An Analytical Study of Trends and Performances of Non-Performing Assets of Commercial Banks in India

Dr. Ramandeep Kaur

Assistant Professor, Institute of Professional Education and Research, Bhopal

ABSTRACT

Banks are crucial to the functioning of any economy due to their role in credit intermediation process, payment &settlement systems and monetary policy diffusion. Stability of the banking system and viability of banks is considered to be of utmost importance for the financial stability as well as the growth of any economy. The biggest challenge banks face especially in India is in the form of high Non-performing assets (NPAs). It might be impossible to eliminate NPAs from the books of the banks, but high levels of NPAs can pose a serious threat to the viability of banks and can be a reason for their failures. The paperaims to study thetrends of NPAs of Public and Private Sector Banks over a period of ten years and tries to predict their future proportions. The research also tries to explore the reason for high NPAsratios in India and tries to find out the international best practices adopted by selected nations to tackle this problem.

Key Words: Non-Performing Assets, trend, Public Sector Banks, Private Sector Banks

INTRODUCTION

The ratio of Non-Performing loans to gross loans has risen by 350% in the last five years. A report by CARE Ratings revealed thatIndia has the highest level of Non-Performing assets (NPAs) among BRICS countries and is ranked fifth on a list of countries with the highest levels of NPAs. China, Brazil and South Africa are all below the 4% mark which is considered as a safe zone. India is however, soaring over 9% as of 2019 and the ratios are still increasing.

According to the financial stability report of Reserve Bank of India (RBI), the worst is yet to come for the Indian Banking industry. **The end of June quarter 2020 saw the total bad loans of India's 38 listed commercial banks crossing Rs 8 lakh crore, which is roughly 11% of the total loans given by the banking industry.** Gross NPAs continued to rise at 9.04% in June to 10.14% in March 2018. It is further predicted that the ratio may even jump to 11.2%.

Globally, the NPAs list is topped by countries known as PIIGS (Portugal, Italy, Ireland, Greece and Spain). Greece has the highest NPA of 36.4% in the world. Its economy is in rags with around 50% of registered unemployed people without a regular job for over one and half year. Other countries like Italy (NPAs 16.4%), Portugal (15.5%), Ireland (11.9%) and Spain (5.3%) are also facing huge NPAs crisis. Spain is ranked at 7th rank below India and Russia based upon NPAs proportion.

Non-Performing Assets (NPAs)

The term 'Non-Performing Assets' (NPAs) used in India resembles the term 'Non-Performing Loans' (NPLs) in the academic literature. Earlier, in India, a Health code system was introduced in 1985, for continuous evaluation of the quality of advance portfolios (loan portfolios) of banks, its effective monitoring and adequate provisioning.

It classified advances into eight codes namely (1) Satisfactory (2) Irregular– accounts for which safety was not suspected, (3) Sick-Viable/under nursing, (4) Non-viable/sticky, (5) Advances recalled, (6) Suit filed accounts, (7) Decreed debts - accounts reflecting serious irregularities, (8) Bad and doubtful debts where recoverability of banks dues become doubtful due to shortfall in the value of security or inability/unwillingness of the borrower to repay the dues. But the health code system, suffered fromvarious drawback in the form of; lack of transparency, objectivity and uniformity of yardstick for measuring NPAs.

In order to bring in transparency as well as to move towards international best practices, prudential norms related to asset classification and provisioning was introduced in India by RBI in the year 1992-93 following Narasimham Committee-I recommendations. The norms brought in quantification and objectivity to assessment of NPAs.
According to RBI's Prudential Norms, an asset becomes a Non-Performing Asset (NPA) or Bad Loan when it stops generating income for the bank (Master-Circular: RBI 2014). Bank's assets are the loans and advances given to customers. If customers do not pay either interest or part of principal or both, the loan turns into a bad loan.
The definition of NPAs was reduced in phases till 2004 in the following manner:

An asset was required to be classified as NPA if-	
From 31st March 1993	It was past due for 4 quarters
From 31st March 1994	It was past due for 3 quarters
From 31st March 1995	It was past due for 2 quarters
From 31st March 2001	It was overdue for 180 days
From 31st March 2004	**It was overdue for 90 days**

However, in terms of Agriculture / Farm Loans; NPAs is assumed in the following manner-For short duration crop; such as paddy, Jowar, Bajra etc. if the loan (installment / interest) is not paid for 2 crop seasons. For Long Duration Crops, the above would be 1 Crop season from the due date.

