
Restraining Wilful Defaults: Need of an hour for Indian Banking system



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Foreword | Mr. Gopal S Jiwarajka, President, PHD Chamber



A strong banking system is crucial for the growth and development of an economy. Non-Performing Assets (NPAs) is an important prudential indicator to assess the financial health of the banking sector. Besides asset quality, NPAs epitomize the credit risk management and efficacy in the allocation of resources.

A high level of NPAs indicates a high incidence of credit defaults and affects the profitability and net-worth of banks and also erodes the value of the asset. Thus, it becomes very important to control the rising level of NPAs which is resulting in deteriorating of quality of banks' assets, posing high level of stress on banks' balance sheet and decaying overall profitability and efficiency of Indian banking system. The growth in Indian Banking sector is going to emerge to the full extent provided that the clean-up of bank balance sheet is undertaken effectively.

In India, the banks have witnessed a surge in their Gross Non Performing Assets (GNPAs) post the global financial crisis consequent to the collapse of Lehman Brothers in 2008. Since, India needs much healthier banks to strengthen and support higher economic growth, further deterioration in NPAs level in banks should be checked urgently.

In the present scenario of rising wilful defaults has become one of the major causes of inflating NPAs in Indian banks. This is observed that wilful defaults have been rising in parallel to rising NPAs in India during the post financial crisis and has become a major cause of concern for Indian banks.

Few suggestions to mitigate the impact of wilful defaults includes careful monitoring of corporate activities after debt is sanctioned, effectively and efficiently tracking undisclosed assets, monitoring the progress of loans, improving credit sanctioning processes of banks, effective resolution plans, training of banking professionals, among others going forward.

Foreword | Rohit Karnatak, Managing Director | India, APAC & EMEA – Global Screening, Pinkerton



This white paper is an attempt to bring to attention the growing threat of NPAs and their impact on curbing the growth of the Indian banking sector. The large number of NPAs has had a considerable impact on the profitability of banks & their accumulation has adversely effected the bank's balance sheet, consequently resulting in a credit slowdown.

Value wilful default suits, have increased more than 7 times from around Rs. 10,298 Crores (2292 Million USD) in FY2005 to Rs. 74,695 Crores (11409 Million USD) in FY2016. In order to reduce the risk posed from wilful default, it is suggested that a systematic assessment and quantification of credit risk must be conducted. It is imperative to move towards a proactive approach for improving the credit sanctioning processes undertaken by banks, in order to sufficiently tackle the issue of stressed assets. This should include thorough background verification of individuals & organizations before allocation of funds, thorough due diligence, including physical verification of operations & collateral, meaningful scrutiny of quarterly progress reports prior to loan disbursal and monitoring of activities after the loan is sanctioned. This should be backed up by internal trainings of banking officials in order to develop the necessary expertise and internal capability to valuate projects and their feasibility.

Actively engaging with the chartered accountant community, and learning from best practices adopted globally towards risk & compliance policies, can add fresh direction & perspective to help bridge the gaps currently being faced by the Indian banking sector.

By failing to prepare one is preparing to fail. Identification and implementation of a holistic internal risk reduction strategy by each bank would be the first step to address this growing threat.

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Abbreviations

Abbreviation	Word/Phrase
AIFIs	All India Financial Institutions
CIBIL	Credit Information Bureau (India) Limited
CRAR	Capital to risk weighted assets ratio
CRILC	Central Repository of Information on Large Credits
DRT	Debt Recovery Tribunal
FBs	Foreign banks
GNPAs	Gross Non Performing Assets
MTM	Mark-to-market
NBFCs	Non-Banking Financial Companies
NPA	Non-Performing Assets
NNPAs	Net non-performing advances
PVBs	Private sector banks
RoA	Return on Asset
RoE	Return on Equity
SDR	Strategic Debt Restructuring
SMA	Special Mention Accounts
SCBs	Scheduled commercial banks



CHAPTER 1 | INTRODUCTION

Abstract

Across the globe, the banking sector acts as the catalyst for the country's economy. Banks play a vital role in providing financial resources especially to capital-intensive sectors such as infrastructure, automobiles, iron and steel, industrials as well as to high growth sectors such as pharmaceuticals, healthcare and consumer discretionary. In emerging economies, banks are more than mere agents of financial intermediation and carry the additional responsibility of achieving the government's social agenda. Owing to this close relationship between banking and economic development, the growth of the overall economy is intrinsically correlated to the health of the banking industry.

Several parameters like Net Profit, Return on Equity (RoE), Return on Asset (RoA) Capital to Risk Weighted Assets Ratio (CRAR), Credit-Deposit ratio etc. are measured for assessing the overall performance of the banks in terms of banks' profitability, capital adequacy and financial inclusion.

Non-Performing Assets (NPA) are an important prudential indicator to assess the financial health of the banking sector. Besides asset quality, NPAs epitomize the credit risk management and efficacy in the allocation of resources.

Against this backdrop, this study pertains to undertake a comprehensive analysis of the present scenario of NPAs and wilful defaults in the country. The analysis also encompasses the implications of wilful defaults on various segments and makes an attempt to suggest concrete measures to curb the growth of non-performing assets in the coming times.

1.1 2008 crisis & Burgeoning NPAs

In India, the banks have witnessed a surge in their Gross Non Performing Assets (GNPAs) post the global financial crisis consequent to the collapse of Lehman Brothers in 2008. A surge in bad loans is majorly attributed to sluggish domestic as well as global economic growth, which in turn discourages companies to invest in new projects and to repay their loans and interest to the banks. Post 2008, the gross advances and gross NPAs have increased significantly.

Gross advances have increased from Rs. 2503431 crore (USD 621805 million¹) in FY2008 to Rs. 8167344 crore (USD 1247523 million) in FY2016. Similarly, gross NPAs have also increased from Rs. 56606 crore (USD 14060 million) in FY2008 to Rs. 611607 crore (USD 93420 million) in FY2016.

Several factors, such as increased financial deepening, increased competition, improvement in asset quality

¹ INR/USD Exchange rate for FY2008 stands at 40.26 and for FY2015 is 61.14

of banks and rapid product innovations contributed to rapid credit expansion in the post crisis period. Infrastructure, SMEs, farm credit and retail sectors primarily powered the growth of bank credit during this period.

This widening divergence in the growth of credit and NPAs, result in the pulling out of funds by foreign investors and sluggish industrial growth, which in turn has painted an adverse picture of the asset quality of Indian banks. However, the post financial crisis period i.e. fiscal years 2009 to 2016, witnessed a reversal in the earlier trends with significant growth in NPAs and gradual decline in gross advances.

Gross NPA ratio rose from 2.3 per cent in FY2009 to 7.5 per cent in FY2016. In absolute terms gross NPAs rose from Rs. 56,000 crores (USD 14060 million) in FY2008 to Rs. 611607 crores (USD 93420 million) in FY2016. However, growth in gross advances registered a steep decline from 25 per cent in FY2008 to around 8 per cent in FY2016.

1.2 NPAs: Global Comparison

At the international level, Indian banks suffered relatively less from the turmoil of the global financial crisis. However, their NPAs are still high amongst the BRICS economies which is disappointing. According

to the World Bank, NPAs to total gross loans of Indian banks stood at 7.6 per cent in 2016.

In contrast, the emerging market and developing economies viz. Thailand, Brazil, China and South Africa recorded NPA to total gross loans at 2.8 per cent, 3.8 per cent, 1.7 per cent and 3.2 per cent, respectively during the same period. Furthermore, the NPAs to total gross loans ratio in India has been increasing significantly since the year 2010.

A startling trend in comparison to countries like China, Japan, United States, South Africa, Thailand and UAE wherein the same metric has remained steady or declined.

On comparing with advanced regions/ countries India's position reflects a better picture. NPA to total loan ratio in the Euro area has risen from 1.8 per cent in 2007 to 5.4 per cent in 2016, majorly attributed to the Euro Zone crisis. Russia also registered an increase in NPA to total loans from 2.5 per cent in 2007 to 9.2 per cent during the same period. United States and Japan both registered a steady ratio of 1.5 per cent in 2016.

Table – 1.1 Cross-country comparison of NPA to Total gross Loans (per cent) of select regions and economies

Country	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Brazil	3	3.1	4.2	3.1	3.5	3.4	2.9	2.9	3.3	3.8
China	6.2	2.4	1.6	1.1	1	1	1	1.2	1.7	1.7
Euro Area	1.8	2.8	4.8	5.4	6	7.5	7.9	6.8	5.7	5.4
Indonesia	4	3.2	3.3	2.5	2.1	1.8	1.7	2.1	2.4	2.9
India	2.7	2.4	2.2	2.4	2.7	3.4	4	4.3	5.9	7.6
Japan	1.5	2.4	2.4	2.5	2.4	2.4	2.3	1.9	1.6	1.5
Russia	2.5	3.8	9.5	8.2	6.6	6	6	6.7	8.3	9.2
United States	1.4	3	5	4.4	3.8	3.3	2.5	1.9	1.5	1.5
South Africa	1.4	3.9	5.9	5.8	4.7	4	3.6	3.2	3.1	3.2
Thailand	7.9	5.7	5.2	3.9	2.9	2.4	2.3	2.3	2.7	2.8
United Arab Emirates	2.9	2.3	4.3	5.6	7.2	8.4	7.3	5.6	5.2	5.3
Hong Kong	0.8	1.23	1.58	0.83	0.69	0.6	0.54	0.51	0.73	0.9

Source: PHD Research Bureau, compiled from World Bank

1.3 Recent Performance of Indian Banks – A Snapshot

As per the Financial Stability Report June 2017 by RBI, India's financial system remains stable despite the fact that banking sector continues to face significant challenges. The deposit growth of scheduled commercial banks (SCBs) has picked up and sluggish credit growth has impacted the Net Interest Income (NII), particularly of public sector banks (PSBs).

The gross non-performing advances (GNPAs) of the banking sector rose, however the stressed advances ratio declined between September 2016 and March 2017 attributing to the fall in restructured standard advances. The performance of Scheduled Commercial Banks (SCBs) is discussed below:

First, SCBs' business growth continued to be subdued with public sector banks (PSBs) continuing to lag behind their private sector peers.

