WHY BAD LOANS MAY BE HIGHER THAN WHAT BANKS, RBI CLAIM

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The article talks about the new restructuring cases for bad loans reported by banks & the loopholes existent in the banking system for restructuring of loans with a quote by **Mr. Laxman Kumar Nasarpuri, Partner, Financial Pundits.**

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Why bad loans may be higher than what banks, RBI claim

Debt restructuring cases are scaling up month by month. In July alone, there were additions of 19 cases amounting to around Rs 11,500 crore. Banks are showing fresh non-performing assets that translate into erosion of profit margins. However, the story does not end with worrying figures while the actual numbers can well be above the recorded data.

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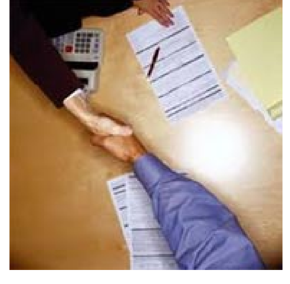

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The spectre of bad loans continues to haunt the banking industry. Debt restructuring cases are rising every month. In July alone, there were additions of 19 cases amounting to around Rs 11,500 crore . Banks are showing fresh non-performing assets (NPAs) that translate into erosion of profit margins. However, the story does not end with worrying figures, ase the actual numbers can be well above official data, declared by the banks and collated by the Reserve Bank of India.

Loan restructuring is the process when a borrower is unable to make timely repayments and approaches the lender to dilute the original terms under which the loan was sanctioned. This may

include lowering of interest rates, or extension of tenure. Under the auspicious of Corporate Debt Restructuring (CDR) cell, banks restructure default loans jointly with mutual consent.

The catch….

RBI had of late, regulated the process of recognizing NPAs. Instead of doing manually, most banks now identify bad loans through computer generated system. An asset turns into NPA when a loan account stops repaying interest for 90 days.

Despite this core banking solution, many industry experts believe, banks still have a room for hiding NPAs. They resort to certain adjustments so that some NPAs do not reflect in their books of accounts especially at the quarter-end. For example, bank managers can coax borrowers to make some payment at the end of every quarter, which will then be reversed the next day. It is more of a mutual understanding between individual corporate client and bank to maintain the “standard asset” status. Standard asset means a loan account where interest payments are being made on time.

When interest payment is overdue for three consecutive months, a company pays interest for one month, to prevent the loan from becoming an NPA.

“Technically, these cannot be treated as bad assets. All these practices protect the account from slipping into NPA category. There are always loopholes to regulations. Banks get bulk business from corporates but not from retail. Hence, they try to accomodate the corporates,” says a senior official associated with the banking industry for the last 15 years on condition of anonymity.

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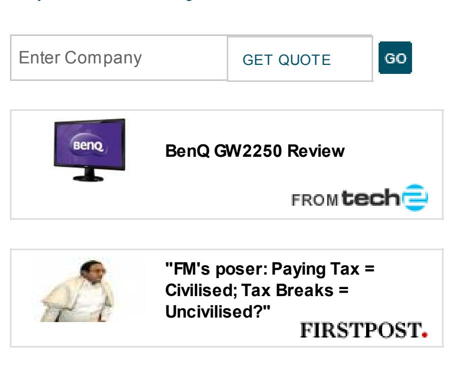

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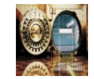
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A month back, a working group set up by RBI recommended to adopt global best practices on restructured loans after two years. In the run up to that after two years, an account will also lose its standard asset status once it is recast and slip into non-performing asset. Moreover, provisioning requirement should increase from 2.0-3.5-5.0% gradually for restructured standard assets in between two years.

However, new norms are yet to be finalized. Rating agency Crisil estimated that bad loans would rise to Rs.2 lakh crore or 3.2 per cent of the total assets by March, 2013. The restructured standard assets, according to the central bank data, were at Rs 97,834 crore in March 2010 and Rs 1,06,859 crore in March 2011.

Are bad loans hurting a common man?