With effect from March 31, 2005, according RBI norms, NPAs can be further subdivided into three categories as (1) Sub-standard assets, (2) Doubtful assets, and (3) Loss assets. The objective criteria for classification of NPAs into the three categories is as follows:

Types of NPAs	**Definition**	**Period**
Sub-standard assets	Assets with well-defined credit weakness resulting in distinct possibility of bank sustaining some loss in liquidation of the debt unless deficiencies are corrected.	NPAs for ≤ 12 months
Doubtful assets	Assets with additional weakness so that full collection of debt is highly questionable and improbable.	Sub-standard assets for 12 months
Loss assets	Assets which are considered uncollectible either by the bank, its internal or external auditors or by the RBI inspectors but the same is not yet written off.	Loss identified

Also, unsecured NPAs have higher provisioning requirements than secured ones.

Reasons for the rise in NPAs in India

1. The period before the sub-prime mortgage crises (pre-2008) was a boom year for the world economy. Optimism was high and credit growth was at an all-time high. Banks gave out loans extensively without checking for credit worthiness. This is what led to the housing bubble which created a chaos in India too.
   As an aftermath, in India defaults became inevitable due to global slowdown and dwindling demand. Generally, borrowers are in need of loans for capital and leverage but as earnings slowed down it made the customers delayed their payables, therefore profits squeezed and exports declined. As a result, borrowers did not have money to return. Eg; One of the most leveraged industry in India is the steel industry. With steel prices going off the cliff due to dumping by China, Korea and Japan, steel makers are left with huge losses. Credit Suisse estimates that $50 billion of debt in the books of the major steel companies is around 15 times of their collective operating profit in fiscal year 2015.
2. The government holds considerable influence on all Public Sector Banks (PSBs). It appoints all the officials and board members and in fact, the government itself is represented on their boards by senior officials of the Finance Ministry. Without the implied agreement of the government, large lending by PSBs would not have been possible. But due to political connections loans were distributed thus adding to the havoc. There are numerous examples of loans been advancedto corporates where they should not have been given. Eg; Kingfisher, Sahara, Reliance, Bhushan Steel to name a few.
   Also, many times when lending was done by a consortium of banks, the smaller banks depended on the background checks carried out by the lead Banks. Thus, fixing of accountability becomes difficult. This is one of the impulsive management practices of the PSBs.
3. According to the BOT (Build-Operate-Transfer) model of Public-Private Partnership (PPP) Infrastructure development in India, private players create Special Purpose Vehicles that makes each project act as an individual entity. These projects are highly leveraged (on an average 70%). Since the gestation period is long and uncertainty is high, equity funding is not very attractive to investors. Therefore, promoters start with high

debt and hope to raise equity closer to the completion of the project to get higher valuations when uncertainty is lower leading to high rewards for investors.
But typically in India, projects are inevitably delayed due to delays in procuring permissions, clearances and land acquisition. This leaves promoters with high risk leverage and no equity to back upon. Also, interest costs rises drastically which further erodes profitability. Low cash flows lead to more delays and the vicious cycle goes on. In addition for the PPP projects, contracts to the private partners were awarded without competitive bidding allowing firms to bid aggressively at commercially unviable terms.

4. To remain competitive, banks largely sells unsecured loans which increases the flow of NPAs. In these cases, the banks are the ones who suffer because instead of taking ownership of failing projects, borrowers just walk away and make the banks absorb the losses of the failed projects. Thus, fraud, willful defaults by borrowers, disputes of borrower with third parties all contribute towards NPA's.
5. With projects getting delayed the investors starts requesting banks to infuse more capital into the projects with the hope that the project can be turned around with the increased funding. In return for the additional funding, banks are given part ownership of the project and the terms of financing are re-negotiated.
6. The banks themselves need to understand and classify the assets based on their quality such as-standard, sub-standard, doubtful and loss assets. Incorrect classification and accounting also leads to increased figures for NPAs.

Potential Consequences of NPAs

Empirically high level of NPAs has been found to be associated with contraction of credit, slowdown of GDP growth, depreciation of exchange rates, inflation and unemployment (Bock and Demyanets 2012, Klein 2013). The impact starts with the pressure NPAs create on the income statement and balance sheet of banks.

