NON PERFORMING ASSETS AND PROFITABILITY OF COMMERCIAL BANKS IN INDIA: ASSESSMENT AND EMERGING ISSUES

C.S.Balasubramaniam

Professor, Babasaheb Gawde Institute of Management Studies, Mumbai
Email: balacs2001@yahoo.co.in

ABSTRACT

The Indian banking system has undergone significant transformation following financial sector reforms as laid out by Shri M.Narasimham Committee in 1991. It is adopting international best practices with a vision to strengthen the banking sector and its operations in the economy. Several prudential and provisioning norms have been introduced, and these are expecting the banks to usher overall efficiency, bring down Non Performing Assets (NPA), to improve the profitability and overall financial health in the banks, in general. In the background of these developments, this research paper attempts to analyze the trend of the NPA of the banks in recent decade since 2000. This paper assumes significance with the recent proposal by RBI to introduce Basel III norms in the banking sector from January 2013. Basel III framework of guidelines formulated by Bank for International Settlements (BIS) in consultation with central banks operating in a number of countries all over the world expect the participating banks in their respective economies to be following healthy financial and operational management policies.

This paper is divided in four parts. The first part brings out a discussion on the concept of NPA in the context of identification and control procedures, impact of NPA on profitability and financial soundness of banks in general. The second part presents a trend analysis of NPAs followed by a series of in depth analyses on the high level of borrowings from banking sector indicating a buildup of sectoral credit booms in general and also raising concerns about financial performance and operations of the borrowers. The third part dwells on the impact of restructuring of advances by banks on the basis of asset classification. Finally, certain issues and perspectives/ challenges on the performance of banking sector and financial stability of the economy emerge as conclusion.

Keywords: Asset classification, Provisioning for NPAs, Capital adequacy norms, Basel III standards, regulatory and supervisory control by RBI over banks

INTRODUCTION

A conceptual discussion on NPA and overall profitability of banks

To start with, performance in terms of profitability is a benchmark for any business enterprise including the banking industry. However, increasing NPAs have a direct impact on profitability of banks as legally banks are not allowed to book income on such accounts and at the same time banks are forced to make provision on such assets as per the Reserve Bank of India (RBI) guidelines on Performing Asset means an asset or account of borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the directions or guidelines relating to asset classification issued by RBI. An amount due under any credit facility is treated as "past due" when it has not been paid within 30 days from the due date. Due to the improvement in the payment and settlement systems, recovery climate, up gradation of technology in the banking system, etc., it was decided to dispense with 'past due' concept, with effect from March 31, 2001. Subsequent guidelines issued by RBI in line with international best practices in accordance with Basel standards ,the prudential norms for income recognition ,asset classification, capital adequacy and provisioning in commercial banks has been introduced.

These guidelines lay emphasis on regulatory and supervisory control of banks by RBI and enhancing the overall financial stability in the economy. It also expects the banks and financial institutions to be following capital adequacy norms, maintain capital provisioning on a risk –weighted assets basis along with operating on income recognition, asset classification and liquidity management. Further, all the commercial banks are subject to regulatory and supervisory frame work by RBI in accordance with switch over to Risk Based Supervision (RBS) in 2003-04 which has concurrently ushered in CAMELS(Capital adequacy, Asset quality, Management, Earnings, Liquidity, Systems and Controls) approach and Basel II norms. In accordance with asset classification norms brought in with effect from March 31, 2004, a non-performing asset (NPA) shell be a loan or an advance, where:

1. Interest and /or instalment of principal remain overdue for a period of more than 90 Days in respect of a Term Loan,
2. The account remains 'out of order' for a period of more than 90 days, in respect of an overdraft/ cash credit (OD/CC)
3. The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
4. Interest and/ or instalment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purpose, and
5. Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.

Also, with increasing deposits made by the public in the banking system, the banking industry cannot afford defaults by borrower s since NPAs affects the repayment capacity of banks.

Further, Reserve Bank of India (RBI) successfully creates excess liquidity in the system through various rate cuts and banks fail to utilize this benefit to its advantage due to the fear of burgeoning non-performing assets.

