Analysis of Movement in Stressed Advances

February 13, 2021 | BFSI Research

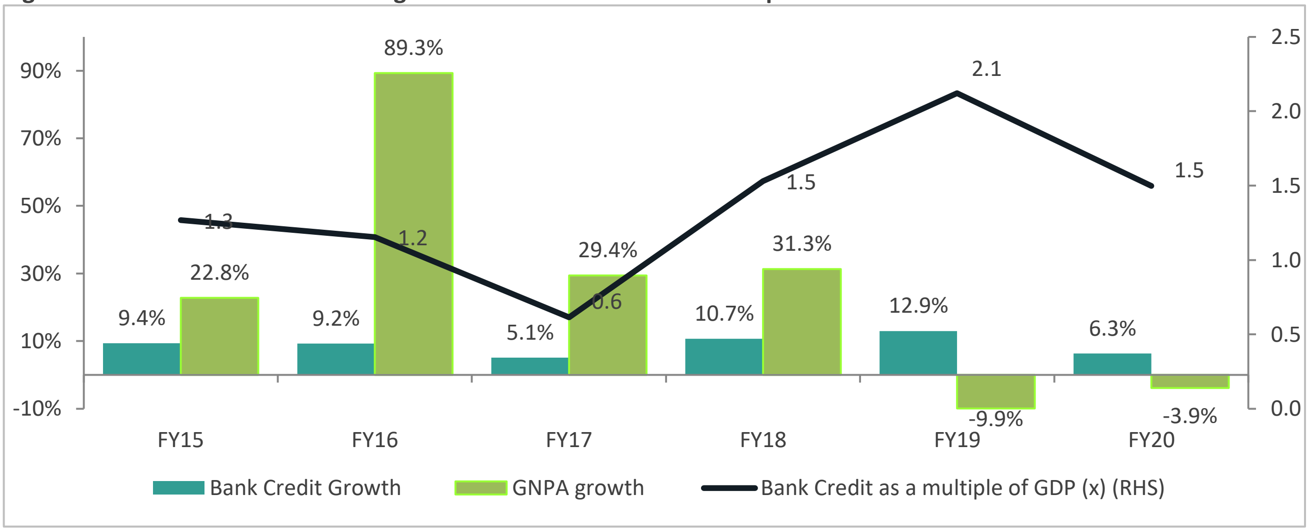
The study looks at the movement in stressed advances of Indian banks. All growth comparisons are made in terms of y-o-y unless stated otherwise.

The worsening in asset quality of Indian banks, especially public sector banks (PSBs), can be traced from FY06 to FY11 (a period of rapid credit expansion), when bank credit grew at an average rate of over 20.0% (as per RBI trend and progress report, 2018). Other factors that contributed to the deterioration in asset quality include weak credit appraisal, post-sanction monitoring standards, project delays and absence of a strong bankruptcy regime until FY17.

Indian banking sector has been facing a large overhang of stressed advances (stressed advances are GNPA plus restructured advances). Higher stressed advances limit the capacity of banks to provide fresh loans. Indian banks witnessed an asset quality pressure over the last five years post the asset quality review (AQR) by the Reserve Bank of India (RBI). As a result, government implemented 4-R strategy, consisting of recognition of NPAs, resolution and recovery, recapitalisation of PSBs and reforms. The measures have enabled recoveries, and early recognition of NPAs led to some improvement in the GNPA and lowering of the slippage ratio (fresh accretion to NPAs). However, bank NPAs continue to dominate the headlines even as the government and RBI work towards resolving the issue, while infusing the necessary capital in PSBs to ensure that they are in a better position.

As can be seen in the figure below, the asset quality concerns increased as growth in GNPAs outpaced bank credit growth till FY18 and the trend got reversed in FY19 and FY20. The bank credit growth has witnessed a slowdown during FY20 as well as low bank credit as a multiple of GDP can be observed.