- **Profitability:** NPAs affect the profitability of the banks adversely by way of affecting both income and expenses. A high NPA means the asset is not performing or bringing in the interest income that it was expected to bring. Income from NPAs can be booked only on actual realization of the same and not on accrual basis. So this will have an adverse impact on bank's interest income. A lower interest income would lead to lower total income and hence lower net profits. From expenses point of view, a high NPA means higher provisioning requirements as well as higher expenses involved in NPA recovery process (like litigation and administrative costs), both of which would reduce the net profits.
- **Capital Adequacy:** Reduction in profits due to high NPA is likely to result in lower retained earnings, which in turn is likely to create adverse effect on Tier 1 component of Capital to Risk Assets Ratio (CRAR). Moreover, Total Risk Weighted Assets (TRWA) increase because of the risks attached to NPA portion of the total asset composition. Increase in TRWA with absolute amount of capital funds remaining intact is likely to bring down CRAR.
- **Liquidity and Credit growth:** Lower profits or earnings arising from NPAs also boils down to lower cash inflow, thereby impairing bank's liquidity. Poor liquidity together with pressure on profits and capital adequacy adversely affects the willingness and ability of the banks to expand its loan portfolio. Reluctance on the part of banks to grant loans can spill over to the economy in the form of credit rationing and credit crunch.
- **Stock prices and Solvency:** High NPAs signals weakness in asset quality of banks and is likely to bring down the stock prices of banks because the investors would perceive assets of such banks to be of high risk.
  Therefore, NPAs can worsen the financial performance of a bank by way of its adverse impact on bank's interest income, higher provisioning requirements and higher expenses involved in NPA recovery. It can also create a dent into the capital adequacy ratio of a bank and impair its liquidity, growth and ability to raise funds from the market. All this can have an adverse effect on the solvency as well the stock prices of the bank.
  If we extend the potential impact of deteriorating asset quality of banks at macro level, it can amount to adversely affecting the credit growth in the economy and therefore leading to an unfavourable impact on the macroeconomic factors like GDP growth.
  Moreover, bailing out of the banks whose assets are stressed through means of capital infusion by government can also turn out to be a heavy burden on the fiscal position of the government. The burden is to be ultimately borne out by the taxpayers of the country.

LITERATURE REVIEW

In the banking literature, the problem of NPAs has been re-examined in several theoretical and empirical studies. Many authors tried to study the reasons of NPAs, the problems created by NPAs and the impact of NPAs on the banking sector. A review of the existing literature throws light upon the key determinants of NPAs across countries.

A considered view is that banks' lending policy could have crucial influence on non-performing loans (Reddy, 2004). Reddy (2004) critically examined various issues pertaining to terms of credit of Indian banks. In this context, it was viewed that 'the element of power has no bearing on the illegal activity. A default is not entirely an irrational decision. Rather a defaulter takes into account probabilistic assessment of various costs and benefits of his decision'. Mohan (2003) conceptualised 'lazy banking' while critically reflecting on banks' investment portfolio and lending policy. In a study of institutional finance structure and implications for industrial growth, Mohan (2004) emphasised on key lending terms of credit, such as maturity and interest-terms of loans to corporate sector. The Indian viewpoint referring to the concepts of 'credit culture' owing to Reddy (2004) and 'lazy banking' owing to Mohan (2003) has an international perspective since several studies in the banking literature agree that banks' lending policy is a major driver of non-performing loans (McGoven, 1993, Christine 1995, Sergio, 1996, Bloem and Gorters, 2001).

The poor quality assets generated during the period of economic boom materializes and shows up in the form of NPLs during the downturn after the boom phase is over(Borio & Lowe, 2002). Jimenez and Saurina (2005) also found evidence of a positive, lagged relationship between rapid credit growth and future NPLs.

In the influential study on 'credit policy, systems and culture', Reddy (2004) raised various critical issues pertaining to credit delivery mechanism of the Indian banking sector. The study focused on the terms of credit such as interest rate charged to various productive activities and borrowers, the approach to risk management and portfolio management in general. There are three pillars on which India's credit system was based in the past. Nkusu (2011) found NPL shocks to have an adverse effect on asset prices, GDP growth and private sector credit. Bock and Demyanets (2012) also found evidence that increase in NPL leads to slowdown in economic activity and depreciation of exchange rate. Klein (2013) found feedback effect of NPLs not only in terms of lower GDP growth and exchange rate depreciation but also in terms of higher unemployment and inflation.

