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Seth G. B. Murarka Arts and Commerce College,

Shegaon, Dist. Buldhana (M.S.)

1st International Conference of

Maharashtra State Commerce Association

Universities Commerce & Management Teachers Association,Gujarat

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A Review of Frauds, NPAs and Stressed Assets in the Indian Banking System

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Abstract

The increasing banking related frauds in banking industry increases the need of management of NPA levels and recovery of bad loans in banks. Frauds in banking sector indirectly increases NPA levels and stressed asset numbers.Government of India and RBI has continuously issuing variety of guidelines, master circulars, provisions, legal and criminal legislations to fight NPA, bad loans, stressed assets, frauds, etc. However, need arises to introduce new rules to improve the prospects of recovery of loans. In recent past, the RBI has taken various regulatory measures to strengthen the lender's ability to deal with stressed asset such as framework for revitalising distressed asset, flexible structuring of project loans, strategic debt restructuring scheme, scheme for sustainable structuring of stressed asset, etc. However, now RBI has abolished all such past-outdated structures and new Framework for Resolution of Stressed Assets is established to take strict control on banks fraudulent regulations.

The study is organised for such pros and cons prevailing in the banking system in recent environment.The study is secondary in nature and shows various provisions and measures by government and banks and RBI for resolution of stressed assets and the considerable loopholes resulting into various frauds in banking sector.

Keywords: NPAs, Restructured Loans, Stressed Asset, RBI, Resolution Plans, Banking Frauds.

Introduction

Banking sector is the most important sector for the growth and development of economy of every country.According to Sec 5(b) of Banking Regulation Act, 1949, "Banking" means, the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise. Bank deposits are obligation to banks by using which banks can finance assets such as loans to individual or businesses. Loans are major source of revenue for the banks, hence, considered as Assets. In financial accounting, an asset is a resource with economic value that an individual, corporation or country owns or controlled with the expectation that it will provide future benefits.In terms of banking loan is a main asset. A loan is a debt provided by an entity (organisation or individual) to another entity at an interest rate, and evidenced by a promissory note which specifies, among other things, the principle amount of money borrowed, the interest rate the lender is charging, and date of repayment. There is difference between loan and credit. Credit means bank grants loan to someone who have ability to borrow while loan is actually the act of providing the debt.

Stressed Assets

So now here we will go for Stressed Asset, which is actually a powerful indicator of the health of the banking system. In simple words Stressed Asset = NPAs + Restructured Loans + Written off Assets.

Restructured Loans

Loan restructuring means the process of reorganisation of a company's outstanding debts by decreasing the rates paid and increasing the time for repayment. It can be said as a new loan that replaces the outstanding balance on an older loan paid over longer period with usually lower instalment amount.

Strategic Debt Restructuring (SDR)

Under this scheme, the banks, who have given loans to a corporate borrower gets the right to convert the full or part of their loans into equity shares in the loan taken company. The RBI in its 1"Framework for Revitalizing Distressed Assets in The Economy- Guidelines on Joint Lenders Forum (JLF)" has suggested change of management as a part of restructuring of stressed assets.The circular also states that the general principle of restructuring should be that the shareholders bear the first loss rather than the debt holders.

Scheme for Sustainable Structuring of Stressed Asset (S4A)

It conceives the determination of sustainable debt level for stressed borrowers by separating sustainable loans from unsustainable loans and converting these into equity/quasi equity instruments. It is basically for bad loans of large projects at an inception stage. The scheme is independently carried out by an Overseeing Committee constituted by Indian Banks Association (IBA) in consultation with RBI.

Abolition Of All These Existing Schemes

As per 2RBI notification DBR.No.BP.BC.101/21.04.048/2017-18 "Resolution of Stressed Assets – Revised Framework", RBI has abolished all such provisions prevalent among banks to restructure defaulted loans and made resolution of defaults time bound of 180 days with the Insolvency and Bankruptcy Code (IBC) becoming the main tool to deal with the defaulters. The abolished provisions include Corporate Debt Restructuring (CDR), Strategic Debt Restructuring (SDR), Scheme for Sustainable Structuring of Stressed Assets (S4A) and even Joint Lenders Forum (JLF) has also been disbanded.

RBI has tightened rules as it said in the notification that, "any failure on the part of lenders in meeting the prescribed timelines or any actions by lenders with an intent to conceal the actual status of accounts or evergreen the stressed accounts, will be subjected to stringent supervisory/enforcement actions as deemed appropriate by the Reserve Bank, including, but not limited to, higher provisioning on such accounts and monetary penalties."

3Framework further states that, Resolution Plans (RP) in case of restructuring, where aggregate exposure of lenders is Rs. 100 Cr. & above, shall require Independent Credit Evaluation (ICE) of residual debt by credit rating agencies specifically authorised by RBI. In case of aggregate exposure of lenders is Rs. 500 Cr. & above, then requires 2 such ICEs.