SCB's Capital to Risk Weighted Assets Ratio (CRAR) improved from 13.4 per cent to 13.6 per cent between September 2016 and March 2017. However, Tier I leverage ratio² has declined marginally during the same period.

Second, SCB's annual Profit after TAX (PAT) increased by 48 per cent in 2016-17 as compared to a decline of about 62% in 2015-16, mainly due to higher increase in Other Operating Income (OOI) and lower risk in risk provisions. However, Public Sector Banks (PSBs) again recorded negative return on their assets. The share of OOI in total operating income has increased sharply from around 31 per cent in 2015-16 to 36.2 per cent in 2016-17 which has majorly contributed by profit on securities trading.

Third, continuing deceleration in the growth of assets of SCBs along with deterioration in their asset quality resulted in a secular decline in the share of net interest income (NII) in total operating income.

Fourth, the gross non-performing advances (GNPAs) ratio of SCBs has increased from 9.2 per cent in September 2016 to 9.6 per cent in March 2017.

According to the report, the banking stability indicator has worsened between September 2016 and March 2017. While, the capital position showed improvement and the asset quality and profitability deteriorated further.

Fifth, the Net Non-Performing Advances (NNPAs) ratio of SCBs has also increased marginally from 5.4 per cent

in September 2016 to 5.5 per cent in March 2017. The stressed advances³ ratio declined from 12.3 per cent to 12 per cent due to the fall in restructured standard advances. Accretion of new NPAs from restructured standard advances declined in 2016-17.

Sixth, large borrowers account for 56 per cent of gross advances and 86.5 per cent of GNPAs of SCBs. While the top 100 large exposures account for 15.2 per cent of gross advances. Non-performing accounts within the top 100 exposures contribute to 25.6 per cent of GNPAs of SCBs. While the level of GNPAs of large borrowers increased between September 2016 and March 2017, their restructured standard advances declined during the same period resulting in reduction of total stressed advances by 1.8 per cent.

Table 1.2 Share of large borrowers in SCBs' loan portfolio

	Mar '15	Mar '16	Sep '16	Mar '17
Gross advances	58.1	58	56.5	56.0
Gross NPAs	72.8	86.4	88.4	86.5

Source: PHD Research Bureau, compiled from RBI

According to the report, the banking stability indicator has worsened between September 2016 and March 2017. While, the capital position showed improvement and the asset quality and profitability deteriorated further.

Seventh, the CRAR of Scheduled Urban Co-operative Banks (SUCBs) increased from 13.0 per cent to 13.6 per cent between September 2016 and March 2017. GNPAs of SUCBs as a percentage of gross advances declined from 8.6 per cent to 7.2 per cent and their provision coverage ratio⁴ increased from 47.2 per cent to 54.2 per cent during the same period.

As per the RBI report, the aggregated balance sheet of the NBFC⁵ sector expanded by 14.5 per cent during 2016-17 as compared to 15.5 per cent in 2015-16. Loans and advances increased by 16.4 and investments increased by 11.9 per cent in March 2017.

Table 1.3 Balance Sheet of NBFCs (Y-O-Y growth)

	Mar - 16	Mar - 17
Share capital	4.8	15.2
Reserves and surplus	14.3	12.2
Total borrowings	15.3	15.0

Source: RBI

² Tier-I leverage ratio is defined as the ratio of Tier-I capital to total assets. Total assets include the credit equivalent of off-balance sheet items

³ For the purpose of analysing the asset quality by RBI, stressed advances are defined as GNPAs plus restructured standard advances.

⁴ Provision coverage ratio=(provisions held for NPA/GNPAs)*100.

⁵ Excluding Government Owned NBFCs

	Mar - 16	Mar - 17
Current liabilities and provisions	31.8	16.0
Total liabilities/ assets	15.5	14.5
Loans & advances	16.6	16.4
Investments	10.8	11.9
Other assets	12.7	7.9
Income/expenditure		
Total income	15.8	8.9
Total expenditure	15.8	9.6
Net profit	15.6	(-) 2.9

Source: RBI

NPAs across all categories such as nationalized banks, SBI and its associates, private sector banks and foreign banks have increased. The large amount of NPAs has had a considerable impact on the profitability of these banks. The accumulation of NPAs has affected bank balance sheets adversely and a consequent credit slowdown.

There are various reasons to which the high amount of NPAs in the public sector can be attributed such as:

1. Exposure to infrastructure projects which had to be developed under PPP model.
2. Priority sector lending: Public Sector Banks have the responsibility to provide credit in order to fulfill the social objectives of government policy.
3. Risk measurement: Public sector banks although adopts policies for borrower screening, credit appraisals and post disbursement monitoring of the loan, however the effectiveness of policies and its implementation needs urgent attention.

⁶ INR/USD average exchange rate has been taken at 65.46 for 2015-16.

Table 1.4 Banks wise Gross NPAs (In Rs. Crore)

Category	Mar - 12	Mar - 13	Mar - 14	Mar - 15	Mar - 16
State Bank of India and its associates	45694	62778	79816	73508	121969
Nationalised banks	66795	101683	147447	204960	417988
Private sector banks	18210	20382	24184	33690	55853
Foreign Banks	6269	7926	11568	10758	15798
Total (All Schedule Commercial Banks)	136968	192769	263015	322916	611607

Source: PHD Research Bureau, compiled from RBI

In order to combat the problem of rising NPAs in the economy, the Government and the Central Bank have taken various steps, outlined in the next section.

1.4 Recent Policy Developments in India

- a.) The government announced '**Indradhanush**', a plan to infuse Rs 70,000 crore (USD 10693 million⁶) in state-owned banks over four years. Under the scheme, public sector unit (PSU) banks will get Rs 25,000 crore (USD 3819 million) in 2015 -16 and 2016-17. Besides, Rs 10,000 crore (USD 1527 million) each would be infused in 2017-18 and 2018-19.
- b.) Legal amendments to the **Debt Recovery Tribunal (DRT) Act (1993) and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002** have been passed by the Government.
- c.) The new **Insolvency and Bankruptcy Code (2016)** is intended to promote entrepreneurship, availability of credit, and balance the interests of all stakeholders by consolidating and amending the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner and for maximization of value of assets of such persons and matters connected therewith or incidental thereto.
- d.) Besides government initiatives, the RBI released the **Framework for Revitalising Distressed Assets in the Economy** in January 2014. It outlines a corrective action plan that will incentivise early identification of problem cases, timely restructuring of accounts which are considered to be viable, and taking prompt steps by banks for recovery or sale of unviable accounts. It also

addresses the issue of information asymmetry and encourages early identification of the problem by setting up a Central Repository of Information on Large Credits (CRILC) to collect, store, and disseminate credit data to lenders. Under this arrangement, banks are now reporting credit information, including classification of an account as Special Mention Accounts (SMA) to CRILC on all their borrowers who are having an aggregate fund-based and non-fund based exposure of Rs. 50 million (USD 0.8 million⁷) and above.

- e.) The RBI has also issued guidelines on **flexible structuring of long term project loans**. Infrastructure and core industries projects are characterized by long gestation periods and large capital investments. The long maturities of such project loans consist of the initial construction period and the economic life of the asset / underlying concession period (usually 25-30 years). In order to ensure stress free repayment of such long gestation loans, their repayment tenor should bear some correspondence to the period when cash flows are generated by the asset.
- f.) The Reserve Bank of India has issued guidelines on a '**Scheme for Sustainable Structuring of Stressed Assets**'. This is in order to strengthen lender's ability to deal with stressed assets, and put real assets back on track by providing an avenue to rework the financial structure of entities facing genuine difficulties.

Resolution of large borrowal accounts which are facing severe financial difficulties may, inter-alia, require co-ordinated deep financial restructuring which often involves a substantial write-down of debt and/or making large provisions.

The Strategic Debt Restructuring (SDR) mechanism provides 18 months for banks to make prescribed provisions for the residual debt and Mark-To-Market (MTM) provisions on their equity holding arising from conversion of debt. Banks have requested for allowing more time to write down the debt and make the required provisions in cases of resolution of large accounts.

- g.) The Financial Stability and Development Council Sub-Committee (FSDC-SC) held its 18th meeting on August 29, 2016. In this meeting, the report of the Financial Stability Board (FSB), Peer Review of India, report of the Working Group (WG) on Development of Corporate Bond Market in India, proposed a Bill on setting up of a statutory Financial Data Management Centre (FDMC), the Minimum Assured Return Scheme (MARS) under

National Pension System (NPS) and regulation of spot exchanges were discussed.

- h.) Effective and capable human resources in regulated entities are important for implementing and fulfilling regulatory objectives. In July 2014, the Reserve Bank had constituted a Committee on Capacity Building with the objective of implementing non-legislative recommendations made by the Financial Sector Legislative Reforms Commission (FSLRC).

These recommendations were related to capacity building in banks and non-banks, PHD Research Bureau 14 streamlining training interventions, and suggesting changes in view of ever increasing challenges in the banking and non-banking sectors. In August 2016, the Reserve Bank issued guidelines on capacity building in banks and AIFs prescribing adoption of some of the recommendations of the committee.

- i.) The Ministry of Corporate Affairs (MCA), Government of India had notified the Companies (Indian Accounting Standards) Rules, 2015 in February 2015. In January 2016, MCA outlined the roadmap for implementing the International Financial Reporting Standards (IFRS) converged Indian Accounting Standards (Ind AS) for banks, non-banking financial companies, select all-India term lending and refinancing institutions and insurance entities.

1.5 Wilful Defaults: Inflating NPAs

A strong banking system is crucial for the growth and development of an economy. NPA is a prudential indicator of the health of the banking system. A high level of NPAs indicates a high incidence of credit defaults and affects the profitability and net-worth of banks and also erodes the value of the asset. The NPA growth involves the necessity of provisions, which reduce the overall profits and shareholders' dividend.

Thus, it becomes very important to control the rising level of NPAs which is resulting in deteriorating of quality of banks' assets, posing high level of stress on banks' balance sheet and decaying overall profitability and efficiency of Indian banking system. The growth in Indian Banking sector is going to emerge to the full extent provided that the clean-up of bank balance sheet is undertaken effectively.