Cross-country but region specific studies were conducted in the context of banks in advanced countries (Nkusu, 2011), banks in new EU member states (Festić et al., 2011), banks in emerging market economies (Bock & Demyanets, 2012) as well as banks in Gulf cooperative council (GCC) countries (Espinoza & Prasad, 2010). Country specific studies covered Austrian banks (Arpa et al., 2001; Kalirai & Scheicher, 2002), Czech banks (Babouček & Jančar, 2005), UK banks (Hoggarth, Sorensen, & Zicchino, 2005), Italian banks (Quagliariello M. 2006) as well as Hong Kong banks (Shu chang, 2002).

One of the recent studies by Bock and Demyanets (2012) conducted in the context of emerging market economies also found credit quality to worsen with weaker terms of trade and fall in debt-creating capital inflows. Bank and foreign portfolio inflows were found to have the biggest impact implying that an unexpected reversal of the capital inflows would cause a sharp increase in NPL.

RESEARCH OBJECTIVES

This analysis is likely to help in identify the challenges in holding NPAs in Indian banks and providing suggestions for handling the same.

- ✓ To study the concept of NPAs and to examine the causes for NPAs in Indian banking industry.
- ✓ To study the trends of Non-Performing Assets across Public Sector Banks and Private Sector Banks in India.
- ✓ To explore the measures taken globally by selected nations to reduce NPAs and provide recommendations to Indian commercial banks for the same.

METHODOLOGY

The study encompasses a period of ten years from 2010-11 to till 2019-2020. Based upon this trend estimation of the financials for the period 2019-20 has be done. The data for the study is collected from secondary sources, publicly available like- RBI websites, Annual Reports of banks and World Bank Open database. In order to provethe second objective, statistical tools in the form of time series analysis and regression analysis are used.

Data Analysis and Findings

The table below shows the trend of Gross Non- Performing Assets to Gross Advances Ratio. This ratio is always mentioned in terms of percentage which indicates the proportion of the NPAs with the advances in gross. The lower is the percentage better is the advancing policy.

Table 1.0: Gross Non-Performing Assets in Banks (Amount in billion**)**

Year	Public Sector Banks (PSBs)			Private Sector Banks (PVBs)		
	Gross Non-Performing Assets (Amount)	Gross Advances (Amount)	GNPA as percentage of Gross Advances (%)	Gross Non-Performing Assets (Amount)	Gross Advances (Amount)	GNPA as percentage of Gross Advances (%)
2010-11	404.52	18190.74	2.2	104.40	4124.41	2.5

2011-12	449.57	22834.73	2.0	138.54	4547.13	3.1
2012-13	599.26	27334.58	2.2	140.17	4877.13	2.9
2013-14	746.00	30798.04	2.4	145.00	5450.14	2.7
2014-15	1172.62	35503.89	3.3	187.68	8716.41	2.2
2015-16	1644.61	45601.69	3.6	210.71	11512.46	1.8
2016-17	2272.64	52159.20	4.4	245.42	13602.53	1.8
2017-18	2784.68	56167.18	5.0	341.06	16073.39	2.1
2018-19	5399.56	58183.48	9.3	561.86	19726.59	2.8
2019-20	6847	58522.01	11.7	932	22731.70	4.1

Source: http://www.rbi.org.in

It is clearly seen from table 1.2 that Gross NPAs as percentage to gross advances of PSBshave steadily increased from 2.2% to 11.7% and also for PVBs from 2.5% to 4.1%. It can also be observed that banks have made substantial progress in granting more advances which reflected more NPAs from their balance sheets over the period of time.
However, the asset quality has deteriorated after 2011-12 with sharp increase in gross NPAs of commercial banks (both PSBs;4.4-11.7% and PVBs; 1.8-4.1%). The sudden increase in NPAs could be because of the slowdown in the domestic economy as well as inadequate appraisal and monitoring of credit proposals (RBI, report). Growth rate of gross NPAs has increased at higher rate than the growth rate of advances, this can be one of the causes for sudden increase of NPAs in commercial banks.

The magnitude of NPAs have a direct impact on banks profitability as legally they are not allowed to book income on such accounts and at the same time banks are forced to make provision on such assets as per RBI guidelines.

The deterioration in asset quality was more noticeable in case of PSBs as compared to PVBs. The gross NPAs of PSBshas increased ata higher rate after 2013-14(Table 1.0), this could be due to the various shortcomings of PSBs.