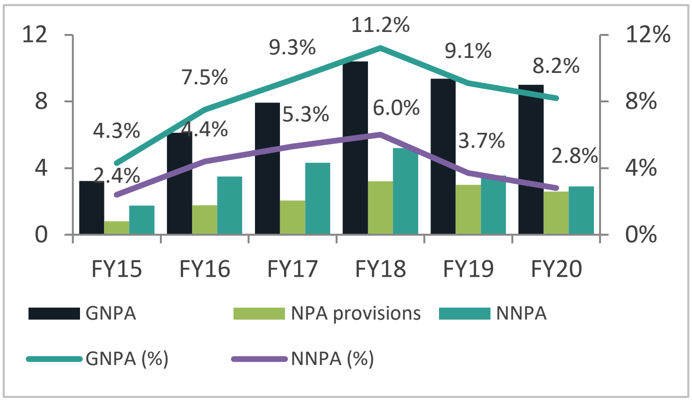
Figure 1: Movement of Bank credit growth and Bank credit as a multiple of GDP



Source: RBI, Care Ratings Calculations

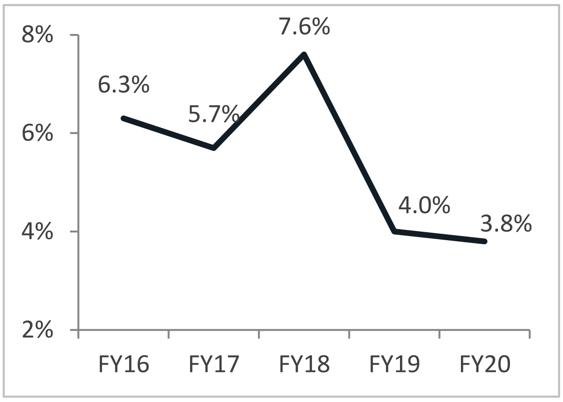
Insolvency and Bankruptcy Code (IBC) was introduced in FY17 for faster resolution of stressed assets by empowering creditors to deal in a transparent and time-bound manner (180 days extendable by another 90 days). In IBC, creditors take the control of assets as compared with earlier system where assets 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 entity is low. The enactment of the IBC has strengthened the NPA resolution process as it creates an environment in the various stakeholders are compelled to decide conclusively and maximum value can be realised from the troubled assets. 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 (refer annexure 1). The banks have already managed to recover around 40% of their dues in large twelve cases, while ten out of these twelve cases have reached at resolution stage. Since last two years, NPA levels have reduced (partly due to loan write offs) 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.

Figure 2: Movement of Asset Quality (Rs lakh crore)



Source: RBI, Note: NPA provisions does not include floating provisions

Figure 3: Movement of Slippage ratio



Source: RBI

In 2015, RBI conducted the asset quality review (AQR) of banks to address concerns over NPAs, which brought significant discrepancies in the actual and reported levels of NPAs; this led to an increase in provisioning requirements of banks which impacted their profitability. Following the AQR, the reported asset quality of banks deteriorated sharply during FY16 to FY18, the principal factors were enumerated as weak credit appraisal and project delays.

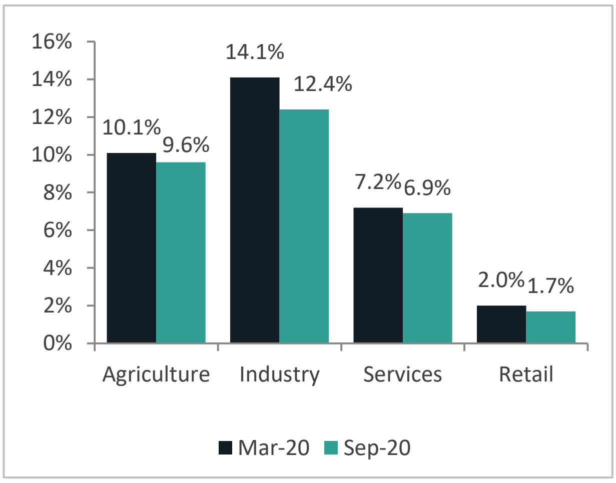
The asset quality of SCBs (largely supported by PSBs) improved in FY19 and FY20 after a long period of stress, driven by lower fresh slippages, resolution, write-offs, recapitalisation and selling of doubtful/loss assets to ARCs by taking haircuts. In absolute terms GNPA of SCBs improved in FY19 and 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). 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 restructured standard advances ratio also witnessed a declining trend since FY18 (refer figure 6). However, it increased to 0.43% in September 2020 as compared with 0.36% in March 2020 which indicates increase in stress on account of the pandemic.