Since, India needs much healthier banks to strengthen and support higher economic growth, further deterioration in NPAs level in banks should be checked urgently.

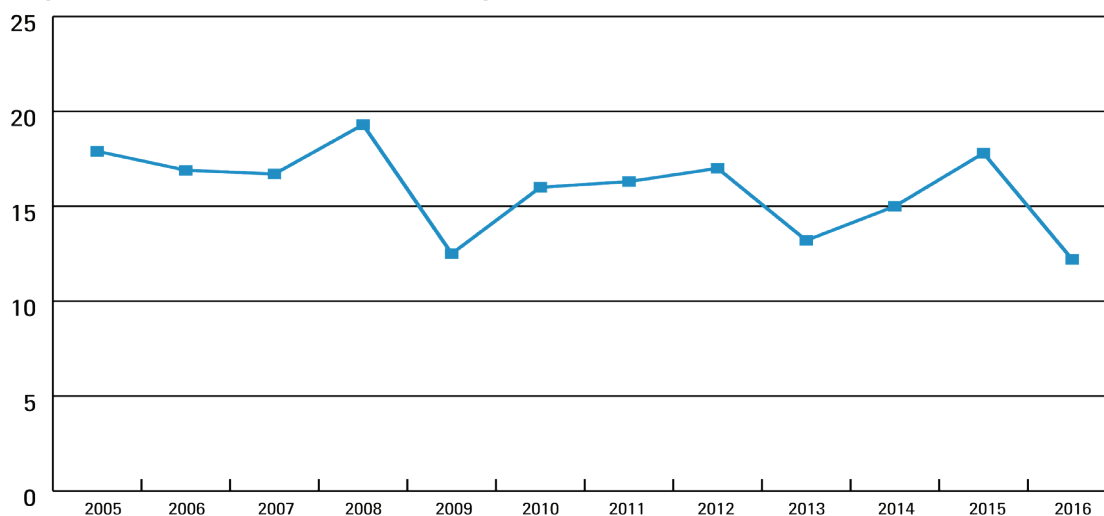
⁷ INR/USD average exchange rate stands at 60.5 for FY2014

Table – 1.5 Willful default suit value of Rs. 25 lakhs and above to Gross NPAs

Year	Gross NPAs (in Rs. crores)	Gross NPAs (USD million)	Value of willful default suit (in Rs. Crores)	Value of willful default suit (USD million)	Willful default value to gross NPAs (in per cent)
FY2005	57396	12774	10298.8	2292	17.9
FY2006	51753	11689	8742.1	1975	16.9
FY2007	50517	11164	8453.0	1868	16.7
FY2008	56606	14060	10904.2	2708	19.3
FY2009	69954	15210	8725.4	1897	12.5
FY2010	81718	17224	13055.5	2752	16.0
FY2011	93997	20630	15274.7	3352	16.3
FY2012	136968	28581	23301.0	4862	17.0
FY2013	192769	35429	25410.3	4670	13.2
FY2014	263015	43472	39507.9	6530	15.0
FY2015	322916	52813	56799.0	9289	17.8
FY2016	611607	93420	74695.0	11409	12.2

Source: PHD Research Bureau, compiled from RBI and CIBIL . Figures for USD have been calculated by using average exchange rate of the respective year Note 1: Gross NPAs data pertain to Scheduled Commercial Banks. Note 2: Value of willful default pertains to suit filed accounts (willful defaulters) of Rs. 25 lakhs and above

Graph 1.1 Willful default value to gross NPAs (in per cent)



Source: PHD Research Bureau, compiled from RBI and CIBIL

There are several factors viz. industrial recession, sluggish economic growth, ineffective recovery system of banks, long legal procedures etc. that have been observed to be responsible for accumulation of NPAs in Indian Banks.

In the present scenario, wilful defaults are one of the major causes of increase in NPAs in Indian banks. During the post financial crisis, it has been observed that wilful defaults have been rising in parallel to rising NPAs and have become a major cause of concern for Indian banks.

This is apparent from Table 1.5 that corresponding to the decline in gross NPAs before the outbreak of global financial crisis from Rs. 57 thousand crores (USD 12774 million) in FY2005 to Rs. 50 thousand crores (USD 11164 million) in FY2007, wilful defaults also witnessed a decline from the value of Rs. 10 thousand crores (USD 2301 million) in FY2005 to around Rs. 8 thousand crores (USD 1877 million) in FY2007. Thereafter, during the post financial crisis period both gross NPAs and wilful defaults witnessed an increase to around Rs. 6 lakh crores (USD 93420 million) and Rs. 74.6 thousand crores (USD 11409 million) respectively in FY 2016. The wilful

Table – 1.6 Gross non-performing assets (NPAs) for Micro & Small Enterprises (Outstanding gross NPA amount in Rs. crore & NPAs in percentages)

	March 2012	March 2013	March 2014*
Public Sector Banks	24,272.44 (USD 5,064.89 million) (6.1 per cent)	28,575 (USD 5,251.80 million) (5.7 per cent)	38,950 (USD 6438 million) (6.3 per cent)
Private Sector Banks	1,881 (USD 393 million) (1.7 per cent)	2,506.44 (USD 461 million) (1.6 per cent)	3,022 (USD 499 million) (1.5 per cent)
Foreign Banks	159.83 (USD 33.35 million) (0.7 per cent)	396.23 (USD 72.8 million) (1.3 per cent)	457.36 (USD 75.59 million) (1.5 per cent)
All Scheduled Commercial Banks	26,313 (USD 5490.7 million) (5 per cent)	31,478 (USD 5785.3 million) (4.6 per cent)	42,429 (USD 7013 million) (5 per cent)

Source: PHD Research Bureau, compiled from RBI. Note: Figures in brackets pertains NPA percentages. Note: Average exchange rate of INR/USD stands at 47.92 for FY2012, 54.41 for FY2013 and 60.50 for FY2014

defaults stands more than Rs. 1 lakh crore (USD 16330 million) during FY2017.

The ratio of wilful defaults to Gross NPAs was at around 18 per cent in FY2005 which declined to about 12.2 per cent in FY2016.

During the post global slowdown, the slow paced growth of the industrial sector and the economy coupled with global developments eroded the repaying capacity of the borrowers. This ultimately resulted in a steep surge in payment defaults, especially wilful payment defaults. Therefore, in the present context, if the health of the banking system is to be improved it is crucial to tighten the regulatory noose on wilful defaulters.

1.6 NPAs in MSME Sector

As envisaged by the Government's Make in India" initiative, easing access to finance for the MSMEs sector is critical for the creation of jobs, exports growth and development of a manufacturing base in India. The MSME sector forms the bedrock of Indian entrepreneurship, and must be nurtured appropriately to realise India's potential. As per the report of the Committee set up to examine the financial architecture of the MSME sector, credit outstanding from scheduled commercial banks to the Micro & Small Enterprises and Medium Enterprises has registered an annual growth of about 23 per cent from March 2012 to March 2014 as compared to annual growth in overall non-food credit of

14.1 per cent during the same period. The report of the committee⁸ set up to review the financial architecture of the MSME sector, recommends using an efficient system of receivables factoring/discounting as one way to significantly address this issue.

The details of Gross Non Performing Assets (GNPAs) ratio to MSMEs and large industries and corporate sector during last fifteen years are appended below. NPA Ratio of MSME (Priority Sector Only) has declined drastically from 18.25 per cent in 2002 to 8.77 per cent in 2016. The NPA Ratio of large industries and corporate sector has declined from 13.63 per cent to 11.75 per cent during the same period.

Table 1.7 Scheduled Commercial Banks (SCBs)

Year	NPA Ratio in MSME (Priority Sector Only)	NPA Ratio in Large Industries
2002	18.25	13.63
2003	13.47	11.83
2004	11.30	9.03
2005	6.43	4.80
2006	5.94	2.81
2007	3.47	1.74
2008	2.52	1.14
2009	3.14	1.21
2010	3.36	1.51
2011	3.32	1.43
2012	3.22	1.94
2013	4.40	3.10
2014	4.71	4.80
2015	5.28	5.64
2016	8.77	11.75

Source: PHD Research Bureau compiled from PIB and RBI

CHAPTER 2 | WILFUL DEFAULTERS CONCEPTUAL & REGULATORY FRAMEWORK

2.1 Wilful defaults: Conceptual & Regulatory Framework w.r.t RBI

Before undertaking a detailed analysis on wilful defaults it is pertinent to highlight its conceptual and regulatory framework in accordance with the recent amendments made by the Reserve Bank of India and its implications for different stakeholders including Banks, Auditors, Guarantors and Borrowers/Wilful defaulters.

2.1.1 Definitions

This is in accordance to the recent master circular on Wilful Defaulters RBI/2015- 16/100DBR.No.CID. BC.22/20.16.003/2015-16 dated July 1, 2015 A 'wilful default' would be deemed to have occurred if any of the following events is noted:

- a.) The unit has defaulted in meeting its payment / repayment obligations to the lender even when it has the capacity to honour the said obligations.
- b.) The unit has defaulted in meeting its payment / repayment obligations to the lender and has not utilised the finance from the lender for the specific purposes for which finance was availed of but has diverted the funds for other purposes.
- c.) The unit has defaulted in meeting its payment / repayment obligations to the lender and has siphoned off the funds so that the funds have not been utilised for the specific purpose for which finance was availed of, nor are the funds available with the unit in the form of other assets.
- d.) The unit has defaulted in meeting its payment / repayment obligations to the lender and has also disposed off or removed the movable fixed assets or immovable property given for the purpose of securing a term loan without the knowledge of the bank / lender.

The identification of the wilful default should be made keeping in view the track record of the borrowers and should not be decided on the basis of isolated transactions / incidents. The default to be categorised as wilful must be intentional, deliberate and calculated and information on wilful defaults should be collected in case of wilful defaults of Rs. 25 lakhs (USD 0.038 million) and above.

The term 'unit' appearing herein has to be taken to include individuals, juristic persons and all other forms of business enterprises, whether incorporated or not. In case of business enterprises (other than companies), banks/FIs may also report (in the Director column)

the names of those persons who are in charge and responsible for the management of the affairs of the business enterprise.