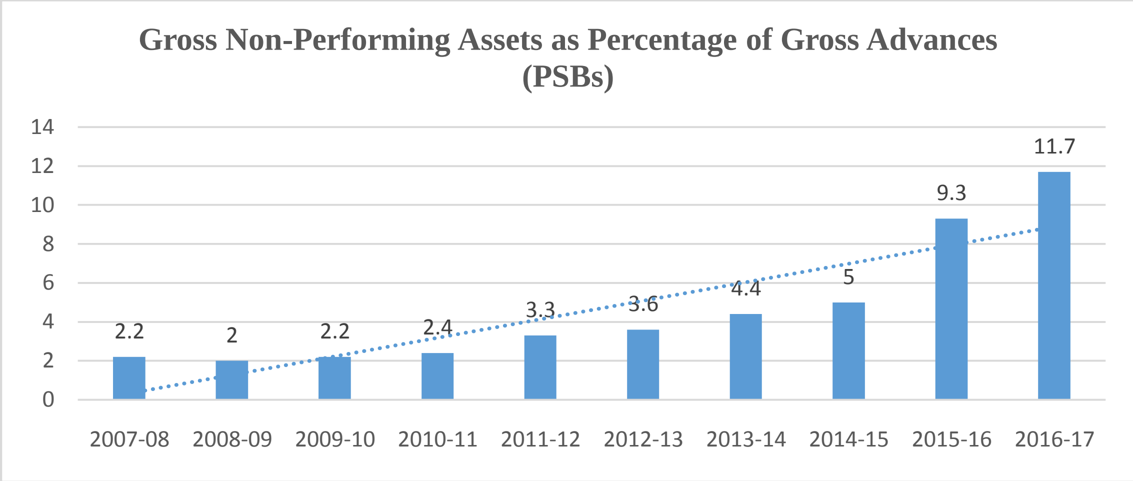
Trend of Gross NPAs to Gross Advances Ratio
A comparative trend analysis of Gross Non-Performing Assets of PSBs and PVBs in India is presented with the help of table 1.1 and graphs 1.1 and 1.2.

Table 1.1: Gross Non-Performing Assets as Percentage of Gross Advances

Type of Bank	**2010-11**	**2011-12**	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**2020-21 (Estimated)**
Public Sector (PSBs)	2.2	2.0	2.2	2.4	3.3	3.6	4.4	5.0	9.3	11.7	**9.84**
Private Sector (PVBs)	2.5	3.1	2.9	2.7	2.2	1.8	1.8	2.1	2.8	4.1	**2.77**

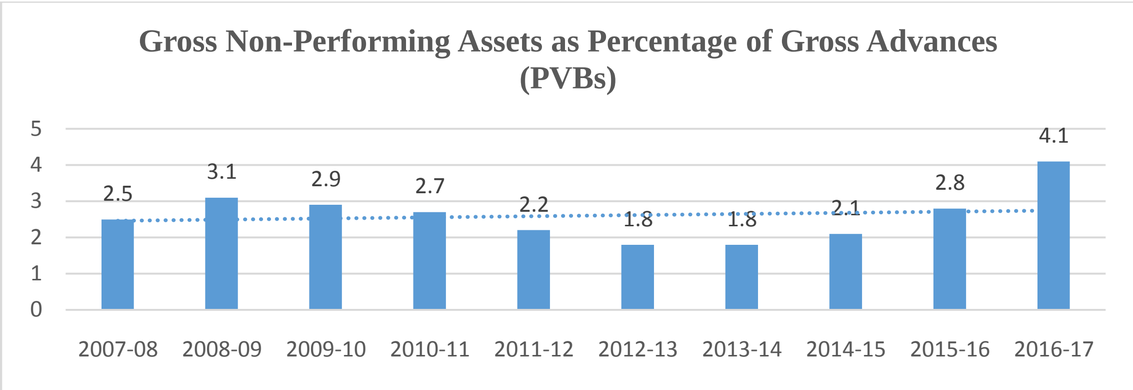
Source: http://www.rbi.org.in

GRAPH 1.1: Time Series Analysis of Gross Non-Performing Assets as Percentage of Gross Advances (PSBs)



It can clearly be seen that the trend line for PSBsshows an increasing trend and in 2017-18, the Gross NPAs to Gross Advances Ratio will lie between 8-10%. The estimated value for 2017-18 is also calculated to be 9.84%.

GRAPH-1.2: Time Series Analysis of Gross Non-Performing Assets as Percentage of Gross Advances (PVBs)



It can clearly be seen that the trend line for PVBs shows a constant trend and in 2017-18, the Gross NPAs to Gross Advances Ratio will lie between 2-3%. The estimated value for 2017-18 is also calculated to be 2.77%.