Non-Performing Assets (NPA)

As per 4"Prudential Norms on Income Recognition, Asset Classification and Provisioning Pertaining to Advances Portfolio" of RBI : An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank.

Identification Of NPA

- Interest &/or instalment of principle remain overdue for a period of more than 90 days in respect of term loan,
- The account remains 'out of order' for a period of more than 90 days, in respect of an Overdraft/Cash Credit (OD/CC),
- The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
- Interest &/or instalment of principal remain overdue for 2 crop seasons for short duration crops, and 1 for long duration crops,
- The amount liquidity facility remains outstanding for more than 90 days, in respect of securitization transaction undertaken in terms of guidelines on securitization dated Feb 1, 2016.
- In respect derivation transactions, the overdue receivables representing positive mark-to-market value of a derivative contract, if these remains unpaid for a period of 90 days from the specified due date of payment.

Asset Classification

- Substandard Assets : An asset remained NPA for a period <= 12 months.
- Doubtful Assets : An asset remained substandard for a period of 12 months.
- Loss Assets : An asset considered as uncollectible and of such little value hat its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.

Review of Literature

Abhilasha Kumari & Jasleen Kaur Bindra(2016) in 5"A new perspective on dealing with stressed assets in India" concludes that the distress can be in the form of asset class, geographic, industry and size, etc. Shraddha Kokane & Dr. Shriram Nerlekar(2017) in 6"Recapitalization of Public Sector Banks – Will it reduce the Non-Performing Asset levels?" states that The infusion of capital will helps banks over their declining NPAs. With increased capital in the balance sheet the toxic assets will be equally balanced out. Dr. Madan Lal Bhasin(2017) in 7"Galloping Non-Performing Assets bringing a stress on India's Banking Sector: An Empirical Study of an Asian Country"said that as per the analysis of findings, banks which have minimal exposure to corporate loans (high retail loans), have the least NPAs. It further concludes that NPA growth needs to be supported with a higher level of provisioning, which in turn has a direct impact on bottom-line.Charan Singh & JagvinderSingh Brar(2016) in 8"Stressed Assets and Banking in India" recommends that to attract best talent available in the banking industry to serve Top management positions in PSBs, 4 things need to be addressed. 1st is tenure of Chairman or MD, government could consider long tenure of 5 years, based on strict performance evaluation criteria. 2nd is retirement age of 60 years could be considered as extending as already in private sector banks. 3rd is remuneration has to be commensurate with the position. 4th is after meeting international standards of selection, the government should set steep performance benchmarks & undertake strict performance appraisals.Charan Singh, Deepanshu Pattanayak, Divyesh Satishkumar Dixit, Kiran Antony, Mohit Agarwala, Ravi Kant, S Mukunda, Siddharth Nayak, Suryaansh Makked, Tamanna Singh, Vipul Mathur(2016) in 9"Frauds in the Indian Banking Industry" conclude that frauds may be primarily due to lack of adequate supervision of top management, faulty incentive mechanism in place for employees; collusion between the staff, corporate borrowers and third party agencies; weak regulatory system; lack of appropriate tools & technologies in place to detect early warning signals of a fraud; lack of awareness of bank employees and customers; & lack of coordination among different banks in India & abroad.Dr. Madan Lal Bhasin(2017) in 10"Integrating Corporate Governance and Forensic Accounting: A study of Asian Country"discovered that the different types of financial and economic crimes prevailing in the Indian economy include the corporate accounting frauds, security market scams, bank frauds such as ATM/credit card frauds, checks frauds, fraudulent fund transfers, withdrawals, presentation of stolen dividend warrants, and improper granting of credit facilities, inflated contract prices, embezzlement, etc.

Stressed Assets Industry in India

It looks weird to say 'Industry' to some kind of 'Bad Assets', but rising number of NPAs in banking sector in recent years arise the need for detail statistical analysis for the same.As per 11RBI Financial Stability Report June 2017, Public Sector Banks continued to record negative returns on their assets. Such continuous deceleration in growth of assets of Scheduled Commercial Banks along with deterioration in their asset quality resulted in declined in the share of Net Interest Income in Total Operating Income.

Large Borrowers Affected Stressed Assets Level

Credit is a continuous process. Recovery of one credit gives rise to another credit. Therefore, it presupposes right selection of borrower which needs complete and comprehensive investigation of all the facts. To arrive at a decision about selection of borrower the banker needs to collect a long chain of information about the borrower. Usual loan application forms filled in by the applicant provide the banker with almost all the required particulars pertaining to the advance. Loan proposals differ widely from each other. There cannot be a strict methodology for accepting or rejecting the proposals.Credit Quality of large borrowers may directly affect the stressed assets levels of any bank. This further leads to fluctuation in profitability and income of the bank. A high degree of NPAs suggests the probability of a large number of credit defaults that affects the profitability and liquidity of banks. Today's increasing banking related frauds in every sector of banking industry is the biggest indication that the credit quality of borrowers plays important role in ultimate existence of banks.Credit Rating Agencies plays a vital role in such circumstances.