The term '**lender**' covers all banks/FIs to which any amount is due, provided it is arising on account of any banking transaction, including off balance sheet transactions such as derivatives, guarantees and letter of credit.

2.1.2 Cut-off limits and Penal measures

This is keeping in view the present limit of Rs. 25 lakh (USD 0.038 million⁹) fixed by the Central Vigilance Commission for reporting of cases of wilful default by the banks / notified by All India Financial Institutions to RBI, any wilful defaulter with an outstanding balance of Rs. 25 lakh (USD 0.038 million) or more, would attract the penal measures. The following penal measures are required to be initiated by the banks and FIs against the identified wilful defaulters:

- i. No additional facilities should be granted by any bank / FI to the listed wilful defaulters.
- ii. Such companies (including their entrepreneurs / promoters) where banks / FIs have identified siphoning / diversion of funds, misrepresentation, falsification of accounts and fraudulent transactions should be debarred from institutional finance from the scheduled commercial banks, Financial Institutions, NBFCs, for floating new ventures for a period of 5 years from the date of removal of their name from the list of wilful defaulters as published/disseminated by RBI/CICs.
- iii. The legal process, wherever warranted, against the borrowers / guarantors and foreclosure for recovery of dues should be initiated expeditiously. The lenders may initiate criminal proceedings against wilful defaulters, wherever necessary.
- iv. Wherever possible, the banks and FIs should adopt a proactive approach for a change of management of the wilfully defaulting borrower unit.
- v. The borrowing company should not induct on its board a person whose name appears in the list of Wilful Defaulters.

2.1.3 End-Use of Funds

The banks/ FIs seek to ensure end use of funds by obtaining certification from the Chartered Accountants in cases of project financing. The banks and FIs, therefore, should not depend entirely on the certificates

⁹ Average exchange rate of INR/USD is 65.4 for FY2016

issued by the Chartered Accountants but strengthen their internal controls and the credit risk management system to enhance the quality of their loan portfolio. This may include thorough background verification of individuals/ organizations before allocation of funds, thorough due diligence including physical verification of operations & collateral, meaningful scrutiny of quarterly progress reports / operating statements.

2.1.4 Role of Guarantors

When a default is made in making repayment by the principal debtor, the banker will be able to proceed against the guarantor / surety. Where a banker has made a claim on the guarantor on account of the default made by the principal debtor, the liability of the guarantor is immediate. In case the said guarantor refuses to comply with the demand made by the creditor / banker, despite having sufficient means to make payment of the dues, such guarantor would also be treated as a wilful defaulter. This treatment of non group corporate and individual guarantors was made applicable with effect from September 9, 2014.

2.1.5 Role of Auditors and Internal Audit

In case any falsification of accounts on the part of the borrowers is observed by the banks / FIs, and if it is observed that the auditors were negligent or deficient in conducting the audit, they should lodge a formal complaint against the auditors of the borrowers with

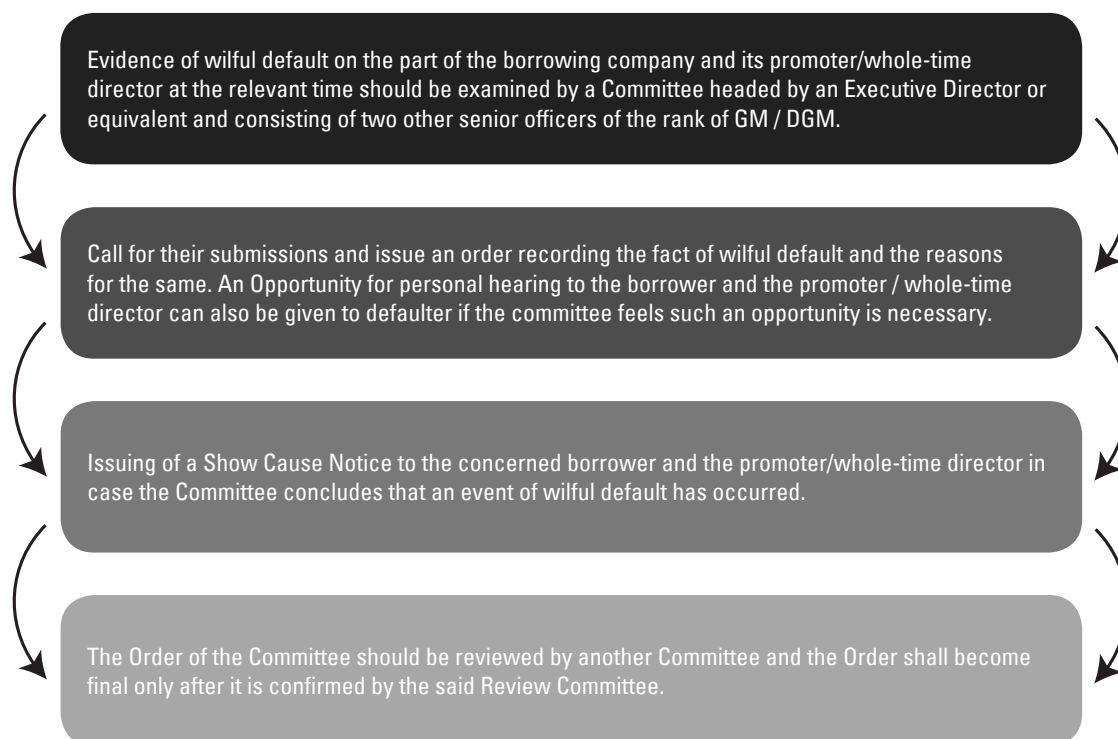
the Institute of Chartered Accountants of India (ICAI) to enable the ICAI to examine and fix accountability of the auditors. The aspect of diversion of funds by the borrowers should be adequately looked into while conducting internal audit / inspection of their offices / branches and periodical reviews on cases of wilful defaults should be submitted to the Audit Committee of the bank.

2.1.6 Reporting to Credit Information Companies

Reserve Bank of India has granted Certificate of Registration to (i) Experian Credit Information Company of India Private Limited, (ii) Equifax Credit Information Services Private Limited, (iii) CRIF High Mark Credit Information Services Private Limited and (iv) Credit Information Bureau (India) Limited (CIBIL) to commence/carry on the business of credit information. Banks / FIs should submit the list of suit-filed accounts and non suit filed accounts of wilful defaulters of Rs. 25 lakh (USD 0.038 million) and above on a monthly or more frequent basis to all the four Credit Information Companies.

2.1.7 Mechanism for Identification of Wilful Defaulters

The transparent mechanism to identify the wilful defaulter according to RBI's recent circular includes the following:



KEY MEASURES FOR RESOLVING STRESSED ASSETS

The gross NPA (GNPA) ratio of the banking system is at 9.6 per cent and the stressed advances ratio at 12 per cent¹⁰ as of March 31, 2017. The persistently high ratio in the past few years is a matter of concern. Large borrowers i.e. borrowers with aggregate exposure of Rs. 5 crores and above account for 86.5 per cent. Several measures have been undertaken by the Government and RBI to strengthen the regulatory, legal, supervisory and institutional framework aiming at facilitating the quick resolution of stressed assets in a timely manner.

Strengthening the Legal Framework

The enactment of the Insolvency and Bankruptcy Code 2016 (IBC) is a step towards improving the credit culture in the country. Earlier, India had multiple laws governing various facets of a corporate rescue and /or insolvency process without having a comprehensive legal framework. The IBC provides a single window, time bound process for resolution of an asset with an explicit emphasis on promotion of entrepreneurship for maximisation of value of assets and balancing the interests of all stakeholders. An asset for a creditor in most cases is very valuable when it is generating adequate cash flow, as compared to an asset under liquidation.

IBC puts a time limit of 180 days (extendable by a further 90 days) within which creditors have to agree to a resolution plan, failing which the adjudicating authority under the law will pass a liquidation order on the insolvent company. Hence, threat of liquidation, which could potentially result in larger losses for creditors, will be an incentive for them to ensure efficient coordination during the insolvency resolution period, so as to quickly arrive at a decision. On the other hand, for the promoter the biggest cost of being pushed under IBC may be the possibility of losing the firm to potential bidders. This will incentivise the firms to avoid defaults or not to over borrow in first place and improve the credit culture in the country. Thereafter, the Banking Regulation (Amendment) Ordinance 2017 empowers the RBI to issue directions to banking companies to initiate an insolvency resolution process in respect of a default, under the provisions of the IBC. It also enables the Reserve Bank to issue directions with respect to stressed assets and specify one or more authorities or committees with such members as the Bank may appoint or approve for appointment to advise banking companies on resolution of stressed assets.

Evolving regulatory framework

Several steps have been undertaken by the RBI to strengthen the supervisory and regulatory framework to ensure timely recognition and disclosure of incipient stress and to facilitate effective and meaningful resolution. One of the significant steps from the perspective of aligning the regulatory norms with international practices is the decision to do away with the regulatory forbearance regarding asset classification on restricting of loans and advances effective April 2015.

The Asset Quality Review (AQR) is one of the critical steps undertaken in 2015-16 in recognizing the aggregate stock of non-performing assets across the banking system. Further, additional tools to deal with problem assets were also introduced, in the absence of an effective resolution framework. These tools primarily facilitate optimal structuring of credit facilities aids in ability to change in ownership/management and help restructuring of stressed assets. A framework has been put in place for greater transparency in the sale of stressed assets by banks for ensuring sale at market determined prices. Further, disclosure requirements have been put in place so that banks disclose the divergence between the NPAs and provisions declared by them in their annual accounts and those assessed during the Annual Financial Inspections (AFIs) process. The recent decision by SEBI that requires listed entities to disclose defaults on, inter alia, bank loans within one working day can make a huge difference in the credit culture.

Institutional measures

Setting up of the Central Repository of Information on Large Credits (CRILC) by RBI in 2014 filled a gap in addressing the information asymmetry regarding NPAs by facilitating collection of data on all borrowers' credit exposures across the banking system. This enables the supervisors or lenders to track the incipient stress by having the aggregate view of borrower and bank wise exposures in a particular account in a timely manner. In order to strengthen the role of the Overseeing Committee (OC), the RBI brought OC under its aegis with an expanded membership to review the process followed by banks for restructuring outside the IBC.