Trend of Net NPAs to Net Advances Ratio

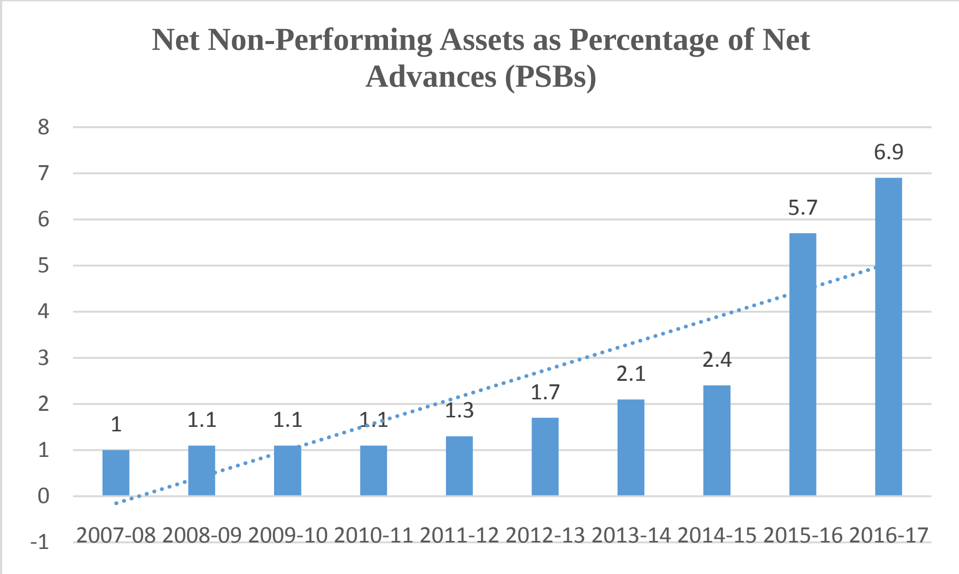
A comparative trend analysis of Net Non-Performing Assets of PSBs and PVBs in India is presented with the help of table 1.2 and graphs 1.3 and 1.4.

Table 1.2: Net Non-Performing Assets as Percentage of Net Advances

Type of Banks	**2007-08**	**2008-09**	**2009-10**	**2010-11**	**2011-12**	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18 (Estimated)**
Public Sector (PSBs)	1.0	1.1	1.1	1.1	1.3	1.7	2.1	2.4	5.7	6.9	**5.43**
Private Sector (PVBs)	1.1	1.0	1.0	1.3	0.62	0.51	0.53	0.66	1.4	2.2	**1.38**

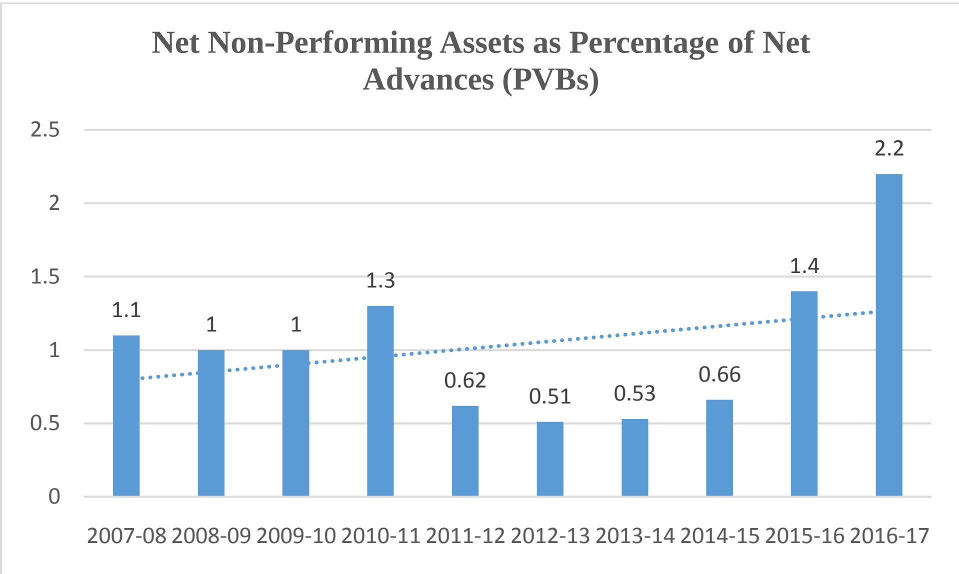
Source: http://www.rbi.org.in

GRAPH-1.3: Time Series Analysis of Net Non-Performing Assets as Percentage of Net Advances (PSBs)



It can clearly be seen that the trend line for PSBs shows an increasing trend and in 2017-18, the Net NPAs to Net Advances Ratio will lie above 5%. The estimated value for 2017-18 is calculated to be 5.43%.