Types of NPA

Gross NPA:

Gross NPAs are the sum total of all loan assets that are classified as NPAs as per RBI guidelines as on Balance Sheet date. Gross NPA reflects the quality of the loans made by banks. It consists of all the nonstandard assets like as sub-standard, doubtful, and loss assets. It can be calculated with the help of following ratio:

Gross NPAs Ratio = Gross NPAs / Gross Advances

Net NPA:

Net NPAs are those type of NPAs in which the bank has deducted the provision regarding NPAs. Net NPA shows the actual burden of banks**.** Since in India, bank balance sheets contain a huge amount of NPAs and the process of recovery and write off of loans is very time consuming, the provisions the banks have to make against the NPAs according to the central bank guidelines, are quite significant. That is why the difference between gross and net NPA is quite high. It can be calculated by following:

Net NPAs = Gross NPAs – Provisions / Gross Advances – Provisions

Asset Classification

Assets are classified into following four categories:

- Standard Assets
- Sub standard Assets
- Doubtful Assets
- Loss Assets

Standard Assets: Standard assets are the ones in which the bank is receiving interest as well as the principal amount of the loan regularly from the customer. Here it is also very important that in this case the arrears of interest and the principal amount of loan do not exceed 90 days at the end of financial year. If asset fails to be in category of standard asset that is amount due more than 90 days then it is NPA and NPAs are further need to classify in sub categories.

Provisioning Norms:

- From the year ending 31.03.2000, the banks should make a general provision of a minimum of 0.40 percent on standard assets on global loan portfolio basis.
- The provisions on standard assets should not be reckoned for arriving at net NPAs.
- The provisions towards Standard Assets need not be netted from gross advances but shown separately as 'Contingent Provisions against Standard Assets' under 'Other Liabilities and Provisions - Others' in Schedule 5 of the balance sheet.

Banks are required to classify non-performing assets further into the following three categories based on the period for which the asset has remained *non-performing* and the *reasonability* of the dues:

- Sub Standard Assets
- Doubtful Assets
- Loss Assets

Sub Standard Assets: With effect from 31 March 2005, a substandard asset would be one, which has remained NPA for a period less than or equal to 12 month. The following features are exhibited by substandard assets: the current net worth of the borrowers / guarantor or the current market value of the security charged is not enough to ensure recovery of the dues to the banks in full; and the asset has well-defined credit weaknesses that jeopardize the liquidation of the debt and are characterized by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.

Provisioning Norms:

A general provision of 10 percent on total outstanding should be made without making any allowance for DICGC/ECGC guarantee cover and securities available.

Doubtful Assets: A loan classified as doubtful has all the weaknesses inherent in assets that were classified as sub-standard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values – highly questionable and improbable. With effect from March 31, 2005, an asset would be classified as doubtful if it remained in the sub-standard category for 12 months.

Loss Assets: A loss asset is one which considered uncollectible and of such little value that its continuance as a bankable asset is not warranted- although there may be some salvage or recovery value. Also, these assets would have been identified as" loss assets "by the bank or internal or external auditors or the RBI inspection but the amount would not have been written-off wholly.

Provisioning Norms:

The entire asset should be written off. If the assets are permitted to remain in the books for any reason, 100 percent of the outstanding should be provided for.

Management/Resolution of NPAs

A reduction in the total gross and net NPAs in the Indian financial system indicates a significant improvement in management of NPAs. This is also on account of various resolution mechanisms introduced in the recent past which include the SRFAESI (Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest) Act, one time settlement schemes, setting up of the Corporate Debt Restructuring (CDR) mechanism, strengthening of Debt Recovery Tribunals (DRTs). From the data available of Public Sector Banks as on March 31, 2003, there were 1,522 numbers of NPAs as on March 31, 2003 which had gross value greater than Rs. 50 million in all the public sector banks in India. The total gross value of these NPAs amounted to Rs. 215 billion. The total number of resolution approaches (including cases where action is to be initiated) is greater than the number of NPAs, indicating some double counting. As can be seen, suit filed and Bureau of Industrial Finance &Reconstruction (BIFR) are the two most common approaches to resolution of NPAs in public sector banks. Rehabilitation has been considered/ adopted in only about 13% of the cases. Settlement has been considered only in 9% of the cases. It is likely to have been adopted in even fewer cases. Data available on resolution strategies adopted by public sector banks suggest that Compromise settlement schemes with borrowers are found to be more effective than legal measures. Many banks have come out with their own restructuring schemes for settlement of NPA accounts. State Bank of India, HDFC Bank Limited, M/s. Dun and Bradstreet Information Services (India) Pvt. Ltd. and M/s. Trans Union to serve as a mechanism for exchange of information between banks and FIs for curbing the growth of NPAs incorporated credit Information Bureau (India) Limited (CIBIL) in January 2001. Pending the enactment of CIB Regulation Bill, the RBI constituted a working group to examine the role of CIBs. As per the recommendations of the working group, Banks and FIs are now required to submit the list of suit-filed cases of Rs. 10 million and above and suit filed cases of wilful defaulters of Rs. 2.5 million and above to RBI as well as CIBIL. CIBIL will share this information with commercial banks and FIs so as to help them minimize adverse selection at appraisal stage.