It reinforces the statute –backed authority of the OC to review the processes and provide requisite comfort to the lenders, particularly public sector banks, to agree to a market determined haircuts as part of restructuring. The Government and the RBI are in dialogue to prepare

¹⁰ Data as per taken by Speech by Hon'ble Governor of RBI, Inaugural Session of the "National Conference on Insolvency and Bankruptcy: Changing Paradigm", Mumbai, August 19, 2017.

a package of measures to enable PSBs to shore up requisite capital in a time bound manner. The measures could include a combination of capital raised from the market, dilution of government

holding, additional capital infusion by the Government, mergers based on strategic fit, sale of non-core assets, etc. Honorable Governor of RBI recently called for a higher recapitalisation of the public sector banks and stated that Public Sector Banks PSBs will need to take haircuts on current exposures under any resolution plan agreed within or outside the IBC.

Banking Regulation (Amendment) Ordinance, 2017

The Ordinance enables the Union Government to authorize the Reserve Bank of India (RBI) to direct banking companies to resolve specific stressed assets leading to effective resolution of stressed assets, particularly in consortium or multiple banking arrangements.

The promulgation of the Banking Regulation (Amendment) Ordinance, 2017 inserted two new Sections (viz. 35AA and 35AB) after Section 35A of the Banking Regulation Act, 1949 enables the Union Government to authorize the Reserve Bank of India (RBI) to direct banking companies to resolve specific stressed assets by initiating the insolvency resolution process, wherever required. The RBI has also been empowered to issue other directions for resolution, and appoint or approve for appointment, authorities or committees to advise banking companies for stressed asset resolution.

This will have a direct impact on effective resolution of stressed assets, particularly in consortium or multiple banking arrangements, as the RBI will be empowered to intervene in specific cases of resolution of non-performing assets, to bring them to a definite conclusion.

The Government is committed to expeditious resolution of stressed assets in the banking system. The recent enactment of the Insolvency and Bankruptcy Code (IBC), 2016 has opened up new possibilities for time bound resolution of stressed assets. The SARFAESI and Debt Recovery Acts have been amended to facilitate recoveries.

Union Cabinet gives in-principle approval for Public Sector Banks to amalgamate through an Alternative Mechanism (AM)

The Union Cabinet chaired by the Honorable Prime Minister Shri Narendra Modi has given in-principle approval for Public Sector Banks to amalgamate through an Alternative Mechanism (AM) on 23rd August 2017. The decision would facilitate consolidation among the Nationalised Banks to create strong and competitive banks. This decision will facilitate the

creation of strong and competitive banks in the public sector space to meet the credit needs of a growing economy, absorb shocks and have the capacity to raise resources without depending unduly on the state exchequer.

The salient features of the Framework for Consolidation of Public Sector Banks are as follows:

1. The decision regarding creating strong and competitive banks would be solely based on commercial considerations.
2. The proposal must start from the Boards of Banks.
3. The proposals received from Banks for in-principle approval to formulate schemes of amalgamation shall be placed before the Alternative Mechanism (AM).
4. After in-principle approval, the Banks will take steps in accordance with law and SEBI's requirements.

The final scheme will be notified by Central Government in consultation with the Reserve Bank of India.

CHAPTER 3 | MEASURING MAMMOTH OF WILFUL DEFAULTS

3.1 Measuring mammoth of wilful defaults

Wilful defaults pose a serious financial threat to the overall Indian banking system in terms of eroding its profitability and lending capacity. This may further lead the Indian industrial sector to become vulnerable and incapable of enhancing level of investments and

production, thus impacting the entire economic system of the country.

In order to understand the gravity of the situation, a brief analysis pertaining to current state and trends of wilful defaults is conducted here below:

Table – 3.1 Suit-filed accounts (Wilful defaulters) of Rs. 25 lacs and above

Fiscal Year	Number of wilful default suit filed	Per cent change in wilful defaults suit filed	Value of wilful default suit (in Rs. Crores)	Value of wilful default suit (USD million)	Per cent change in value of wilful default Suits
FY2002	1676	–	6241.54	1309	–
FY2003	2495	48.9	11364.8	2348	82.1
FY2004	2820	13.0	13938.2	3033	22.6
FY2005	2608	-7.5	10339.6	2301	-25.8
FY2006	2501	-4.1	8781.6	1983	-15.1
FY2007	2146	-14.2	8493.1	1877	-3.3
FY2008	2778	29.5	10944.5	2718	28.9
FY2009	2253	-18.9	8725.8	1897	-20.3
FY2010	3463	53.8	13184.7	2779	51.1
FY2011	4021	16.1	15315.1	3361	16.1
FY2012	4440	10.4	23326.9	4868	52.3
FY2013	3890	-12.4	25410.3	4670	8.9
FY2014	5092	30.9	39507.9	6530	55.5
FY2015	6005	17.9	57373.3	9383	45.2
FY2016	7525	25.3	125791.4	19214	119.3
FY2017	8569	15.9	109558.8	16330	43.1

Source: PHD Research Bureau, compiled from RBI and CIBIL

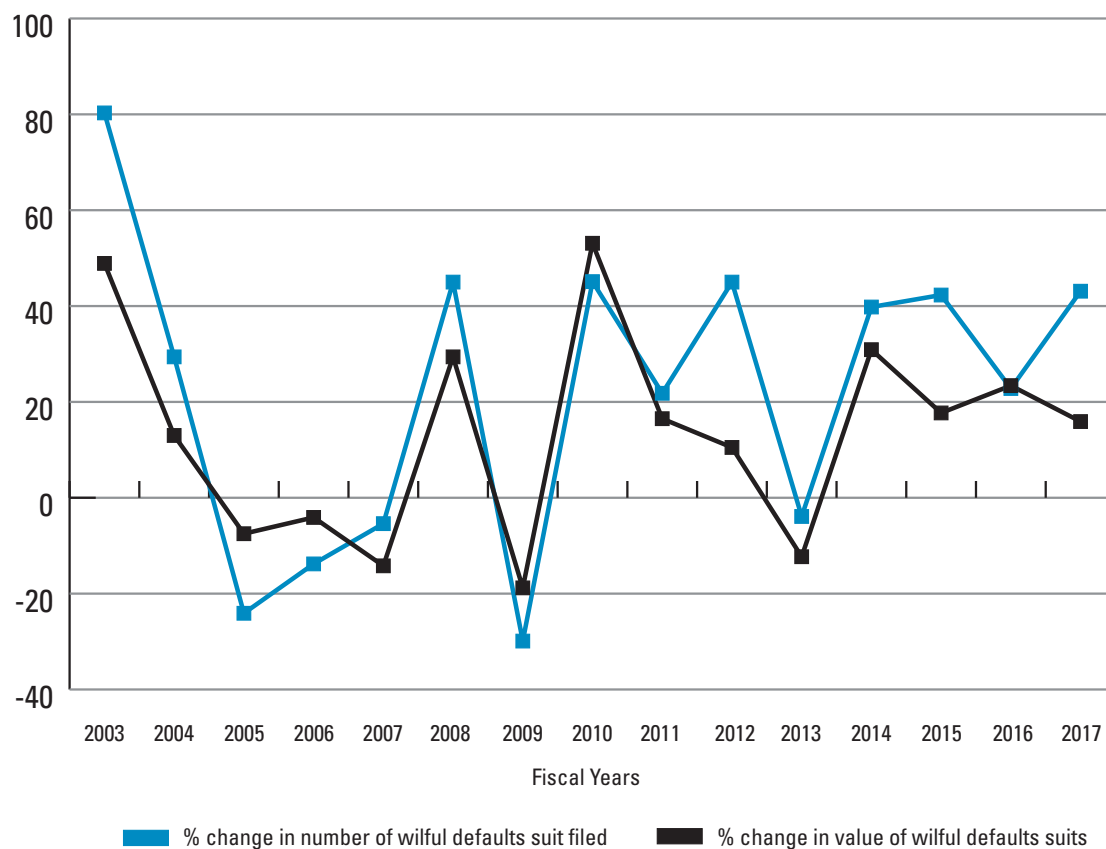
3.1.1 Wilful defaults – Number and Absolute Value of suits filed

Table 3.1 shows the number of suits filed against wilful defaulters as being more than 1670 in FY2002, which after rising by 49 per cent reached 2491 in FY2003. They eventually started declining and remained in negative growth trajectory during the three years preceding the global financial crisis. This indicates a decline in wilful defaulters corresponding to fall in NPAs in Indian banking system. However, FY2008 witnessed a steep rise in the number of wilful default suits to 2774 which can be attributed to the financial meltdown of the global economy.

Since then, barring a few years, the number of suits filed in the case of wilful defaulters have been steadily on the rise. During the period FY2008 - FY2017, the average growth in number of suits for wilful defaults have risen by around 17 per cent. In all, number of suits filed pertaining to wilful defaults rose about 5 times from 1673 in FY2002 to more than 8500 in FY2017.

In terms of absolute value, wilful defaults increased by more than 17 times from around Rs. 6,175.4 crores (USD 1294 million) in FY2002 to Rs. 1,09,558 crores (USD 16330 million) in FY2017.

Figure – 3.1 Suit-filed accounts (Willful defaulters) of Rs. 25 lacs and above



Source : PHD Research Bureau, compiled from Credit Information Bureau (India) Limited

3.1.2 Wilful defaults – State Wise

State-wise analyses of wilful defaults suits shows that out of the total of 8569 suits, Maharashtra, as on 31st March, 2017 registered over 1600 number of wilful suits filed accounts; the highest amongst all States in the country (Figure -3.2) . On the other hand, West Bengal, Delhi, Andhra Pradesh and Tamil Nadu registered 1097, 813, 767 and 552 suits respectively at the same point of time.