GRAPH-1.4: Time Series Analysis of Net Non-Performing Assets as Percentage of Net Advances (PVBs)



It can clearly be seen that the trend line for PVBs shows a constant trend and in 2017-18, the Net NPAs to Net Advances Ratio will lie between 1-1.5%. The estimated value for 2017-18 is also calculated to be 1.38%.

Asset Classification of Public Sector and Private Sector Banks

Advances in each of the four asset categories (standard, substandard, doubtful and loss) of the PSBs and PVBs during 2016 and 2017 are given in the table 1.3.

Table (1.3): Classification of Loan Assets – Bank Group-wise

(As at end-March 2017)

(Amount in billion)

Bank Group	Year	Standard Assets		Sub-Standard Assets		Doubtful Assets		Loss Assets	
		Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
PSBs	2016	52,875	90.7	2,005	3.4	3,232	5.5	163	0.3
	2017	51,816	88.3	1,731	3.0	4,904	8.4	213	0.4
PVBs	2016	19,184	97.2	186	0.9	311	1.6	62	0.3
	2017	21,748	95.9	310	1.4	519	2.3	90	0.4

Source: http://www.rbi.org.in

The proportion of standard assets of PSBs has decreased from 90.7 percent in March 2016 to 88.3 percent in March 2017. The same decreased trend can also be seen for PVBs from 97.2 % to 95.9%. The sub-standard assets almost remained constantwith slight decrease for PSBsand a slight increase for PVBs. The doubtful assets trend moved quite opposite to the standard assets trend; also for PSBs a huge increase can be seen from 5.5 percent to 8.4 percent and 1.6 to 2.3 for PVBs. It can also be learnt that the proportion of doubtful debts is more than sub-standard assets, which should be controlled. The loss assets percentage is also increasing in the same proportion i.e.0.3 to 0.4 for PSBs and PVBs.

RECOMMENDATIONS AND CONCLUSION

When it comes to resolving Non-Performing Assets, identifying the problem is the first step. Banks need to transparently and credibly assess the quality of their assets and build up provisions against expected losses. A credible guidance to markets can help to restore market confidence damaged by rising NPAs. Relying on bank's voluntary efforts to resolve NPAs may not be sufficient even when NPAs are recognised. The regulator may guide banks as to the optimal use of their capital buffers and determine target loan loss provisions. Banks may need to develop special capacity to deal with NPAs which is another area which should be focussed.

Although there are various measures adopted by Indian Government and RBI in last few years to curb the problem of NPAs such as: 'Mission Indradhanush', Introduction of Bankruptcy code, Corporate Debt Restructuring (CDR) mechanism, Asset Reconstruction Companies (AMC), channels of recoveries in the form of Lok Adalats, One time settlement (OTS), Debt Recovery Tribunals (DRTs), Compromise Settlement, Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) act etc. Still the trend shows that these measures are not very effective for dipping the problem of NPAs. It is therefore important to look at some of the key strategies undertaken by other countries to address the NPAs issue, so that the best possible practice can be adopted.

Key Strategies adopted globally to mitigate NPAs ratios

The following are the practices followed by some nations which have drastically made changes in their NPAs ratios-

China: It can be learned that China's NPAs in the early 2000s were far higher than India's from the period 2001-2005. Since then, China has made a significant effort to fine-tune NPAs and today, they are much less than in India.China's NPA ratio is less than 2 percent.They adopted a four-point strategy to address the problems.

- ✓ Reduce risks by strengthening banks and spearheading reforms of the state-owned enterprises (SOEs) by reducing their level of debt.
- ✓ Passing laws that allowed the creation of asset management companies, equity participation and most importantly, asset-based securitization. The "securitization" approach is being taken by the Chinese to handle even their current NPA issue and is reportedly being piloted by a handful of large banks with specific emphasis on domestic investors. According to the International Monetary Fund (IMF), this is a prudent and preferred strategy since it gets assets off the balance sheets quickly and allows banks to receive cash which could be used for lending.
- ✓ Ensuring that the government had the financial loss of debt "discounted" and debt equity swaps were allowed in case a growth opportunity existed.
- ✓ Producing incentives like tax breaks, exemption from administrative fees and transparent evaluations norms. These measures were indeed very much successful in reducing NPAs.