The proportion of SMA-0 accounts witnessed an increase in September 2020, which can be attributed to an initial stress after moratorium period which ended in August 2020. However, the share of SMA-1 and SMA-2 stood relatively at lower levels in September 2020, partly due to moratorium. Various regulatory dispensations (e.g., 6-month moratorium, ECLGS scheme, Supreme Court stay order for classification of NPAs) have been extended in response to the pandemic, which has resulted in lower NPAs. The withdrawal of these measures will result in sudden spike in NPAs of banks, as has been indicated by pro forma NPA reporting by various banks/NBFCs.

Slippages - In FY18, banks had reached at an elevated level of stress as slippages increased sharply to 7.6%. This is largely attributable to restructured advances turning into NPAs and decline in standard advances. In FY18, the pickup, in resolutions (through IBC channel) and decline in slippages helped banks to ease the stress in few large accounts. The situation improved significantly in FY19 and FY20 as slippage ratio declined to 4.0% and 3.8%, respectively.

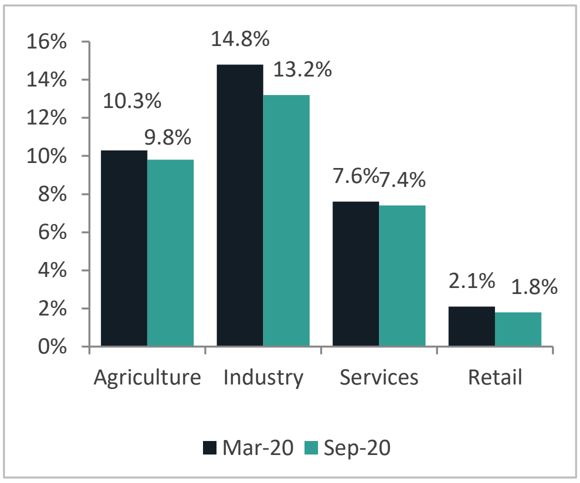
Stress in large group - If we observe, during FY17, the group of large borrower accounts (exposure of Rs.5 crore or more) accounted for around 86.5% of GNPAs, while their share in total advances was 56.0%. The loan accounts with sign of stress (including SMA-0, SMA-1, SMA-2, NPAs and restructured advances) accounted for 32.0% of the total funded amount outstanding of PSBs as against 17.4% of PVBs during FY17. In FY20, the share of large borrower accounts declined to 78.3% of GNPAs and 51.3% of total advances. In September 2020, the share of large borrower accounts further declined to 73.5% of GNPAs and 50.5% of total advances, which indicates that incrementally the credit and NPA accretion is in small borrowers' category.

