'CMAs CAN GUIDE BANKS IN PRE-SANCTION, POST-SANCTION AND MONITORING OF STRESSED ASSET LEVELS'

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MA What should be the concerns of banks on NPA management during this economic downturn in India?
Banks have been increasingly facing the pressure of non-performing assets owing to the protracted economic slowdown in India. Stalled manufacturing and infrastructure projects have blocked cash flows of the big ticket bank borrowers leading to recovery woes for banks, particularly for Public Sector banks.

Now, when it seems that economic growth may take some more time to revive, the prime concern of the banks should be to prevent fresh slippages and step up recovery especially from big ticket accounts. Another concern for the banks should be making provisions for bad/restructured assets as per new prudential guidelines. High provisions adversely impact the profits and thereby constrain the profit plough-back which is an important source of capital to meet Basel III requirements.

MA Are big ticket advances responsible for the burgeoning of NPAs? What remedial measures would you suggest?
Yes. Big ticket advances are a major cause of burgeoning NPAs because:
- Apart from size, many of these accounts tend to be over leveraged with huge debt burdens, which they could service in good times, but in strained economic conditions, it is difficult to service when sales decline/ receivables pile up.
- These accounts are more susceptible to adverse changes in the macro-economic situation. With the projections of business having been made in better times, the expected cash flows would be high and economic downturns would upset the repayment cycle.
- The level of collateralization is generally less in these accounts and the promoters can often hide behind the corporate veil.

Remedial measures:
- Strengthening of the debt recovery mechanism presently available.
- Making the promoters personally liable in case of wilful default.
- Penal provisions for defaulters – this can have a deterrent effect.

MA What is your view about credit to the SME sector? How much of it could become NPA? Are there any guidelines from the government on this?
The SME sector is a vast category covering both manufacturing and service enterprises and as such the risk in SME is not uniform. The risk perception with regard to a manufacturing enterprise will not be the same as the risk associated with a service enterprise, operating in a relatively more stable market. The investment levels are also very different and as such treating the entire SME sector as a single monolithic category is not advisable.
- It also needs to be stated that the collateral coverage in the case of SMEs is higher and action under SARFAESI can generally be initiated and brought to a satisfactory conclusion.
- Putting a definite figure on the amount that could become NPA is not possible. The experiences of different banks are also not uniform. For example, in PNB the delinquency ratio of SMEs has gone down in FY 14 as compared to FY 13.
- The guidelines from the Government with regard to SMEs relate to the dispensation of credit to the sector. Banks have annual targets for SMEs and the Govt. monitors the progress made. There are also guidelines for timely restructuring and nursing of sick, viable SME accounts.

MA How successful has the SARFAESI Act 2002 been in helping banks to manage NPA?
- The SARFAESI Act has been of great assistance to bankers. It marks the first piece of legislation that

allows bankers to sell properties charged to them without the intervention of the courts.
- However, there are a number of cases where actions taken by the banks under SARFAESI have been stayed by the DRTs and the cases follow the set legal procedures and are subject to the delays thereof.
- SARFAESI can work better if actions under the Act are not stayed on flimsy grounds.
- There are other cases where problems are faced with regard to taking physical possession, where the borrowers use local influence and power.

MA How is NPA affecting the profitability and efficiency of banks in India?
- NPAs have resulted in bringing down the yield on advances.
- With increasing NPAs the cost of credit goes up, thus reducing the efficiency of banks.
- Recovery of NPAs is service intensive and has a high service cost. It also diverts resources from more productive work.
- Increased provisions have reduced the Net Profits of banks. This has an adverse impact on all the profitability ratios – ROE, ROA, etc.
- Where NPAs are common in a particular industry, further credit to the industry has been reduced.
- In an economic downturn even if possession of securities is taken, finding alternative buyers and realising optimum amounts still remains a challenge.