European Union: European Central Bank published its final guidance on non-performing loans (NPLs), setting out expectations in relation to strategy, governance, and operations. These rules aim to provide EU banks with best practices regarding NPA management and monitoring.

- ✓ Governance: It defined objectives and incentives for NPL workout activities and periodically (at least quarterly) monitor progress made in comparison with the targets and milestones defined in the NPL strategy. It also ensured sufficient internal controls over NPL management processes (with a special focus on activities linked to NPL classifications, provisioning, collateral valuations, and sustainability of solutions.
- ✓ Strategy: Institutions with high levels of NPLs are required to implement "realistic and ambitious strategies" to effectively reduce their NPL portfolios. The ECB does not set any quantitative targets for NPL reduction, but stipulates that banks should set these targets and develop a detailed implementation plan, considering their operating environment.
- ✓ Operations: High-NPL banks are expected to set up separate and dedicated workout units for the monitoring of NPLs. To avoid potential conflicts of interest, these workout units should be separated from units responsible for loans origination. The staff in charge of NPLs has to be sufficiently trained to deal with the issues related to each stage of the NPL lifecycle.

Japan

Japan's Corporate Reorganisation Law was amended to improve the efficiencyand the threat of suspension of banking business. Before 2002, an 'Assembly of Related Persons' had to be summoned three times before a loan could be restructured, even if no party requested that it be convened. Since 2002, only courts or selected parties, such as creditors' committees, can summon the 'Assembly of Related Persons', in order to speed up the bankruptcy process. In addition, a rehabilitation plan can be granted by a simple majority rather than by two thirds of voters. In 2001, the 'Private Rearrangement Guidelines' established general principles for out-of-court debt workout processes, in order to make out-of-court restructuring easier to implement. Apart from all this corporate assistance policies, loss compensation by deposit insurance corporation and purchase of assets from financial institutions are other measures.

United States

In response to the savings and loan crisis, Congress enacted the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), which created the Resolution Trust Corporation (RTC) in 1989. RTC usually lowered the price of its assets, which allowed it to dispose of NPLs more quickly. The RTC merged with the Federal Deposit Insurance Corporation (FDIC) in 1995 and the FDIC is still the reviver for many US failing banks. In 2005, the United States introduced simplified procedures within insolvency laws for SMEs. A new Chapter 11 was created for SMEs, with special provisions such as standardised forms, simplified procedures, and no requirement for a creditor committee. Subsequently, an initiative to amend the provisions of Chapter 12 (a simplified procedure for family farmers or fishermen) was launched.

NPAs: Suggested Practices for India

- Establishment of an environment for fair valuation of assets.
- Corporate governance issues in PSBs should be addressed. This include explicit fit and proper criteria for appointment of top executives and establishing system of an open market wide search for Chairman.
- A well-developed secondary market for corporate debt, including distressed debt.
- No immediate taxation of non-cash corporate reorganizations, e.g., mergers, share swaps.
- The strategy of high-NPA banks' should be supported by an operational plan that should clearly define how the bank will operationally implement its NPA strategy over a time horizon of at least one to three years. This operating plan shall be approved by the management body.
- Establishing a strong financial regulator able to take over banks whose risk-weighted capital adequacy ratio falls below an acceptable level.
- Adequate technical infrastructure, where all NPA-related data should be centrally stored in robust and secured IT systems. An early warning mechanism and comprehensive MIS(Management Information System) can play an important role in credit monitoring. MIS must enable timely detection of problem accounts, flag early signs of delinquencies and facilitate timely information to management on these aspects.
- Robust securitization structure which involve the transfer of debt to privately managed special purpose vehicles that have a clearer mandate and expertise to engage in corporate restructuring.
- Substantial institutional capacity in terms of experienced judges and insolvency professionals to carry out of court settlements.

Thus, to deal with rising NPAs, India has already taken various vital measures inspired by the international best practices and the ultimate is the introduction of Insolvency and Bankruptcy (IBC) Code in May 2016, consolidating the existing framework by creating a single law for insolvency and bankruptcy, which is expected to ensure time-bound settlement. The effects of this law has already started emerging and the corporates are already feeling the heat but due to certain economic and political factorsmany other reforms still lack implementation and take time to give appropriate results.

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