Figure 4: Sector-wise GNPA ratio



Source: RBI

Figure 5: Sector-wise stressed advances ratio

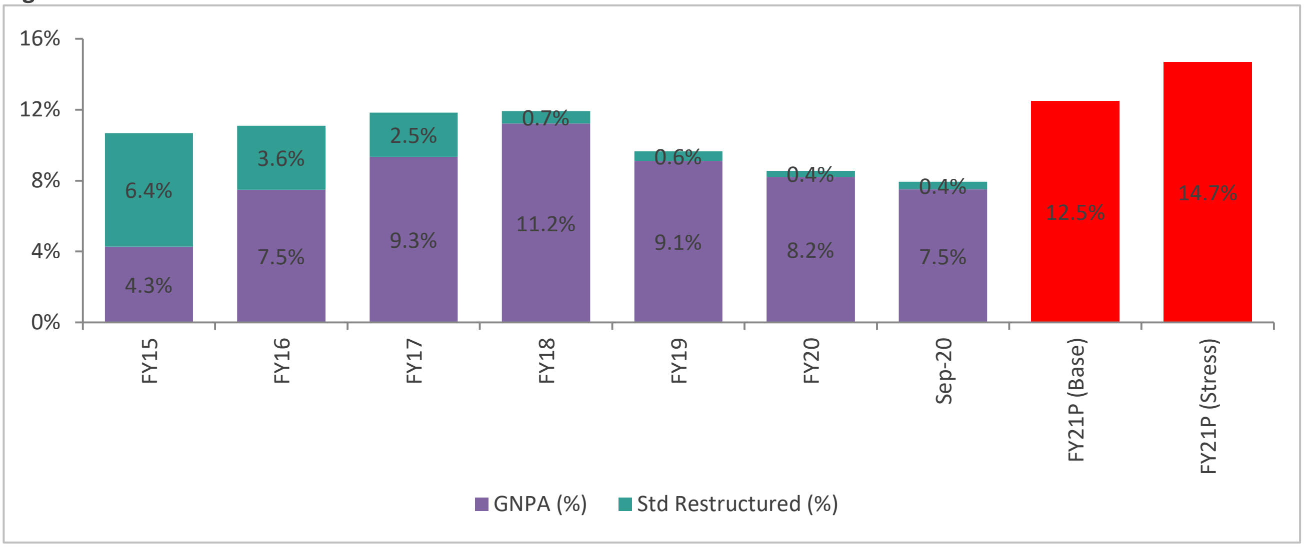


Source: RBI

As can be seen in above figures, GNPA of major sectors improved noticeably in September 2020 over March 2020 period. Retail sector GNPAs improved marginally in September 2020. Industry sector accounts for major portion of stressed advances, followed by agriculture, services and retail. However, industry sector witnessed a consistent decline in its GNPA from FY18 to September 2020 on account of recoveries/write-offs. Furthermore, as the industry segment accounted for a significant share of the NPAs, the SCBs pivoting to retail sector aided SCBs in bringing down their GNPA levels.

Among the sub segments within industry, GNPA ratio of all major segments (e.g. construction, infrastructure, and electricity) declined in September 2020 as compared with March 2020 levels. GNPA ratios of infrastructure (with a share of 37.3% in bank credit to industry sector) declined from 13.1% in March 2020 to 11.9% in September 2020. While GNPA ratio of electricity (17.9% share), basic metal and their products (11.3% share) and construction (4.0% share) declined from 13.5%, 16.2%, 24.3% in March 2020 to 11.2%, 12.6%, 21.5% in September 2020, respectively.

Figure 6: Movement in stressed advances



Source: RBI, Care Ratings Calculations; Note: FY21 GNPA (%) proj*ection is as per RBI report*

As can be seen in Figure 6, the stressed advances declined from 10.7% in FY15 to 7.9% in September 2020, after reaching at peak in FY18 (11.9%), supported by early recognition and resolution.

Until FY17, the recoveries of banks were lower. In FY17, Debt Recovery Tribunals (DRTs) was a major mode of recovery and a significant improvement in recovery by DRTs was due to opening of new tribunals, strengthening existing infrastructure and digitisation. From FY18 onwards, the recoveries under Insolvency and Bankruptcy Code (IBC) remained a major mode of recoveries.

As can be observed in Figure 7, there is a consistent improvement in total recoveries from FY15 to FY20. However, recovery through SARFAESI also emerged as a major mode of recovery in terms of recovery rate (refer annexure for more details). Until FY17, the average recovery through channels that existed before IBC e.g. SARFAESI Act, DRTs and

Lok Adalats has witnessed a declining trend over the years. Interestingly the average recovery through IBC is greater than these recovery channels and it is improving gradually which is attributed to importance of such recovery channel. In FY20, cases referred to various recovery channels increased by 40.2% by volume, whereas in terms of value it marginally grew by 2.3%.