Few States viz. Gujarat, Punjab and Karnataka, registered more than 400 wilful suits, while Uttar Pradesh's wilful suits stands at 344 as on 31st March 2017. Kerala, New Delhi and Madhya Pradesh registered more than 200 numbers of wilful suits. The

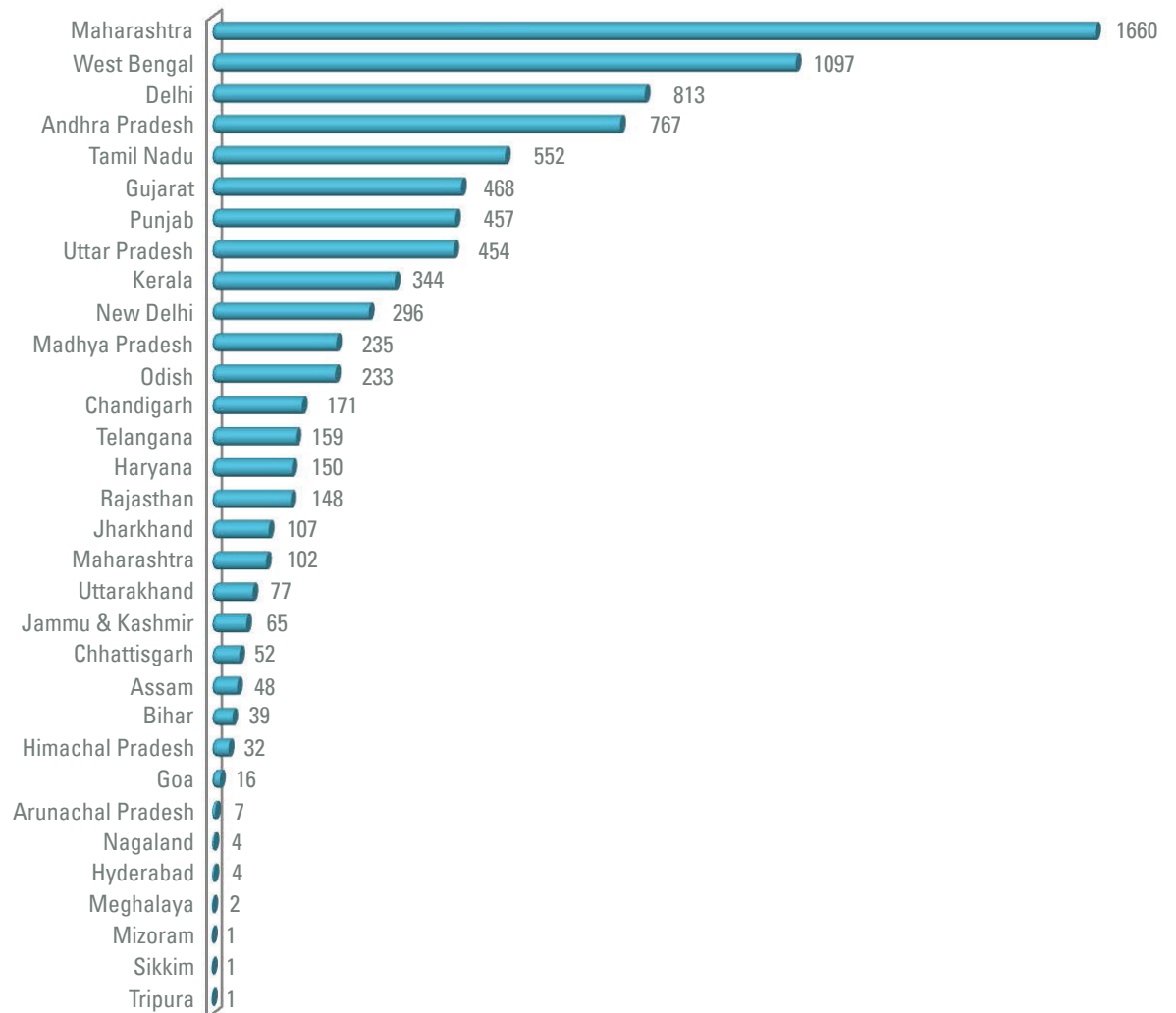
rest of the States, registered less than 100 suits filed against wilful defaulters as on the same point of time.

In terms of value of suits¹¹ filed against wilful defaulters, Maharashtra, Delhi, West Bengal, Tamil Nadu and Gujarat are the top five States registering the highest value of wilful defaults in the country. Maharashtra with wilful defaults of Rs. 40 thousand crores (USD 5977 million) accounts for the highest value of suits filed against wilful defaults as on 31st March, 2017. This is followed by Delhi with wilful defaults of value Rs 14,549 crores (USD 2169 million), West Bengal at Rs 10,054 crores (USD 1499 million), Tamil Nadu with wilful defaults of value over Rs. 8 thousand crore (USD 1201 million¹²) and Gujarat having wilful defaults of value over Rs. 7 thousand crore (USD 1084 million).

¹¹ Data pertains to as on 22nd August 2017

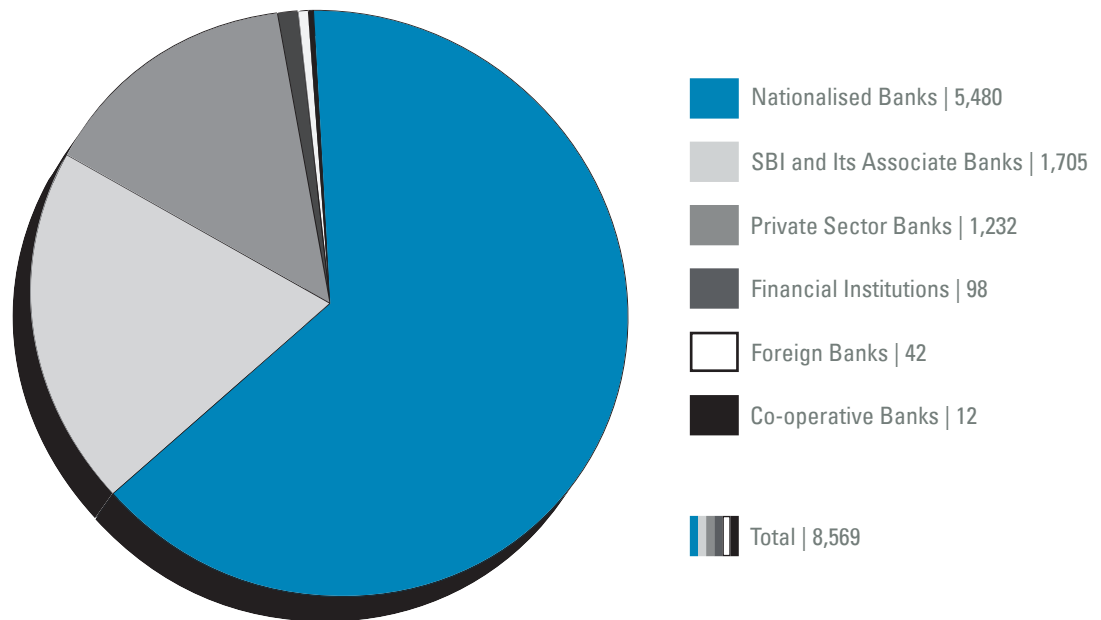
¹² Average exchange rate of INR/USD for FY2016 stands at 65.46

Figure – 3.2 Number of Suits filed accounts (wilful defaulters) of Rs. 25 Lacs and above as on 31st March, 2016 by Geographic Distribution



Source : PHD Research Bureau, compiled from CIBIL. Note: Data pertains to as on 22nd August 2017

Figure – 3.3 Suit-filed accounts (wilful defaulters) of Rs. 25 Lacs and above as on 31st March -2016



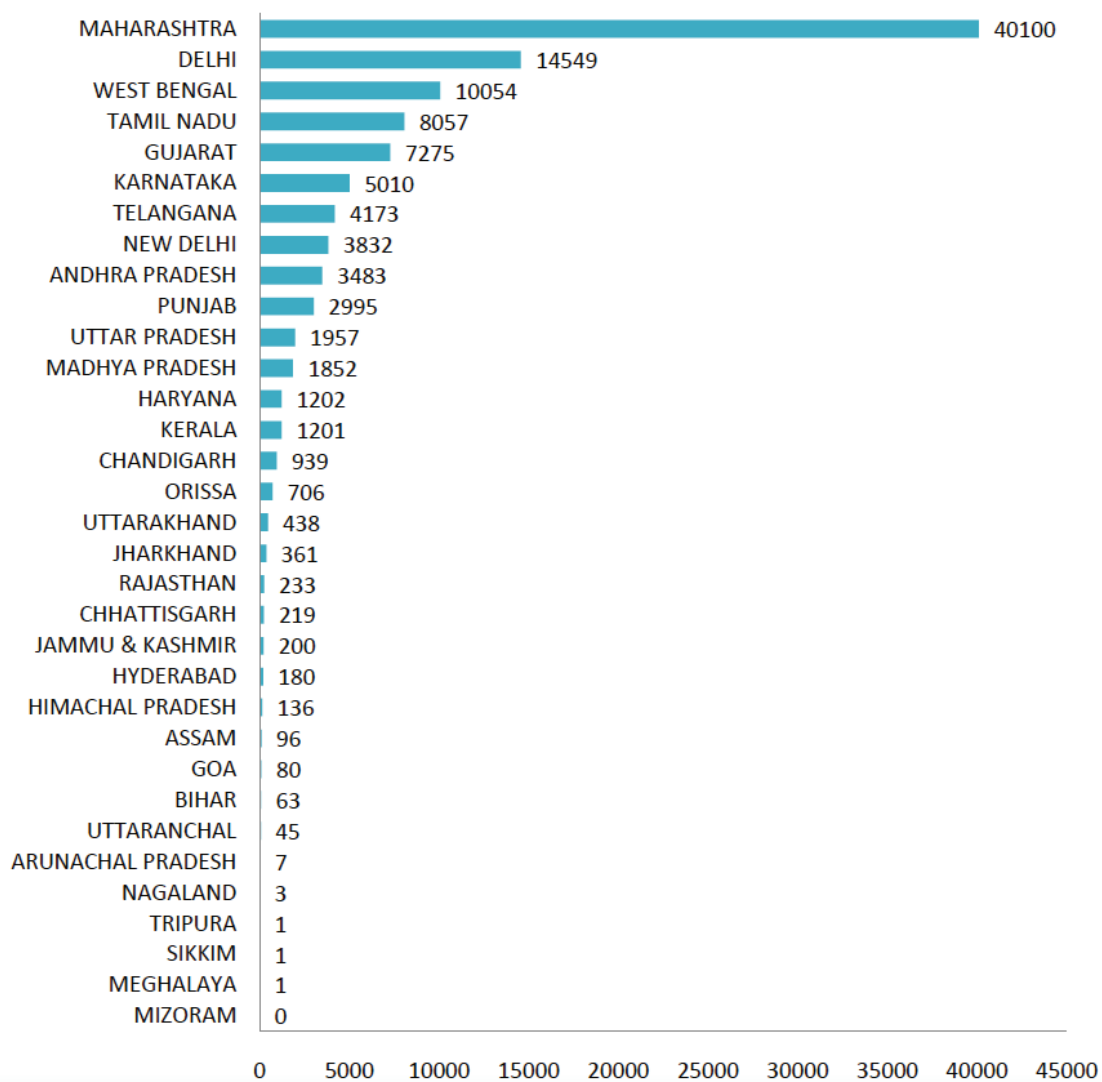
Source : PHD Research Bureau, compiled from CIBIL. Note: Data pertains to as on 22nd August 2017