MA Do Basel II and Basel III provide sufficient provisions to manage NPA?
Basel II and Basel III guidelines enumerate capital adequacy norms and prudential treatment of all asset classes (including NPA and restructured asset) for capital requirement for banks. These guidelines do not focus on the best practice for NPA / Stressed Asset containment – instead it prescribes the capital quantum that should be kept aside for bad loans. A Basel guideline on capital requirement is a sort of an ex-post risk mitigation way and does not focus on NPA management including its curtailment.

MA Are prudential guidelines relevant when borrowers are facing a cash flow crunch and banks are finding it difficult to provision for NPA accounts?
The concerns and priorities of the regulator and the lenders are different and they should necessarily be. The regulator frames prudential guidelines to strengthen banks during the period of difficulty and thus ensuring their sustainability. At the same time, banks look for profitability and continuity. Prudential guidelines at this period of economic downturn help to ensure the continuity and stability of the banking system. The relevance of prudential guidelines for asset classification and provisioning requirements is intact since they are based on the tenet of managing risk in banking business in all the phases of business cycle.

MA In continuation to the above question, could a situation based guideline from RBI provide relief to genuine borrowers?
Borrowers are getting relief through the restructuring schemes of Banks such as CDR, Non-CDR schemes, Debt Recovery Mechanism (DRM) for SMEs etc. The genuine borrowers i.e. where the reasons for delinquency are beyond the control of borrowers, get relief as per the laid down system for each distress situation. However, there is a need to take into account the problems of borrowers who have taken loans for a project that is stalled for no fault of theirs – such as inability of the govt. to acquire land, or provide fuel linkages or environmental clearances. It is a matter of priority that such bottlenecks must be removed first instead of classification and treatment as non-performing assets etc.

MA Would two sets of prudential guidelines be suitable for two different economic scenarios, one at the time of an upbeat economy and one at the time of a downturn?
I think that one integrated set of prudential guidelines is required to deal with the requirements of different prevailing scenario. During the flourishing economy, prudential guidelines should be proactively framed to build cushion for the banks to meet future contingencies. In the event of deceleration and high risk in the economy the guidelines must enable the banks to draw upon the reserves created for stressful times i.e. counter cyclical buffers etc. One, modification is suggested that during the stressful times the financial system needs to be facilitated by the regulator to build in fresh provisions and reserves at bit lower rate, commensurate with the then profitability of banks. The shortfall against the prevalent rates can be covered by the banks in phased manner on the upturn in economic cycle.

MA Could professionals like CMAs help the banking sector to check this problem? In what way could CMAs help in other areas of banking.
Professionals like Cost and Management Accountants can play an important role in the current scenario to help the banking sector effectively manage NPAs. CMAs can guide banks in pre-sanction, post-sanction and monitoring of stressed asset levels.

At pre-sanction level, they can advise for better appraisal through expert TEV study and industry analysis. During the post sanction and monitoring level, they can help the banks through analysing end use of funds, verifying book debts and Training of operating level staff in detecting incipient sickness/ understanding alert signals etc.

Apart from the above, financial professionals inter alia Cost and Management Accountants can help the banks in cost-benefit analysis of products and services, the banks offer, advising strategies for reducing cost of products, portfolio analysis and stress testing etc.

MA Is there any proper guidance by RBI to evaluate the "cost of risk" in banking?
There are regulatory provisions defined by RBI for restructured accounts and for NPA accounts – Sub Standard, Doubtful and Loss. Banks going for riskier loans inevitably have to make higher provisions as these loans become non-performing, with provisions increasing in proportion to the age of the NPAs. This is the cost of risk for the bank – and the provisioning guidelines give adequate guidance.

MA Could CMAs act as specialist officers in Risk Management, Audit and Credit Analysis through the Institute of Banking Personnel Selection?
The banks are recruiting specialist officers like Cost Accountants, Chartered Accounts and personnel with ICWA background as specialist officers through Institute of Banking Personnel Selection (IBPS). They are placed in various strategic functional areas in the banks where their expertise is best utilised like product pricing, industry analysis, industry rating, credit appraisal and audit –to name a few.

With introduction of complex products and services like derivatives in Indian banks and expansion of business lines and products lines of the banks, the requirement of such specialists will increase further.