Figure 7: NPAs recovered through various channels

Recovery Channels (Rs crore)	FY15	FY16	FY17	FY18	FY19	FY20
	Amount recovered as a % of Amount involved	Amount recovered as a % of Amount involved	Amount recovered as a % of Amount involved	Amount recovered as a % of Amount involved	Amount recovered as a % of Amount involved	Amount recovered as a % of Amount involved
Lok Adalats	3.2%	4.5%	3.6%	4.0%	5.1%	6.2%
DRTs	7.0%	9.2%	24.4%	5.4%	3.9%	4.1%
SARFAESI	16.3%	16.5%	6.9%	32.2%	15.0%	26.7%
IBC				49.6%	45.7%	45.5%
Total recovery in %	12.4%	10.3%	9.8%	14.9%	16.3%	23.2%
Total amount recovered	30,792	22,768	28,000	40,352	1,18,647	1,72,565

Source: RBI; Care Ratings Calculations

Loan Moratorium announced by RBI

In March 2020, RBI permitted all lending institutions to allow moratorium of three months till May 2020, which was further extended till August 2020 to the borrowers impacted by the pandemic. As on August 31, 2020, the overall percentage of SCBs customers availed the loan moratorium has been lower as compared with April 2020. Among the sectors MSME segment under banks availed the scheme most. Around 77.0% of MSME customers have availed the moratorium as of August 30, 2020 as compared with 44.0% as of April 30, 2020. Other categories such as corporates, individuals, witnessed a reduction in August 2020 as compared with April 2020. At system level, percentage of amount under loan moratorium has improved from 50.1% in April 2020 to 40.4% in August 2020. The moratorium offered by the banks has been lifted beginning September 01, 2020, so the after-effect and the impact on the banks' balance sheets may be witnessed in the subsequent period. As per the reports, so far, restructuring requests are lower than expected earlier led by improvement in the economic activities and also due to the extension in ECLGS scheme to provide liquidity support.

Figure 8: Loan Moratorium as on August 31, 2020

	Corporate		MSME		Individual		Others		Total	
Aug-20	% of total Customers	% of total outstanding	% of total Customers	% of total outstanding	% of total Customers	% of total outstanding	% of total Customers	% of total outstanding	% of total Customers	% of total outstanding
NBFCs	42.7%	37.2%	68.8%	67.0%	23.1%	56.5%	50.2%	33.2%	26.6%	44.9%
SCBs	18.0%	30.4%	77.2%	68.1%	43.7%	33.9%	35.6%	39.1%	43.8%	37.9%
System	31.3%	34.3%	77.5%	69.3%	42.6%	41.0%	45.4%	42.1%	45.6%	40.4%

Source: RBI

Figure 9: Loan Moratorium as on April 30, 2020

	Corporate		MSME		Individual		Others		Total	
Apr-20	% of total Customers	% of total outstanding	% of total Customers	% of total outstanding	% of total Customers	% of total outstanding	% of total Customers	% of total outstanding	% of total Customers	% of total outstanding
NBFCs	39.7%	56.2%	60.7%	61.1%	32.5%	45.9%	37.3%	41.4%	29.0%	49.0%
SCBs	24.7%	39.1%	43.1%	65.3%	52.1%	56.2%	45.7%	55.7%	55.1%	50.0%
System	30.8%	41.9%	45.8%	65.0%	50.4%	55.3%	45.7%	54.6%	48.6%	50.1%

Source: RBI

GNPAs

The GNPA ratio of SCBs stood at 7.0% in Q3FY21 as compared with 7.5% in Q2FY21 and 9.3% in Q3FY20. As per disclosures by 22 SCBs, the pro forma GNPA would have been over Rs.8.0 lakh crore, which indicates that around Rs.1.2 lakh crore (approximately 1.2% of advances of these 22 SCBs) of bad loans exist in the system which is yet to be recognized by the banks. However, following this, majority of banks have kept aside extra provisioning for NPAs that may arise in future, or else the provisions would have been lower than reported in December 2020. The actual impact on the banks' balance sheet may be witnessed in Q4FY21 and subsequent period.

The GNPA ratio is expected to increase from 7.5% level (observed in September 2020) by the end of FY21, primarily due to SMA 1 and SMA 2 corporate loans under moratorium, lower rated corporates not eligible for the restructuring and exposure to unsecured personal loans. As per RBI's Financial Stability Report (July 2020), the GNPA ratio of all SCBs may increase to 12.5% (baseline scenario) and 14.7% (severely stressed scenario) by March 2021 and as per RBI's Financial Stability Report (January 2021), GNPA ratio of all SCBs is expected to increase to 13.5% (baseline scenario) and 14.8% (severely stressed scenario) by September 2021.