"In this entire debt restructuring episode, the common man is the worst affected person as it is public exchequer's money which is going to be utilised to bail out the potential / declared NPA accounts," says Laxman Nasarpuri, Partner Financial Pundits, a Financial Advisory Services firm.

"It is the tax payers' money, which is being used to manage such crisis. Many companies are taking advantage of the CDR mechanism. If a company defaults due to inefficiencies or mismanagement , CDR door should not be opened to it. Only genuine debt repayment problems arising out of industry blues or natural calamity or such other factors which are beyond the control of the management should be referred to CDR cell. The companies should not be allowed to exploit the CDR mechanism"

When banks' profit margins are hit due to rising NPAs, they fall short of capital. The government of India, which is a majority share holder in state-owned banks (57-67%) then provides capital in those banks. The government infuses capital out of tax payers' money. Recently, it is doing the same by asking the state-owned insurer - LIC of India to increase stake in banks irrespective of their future prospect. LIC is the largest insurer with more than 71% market share in the insurance industry.

Retail vs corporate customers

"In India, it is quite unfortunate that a retail customer or a young entrepreneur has to trudge his/her shoes in getting a bank loan (business, home, educational, auto or personal) after providing more than adequate collateral securities and personal guarantees. The crowning irony is that most corporate, which bargain with banks to get cheaper loans get the facility at their door step, at times even without any collateral. Banks vie each other to give them loans," points out Nasarpuri.

In the process , lots of young and budding techno entrepreneurs with sound academic credentials are left out in the cold searching for initial capital to turn their ideas into reality.

Bankers virtually run from pillar to post when a corporate defaults in repaying loans. Many bankers (of DGM or GM ranks) complain privately that company managements even refuse to take phone calls and sometimes threaten them of informing the local police in case lenders reach their residence to contact them.

At the time of default also, retail customers are very cooperative rather than companies. According to a CEO of an asset reconstruction company, he never faces any problem in retail recoveries. Interestingly, companies threat them with different legal consequences whenever efforts of recoveries are made.

"It is always easy to deal with retail borrowers rather than corporate borrowers, who know the gaps of regulations," quips the CEO, who did not wish to be named.

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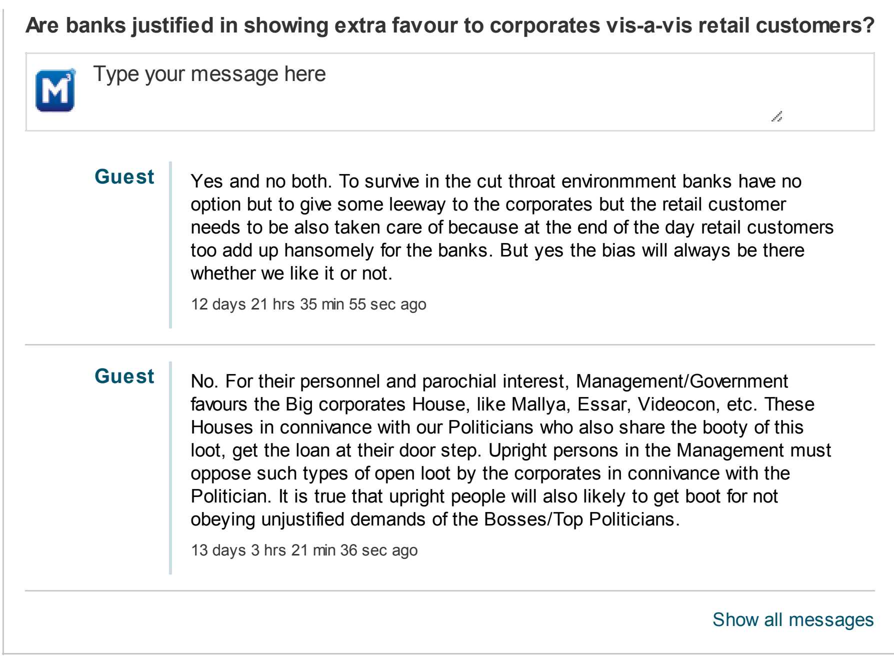

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