CDR is a nonstatutory mechanism based on debtor-creditor agreement and inter-creditor agreement. Restructuring helps in aligning repayment obligations for bankers with the cash flow projections as reassessed at the time of restructuring. Therefore, it is critical to prepare a restructuring plan on the lines of the expected business plan along with projected cash flows.

The CDR process is being stabilized. Certain revisions are envisaged with respect to the eligibility criteria (amount of borrowings) and time frame for restructuring. Foreign banks are not members of the CDR forum, and it is expected that they would be signing the agreements shortly. However they attend meetings. The first ARC to be operational in India-Asset Reconstruction Company of India (ARCIL) is a member of the CDR forum. Lenders in India prefer to resort to CDR mechanism to avoid unnecessary delays in multiple lender arrangements and to increase transparency in the process. While in the RBI guidelines it has been recommended to involve independent consultants, banks are so far resorting to their internal teams for recommending restructuring programs.

High cost of funds due to NPAs

Quite often genuine borrowers face the difficulties in raising funds from banks due to mounting NPAs. Either the bank is reluctant in providing the requisite funds to the genuine borrowers or if the funds are provided, they come at a very high cost to compensate the lender’s losses caused due to high level of NPAs. Therefore, quite often the corporate prefer to raise funds through commercial papers (CPs) where the interest rate on working capital charged by banks is higher.th the enactment of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, banks can issue notices to the defaulters to pay up the dues and the borrowers will have to clear their dues within 60 days. Once the borrower receives a notice from the concerned bank and the financial institution, the secured assets mentioned in the notice cannot be sold or transferred without the consent of the lenders. The main purpose of this notice is to inform the borrower that either the sum due to the bank or financial institution is paid by the borrower or else the former will take action by way of taking over the possession of assets. Besides assets, banks can also take over the management of the company. Thus the bankers under the aforementioned Act will have the much needed authority to either sell the assets of the defaulting companies or change their management. But the protection under the said Act only provides a partial solution. What banks should ensure is that they should move with speed and charged with momentum in disposing off the assets. This is because as uncertainty increases with the passage of time, there is all possibility that the recoverable value of asset also reduces and it cannot fetch good price. If faced with such a situation than the very purpose of getting protection under the Securitisation Act, 2002 would be defeated and the hope of seeing a ‘must have growing banking sector ‘can easily vanish.

Impact of NPA on the operations of banks

Profitability

NPA means booking of money in terms of bad asset, which occurred due to wrong choice of client. Because of the money getting blocked the prodigality of bank decreases not only by the amount of NPA but NPA lead to opportunity cost also as that much of profit invested in some return earning project/asset. So NPA does not affect current profit but also future stream of profit, which may lead to loss of some long-term beneficial opportunity. Another impact of reduction in profitability is low ROI (return on investment), which adversely affect current earning of bank.

Liquidity

Money is getting blocked, decreased profit lead to lack of enough cash at hand which lead to borrowing money for shortest period of time which lead to additional cost to the company. Difficulty in operating the functions of bank is another cause of NPA due to lack of money.

Involvement of Management

Time and efforts of management is another indirect cost which bank has to bear due to NPA. Time and efforts of management in handling and managing NPA would have diverted to some fruitful activities, which would have given good returns. Now days, banks have special employees to deal and handle NPAs, which is additional cost to the bank.

Credit Loss

If a bank is facing problem of NPA, then it adversely affects the value of bank in terms of market for credit. It will lose its goodwill and brand image and credit which have negative impact to the people who are putting in their money in the banks.

