The NPA decade: Events that changed the face of banking sector

Warning bells were ringing

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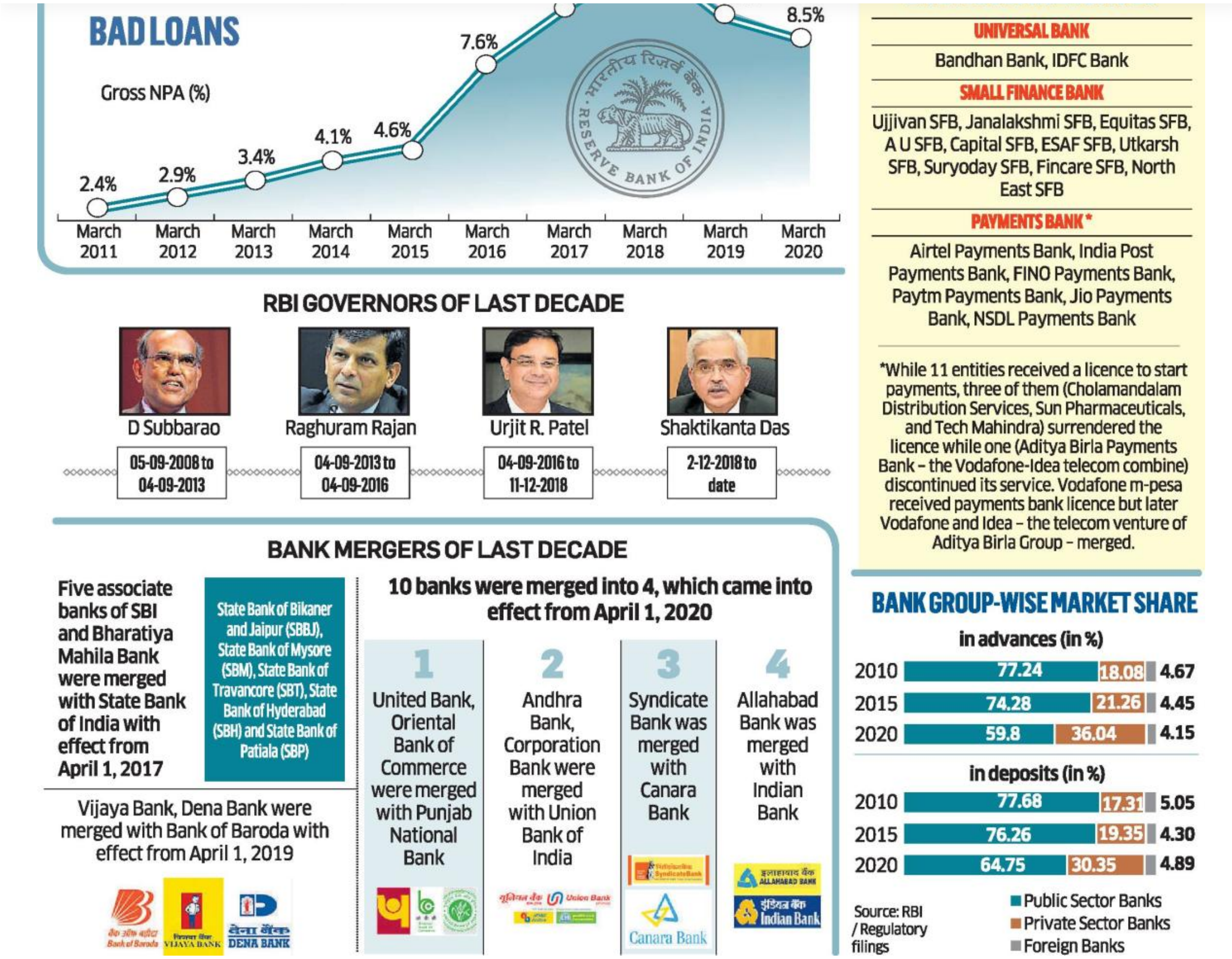
Phone banking assumed a different connotation in the early part of the last decade. It referred to phone calls from Raisina Hill (where the finance ministry is located) to public sector bank chief executives 'to get things done', - meaning asking them to extend a loan to a corporate who could not pass the risk test of lenders.

The poor underwriting standards resulted in high credit growth, at a time when interest rates were kept low to tide over the disruptions caused by the global financial crisis of 2008. Bank credit rebounded with 22.6% growth in 2010-11 after a subdued performance in the previous year.

Such indiscriminate lending had made the banking regulator worried. "The periods of high credit growth have the potential to give rise to credit boom … which have often been identified to be precursors to credit busts and financial crises," the financial stability report of the RBI released in June 2011 noted. "…underwriting standards would need to be tightened in order to ensure that the quality of credit does not deteriorate, going forward," it said.

Those warning bells were ignored. It resulted in the kind of situation that probably defined the course of the banking sector during the decade.



