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NPA clock ticks again after SC lifts stay; IBC back in action from today. What impact will banks face?

The bad-loan clock has started ticking again with the Supreme Court lifting the stay that barred banks from classifying fresh NPAs (non-performing assets) after August 31. Also, the Insolvency and Bankruptcy Code (IBC) will start operations after a year's gap. What impact will these developments have on banks?

Experts are of the view that there will be a rise in gross NPA levels for banks as proforma NPAs will now become actual. "We have analysed the numbers of 22 large banks that have reported proforma NPAs. With the Supreme Court stay being lifted, these figures will become actual NPAs. The expected increase will be around 1.2 per cent (in GNPAs)," said Sanjay Agarwal, head of BFSI at CARE rating agency.

After the apex court's stay, banks were treating bad-loan accounts in two ways. They accounted for bad loans as bad loans, showing proforma gross NPAs while announcing their quarterly financial results. But, when it came to the banks' relation with the defaulting customer, the loan continued to be treated as a standard one. After the latest court verdict, banks can return to tagging NPAs as NPAs.

The Supreme Court, had, on September 3, 2020, put a stop on the NPA clock to help Covid-hit borrowers asking banks not to tag accounts that were standard as of August 31 as NPAs. But, this created difficulties for the industry in terms of asset classification. The Supreme Court has now lifted that stay.

"There will surely be an increase in NPA levels as banks have to now report full NPAs. But, the impact in terms of capital and provisioning will not be much since banks have already made sufficient provisions on such loans," said Sidhharth Purohit, analyst at SMC Global Securities. Indian banks had total Gross NPAs of 7.5 percent as of September 2020. The RBI has projected that this figure will rise to 13.5 per cent by September 2021.

Big spike in IBC cases unlikely

At the same time, a significant jump in IBC cases is unlikely since the provision for one-time restructuring (OTR) already exists, said Agarwal of CARE. "There was a six-month moratorium for stressed borrowers and this is followed by an OTR. Also, there was a government emergency credit guarantee scheme. Looking at all of these together, I do not see a reason for a substantial jump in IBC cases," he opined.

The Government had put a freeze on fresh IBC cases last year for a period of 12 months to help stressed borrowers hit by the Covid-19 pandemic. This meant a sharp decline in the fresh IBC cases. But, that deadline is expiring today.

The IBC was introduced in FY17 for faster resolution of stressed assets by empowering creditors to deal in a transparent and time-bound manner. This mandates resolution of stressed assets within a period of 270 days. The launch of IBC is a major reform in the Indian banking sector. It has helped banks recover whatever value is left in assets that have gone bad (where repayments have stopped).

Under the IBC, creditors take control of assets as compared with the earlier system, where assets remain in possession of debtors till the time of resolution or liquidation. Liquidation sometimes can be an efficient mode of resolution for debtors as the scope of revival of an entity is low. This mechanism has helped to speed up the NPA resolution process.

The shift of power in favour of creditor's results in speedier and unbiased resolution process and help in improving the credit repayment culture. The implementation of the IBC has seen significant improvement, which has resulted in resolution of few large ticket size NPAs," CARE said in a report published on February 13.

According to the rating agency, banks have already managed to recover around 40 percent of their dues in 12 large cases, of which ten have reached the resolution stage. "Since the last two years, NPA levels have reduced (partly due to loan writeoffs) and the challenge for banks continues in the current year due to pandemic and nationwide lockdown, which has resulted in muted economic activities across the country," the CARE report said.

Indian banks have seen a significant spike in NPAs after the RBI initiated early identification of stressed assets and Asset Quality Review (AQR) for banks. This forced banks to dig out the hidden dirt in their balance sheets. The exercise caused a sharp spike in reported NPAs. But NPAs started declining in the last two years due to significant loan writeoffs and high provisioning. Provisions refer to the money set aside against NPA losses. A loan becomes an NPA if there is no repayment for 90 days.

In absolute terms, the GNPAs of scheduled commercial banks improved in FY19 and FY20 to Rs.9.4 lakh crore and Rs.8.9 lakh crore, respectively, after reaching a peak in FY18 (Rs.10.4 lakh crore), CARE said.

"Part of write-offs in FY19 was due to aging of loans, while IBC gave a boost to recoveries during the same period. With a substantial increase in NPA provisions, Net NPAs moderated to 3.7% and 2.8% in FY19 and FY20, respectively, the ratio further improved to 2.1% in September 2020," the agency said.

Further, the restructured standard advances ratio has also witnessed a declining trend since FY18. However, it increased to 0.43 per cent in September 2020 as compared with 0.36 per cent in March, 2020, which indicates an increase in the stress on account of the pandemic, CARE said.