A trend analysis of NPAs of Scheduled Commercial Banks (SCBs)

Table 1. Gross and net NPAs of Scheduled Commercial Banks
(Rs.inCrs)

Years	Gross NPAs				Net NPAs			
	Gross Advances	Amount	% to Net Advances	% to Total Assets	Net Advances	Amount	% to Net Advances	% to Total Assets
2000-01	5,58,766	63,883	11.4	4.9	5,26,329	32,632	6.2	2.72
2001-02	6,80,958	70,861	10.4	4.6	6,45,859	35,554	5.5	2.3
2002-03	7,78,043	68,717	8.8	4	7,40,473	29,692	4.4	1.8
2003-04	9,02,026	64,785	7.2	3.3	8,62,643	24,396	2.9	1.2
2004-05	11,52,682	59,373	5.2	2.5	11,15,663	21,754	2	0.9
2005-06	15,51,378	51,816	3.3	1.9	15,15,669	18,529	1.2	0.7
2006-07	20,12,510	50,486	2.5	1.5	19,81,237	20,101	1	0.6
2007-08	25,07,885	56,309	2.3	1.3	24,77,039	24,734	1	0.6
2008-09	30,38,254	68,328	2.25	1.3	30,00,906	31,564	1.05	0.6
2009-10	35,45,900	84,747	2.39	1.3	34,93,393	39,126	1.12	0.6

Source: Report on Trend and Progress on Banking Sector 2010-11.

There was a significant decline in the non-performing assets (NPAs) of SCBs in 2003-04, despite adoption of 90 day delinquency norm from March 31, 2004. The gross NPAs of SCBs declined from 4.9 per cent of total assets in 2000-01 to 3.3 per cent in 2003-04. The corresponding decline in net NPAs was from 2.72 per cent to 1.2 per cent. Both gross NPAs and net NPAs declined in absolute terms also. While the gross NPAs declined from Rs. 68,717 crores in 2002-03 to Rs. 64,785 crore in 2003-04, net NPAs declined from Rs. 32,632 crores to Rs. 24,396 crores in the same period. The gross NPAs of SCBs declined by Rs.7, 309 corers during 2005-06 over and above the decline of Rs.6, 561 corers in the previous year. Increased recovery of NPAs, decline in fresh slippages and a sharp increase in gross loans and advances by SCBs led to a sharp decline in the ratio of gross NPAs to gross advances to 3.3 per cent at end-March 2006 from 5.2 per cent at end-March 2005. Likewise, net NPAs as percentage of net advances declined to 1.2 per cent from 2.0 per cent at end-March 2005 and gross NPAs to total assets 1.83 percent at end-March 2006 from 2.52 at end-March 2005. The setting up of the Asset Reconstruction Corporation of India (ARCIL) has provided a major boost to banks‘efforts to recover their NPAs. Indian banks recovered a higher amount of NPAs during 2007-08 than that during the previous year. Though the total amount recovered and written-off at Rs.28, 283 crores in 2007-08 was higher than Rs.26, 243 crores in the previous year, it was lower than fresh addition of NPAs (Rs.34, 420 crores) during the year. As a result, the gross NPAs of SCBs increased by Rs.6, 136 crores in 2007-08. The hardening of interest rates might have made the repayment of loans difficult for some borrowers, resulting in some increase in NPAs in this sector. Notwithstanding increase in gross NPAs of the banking sector, The gross NPAs as a percent of total assets per cent is declined to 1.3 during the year 2006-07 and net NPAs to total assets percent is also declined to 0.57. In the year 2008-09 provisioning made was higher than write-back of excess provisioning, net NPAs increased during the year due to increase in gross NPAs, the gross NPAs to gross advances ratio for SCBs is 2.25 per cent and the gross NPAs to total assets, net NPAs to total assets per cent is 1.3 & 0.6. The SRFAESI Act has, thus, been the most important means of recovery of NPAs. However, there has been a steady fall in the amount of NPAs recovered under SRFAESI Act as per cent of the total amount of NPAs involved under this channel in recent years, a trend which could also be seen between 2008-09 and 2009-10.