3.1.3 Wilful defaults – Institution wise

Indian financial system which comprises of major financial institutions, foreign banks, nationalized banks, private sector banks, SBI and its associate banks, witnessed wide variations pertaining to the number of suits filed against wilful defaulters. This is apparent in figure- 3.3 where of the total suits filed against wilful defaults amounting to 8569 suits, nationalized banks registered the highest number of suits filed i.e. 5480

which constitutes around 64 per cent share in the total suits filed as on 31st March 2017. This is followed by the SBI and its associates which have registered more than 1700 cases and constitute for 31 per cent of the total wilful defaults suit filed at the same point of time. Meanwhile, private sector banks, financial institutions, foreign banks and co-operative banks combined together have filed 1384 suits and constitute for 16 per cent of the total suits filed at the same point of time.

Figure – 3.4 Value of Suits filed accounts -Wilful defaulters of Rs. 25 Lacs and above as on 31st March, 2016 (in Rs. Crore) State-wise



Source: PHD Research Bureau, compiled from CIBIL

CHAPTER 4 | FACTORS CAUSING NPAs AND ITS IMPLICATIONS

A strong and vibrant banking sector is critical for a flourishing economy. The growth of NPAs can be attributed to multiple factors, including internal as well as external factors.

Internal factors include funds borrowed for a particular purpose but not used for the said purpose, non-completion of project in time, poor recovery of receivables, wilful defaults, siphoning of funds, fraud, disputes, management disputes, diversion of funds, business failures, inability of the corporates to meet adequate capital requirements, etc.

On the other hand, external factors include natural calamities like floods, accidents, shortage of raw materials, recession in other countries, and changes in Government policy environment.

Higher NPA ratio trembles the confidence of investors, depositors and lenders. It also causes poor circulation of funds, which in turn have deleterious effects on the deployment of credit. The non-recovery of loans effects not only the availability of credit but also the financial soundness of the banks. As the NPA of the banks rise, the scarcity of funds in the Indian security markets rises, willingness of bank for loans diminishes and as a result shareholders of the banks will lose a lot of money as banks themselves will find it tough to survive in the market.

In such scenario, the price of loans, i.e. the interest rates will shoot up and will directly impact the investors who wish to apply loans for infrastructural or industrial projects. This ultimately impacts the retail consumers, who are forced to shell out higher interest rates for the loans.

Further, low release of funds from the security markets will hurt the overall demand in the Indian economy. In a nutshell, the high incidence of NPAs has a cascading effect on all important financial ratios of the banks viz., Net Interest Margin, Return on Assets, Profitability, Dividend Payout, Provision Coverage Ratio, Credit contraction etc. This may likely erode the value of all stakeholders including shareholders, depositors, borrowers, employees and the general public at large.

CHAPTER 5 | ASSET RESTRUCTURING COMPANIES

Keeping in view the greater role envisaged for Asset Reconstruction Companies (ARCs) and recent regulatory changes governing sale of stressed assets by banks to ARC, the RBI has decided to fix the minimum Net Owned Fund (NOF) requirement for ARCs at Rs. 100 crore (USD¹³ 15.5 million) on an ongoing basis with effect from April 28, 2017. Further, no ARC shall commence or carry on the business of securitisation or asset reconstruction without having Net Owned Fund (NOF) of not less than Rs. 2 crores or such other higher amount as per the notification by RBI.

RBI as part of the framework for revitalising distressed assets in the economy had amended certain guidelines relating to sale of Non-Performing Assets (NPAs) by banks to Securitisation Companies (SCs) / Reconstruction Companies (RCs). In order to further strengthen the bank's ability to resolve their stressed assets effectively, it has been decided to put in place an improved framework governing sale of such assets by banks to SCs/RCs/other banks/NBFCs/Financial institutions etc.

Guidelines on sale of stressed assets by banks

In terms of extant instructions of the Reserve bank, the board of banks shall lay down detailed policies and guidelines on sale of their stressed assets to Securitisation Companies (SCs)/ Reconstruction Companies (RCs) which shall cover the following aspects:

- Financial assets to be sold
- Norms and procedures for sale of such financial assets
- A valuation procedure to be followed to ensure that a realistic value of financial assets is reasonably estimated.
- Delegation of powers of various functionaries for taking decision on the sale of the financial assets.

In order to enhance transparency in the entire process of sale of stressed assets, it has been decided by RBI as under:

- Identification of stressed assets beyond a specifies value, as may be determined by bank's policy for sale shall be top-down i.e., the head office/corporate office of the bank shall be actively involved in identification of stressed assets, including assets which are classified as Special Mention Account, to be put on sale. Early identification will help in low vintage and better

price realization for banks.

- At least once in a year, preferably at the beginning of the year, banks shall, with the approval of their Board, identify and list internally the specific financial assets identified for sale to other institutions, including SCs/RCs
- At a minimum, all assets classified as 'doubtful asset' above a threshold amount should be reviewed by the board/board committee on periodic basis. The assets identified for exit shall be listed for the purpose of sale.
- Prospective buyers need not be restricted to SCs/RCs. Banks may also offer the assets to other banks/NBFCs/FIs, etc. who have the necessary capital and expertise in resolving stressed assets. Participation of more buyers will result in better price discovery.
- In order to attract a wide variety of buyers, the invitation for bids should be preferably be publicly solicited so as to enable participation of as many prospective buyers as possible. In such cases, it would be desirable to use e-auction platforms.
- Banks must provide adequate time for due diligence by prospective buyers which may vary as per the size of the assets, with a floor of two weeks
- Banks should have clear policies with regard to valuation of assets proposed to be sold.
- The cost of valuation exercise shall be borne by the bank, to ensure that the bank's interests are protected.
- The discount rate used by banks in the valuation exercise shall be spelt out in the policy. This may be either the cost of equity or average cost of funds or the opportunity cost or some other relevant rate, subject to a floor of the contracted interest rate and penalty, if any.
- Banks shall review the efficacy of their extant policies on sale of NPAs with valuation of stressed assets and rework their policies.
- In order to make sure that sale of stressed assets by banks actually result in true sale of assets and to create a vibrant stressed assets market, it has been decided by RBI to progressively restrict banks' investment in Security Receipts (SRs) backed by their own stressed assets.

CHAPTER 6 | SUGGESTIONS/RECOMMENDATIONS

- **Improving credit sanctioning processes of banks:** The assessment and quantification of credit risk by banks should follow scientific methods and must be priced accordingly. This process should include thorough background verification of individuals/ organizations before allocation of funds. The thorough due diligence should include physical verification of operations & collateral, meaningful scrutiny of quarterly progress reports / and operating statements. Risk must be controlled through Loan Review Mechanism and portfolio management. Besides proper credit risk management, banks must structure credit schemes as indicated appropriate by the analysis of company cash flows.
- **Monitoring corporate activity after debt is sanctioned:** Banks must keep track of business activities after it sanctions a loan in order to identify the probable defaulters and take corrective action in a timely manner.
- **Tracking undisclosed assets:** The bank must make a thorough assessment of the borrower's assets other than those pledged as collateral, as it will enable them to recover their loans in case of willful default.
- **Loan waiver schemes:** Loans to priority sector, specially farming, are often waived by the government, particularly state governments. The government should avoid mass waivers as it encourages willful defaults and leaves an impression that their loan repayment will be waived.
- The recent announcement made by the Government of India has given more powers to the RBI to curtail the menace of NPAs. This involves setting up of an Internal Advisory Committee (IAC) by RBI which comprises majorly of its independent Board Members, to advise it in regard to the cases that may be considered for resolution under the Insolvency and Bankruptcy Code, 2016 (IBC).

The IAC also arrived at an objective, non-discretionary criterion for referring accounts for resolution under IBC. In particular, the IAC recommended for IBC reference all accounts with fund and non-fund based outstanding amount PHD Research Bureau 35 greater than Rs. 5000 crore, with 60 per cent or more classified as non-performing by banks as of March 31, 2016. The IAC noted that under the recommended criterion, 12 accounts totaling about 25 per cent of the current gross NPAs of the banking system would qualify for immediate reference under IBC.

As regards the other non-performing accounts which do not qualify under the above criteria, the IAC recommended that banks should finalise a resolution plan within six months. In cases where a viable resolution plan is not agreed upon within six months, banks should be required to file for insolvency proceedings under the IBC. In this regard, banks should effectively finalize their resolution plans in order to overcome the negative impact of NPAs on their banking activities and the overall banking system.

