserves (Islam et al)[3].

When the banker thinks that it is un-remunerative either to file suit and/or continuing the loan account in bank's books, then bank may go for waivement of legal action and/or writing of dues. In case of waiver of legal action banks take a decision not to pursue recovery through a court of law and through write off the banks decide to close the account by transfer of funds from their profits to the loan account. Circumstances under which legal actions are waived and dues are written off:

Waivement of Legal Action:

- Means available with borrower and guarantors are insufficient.
- Borrowers are beneficiaries under Government sponsored schemes and the economic conditions of the beneficiaries are still persisting in subsistence level.
- Recovery cost is quite high and prohibitive as recovery expected is not going to equalize even the cost.
- Borrowers are absconding and/or untraceable.
- Obtaining periodic balance confirmation letters-cum-acknowledgement have become a cumbersome process and not remunerative to bank.
- Securities are already disposed of by the borrower either in part or whole and no assets are available to banks for recovery of dues.

Writing off dues:

In addition to the factors which favour Waivement of legal action, if situation is such, that it has become quite un remunerative to continue the account in bank's book, due to one reason or the other, then Bank goes for writing off dues. Under following situations the bank may proceed with write off dues:

- When cost involved in servicing the loan has become high and prohibitive.
- When borrowers are adjudicated as insolvents and bank has already realised part of its dues as a secured creditor.
- When revenue authorities under State Public Recovery Act have already affected maximum recovery through sale proceeds of bank's security and/or properties of borrowers and chance of further recovery is quite bleak.
- When proceeding has turned out to be a futile exercise as borrower and guarantors are untraceable.
- When decrees remain unexecuted for years together (Toor1994)[4].

Table 1 Trends in slippages and recovery (Rs Bn)

Particulars	2001-2013	2001-2007	2008-2013
NPAs at Beginning of the period	604	604	505
New Accretion to NPAs during the period	6248	1591	4657
Reduction in NPAs during the period	4920	1690	3230
Due to up gradation	1109	240	869
Due to write-off	2036	739	1297
Due to actual recovery	1775	711	1064
NPAs at End of the period	1932	505	1932

Source: RBI (2013)

Fresh accretion to NPAs during the year, provide a better metric to assess the credit management system in banks. While the slippages reduced during early 2000s, they started rising significantly since 2006-07. Growth rate of slippages which was negative till 2005-06, turned sharply positive in 2006-07 reaching a peak of 51.6 per cent in 2011-12. The net slippages (slippages net of recovery during the year) also showed the same trend. Contrary to the popular notion that the rising NPAs are fallout of the global financial crisis, the data suggests that the credit administration in the banks had started weakening and the asset quality had started deteriorating even before the onset of the crisis. Further, slippages exceeded reduction in NPAs, especially post crisis, as the ratio of reduction in NPAs to slippages fell dramatically – from about 105.3 per cent in 2001-07 to 70.8 per cent in 2007-13.

Simultaneously with increased slippages, recovery efforts of the banks suffered compounding the asset quality concerns as evidenced by the increasing trend in the ratio of slippages to recovery and up gradation since 2006-07 and the relative large share of write offs in total reduction in NPAs of banks. The ratio of slippages to recovery and up gradation represents the extent to which banks have been able to reduce their NPAs through recovery efforts. The ratio for the banking sector as a whole deteriorated from a low of 125.4 per cent in 2005-06 to 264.1 per cent during 2009-10 and remained elevated at 257.0 per cent in 2012-13. Recovery performance also varied widely across banks.