During the crisis year 2008-09, the gross NPA ratio remained unchanged for Indian banks. However, during 2009-10, the gross NPA ratio showed an increase to 2.39 per cent. After netting out provisions, there was a rise in the net NPA ratio of SCBs from 1.05 per cent at end-March 2009 to 1.12 per cent at end-March 2010. The growth in NPAs of Indian banks has largely followed a lagged cyclical pattern with regard to credit growth, the pro-cyclical behaviour of the banking system, wherein asset quality can get compromised during periods of high credit growth and this can result in the creation of NPAs for banks in the later years. At end- June 2010, there were 13 registered Securitisation Companies /reconstruction companies in India. Of the total amount of assets securitized by these companies at end-June 2010, the largest amount was subscribed to by banks. The net NPAs to net advances ratio of each of the public sector banks as at end-March 2009 was less than 2 per cent. This suggests overall improvement in the financial health of Indian banks in recent years.

Classification of Loan Assets - Bank Group-wise

(As at end-March)

(Amount in Rs. crore)

Bank Group/Year	Standard Assets		Sub-standard Assets		Doubtful Assets		Loss Assets		Total Gross NPAs		Total Gross Advances
	Amount	per cent*	Amount	per cent*	Amount	per cent*	Amount	per cent*	Amount	per cent*	Amount
1	2	3	4	5	6	7	8	9	10	11	12
Scheduled Commercial Banks											
2008	24,51,217	97.7	26,541	1.1	24,507	1.0	5,619	0.2	56,668	2.3	25,07,885
2009	29,61,524	97.7	37,030	1.2	26,998	0.9	6,035	0.2	70,063	2.3	30,31,587
Public Sector Banks											
2008	17,78,476	97.8	17,290	1.0	19,291	1.1	4,018	0.2	40,598	2.2	18,19,074
2009	22,37,556	98.0	20,603	0.9	21,019	0.9	4,296	0.2	45,918	2.0	22,83,473
Old Private Sector Banks											
2008	1,10,847	97.7	816	0.7	1,346	1.2	395	0.3	2,557	2.3	1,13,404
2009	1,20,733	97.6	1,295	1.1	1,267	1.0	390	0.3	2,952	2.4	1,23,685
New Private Sector Banks											
2008	4,02,013	97.5	6,473	1.6	3,106	0.8	849	0.2	10,428	2.5	4,12,441
2009	4,40,813	96.9	9,258	2.0	3,708	0.8	934	0.2	13,900	3.1	4,54,713
Foreign Banks											
2008	1,59,882	98.1	1,962	1.2	764	0.5	358	0.2	3,084	1.9	1,62,966
2009	1,62,422	95.7	5,874	3.5	1,004	0.6	416	0.3	7,294	4.3	1,69,716

* : percent to gross advances

Note: 1. Constituent items may not add up to the total due to rounding off.
2. Data for 2009 excludes Tamilnad Merchantile Bank

Source: DSB Returns (BSA) submitted by respective banks.

Source: Report on Trend and Progress on Banking Sector 2010-11

It is noteworthy that while the share of NPAs in 'doubtful' and 'loss' category remained more or less static, the share of 'sub-standard' category witnessed some variations. As per the asset classification norms, a sub-standard asset is one which has remained NPA for a period of up to 12 months. Thus, the above-mentioned increase in the share of sub-standard category is indicative of deterioration of the assets in the year 2008-09.

Sector-wise NPAs – Bank Group-wise*

(Amount in Rs. crore)

Sector	Public Sector Banks		Old Private Sector Banks		New Private Sector Banks		All SCBs	
	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09
1	2	3	4	5	6	7	8	9
A. Priority Sector	25,287 (0.8)	24,318 (0.7)	1,338 (0.7)	1,233 (0.5)	2,080 (0.3)	2,407 (0.3)	28,705 (0.7)	27,958 (0.5)
i) Agriculture	8,268 (0.3)	5,708 (0.2)	243 (0.1)	263 (0.1)	1,225 (0.2)	1,178 (0.2)	9,735 (0.2)	7,149 (0.1)
ii) Small Scale Industries	5,805 (0.2)	6,984 (0.2)	359 (0.2)	307 (0.1)	292 -	363 -	6,456 (0.2)	7,654 (0.2)
iii) Others	11,214 (0.4)	11,626 (0.3)	737 (0.4)	663 (0.3)	563 (0.1)	866 (0.1)	12,514 (0.3)	13,155 (0.3)
B. Public Sector	299 -	474 -	- -	- -	- -	75 -	299 -	549 -
C. Non-Priority Sector	14,163 (0.5)	19,251 (0.5)	1,219 (0.6)	1,839 (0.8)	8,339 (1.1)	11,334 (1.4)	23,721 (0.6)	32,423 (0.6)
Total (A+B+C)	**39,749 (1.3)**	**44,042 (1.2)**	**2,557 (1.3)**	**3,072 (1.3)**	**10,419 (1.4)**	**13,815 (1.7)**	**52,725 (1.2)**	**60,930 (1.2)**

* : Excluding foreign banks.
- : nil/negligible.
Note: Figures in brackets indicate percentage to the total assets of the respective bank group.
Source: Based on off-site returns submitted by banks.