Share Of Large Borrowers In Stressed Assets And NPAs

In continuous increase in NPAs in the banking system and with a mandate of activating and coordinating the mechanism to manage stressed assets in the economy so that transparent credit information becomes available for sound risk management and financial stability, the RBI introduced a "Framework for Revitalising Distressed Assets in the Economy" in January 2014. For this the RBI set up the Central Repository of Information on Large Credits (CRILC) to collect, store, and disseminate credit data to lenders. Its main objective is to make early recognition of asset quality problems by reducing information asymmetry and helping banks to take informed credit decisions.

As per the new notification states above - Defaulters of Rs. 5 Cr. & above will be monitored by RBI on a weekly basis through RBI's Central Repository of Information on Large Credits (CRILC).

Frauds In Banking Sector

Multiple banking is an arrangement, where a borrower avails of finance independently from more than one bank. Thus, there is no contractual relationship between various bankers. Also in such arrangements, each banker is free to do his own credit assessment and hold security independent of other bankers. But with the loopholes in multiple banking arrangements adversely impacting their books, commercial banks now want a consortium to be made mandatory for large corporate credit, said by 12the article published in "BUSINESS STANDARD" titled "Banks want compulsory consortium arrangement for large credit"on Jan 2015.. Article states that as per bankers, guidelines issued by RBI on sharing of information had failed to bring desired discipline in multiple banking arrangements.Under consortium financing, several banks (or financial institutions) finance a borrower with common appraisal, common documentation,joint supervision and follow - up exercises.

Recently, the India's second largest state owned lender Punjab National Bank disclosed on Feb 14, 2018 that it was the victim of the country's largest bank fraud. It disclosed amount over Rs. 11,000 Cr. fraud allegedly by one of the country's richest men, diamantaire Nirav Modi.In its first complaint PNB alleged that the fraud was led by Modi, a jeweller who's no. 85 on Forbes's 2017 list of India's richest people. It said that Modi was helped by a former PNB employee, Gokulnath Shetty, who was the deputy general manager of Foreign Exchange department in one of its branches in Mumbai. As per the 13Bloomberg in 2011 PNB employee starts allegedly providing fraudulent letters of understanding to Modi and associates. In Feb 2016 hackers make off $81 million by sending fake messages through the Bangladesh Bank's 14Swift interbank messaging system. In August 2016 RBI sends a circular to all Indian lenders, advising them to make sure their internal software – core banking solution or CBS – is properly integrated with Swift. In March 15, 2017 Banks were due to report the results of this verification to RBI. In May 2017 PNB employee who was allegedly colluding with Modi retires. In Jan 16, 2018 PNB alleges that billionaire jeweller Nirav Modiassociates sought fresh funds from PNB; PNB begins digging into transaction history. In Jan 25, 2018 PNB says it found first evidence of fraud. It tells customers that it will immediately start updating its CBS to the latest version, which will be used starting Jan 29. In Jan 29, 2018 PNB submits report on fraud to RBI and files complaint with federal investigators. In Feb 14, 2018 PNB disclose $1.8 billion fraud (over Rs. 11,000 Cr.). in Feb 15, 2018 RBI tells banks to revisit controls outlined in 2016 advisories, according to document seen by Bloomberg. In Feb 21, 2018 banks due to report to RBI on implementation of these controls, according to document seen by 15Bloomberg.

Conclusion and Suggestion

The best indicator for the health of Indian Banking is not only the level of Stressed Assets and NPAs but how the Government and the Apex Banking institutions take steps to resolve it.Stressed Accounts strongly affects the profitability of banks and thereby overall operations and performance.Similarly, it is important to note that elimination of Stressed assets from the books of banks is not an easy task because credit risks cannot be fully eliminated from the books of business performing trade of financial services. If there is credit risk then there must be some kind positive and negative both factors must be available to manage such risk. The important point is banking regulators cannot perform whole job of resolution in case of any problem whether about stressed accounts or if such accounts reported as fraud without having the 100 % authority to on ownership in case matter. However, as per study we can say that some measures and revolutionary steps by both government and RBI must be appreciated fully such as:

- Implementation of Special Mention Accounts (SMA) norms for early identification of stressed assets.
- Last year, the Central bank allowed the banks to sell even the loans where the principle or interest was overdue 60 days rather than 90 days.
- Abolition of old norms and establishment of strict IBC scheme and extension of defaults time bound from 90 days to 180 days.
- Revised framework provides strict time limit on Central Repository of Information of Large Credits.Such continuous information monitoring and providing system and tagging individuals and companies as wilful defaulter would help in creating a strong network in preventing fraud and thereby controlling stress in banks.

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