Table 2 Recovery from Written-Off Accounts during the fiscal year ended (` Rs Mn)

	Mar-01	Mar-02	Mar-03	Mar-04	Mar-05	Mar-06	Mar-07	Mar-08	Mar-09	Mar-10	Mar-11	Mar-12	Mar-13
All Banks	4,240	5,010	4,790	10,650	17,680	29,020	24,800	31,010	36,860	43,620	50,360	51,910	69,600
PSBs	4,180	4,940	4,630	10,080	16,120	26,990	22,200	28,240	33,720	38,190	44,120	46,560	59,53
OPBs	20	30	50	260	450	840	1,320	1,730	2,170	2,070	2,310	2,010	2,000
NPBs	30	20	40	300	1,110	1,090	1,200	870	920	1,970	3,270	2,940	7,790
FBs	0	10	60	0	0	100	80	160	40	1,390	660	400	290

Source: RBI (2013)

Table 3 Written-Off Accounts during the fiscal year ended (` Rs Mn)

	Mar-01	Mar-02	Mar-03	Mar-04	Mar-05	Mar-06	Mar-07	Mar-08	Mar-09	Mar-10	Mar-11	Mar-12	Mar-13
All Banks	64,460	87,110	120,210	135,590	108,230	116,570	116,210	116,530	159,960	250,190	238,960	208,920	322,180
PSBs	55,550	64,280	94,480	113,080	80,480	87,990	91,890	80,190	69,660	111,850	177,940	155,510	270,130
OPBs	3,310	5,880	6,530	5,250	4,640	5,440	6,100	7,240	6,160	8,840	6,820	6,710	8,630
NPBs	5,800	8,960	15,640	12,860	16,820	14,090	12,320	15,770	50,630	67,120	23,360	30,240	34,870
FBs	200	7,980	3,560	4,400	6,280	9,050	5,900	13,340	33,500	62,380	30,830	16,460	8,550

Source: RBI (2013)

There is evidence of increased use of write offs by banks to reduce NPAs, which is a pointer to weaknesses in credit management. Write offs were initially introduced as a tool for banks to manage their tax liabilities on impaired assets. However, they subsequently emerged as a tool for banks to manage their reported gross NPA numbers. Write offs, in fact, contributed significantly to the reduction in the quantum of gross NPAs as compared to actual recoveries and up gradations. Write offs as a percentage of terminal reduction has consistently been above 50 per cent mark.

These practices clearly engender moral hazard issues as they reduce the banks' drive to improve recovery efforts. They also result in leakages in the recovery process. This is evidenced by the fact that, on an average, less than 10 per cent of the total amount written off (including the technical write off) is recovered.

Further bearing testimony to the poor recovery efforts of the banking system are the trends in the ratio of up gradation to slippages. Even in the 'good' times, the ratio was never more than 20 per cent – a clear sign of poor standards of credit and recovery administration as well as a certain amount of apathy on the part of banks in expending efforts to revive accounts. The spirit of good credit management is to revive genuine problem accounts and not to retain them as NPAs for an eventual write- off.

The new private sector banks and foreign banks recorded higher slippage ratio immediately after crisis but were able to arrest the increasing trend in slippages through focused attention on credit risk management including exit strategies. In recent years, the ratio has risen sharply for PSBs. This indicates that new private sector banks and foreign banks were able to manage their asset quality better than PSBs as they were quick in identifying NPAs, while PSBs resorted to retrospective restructuring to report lower NPAs initially. This practice eventually tipped the scale against the PSBs and thus, in hindsight, regulatory guidelines also contributed to the decline in the asset quality of the PSBs.

The bank group wise trends in slippages are further re-enforced when the trends in slippages and fresh restructuring are examined. The ratio of slippages and fresh restructuring to advances rose sharply for the PSBs post crisis – from 5.2 per cent in March 2009 to 7.1 per cent in March 2013. The ratio reduced for foreign banks and new private sector banks and stood at a much more robust 1.8 per cent in March 2013.It is, thus, clear that the weaknesses in credit and recovery administration that existed prior to the crisis, especially in the case of PSBs, were not dealt with in a timely manner. Viewed in conjunction with the trends in restructuring of advances, however, there are evident and growing concerns about the asset quality of banks in India (Chakrabarty 2013)[5].

Conclusion

Indian banks have to play more proactive role in minimising the level of NPAs. Foreign banks and private banks are more effective in recovering the due amount from the defaulters compared to Public sector banks. Write off of NPAs may not be a solution for the problem. The success of lending and recovery is possible only through the proper attention and concerted efforts by all stakeholders like regulators, policy makers, banks and bank customers.

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