Source: Report on Trend and Progress on Banking Sector 2010-11

While the NPAs of priority sector registered a decline on year-on-year basis, that of non-priority sector registered a rise of 36.7 per cent. The decline in priority sector NPAs was contributed by the agricultural sector, partly reflecting the effect of the debt waiver scheme for farmers announced by the Central Government in 2007. The sharp rise in NPAs of non-priority sector was reflective of the slowdown in the economy and stressed financial conditions of corporates . It is noteworthy that the Reserve Bank has issued guidelines regarding restructuring of loans, as a one-time measure and for a limited period of time in view of the extraordinary external factors, for preserving the economic and productive value of assets which were otherwise viable.

The asset quality of the banking sector improved in 2010-11 over the previous year. The gross NPAs to gross advances ratio declined to 2.25 per cent in 2010-11 from 2.39 per cent in the previous year. The GNPAs, however, increased in absolute terms in 2010-11 over the previous year, though at a lower rate. The improvement in asset quality was visible in both private sector banks and foreign banks. Public sector banks, however, witnessed deterioration in asset quality in 2010-11 over the previous year. This was mainly due to deterioration in asset quality of the SBI group. Among the bank groups, SBI group reported the highest GNPA ratio followed by foreign banks in 2010-11. Foreign banks, however, registered a decline in gross non-performing loans in 2010-11 over the previous year.

Banking sector has written off ten per cent of the previous year's outstanding GNPAs

During the year 2010-11, the banking sector has written off almost ten per cent of the Outstanding gross non-performing loans (as at end-March 2010), which helped in limiting the growth of gross non-performing loans. The extent of write off was lower in 2010-11 as compared with the previous year; however, in comparison with 2008 and 2009, the ratio was on the higher side. This indicated that during the last two years, writing off of NPAs was an important factor in maintaining the asset quality of the banking sector at tolerable levels. The percentage of outstanding GNPAs written off to total outstanding GNPAs (as at end-March 2010) was particularly high for SBI group and new private sector banks.

Impact of Restructuring of Advances of the SCBs on the basis of Asset Quality

Table: Impact of Restructuring on Asset Quality of SCBs

(Amount in ₹ crore)

Item	All SCBs			Y-on-Y Growth rate		
	March 2009	March 2010	March 2011	2009 over 2008	2010 over 2009	2011 over 2010
1	2	3	4	5	6	7
Total Gross Advances	27,93,572	32,71,896	40,12,079	19.79	17.12	22.62
Standard Advances	27,25,350	31,90,080	39,17,991	19.73	17.05	22.82
Of which Restructured	60,379	97,834	1,06,859	192.98	60.19	10.53
Total Gross NPAs	68,222	81,816	94,088	22.17	19.93	14.84
Total Gross NPAs to Total Gross Advances	2.44	2.50	2.35			
Restructured standard advances as % of gross advances	2.16	2.99	2.66			
Scenario-I - 15 per cent of Restructured Standard Advances turning NPAs						
Scenario-I NPAs	77,279	96,491	1,10,116	31.13	24.64	14.19
Scenario-I NPA Ratio	2.77	2.94	2.74			
Scenario-II - 25 per cent of Restructured Standard Advances turning NPAs						
Scenario-II NPAs	83,317	1,05,996	1,20,684	36.59	27.22	13.86
Scenario-II NPA Ratio	2.98	3.24	3.01			
Scenario-III - 100 per cent of Restructured Standard Advances turning NPAs						
Scenario-III NPAs	1,28,601	1,78,537	2,00,860	68.21	38.83	12.50
Scenario-III NPA Ratio	4.60	5.46	5.01			