The rise and rise of bad loans

Gross non-performing assets of commercial banks was at 2.4% of gross advances at the end of March 2011. By March 2018, the ratio hit a peak of 11.5%. For a few public sector banks, one-third of their loans had turned sour.

The narrative of the decade revolved around ballooning bad loans. Willful defaulter, crony capitalist etc. entered bankers' lexicon.

It became essential to get a true picture of the bad loans since these banks were kicking the can down the road – by not declaring the true classification of an asset. The existing chief executive of a public clean up the balance sheet. But by the end of the new one's term, the same thing was repeated. And the cycle went on.

Raghuram Rajan, who was appointed as the governor of the RBI in 2013 decided to do the clean up act by announcing an asset quality review (AQR). RBI inspectors went meticulously through the bank books and identified various assets which should have been classified as sub-standard.

“This exercise took the lid off,” said a retired banker, referring to the avalanche of NPAs that hit the banking sector following the AQR.

“NPAs have ballooned because of large scale indiscriminate lending during the beginning of the last decade,” said Madan Sabnavis - Chief Economist, CARE Ratings.

“Then there was corporate debt restructuring which camouflaged it [postponing NPA recognition]. Today it looks like the worst is over. But because of various flexibilities that were provided by the RBI [in 2020] in terms of recognition and restructuring on NPA, we do not have a clear picture as of now and we cannot tell with any confidence that the worst is really behind us. My sense is that the number will increase; currently it is 8.5%, which will go up to 12%,” Sabnavis told *DH* referring to the measures taken by the RBI after the Coronavirus pandemic broke out early last year.

Resolution

While recognition of bad loans was underway, a resolution mechanism was taking shape simultaneously. In October, 2016, the Insolvency and Bankruptcy Board of India was established under the Insolvency and Bankruptcy Code, 2016 (Code).

“This was one of the recent important, unconventional legislation introduced by the legislature to deal with the resolution of stressed assets and to strengthen the banking sector by reducing their burden and making credit available,” said Ashish Pyasi, Associate Partner Dhir and Dhir Associates.

This RBI prepared a list of 12 big borrowers which was sent to banks for proceeding under bankruptcy laws. These 12 accounts constituted 25% of the Rs 10 lakh crore NPAs of the banking system. Essar Steel, Bhushan Steel, Alok Industries – were some of the names in the list. IBC, one of the key developments of the last 10 years, achieved the objective to a great extent but there is a long way to go.

“The code has helped the bankers to clear their books, resolve the stressed assets, maximize value assets expeditiously, however, not within the time stipulated in the code. We have seen so many cases creditors which has also affected the resolution of those stressed assets," Tyagi said.

Inflation targeting

Another legacy of the high-growth years was high inflation. Interest rates were lowered to boost growth, but that accompanied high inflation. A committee was set up under Urjit Patel who was then the deputy governor in-charge of monetary policy (later became governor succeeding Rajan) to review the RBI's monetary policy framework. The committee suggested an inflation-targeting framework along with a six-member monetary policy committee to decide interest rate.

Price rise was brought under control after the new framework was put in motion in 2016.

2020, however, was an outlier as inflation stayed above the central bank upper tolerance zone of 6%. The focus of the central bank in 2020, in the wake of the pandemic which resulted in GDP growth contracting, has been to push growth.

Over a dozen new banks

The decade also marked a decisive shift on the issue granting bank licenses to new entities. RBI was known to be a conservative regulator when it comes to allowing private sector entities to open banks. It took the regulator over ten years to issue fresh licenses to IDFC and Bandhan, in 2014.

The approach changed over the course of the decade as the concept of niche banking entities was floated. Till then there was only one kind of license – universal bank licenses. (A handful of Local Area Bank licences were given but there was not much success). In 2015, licenses were issued to 10 small finance banks and eleven payments banks. In addition, the regulator introduced on-tap licensing – which means an entity can apply for a bank license any time it wishes to rather than waiting for the regulator to open the window.

As the decade neared to close, another development took place which could have a significant bearing on the banking sector. An Internal Working Group of RBI recommended bank licenses to corporate houses – that is a business house having total assets of Rs 5,000 crore or more, where the non-financial business of the group accounts for more than 40% in terms of total assets or gross income. The present bank license norms do not allow corporate houses to enter banking.

PSB Merger

Bank merger was considered blasphemous till the Narendra Modi government came into power in with its parent, enabling the banking behemoth to enter the league of the top 50 global banks in terms of assets. The exercise was followed up by merging public sector lenders Vijaya Bank and Dena Bank with Bank of Baroda in 2019. The merger process was taken forward on a much larger scale after the Modi government came back to power with a resounding majority as it announced folding up of 10 public sector banks into 4 in August 2019. These mergers came into effect from April 1, 2020. Consolidation of public sector banks which was a pipedream for long, became a reality.

(The writer is a Mumbai-based senior journalist)

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