- The RBI has issued guidelines that entail involvement of top management in actively managing the credit risk of the banks. Banks are required to put in place proactive credit risk management practices like annual/half-yearly industry studies and individual obligor reviews, credit audit which entails periodic credit calls that are documented, periodic visits of plant and business site, and at least quarterly management reviews of troubled exposures / weak credits.
- **Public Sector Banks:** Greater autonomy should be awarded to PSBs in terms of governance, HR and operations. This would result in accountability while conserving the stability that comes with publicly owned enterprises. It would also enable PSBs to use new technology and processes. A few reforms driven by a global reform structure pertaining to capital, liquidity and disclosure standards under the Basel III package and other measures are Total Loss Absorbing Capacity (TLAC), Systemically Important Banks (SIBs), misconduct rules, etc.
- Public Sector Banks should appoint Relationship Managers for sets of Customers. Apart from managing the relationship between Bank and Corporate customer, the Relationship Manager should also be a "Whistle Blower". He should blow the whistle as and when he finds that the concerned Corporate has delayed in Salary payment, in Provident Fund or any other Statutory Obligations. This is the first sign of sickness and action plan should be made immediately with the concerned Corporate to eradicate the problem at the very start. Corporates which require help at initial stage should be helped immediately, if it is a true and genuine case.
- Banks should concentrate on financial viability and liquidity of each of its customers and not only on Securities. Each Bank should get a Private Market Report, through its own contact, about the proposed Applicant and its PHD Research Bureau 36 Promoters. Banks should be proactive

in sanctioning and disbursing their loans so that Corporates don't stop for finance which ultimately leads into NPAs.

- Promoters not following **proper financial management** practices should be held accountable. Middle level staff and clerical staff needs to be educated towards customer service, promptness and implementation of decisions. There should be a periodical visit of people from the Banks Head Office or Regional office to the various Corporates to assess the ground reality of the situation. Further, Crony Capitalism has to be stopped immediately.
 - **Reducing dependence on restructuring loans:** Banks must reduce their dependence on restructuring loans. They should strengthen the process of identifying and recovering stressed assets as soon as possible. Banks should also diversify their customer base to reduce concentrated exposure, especially to sectors which are prone to NPAs.
 - **Training of banking professionals:** It is imperative to create a skilled workforce so that banks can have necessary expertise and develop internal capabilities to evaluate projects and their feasibility. Further, there must be incentives and penalties for banking professionals in order to ensure accountability on their behalf.
 - Consolidation of various banks is necessary as it will help in creating healthier banking system in the country. It may results into revenue enhancements, value maximization, efficiency gains, costs savings, diversification of customers and assets, ease to access banking activities and large banks will help in attaining international recognition, among others. However, it is necessary that the employment scenario is not impacted.
- Going ahead, increased automation would lead to reduction in cost and leave more room for increase in budgets for trainings and creating wings to oversee and monitor corporate activity after debt is sanctioned. Further, it will facilitate the borrowers to no longer go to multiple wings to get a loan sanctioned from a single bank entity.
 - There is also a need to look into the role of Chartered Accountants' on whose recommendation of healthy books, the bank goes ahead and sanctions funds. However, a more holistic approach is required to mitigate the risk of NPAs. It is necessary that independent credit check must be promoted to avail the loan, monitor activities after debt is sanctioned and risk mitigation checks are put in place to ensure minimum risk exposure and prevent wilful default proactively.

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The Research Bureau has been instrumental in forecasting various lead economic indicators national and sub-national. Many of its research reports have been widely covered by media and leading business newspapers.

Research Activities	Comments on Economic Developments	Newsletters	Consultancy
Research Studies	Macro Economy	Economic Affairs Newsletter (EAC)	Trade & Investment Facilitation Services (TIFS)
State Profiles	States Development	Economic & Business Outlook (EBO)	Business Research Consultancy
Impact Assessments	Infrastructure	Global Economic Monitor (GEM)	
Thematic Research Reports	Foreign Exchange market	Trade & Investment Facilitator (TIF)	
Releases on Economic Developments	Global Economy & International Trade	State Development Monitor (SDM)	

Studies Undertaken by PHD Research Bureau

A: Thematic research reports

1. Comparative study on power situation in Northern and Central states of India (September 2011)
2. Economic Analysis of State (October 2011)
3. Growth Prospects of the Indian Economy, Vision 2021 (December 2011)
4. Budget 2012-13: Move Towards Consolidation (March 2012)
5. Emerging Trends in Exchange Rate Volatility (Apr 2012)
6. The Indian Direct Selling Industry Annual Survey 2010-11 (May 2012)
7. Global Economic Challenges: Implications for India (May 2012)
8. India Agronomics: An Agriculture Economy Update (August 2012)
9. Reforms to Push Growth on High Road (September 2012)
10. The Indian Direct Selling Industry Annual Survey 2011-12: Beating Slowdown (March 2013)
11. Budget 2013-14: Moving on reforms (March 2013)
12. India- Africa Promise Diverse Opportunities (November 2013)
13. India- Africa Promise Diverse Opportunities: Suggestions Report (November 2013)
14. Annual survey of Indian Direct Selling Industry-2012-13 (December 2013)
15. Imperatives for Double Digit Growth (December 2013)
16. Women Safety in Delhi: Issues and Challenges to Employment (March 2014)
17. Emerging Contours in the MSME sector of Uttarakhand (April 2014)
18. Roadmap for New Government (May 2014)
19. Youth Economics (May 2014)
20. Economy on the Eve of Union Budget 2014-15 (July 2014)
21. Budget 2014-15: Promise of Progress (July 2014)
22. Agronomics 2014: Impact on economic growth and inflation (August 2014)
23. 100 Days of new Government (September 2014)
24. Make in India: Bolstering Manufacturing Sector (October 2014)
25. The Indian Direct Selling Industry Annual Survey 2013-14 (November 2014)
26. Participated in a survey to audit SEZs in India with CAG Office of India (November 2014)
27. Role of MSMEs in Make in India with reference to Ease of Doing Business in Ghaziabad (Nov 2014)
28. Exploring Prospects for Make in India and Made in India: A Study (January 2015)
29. SEZs in India: Criss-Cross Concerns (February 2015)
30. Socio-Economic Impact of Check Dams in Sikar District of Rajasthan (February 2015)

31. India - USA Economic Relations (February 2015)
32. Economy on the Eve of Union Budget 2015-16 (February 2015)
33. Budget Analysis (2015-16)
34. Druzhba-Dosti: India's Trade Opportunities with Russia (April 2015)
35. Impact of Labour Reforms on Industry in Rajasthan: A survey study (July 2015)
36. Progress of Make in India (September 2015)
37. Grown Diamonds, A Sunrise Industry in India: Prospects for Economic Growth (November 2015)
38. Annual survey of Indian Direct Selling Industry 2014-15 (December 2015)
39. India's Foreign Trade Policy Environment Past, Present and Future (December 2015)
40. Revisiting the emerging economic powers as drivers in promoting global economic growth (February 2016)
41. Bolstering MSMEs for Make in India with special focus on CSR (March 2016)
42. BREXIT impact on Indian Economy (July 2016)
43. India's Exports Outlook (August 2016)
44. Ease of Doing Business : Suggestive Measures for States (October 2016)
45. Transforming India through Make in India, Skill India and Digital India (November 2016)
46. Impact of Demonetization on Economy, Businesses and People (January 2017)
47. Economy on the eve of Budget 2017-18 (January 2017)
48. Union Budget 2017-18: A budget for all inclusive development (February 2017)
49. Annual Survey of Indian Direct Selling Industry 2015-16 (February 2017)
50. Worklife Balance and Health Concerns of Women: A Survey (March 2017)
51. Special Economic Zones: Performance, Problems and Opportunities (April 2017)
52. Feasibility Study (socio-Economic Survey) of Ambala and Rohtak Districts in Haryana (March 2017)
53. Goods and Services (GST): So far (July 2017)
54. Reshaping India-Africa Trade: Dynamics and Export Potentiality of Indian Products in Africa (July 2017)
55. Industry Perspective on Bitcoins (July 2017)
56. Senior Housing: A sunrise sector in India (Sep 2017)

B: State profiles

57. Rajasthan: The State Profile (April 2011)
58. Uttarakhand: The State Profile (June 2011)
59. Punjab: The State Profile (November 2011)
60. J&K: The State Profile (December 2011)
61. Uttar Pradesh: The State Profile (December 2011)

62. Bihar: The State Profile (June 2012)
63. Himachal Pradesh: The State Profile (June 2012)
64. Madhya Pradesh: The State Profile (August 2012)
65. Resurgent Bihar (April 2013)
66. Life ahead for Uttarakhand (August 2013)
67. Punjab: The State Profile (February 2014)
68. Haryana: Bolstering Industrialization (May 2015)
69. Progressive Uttar Pradesh: Building Uttar Pradesh of Tomorrow (August 2015)
70. Suggestions for Progressive Uttar Pradesh (August 2015)
71. State profile of Telangana- The dynamic state of India (April 2016)
72. Smart Infrastructure Summit 2016- Transforming Uttar Pradesh (August 2016)
73. Smart Infrastructure Summit 2016-Transforming Uttar Pradesh : Suggestions for the State Government (August 2016)
74. Rising Jharkhand: An Emerging Investment Hub (February 2017)
75. Punjab: Roadmap for the New Government Suggestions for the Industrial and Socio-Economic Development – Focus MSMEs ease of doing business (May 2017)
76. Prospering Himachal Pradesh: A mountain of opportunities (Aug 2017)

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ABOUT THE PHD CHAMBER

PHD Chamber of Commerce & Industry, a leading Industry Chamber of India, ever since its inception in 1905, has been an active participant in the India Growth Story through its Advocacy Role for the Policy Makers and Regulators of the Country. Regular interactions, Seminars, Conference and Conclaves allow healthy and constructive discussions between Government, Industry and International Agencies bringing out the Vitals for Growth. As a true representative of the Industry with a large membership base of 48000 direct and indirect members, PHD Chamber has forged ahead leveraging its legacy with the Industry knowledge across sectors (58 Industry verticals being covered through Expert Committees), a deep understanding of the Economy at large and the populace at the micro level.

At a Global level we have been working with the Embassies and High Commissions in India to bring in the International Best Practices and Business Opportunities.



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Pinkerton traces its roots to 1850 when Allan Pinkerton founded the Pinkerton National Detective Agency. Today, Pinkerton offers organizations a range of corporate risk management services from security consulting and investigations to executive protection, employment screening and security intelligence. With employees and offices worldwide, Pinkerton maintains an unmatched reputation for protecting clients and their assets around the globe.

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