Source: Report on Trend and Progress on Banking Sector 2010-11

In the aftermath of the global financial turmoil in 2007, the Reserve Bank had proactively taken many steps to arrest the downward spiral, if any, in the economy and the banking sector. Amongst those steps, one important measure was allowing banks to restructure their advances, as a one-time measure. Accordingly, the Reserve Bank issued guidelines on restructuring of advances by banks in August 2008 by which banks were allowed to restructure accounts of viable entities classified as standard, sub-standard and doubtful. Though it was prescribed in August 2008 that accounts classified as standard assets should be immediately reclassified as sub-standard assets upon restructuring, in January 2009, an exceptional/special regulatory treatment was granted to all accounts, which were standard as on September 1, 2008. The exceptional/special regulatory treatment permits treating standard accounts as standard after restructuring, provided certain conditions are met. The special regulatory treatment allowed to the standard accounts helped the banking sector to limit the growth of gross nonperforming advances. However, there was always a concern how many of these restructured standard accounts will fall back into the NPA category over a period of time as these borrowers were facing temporary cash flow problems in the wake of the global financial turmoil. Thus, the impact of restructuring of advances on the asset quality of the banking sector will be shaped by the per cent of restructured standard accounts falling back into the NPA category. Data on restructuring of advances by bank groups since September 2008 indicate that public sector banks account for major portion of the restructuring of standard advances. At the system level, the restructured standard advances as a percentage of gross advances increased from 2.16 per cent as at end-March 2009 to 2.66 per cent as at end-March 2011. To assess the impact of restructuring of standard advances on the asset quality of the banking sector, different scenarios have been developed assuming different values for the percentage of restructured standard advances falling back into the NPA category. Results are provided in the above Table. Under the extreme assumption that the entire restructured standard advances would have become NPAs if these were not restructured, the gross NPA ratio would have been as high as 5.01 per cent as at end-March 2011 as against the reported GNPA ratio of 2.35 per cent.

CONCLUSION

On the basis of the foregoing discussion, certain broad observations, issues and perspectives on the performance of banking sector and financial stability of the economy on the eve of the introduction of Basel III norms by RBI to the banks would be appropriate:

1. In retrospect, the Indian Banks have overall demonstrated a trend of continued good performance and profitability despite rising interest rates, increase in operating costs and the spillover effects of recent global financial crisis .This is reflected in higher credit growth deposit record, better return on assets, and return on equities. (ROE) The capital position improved significantly as the banks were able to mobilise substantial funds.
2. As observed from the above analysis, the level of NPAs is high with all banks currently and the banks would be expected to bring down their NPA. This can be achieved by good credit appraisal procedures, effective internal control systems along with their efforts to improve asset quality in their balance sheets.
3. However, maintaining profitability is a challenge to commercial banks especially in a highly competitive era and opening up of banking business to NBFC and foreign

banks in general. This assumes significance in a period of rising interest rates and operating costs of borrowers in general.

4. Banks would make efforts to mobilise funds in order to comply with provisioning norms and capital adequacy requirements while meeting Basel III standards which will be brought in by RBI shortly. However, the Capital requirements would be large considering the varied structure of banks and financial institutions operating in the economy and their NPA levels. The capital market environment currently prevailing in the economy would pose problems for the capital mobilisation by the banks.

5. Finally , it is significant to note that new and private sector banks led by ICICI Bank and HDFC Bank , with their high capital adequacy ratios, enhanced proportion of common equity and better IT and other modern financial skills of the personnel, are well placed to comply with Basel III norms in general. PSU banks although dominant banks in the Indian financial system may take more time and face challenges in following the Basel III guidelines in the ensuing years.

REFERENCES

1. Anand Sinha :'Indian Banking :Journey into the future 'RBI Monthly Bulletin , February 2012
2. K.C.Chakrabarty :'Indian Banking Sector :Towards the next orbit' , RBI Monthly Bulletin, March 2012
3. B.Mahapatra : Implications of Basel III for Capital,liquidityand profitability of Banks , April 2012.
4. Reserve Bank of India (RBI) : Report on Trend and Progress of Banking in India : 2010-11, RBI, (November 2011)
5. K.C.Shekhar & Lekshmy Shekhar: Banking: Theory & Practice, Vikas Publishing House, 2011.
6. Soumya Kanti Ghosh : 'Bank books point to real slow down' , Financial Express, May 29, 2012
7. Several articles, editorials and news items from Economic Times, Financial Express, Business Standard, and other economic/ business dailies.