Proposal of setting up an Asset Reconstruction Company (ARC) and Asset Management Company (AMC)

In the Union Budget 2021-2022, the Financial Minister has proposed to set up ARC/AMCs to aggregate and dispose existing stressed assets in the banking system. This process will enable aggregation of bad loans from several banks to single entity which is a market making mechanism to deal with NPA issue and help banks to focus on credit. The contours of the operating and regulatory framework for such an ARC/ AMC remains to be seen as various aspects are yet to be clarified. As per reports, the ARC/AMC will be set by PSBs and PVBs and bad loans of more than Rs.500 crore each will be eligible for aggregation by the new ARC/AMC.

Concluding remarks

As there have been several attempts made in the past to resolve stressed assets issue, still the progress is limited. RBI has put in process for timely recognition and disclosure of NPAs to recognise the stress in banking system appropriately. The adequate capital infusion and balance sheet clean up may enable banks to grow more.

Around 67.0% of the total customers of PSBs and around 50.0% of the total customers of PVBs have availed the loan moratorium as of April 30, 2020. This has reversed in August 2020, as PVBs customers accounted for larger share (i.e., around 55.0%). At system level, percentage of amount under loan moratorium has improved from 50.1% in April 2020 to 40.4% in August 2020. The asset quality of banks is expected to witness a pressure in the medium term, as complete picture of moratorium, the pause on asset classification and restructuring allowed is yet to show the results.

The credit growth for the current financial year is expected to be muted and remain in the single digits. The slippage ratio is expected to remain elevated in the medium term, as during H1FY21, slippages were lower due to moratorium and Supreme Court stay on NPA classification. To provide relief to the pandemic hit companies, government has suspended IBC proceedings till March 2021. There may be a substantial jump in fresh proceedings once the suspension is over, till then resolution of NPAs is expected to remain muted.

Annexure

Name of Corporate Debtors	Claims of Financial Creditors			Realisation by Claimants as %	Resolution Applicant Identified
	Amount Admitted	Amount Realised	Realisation as % of Claims	of Liquidation Value	
Electrosteel Steels	13,175	5,320	40%	183%	Vedanta Ltd.
Bhushan Steel Ltd.	56,022	35,571	64%	253%	Bamnipal Steel Ltd. (Tata Steel)
Monnet Ispat and Energy Ltd.	11,015	2,892	26%	123%	Consortium of JSW and Aion
Essar Steel India	49,473	41,018	83%	267%	Arcelor Mittal
Alok Industries Ltd.	29,523	5,052	17%	115%	Reliance Ind., JM ARC
Jaypee Infratech Ltd.	23,176	23,223	100%	131%	NBCC (India) Limited
Jyoti Structures Ltd.	7,365	3,691	50%	387%	Group led by Sharad Sanghi (#)
Bhushan Power & Steel Ltd.	47,158	19,350	41%	209%	JSW Steel Ltd. (#)
Amtek Auto Ltd.	12,641	2,615	21%	170%	Deccan Value Investors L.P. and DVI PE (Mauritius) Ltd (#)
Era Infra Engineering Ltd.	Under CIRP				
Lanco Infratech Ltd.	Under Liquidation				
ABG Shipyard Ltd.	Under Liquidation				

Source: IBBI; Note: # Final settlement pending

Contact:

Sanjay Agarwal	Senior Director	sanjay.agarwal@careratings.com	+91-22- 6754 3582	+91- 81080 07676
Saurabh Bhalerao	Associate Director – BFSI Research	saurabh.bhalerao@careratings.com	+91-22-6754 3573	+91- 90049 52514
Pravin Mule	Research Analyst – BFSI Research	pravin.mule@careratings.com	+91-22-6754 3553	+91- 98192 80043
Mradul Mishra	(Media Contact)	mradul.mishra@careratings.com	+91-22-6754 3631	

CARE Ratings Limited
Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway, Sion (East), Mumbai - 400 022
Tel. : +91-22-6754 3456 I CIN: L67190MH1993PLC071691

Connect: