FICCI

Financial Foresights

Views, Reflection and Erudition

VOL. NO. 6 | ISSUE NO. 2 | Q3 FY16

NPA Management in Banks

FEDERATION OF INDIAN CHAMBERS OF COMMERCE AND INDUSTRY

Industry's Voice for Policy Change

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Preface

Currently in its sixth year of publication, the Financial Foresights has gone a long way in providing valuable inputs to FICCI's extensive and growing network of members and stakeholders on various topics concerning the financial sector. The current issue of our digest focuses on 'NPA Management in Banks'.

A review of the Indian banking system shows that the foremost challenge it currently faces relates to dealing with the rising amount of non-performing assets (NPAs). Data from the Reserve Bank of India shows that amount of gross NPAs as a percentage of gross advances in the banking system has gone up to 5.1 per cent (Sept 2015). Additionally, the quantum of restructured standard advances as a percentage of gross advances stands at 6.2 per cent. Taken together (NPAs and restructured advances), stressed advances ratio in the banking sector stands at 11.3 per cent or about Rs. 7 lakh crore.

The present state of affairs remains worrisome. Several steps have been undertaken by the Reserve Bank of India over the past two years to deal with the issue of NPAs. Prominent among the remedial measures adopted, is the introduction of a Strategic Debt Restructuring (SDR) mechanism which enabled banks to collectively take a 51% equity stake in the company and over an 18 month moratorium period find a new buyer and restructure a loan.

Moreover, ARCs have been an important means to help banks manage NPAs. However, the existing system doesn't seem to be working effectively. As such focused measures are required that will enhance the stressed asset management and effectiveness of ARCs. Further, there is a need to look beyond the existing system and address the specific nature of the problem through a specialized ARC framework. Based on study of various international experiences (Malaysia, Taiwan, Thailand, Korea, etc.), FICCI has suggested the creation of a specialized entity called National Asset Management Company (NAMCO) which will be a time bound and closed ended framework for one-time resolution of large NPAs in India.

While remedial actions are definitely required, it is equally important to adopt a preventive approach with long term perspective in mind. Preventive Measures such as improving in-house credit appraisal and project monitoring capacity in banks to conduct techno-economic feasibility studies of proposals are critical measures that should be implemented. Moreover, there is a need to arrange for the review of large NPA cases in the past to facilitate problem based learning. Lastly, but most importantly, sector specific policy level issues need to be addressed effectively so that projects that are impacted due to changes in the regulatory framework can get a reprieve.

Given the centrality of the banking system in the Indian economy, it is critical to restore it to good health so that it can participate effectively in the economic recovery and support growth. It is in this context that in this issue we take a closer look on 'NPA Management in Banks' with inputs from leading names in the India's financial sector.

We look forward to your views and suggestions to help us improve the content of the digest and make it more relevant and informative.

Dr. A. Didar Singh
Secretary General
FICCI

Industry Insights

Role of ARCs in NPA Management

Rashesh Shah
Vice President FICCI & Chairman and CEO, Edelweiss Financial Services Ltd.

Current NPA Situation

Post global financial crisis, growth trajectory of banks have witnessed a sea change. Annual bank credit growth fell from ~25% during 2002-08 to ~15% during 2009-13 and most recently below 10%. Economic slowdown in post Lehman Brothers era combined with over-exacting regulations and government's inability to adequately fund public sector banks (PSBs) seems to have forestalled the high growth of Indian banking sector.

However, high growth phases are also when Stressed Assets (SA) are generated within the banking sector. Due to easy availability of credit, not so stringent underwriting, excess capacity creation are the reasons due to which stressed assets are generated in the banking system. The NPAs have a lead time and usually the impact of high growth in credit assets is visible after a lag of few years. If the Bank NPAs and restructured assets are to be combined then total NPAs in system are at 11%, as high as when the banking reforms were started in 2000. The stress is not evenly distributed across the entire banking system and is largely concentrated in Public Sector Banks (PSBs) with stress reaching a level greater than 15% of advances.

The current NPA situation is precarious. Firstly, the companies have become too large to fail and hence, systemically it is important to resolve these NPAs. Many of the NPAs are in

core sectors like steel, utilities, and infrastructure. If these are not resolved, then it will be difficult for India to provide requisite infrastructure for growth. Also, The NPAs in the system are creating reluctance on part of Banks to grow credit and on the other side, the companies are unable to take credit due to stressed balance sheets. Large amounts of restructured loans will soon be completing the initial moratorium period and further accretions to the NPAs are expected over the next 12-18 months. A delay in economic revival will further accentuate the problem being faced by banking system. In addition, Capital adequacy of banks which is under pressure will get further stressed due to high NPAs. viz. NPA + restructured assets as a ratio of advances is in the range of 11%, the entire equity capital is at risk.

As said by Raghuram Rajan in November 2013 -"You can put lipstick on a pig but it doesn't become a princess. So dressing up a loan and showing it as restructured and not provisioning for it when it stops paying, is an issue". There is an urgent need to solve the current NPAs and put a roadmap to reduce the reasons which lead to creation of such high NPAs.

Under Raghuram Rajan's stewardship, the RBI has announced a host of measures to reign in this problem. Some of the changes introduced include the recent move by RBI are

- Allowing banks to take equity by converting their debt
- Implementation of SMA (Special Mention Accounts) norms have helped in early identification of stress assets In the system
- Creation of an empowered Joint Lender Forum to expedite the process for resolving of NPAs
- Tagging individuals and companies as willful defaulter would help in creating a strong deterrent
- Early last year, the central bank allowed the banks to sell even the loans where the principal or interest was overdue by 60 days rather than 90 days, earlier. In essence, it allowed banks to start selling assets early if they felt the loan was non-redeemable
- Nudging banks to sell NPAs to professionally managed ARCs, who could resolve assets. The RBI extended the benefit which allows banks to spread the loss from sale of assets to ARCs, over two years. Available till March 2016, this benefit has resulted in surge in efforts from banks to clean their balance sheets

Role of ARCs in resolving the NPA situation

ARCs are an important means to help banks manage NPAs. At its heart, ARC business is a resolution business and not a recovery business.

However, ARCs do not have any magic spell for reviving a non performing asset. Process of resolving a stressed asset requires aggregation of debt outstanding to various banks, arrangement of capital, rightsizing the business and bringing in a strategic partner.This requires a period of 3-5 years, first few years to resolve the issues and then the balance period for consolidation and growth.

The growth of ARCs in India has been primarily in 3 phases, the current one being the 3rd phase and the most prominent phase. ARCs have been doing a lot of work to ensure that the banking system is relieved from the structural NPA problem which they are currently facing. Approximately, Rs. 130,000 Crores worth of Gross NPA were sold from 2010 to 2015 to ARCs, however the same is much lower than the current stock of total Gross NPA in the Indian Banking system of ~Rs. 316,000 Crores as on 31st March 2015.

In last few years, banks were incentivized to sell fresh NPAs to

ARCs for revival. The banks also responded effectively and majority of assets sold are fresh NPAs with potential to resolve and revive. RBI also raised the skin in the business for ARCs by increasing the contribution to 15%. This has made sure that only serious ARCs participate in the business and pricing can be made more realistic by the banks.

ARCs system has so far worked well to absorb the NPA sales put forth by banks and assisted them in the process. Several large projects, which would have gone down the drain, if they continued to remain NPA in the books of the Bank, have been sustained and are in consolidation phases. If these assets get revived over a period of next 2-3 years, this will be significant improvement for the banking system. Very large assets, even with debt over 4,000 Crores, have been absorbed by the ARC system, and are now under restructuring / consolidation.

ARCs can act as a catalyst in resolution process for Banks due to several advantages

- ARCs can bring debt under a single umbrella (debt aggregation) and provide resolution to multiple issues by bringing various stakeholders on a single table. This includes providing additional working capital finance to such companies.
- ARCs can provide a practical approach to restructuring, where restructuring is mapped to sustainable debt and possible cash flows. ARCs also offer a more flexible and dynamic approach to resolution of any issues during the restructuring/reconstruction period.

- Faster decision making and execution assists the borrower companies to adapt to any changes in the business environment. Sale of non-core assets can also be expedited, since NOCs from multiple banks are not required and single window approach is adopted.

- ARCs can also provide their acumen and connect with international/domestic investors and strategic partners to ensure that the companies in their portfolio are revived at the earliest. ARCs are specialized agencies and their focus on such activities is much higher than the NPA management cells of many public sector banks.

Key factors to enhance effectiveness of ARCs

The ARCs can be made more effective provided some structural issues can be resolved. Some of these issues are :

- Banks not following a consortium approach is a major issue which leads to delay of 12-18 months for debt aggregation. ARCs have to resort to a time-consuming process of dealing with each bank separately often at differing commercial terms. ARCs have had to endure long period of effort to aggregate enough debt to control resolution of the accounts. Incentive structure has to be introduced for banks where 100% debt is sold at the same time by all banks to an ARC. This will expedite

- ARCs have limited financial muscle, which leaves little scope for revival. ARCs have spent approximately Rs. 8,800 Crores to acquire total assets of Rs 1.89 lakh crore of book value till date at a cost of ~Rs. 62,000 crore. If all NPAs do find themselves in market, that's another Rs 3.10 lakh Crore on sale, assuming similar pricing for the assets, it will require at least ~Rs. 17,000 crore of capital from ARCs by the 15:85 principle. That kind of money ARCs do not have today because of various reasons. ARCs are not allowed to go public for now and there is no secondary market for security receipts. With the cash component increased to 15 per cent of acquisition, the current net worth of ARCs would be sufficient to acquire only Rs. 20,000 Crore of stressed assets. Assuming ARCs acquire the NPAs at a discounted norm of 60 per cent of book value, all ARCs put together can garner Rs 33,300 Crore of NPAs. Removing the cap of 50% from the sponsor holding will be a big booster for capital infusion in ARCs as strong financial groups will become interested in the space.

- The companies under reconstruction require working capital lines and in many cases even the non-fund based requirements are high. The selling banks cannot lend, while non-bank entities, such as private equity or NBFC, demand very high interest along with priority in repayment over existing debt. Further the banking system is completely against any new exposure including non-fund based to these companies, even if they have come out of their structural issues. This leaves the responsibility of providing working capital finance on the ARCs and even non-fund based limits have to be raised against 100% cash margins.

- ARCs are not in a position to do the change of management easily. Infact the management has to be restored to original promoters in case the company is fully revived and all debts are repaid. This acts as a deterrent for any new investor to take management control in any business.

- The ARCs are not on par with the banking system when it comes to equity conversion. While RBI has given sweeping powers to banks in form of SDR and even in case of normal debt conversion, ARCs are restricted to maximum 26% of equity share in a particular company. To bring level playing field as well as to give more teeth to ARCs against promoters of companies having good potential but low promoter intent to revive, similar power should be given to

ARCs as to banks. Atleast 49% conversion should be allowed to ARCs, but power to go upto 51% also will be a big boost.

- It is difficult to remove promoter out of the company. There are currently 20 lakh recovery cases pending in Lok Adalats, Debt Recovery Tribunals (DRTs) and SARFAESI. According to the RBI, Rs 1,73,100 crore worth of money is locked in courts with the recovery record at Rs 31,100 crore as on March 31, 2014. There needs to be new mechanism to ensure speedier recovery. The bankruptcy reforms seem to be a step in the right direction.
- There can be measures to clarify the taxation related issues like TDS and taxation of SRs in the hand of the seller banks.
- While the same company's debt might be valued at a huge discount owing to net losses/devaluation in working capital assets, but the Banks are unwilling to part the loans at realistic prices due to provisioning/write-off issues in balance sheet. The ARCs can offer only realistic prices with discount for the contingent liabilities, information deficit & time value of money. The banks however see this as pure asset valuation exercise and the current assets valuation cannot be properly assessed in such companies. This creates a price expectation gap which needs to be bridged.

One solution is for the Indian Banks' Association in consultation with Association of Asset Reconstruction Companies to draw contours of mutually acceptable methodology for reserve price valuation. Discovery of fair price for NPAs may definitely help in more deals going through auctions and also generate interest from secondary investors like distress asset funds which can participate via securitisation and reconstruction companies

Renewed focus on NPAs by RBI is a welcome step. However, both Banks and ARCs will need lot of regulatory support and new policies to enable them to structurally overcome the current stock of NPAs and to reduce the NPA formation in the system.

Rashesh Shah

Vice President FICCI & Chairman and CEO, Edelweiss Financial Services Ltd.

Rashesh Shah has spent over 25 years in the corporate and financial markets sector and is one of the leading spokespersons for the industry.

Rashesh started Edelweiss in 1996 that has since grown into one of India's leading diversified financial services conglomerates.The INR 270 billion Edelweiss Group is present across all significant areas of financial services including Credit, Housing Finance, Financial Markets, Commodities, Asset Management and Life Insurance. The Group has 240 offices in 125 cities, including eight international offices in New York, Canada, Dubai, Hong Kong, Singapore, Mauritius, Nigeria and Chad with headquarters in Mumbai, India

Rashesh is passionate about financial services and the role it can play in translating India's vast savings into investments; thereby powering economic growth and development. Under his leadership, Edelweiss has combined technology, innovation and growth oriented entrepreneurship with a strong focus on risk management to become one of the more successful, stable and well respected financial services companies in India.

Finance Asia, Hong Kong ranked Edelweiss as India's Best Managed mid-cap company in 2013 and 2014.

A regular commentator on macro- economic policies, development matters and financial markets in the mainline and financial media, Rashesh serves on the Boards of various companies and public institutions. He has previously been on the Executive Committee of the National Stock Exchange and also on the SEBI (Stock Exchange Board of India) committee to review Insider Trading Regulations. He currently serves as Chairman, Maharashtra Council of FICCI and is a part of the Directors Forum formed by corporate stalwarts under the aegis of the FICCI Center for Corporate Governance seeking to improve the quality of board-level governance in Indian industry.

An MBA from Indian Institute of Management, Ahmedabad, Rashesh also holds a Diploma in International Trade from the Indian Institute of Foreign Trade, New Delhi. A voracious reader, a fitness enthusiast and an avid runner, Rashesh has recently participated in a triathlon and continues to participate in marathons across the globe.

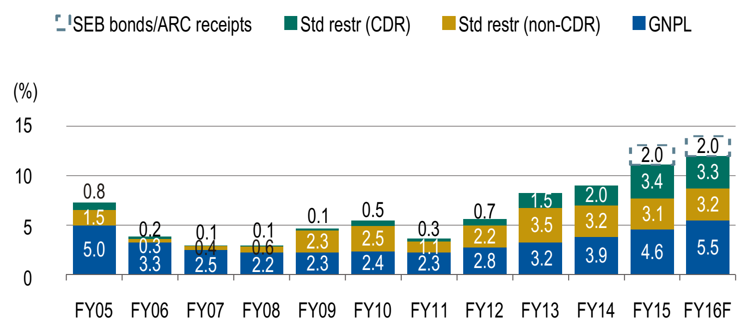
NPA Management in Banks

Abhishek Bhattacharya,
Co-Head - Banks and FI rating,
India Ratings & Research

The size and shape of the problem

The biggest challenge facing Indian banks today is the sheer size of their asset quality problems. India Ratings and Research (Ind-Ra) expects the total quantum of stressed assets to increase to 14-15% of bank credit by FY17 from just 3.7% in FY11 (13.1% in FY15). In FY15, total impaired assets amounted to 13.1% of bank credit including 4.6% in gross non-performing loans, 6.5% in standard restructured loans and another 2% including the outstanding receipts of asset reconstruction companies and the State Discom bonds.

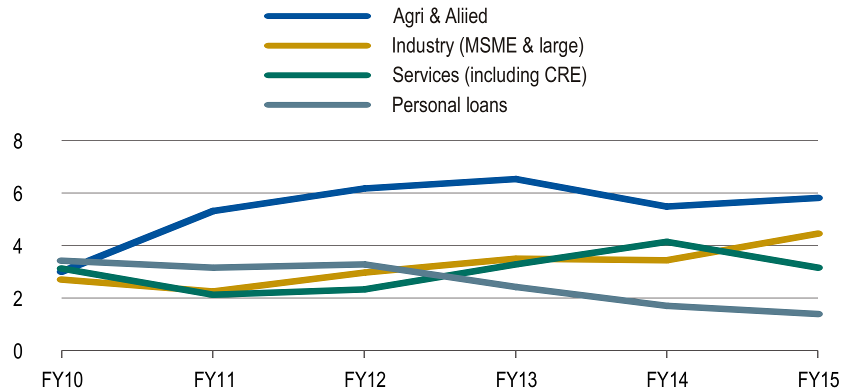
Figure 1
Impaired Loans as % of Gross Advances



Source: RBI, Ind-Ra

Figure 2

Movement of Sector-wise GNPA–% (Top 5 Banks)



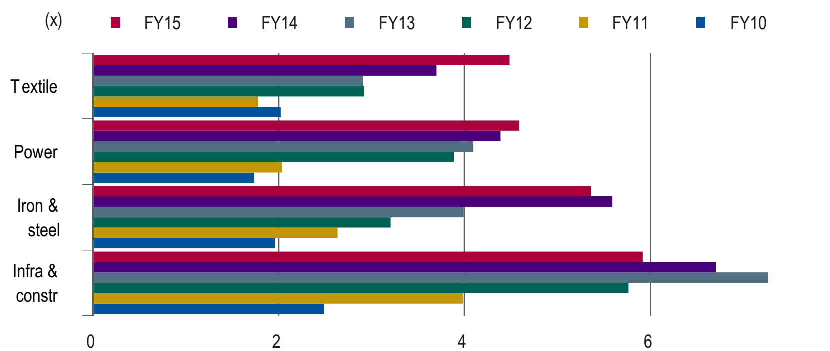
Source: Annual reports, Ace Equity

Agri and corporate sector have been the main contributors to impaired assets in the current cycle while retail loans have reported steady improvement over the last few years. While credit to agriculture and allied sectors have continued to show stress on account of three successive weak monsoons, impact from unseasonal rains and directed lending, loans to corporates have shown significant deterioration too. Asset quality for corporate sector has always demonstrated a strong correlation with the economic cycle; however, the stress this time is distinctly different from the previous slowdown. The corporate leverage has increased significantly over the last three to four years across sectors and it would take a few years of strong operating growth before it turns moderately comfortable. Hence a sharp pullback in delinquencies as seen in the previous cycle (FY02-FY07) would be unlikely this time around.

While the cyclical sectors (metals, textiles) continue to suffer from weak global cues and meltdown in

Figure 3

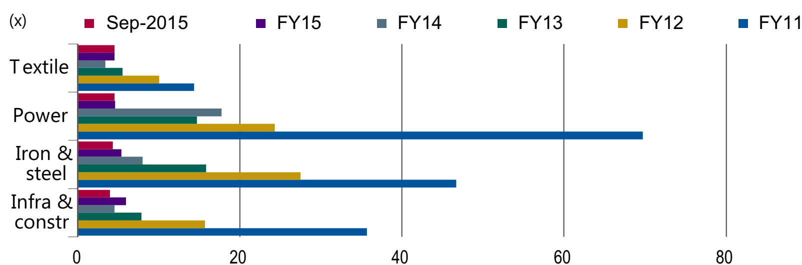
Median D/E Ratio for Stressed Corporates



Source: Ace Equity; Ind-Ra

Figure 4

Median MCap to Debt for Stressed Corporates



Source: Ace Equity; Ind-Ra. Market cap as on September 2015

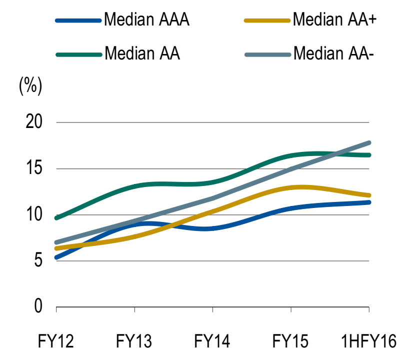
commodity cycle, the infrastructure sector continues to struggle with its own execution challenges. While most of these assets have inherent viability, Ind-Ra believes the sheer extent of the leverage makes the current debt level unviable for many of these corporates.

Also the headline impaired asset ratios don't reflect the current magnitude of stress sitting on banks' books. Ind-Ra analysed 30 large, stressed corporates, each with aggregate bank debt of over INR50bn totalling to about 7%-8% of the overall bank credit. Bank loans to all these corporates are accounted as performing (most of them figure as SMA1/SMA2 accounts). The power and other infrastructure sectors account for 50% of this exposure while the iron & steel sector accounts for another 32%. These companies have seen a significant increase in their leverage over the last few years and exhibit weak leverage ratios. Even assuming a significant pick up in capacity utilization and benign interest coverage ratios most of these corporates reflect unsustainably high debt and would potentially imply a haircut for the lenders or the promoters over the next few years. Adding them to the identified impaired assets shows a much higher proportion of stressed assets in a few key sectors.

Ind-Ra's stress test which considers credit costs from cyclical, infrastructure and single name concentration also highlights that banks' operating buffers might not suffice in case of a stress case scenario. While bank's concentration ratios have seen some improvement over the last few years (median top 20 exposure for banks was 180% in Mar'15; 250% in Mar'11), stickier recovery trajectory and depleted provision coverage ratios would keep credit costs high in the medium term.

Figure 7

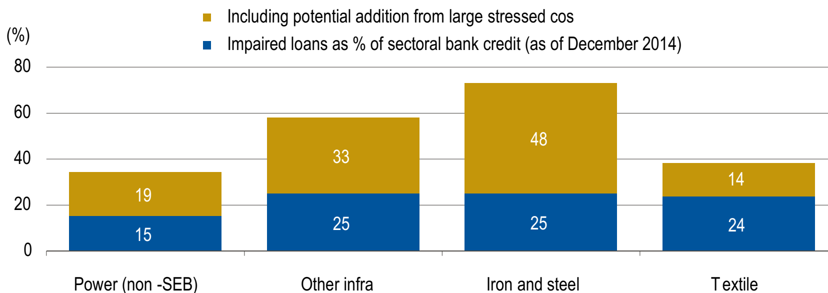
Impaired Asset Ratio Remains Elevated



Source: Bank annual reports and investor presentations

Figure 5

Top Sectors Contributing to Impaired Assets

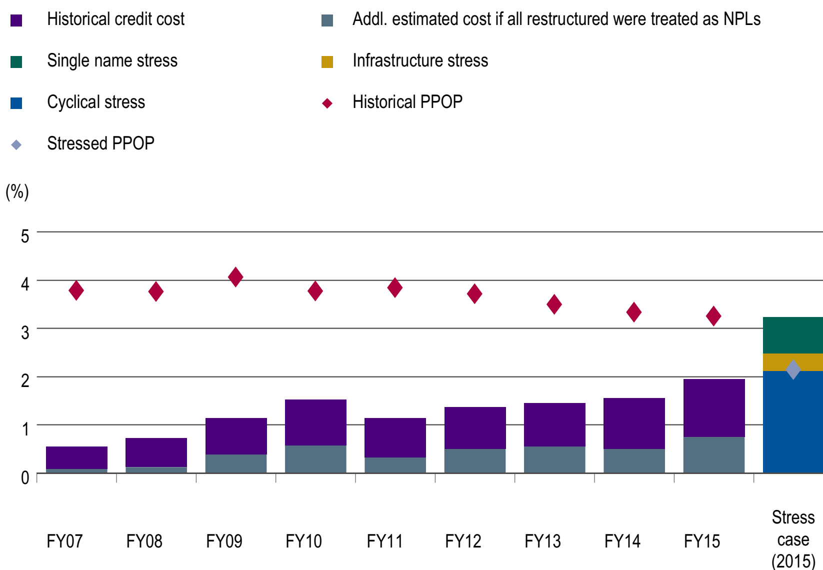


Source: RBI FSR; Ind-Ra's estimates

Figure 6

Stress Test Result of Banks Point toStress from Single Name Concentration

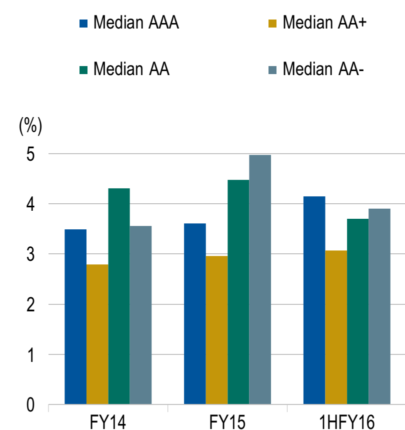
As % of average loans



Source: Ind- Ra. System test result obtained as weighted average of individual bank stress test results

Figure 8

NPA Additions/Opening Loans-Public Sector Banks



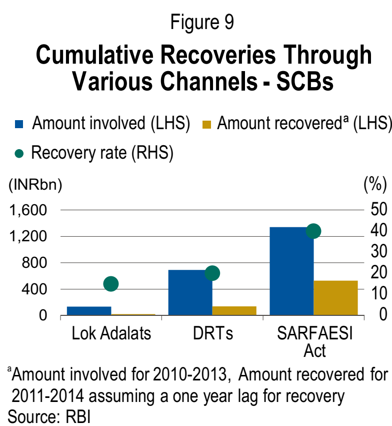
Source: Investor presentations, Basel III disclosures. 1HFY16 numbers are annualised

For the Public Sector banks (PSBs), impaired asset ratio stood at 15.4% as of Sep'15. In the last one year banks have been classifying stressed loans as standard assets with the help of the flexible restructuring and the conversion of debt to equity scheme. Loans worth around INR1.2trn have been restructured under the 5/25 and the strategic debt restructuring (SDR) scheme. As per the trends, fresh NPA accretion for some banks are yet to peak and recovery trends have been lower in this half year, which has led to increases in the NPA ratios. While AAA rated PSBs have seen improvements in their recoveries, the additions to NPA for these large banks have increased this year. Significant decline in recovery rates are evident in the weaker rated PSBs (AA and AA-), indicating the long grind ahead for resolution of the NPA problem.

What can enable a more effective resolution framework and lower credit cost volatility?

Figure 9

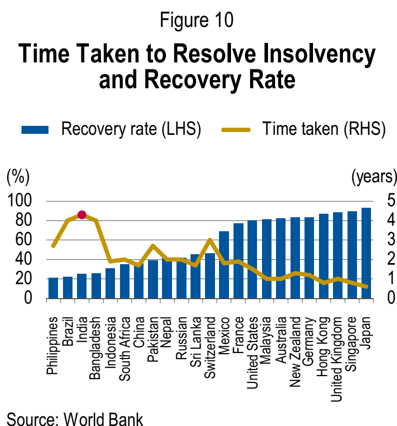
Cumulative Recoveries Through Various Channels - SCBs



[a]Amount involved for 2010-2013, Amount recovered for 2011-2014 assuming a one year lag for recovery
Source: RBI

Figure 10

Time Taken to Resolve Insolvency and Recovery Rate



Source: World Bank

Need for an effective bankruptcy code

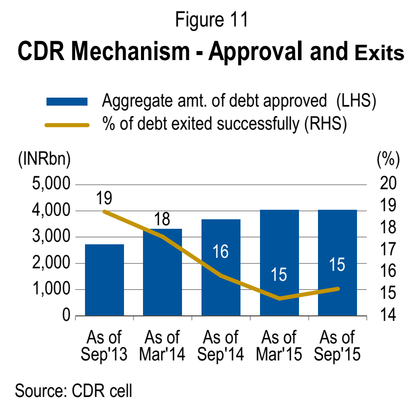
While the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI), 2002 has been a big improvement over the debt recovery tribunals, it has proven to be less effective over the period of time on account of inefficient enforcement and court delays. Average recovery rate has trended around 40% while the time taken to resolve has been over four years. The inefficiencies in the process have led to delay in attempts by lenders to liquidate assets or take management control of the entity in contention. Under the current set of rules, time taken to decide on eligibility of a case takes years in addition to the stretched resolution cycle. World Bank data as of June 2015 indicates that India lags behind most of the emerging market economies in the time taken to resolve cases of insolvency. A government panel has recently proposed for a new bankruptcy code which could be tabled in the current parliament session. The proposed framework prescribes insolvency resolution within 180 days of the bankruptcy application, along with a new regulatory body overseeing the whole process. Ind-Ra believes effective enforcement of the new proposed bankruptcy code could go a long way in relatively quicker resolution of recovery cases and more importantly prove a big deterrent for wilful defaulters.

Concerted asset management approach to stressed asset resolution

As highlighted above the stressed asset problem this time has deeper correlation with the state of balance sheets than the cyclicality of the operating performance and it needs an asset management approach rather than a recovery approach for more efficient realization from bad assets. As the recovery experience from some of the recent large ticket defaults show, liquidation of available collaterals has hardly returned more than 30 cents to the dollar for the lenders. Even some of the recent asset sales have given very low returns for the lenders. Given that most of these large corporate exposures have inherent value over a longer gestation period given significant demand supply mismatches across sectors, lenders need to develop turnaround competencies to prune the balance sheets, hive off unproductive business segments and drive stronger valuations for the core businesses. Banks also need to develop the nimbleness to differentiate between wilful defaulters and borrowers in genuine distress. Recent shift to proactive management of special mention accounts (SMA) through the joint lender's forum seems to be a step in the right direction as compared to reactive CDR cell mechanism. However, this private equity approach to managing bad assets would require significant augmentation in both banks' credit appraisal and restructuring capabilities.

Figure 11

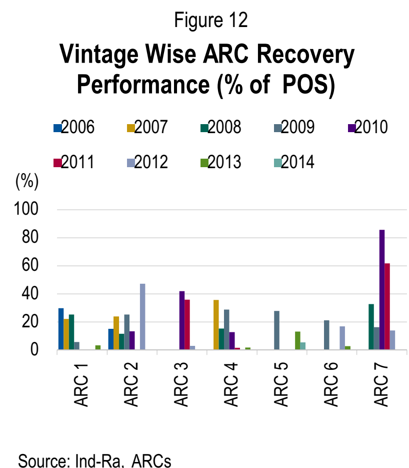
CDR Mechanism - Approval and Exits



Source: CDR cell

Figure 12

Vintage Wise ARC Recovery Performance (% of POS)



Source: Ind-Ra, ARCs

Making ARCs more active and efficient

For efficient resolution of bad assets, there is a need for banks to work with asset reconstruction companies (ARCs) more closely and to make these ARCs more active. Despite RBI's continued efforts India remains far from being a vibrant asset sale market. There are two main issues restricting a higher participation from the ARCs, namely asset pricing and consortium lending complications. To encourage banks to sell their stressed assets with effect from August 2014, RBI implemented the 15:85 regulations for ARCs. This regulation, however, has limited ARCs potential of buying large NPAs as capital remains a constraint. Banks are looking to clean up their books but are unwilling to sell NPAs at a significant discount. Banks need to be more realistic in arriving at the realizable value and have a clear laid-out system for timely disposal of non-performing assets. ARCs usually find it difficult to attract capital if at least 60% of the consortium has not agreed to sell their loans. This issue can be tackled by developing a concept of consortium sale, wherein banks co-ordinate towards collectively selling the non-performing assets. Even in terms of ARC performance, there is need to take an asset management approach to improve their realization from bad assets. As per RBI data the average recovery rate by ARCs (assets resolved as a % to assets acquired) was 31% as of Mar'15. Across all ARC trust pools rated by Ind-Ra, only 21% of trusts had higher recovery than initial view while 51% of trusts had lower recoveries even after 5 years of seasoning.

Building pragmatic capital and provision buffers

The core tenets of credit risk management are precise measurement of risk through credit rating, efficient pricing of risk and finally keeping prudent operating and capital buffers for expected and unexpected loan losses respectively. While the balance sheet provision coverage has come down to a median of 47% for Mar'15 compared to 60% in Mar'11, the median core equity tier-1 (CET1) ratios of PSBs languish around 7% currently. In case of standard assets, there is a general provisioning norm of 0.4% with higher rate for specific sectors. Given the increasing stickiness of bad assets, specific provision coverage needs to be ramped up to close to 70-75% to provide for NPL aging related volatility. Assessing stressed sectors proactively and creating prudent contingent or floating provisions is need of the hour to smoothen any potential volatility from a credit cost spike. Also as Ind-Ra's analysis on large stressed corporates indicates, additional CET1 cushion of 1.5-2% on top of the Basel-III mandated ratios and capital buffers (CCB, CCCB, D-SIB) would be required to address unexpected losses from large concentrations.

Leveraging technology

Finally, in a landscape where RBI has opened up the field for technological disruptors like payment banks on the liability side and small finance banks on the asset side, NPA management also needs to move into the new age. Increasing use of technology would be critical for preventive as well as post delinquency management of non-performing assets. Technology can be used in helping identify the right customers to lend to along with timely dissemination of crucial information pertinent to the lending decision. For example, many small NBFCs use technology to integrate monsoon forecast with Agri-lending to reduce potential stress. Technology can be harnessed to make this information on defaulters available on a real time basis, helping banks recognize wilful defaulters before extending them credit. Technology can be used to create layers of early warning signals customized for each asset type to throw automated red flags for perusal. Further the use of technology can be made in strengthening the internal predictive and pre-emptive analytics framework of the banks to flag off borrowers and accounts, there by focusing on proactive rather than reactive measures.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings and Research has been compensated for the provision of the ratings.

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Asset quality of Indian banks: Are we barking up the wrong tree?

Sujan Hajra
Chief Economist at Anand Rathi Group

Asset quality of the Indian private sector banks compares favourably with the global peers. The recent performances by the public sector banks in managing stressed assets have, on the other hand, been considerably and persistently worse than the private sector banks. This has almost singularly led to the ongoing sharp asset quality deterioration of the overall banking sector. Measures to improve asset quality of the Indian banking system, therefore, need to specifically address issues arising out of the links between bank ownership pattern and asset quality.

Beyond the usual suspects

The marked asset quality deterioration of the Indian commercial banking system has turned into a grave concern for financial stability as well as for the funding of economic activity. Between 2007 and 2015, loans by commercial banks in India increased 2.6 times and non-performing loans (NPL) nearly five-fold (to $50 billion). Standard restructured assets, which are nearly thrice as likely to turn non-performing than standard non-restructured loans, proliferated to $70 billion in 2015, from just $2 billion in 2007. In 2015, 11% of the bank loans in India were stressed - either NPL or restructured.[1]

[1] This article uses both Indian and international data sources. International data are on calendar-year basis; Indian data are on financial-year basis. For convenience of discussion, this distinction has not been made in the written text.

A series of legislative, judicial and executive measures have been initiated to address the situation; many more are in various stages of deliberation and implementation. Yet, issues such as bankruptcy rules, speed of judicial processes, functioning of the credit-information systems or asset-reconstruction mechanisms are still major concerns. Willful default by large corporate bodies is another key source of worry. This article attempts to make two major points.

First, from a global perspective, Indian private sector banks have done well in containing NPLs. Second, the recent performances by the public sector banks in managing stressed assets have distinctly and persistently been worse than the private sector banks. Measures to improve the asset quality of the Indian banking system, therefore, need to specifically address issues arising out of the links between bank ownership pattern and asset quality.

Non-performing loans: India and the world

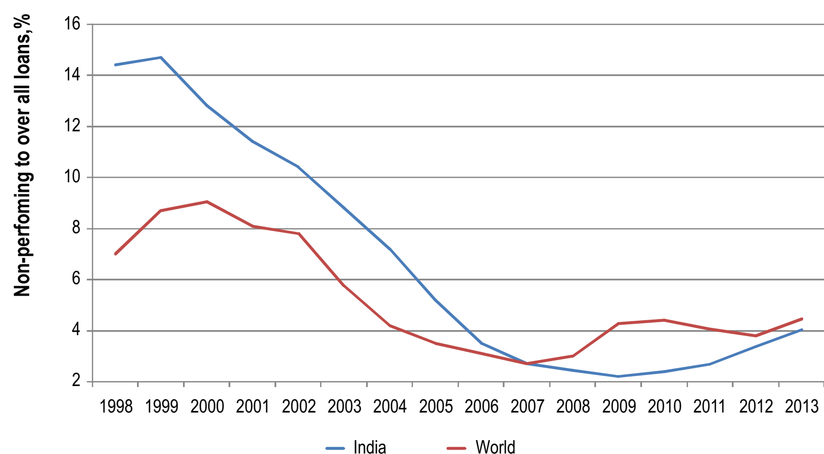
Country-wise data on bank NPL to outstanding loan ratios published by the World Bank show that the ratio for the Indian banks in 1998 was double that of the global average (Fig 1). It improved continuously and converged with the global benchmark by 2007. After the 2008 global financial crisis (GFC), bank asset quality deteriorated across the world-and India was no exception. Yet, since 2008, the NPL ratio in India has been better than the world average.

While the directions of the NPL ratios in India and the world have largely been similar, some differences are evident. For example, with the GFC, the NPL ratio globally started rising in 2008. In India, the ratio bottomed out only in 2009 (versus 2007 for the world). Moreover, until 2011, the worsening of bank asset quality in India was modest by global standards. In contrast, since 2012, the NPL ratio in India has been rising sharply and had nearly touched the global average. World Bank data on country-wise bank asset quality is available up to 2013. Till that year, the NPL ratio in India was lower than the world average, albeit marginally.

A comparison between the asset qualities of the Indian public and private sector banks with the global average throws up three interesting points. First, like banks across the world, the NPL ratio of Indian private sector banks deteriorated with the GFC in 2008. Indian public sector banks, however, bucked this trend. In fact, these banks registered the lowest ever NPL ratio in 2009 and the situation was largely unaltered until 2011.

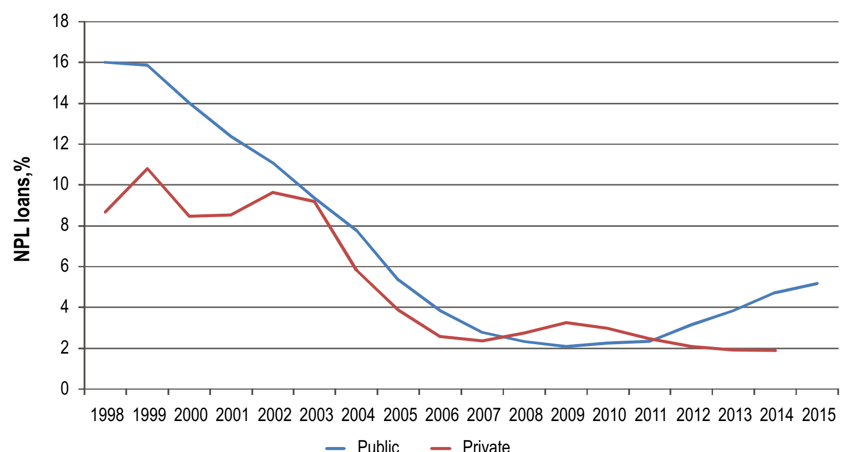
Second, the global NPL ratio started improving in 2011; for Indian private sector banks that came in 2010. In contrast, the NPL ratio of Indian public sector banks started deteriorating substantially only in 2012. In 2013, the NPL ratio of Indian private sector banks was at an historic low, while for Indian public sector banks it was the worst since 2007. Since then, while the private sector banks have largely held to the NPL ratio of 2013, that ratio for Indian public sector banks has been deteriorating substantially. In 2015, the NPL ratio of the public sector banks was at the worst level in ten years (Fig 2).

Fig 1: India ahead of the world in NPL ratio



Source: World Bank, Anand Rathi Research.

Fig 2: NPL of public sector banks in 2015 at a 10-year high



Source: Reserve Bank of India, Anand Rathi Research.

Third, the NPL ratio of Indian private sector banks in recent years has been better than not only most of the emerging market countries but also most of the high-income countries including France, Japan, Germany or the US. In contrast, the NPL ratio of the public sector banks is currently well above the global average of 2013.

Bank asset quality and ownership structure

There is enough evidence to suggest that the asset quality deterioration of the Indian banking system after 2007 is not only predominantly but also almost exclusively a problem of the public sector banks. The following data corroborate this:

- In 2015, Indian public sector banks accounted for 75% of the bank loans and 86% of the NPLs. The private sector banks, on the other hand, accounted for 20% of the loans and 9% of the NPLs. (The balance was accounted by the foreign banks operating in India.)
- The situation is even worse for the public sector banks in the context of restructured assets, in which the share of these banks was 93% in 2015.
- The share of the public sector banks in the overall stressed (NPL plus standard restructured) assets of the commercial banking sector shot up, from 74% in 2008 to 90% in 2015, while that of the private sector banks slid, from 22% to 8% in the same period.
- The stressed assets to loan ratio of the public sector banks jumped from 3.2% in 2008 to 13.2% in 2015, while for private sector banks it rose from 3.4% to 4.5% in the same period. It needs to be recognized that this wide divergence in stressed asset ratios for public and private sector banks were not on account of differences in loan growth during this period since the credit growth rates of both the groups were similar.

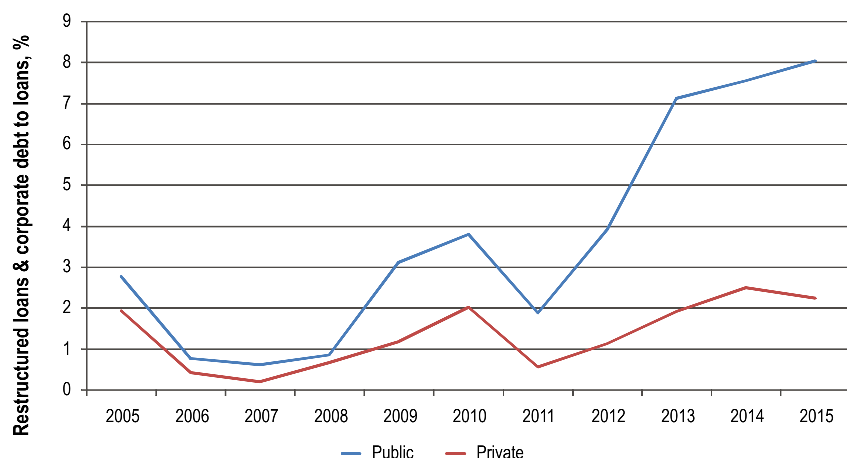
During the upturn in the business cycle, the NPL ratio is likely to fall since loan growth accelerates along with deceleration in NPL generation. The opposite happens during a downturn. On expected lines, banks across the world experienced an increase in the NPL ratio during the global slowdown caused by the GFC (Fig 1). While the Indian private sector banks faced a similar fate, the public sector banks bucked this trend until 2011 (Fig 2).

It appears that while the private sector banks pro-actively recognized NPLs in the thick of the economic downturn in 2008, the public sector banks procrastinated by restructuring increasing portions of potential NPLs. During 2008 and 2009, fresh additions to the NPLs of the private sector banks jumped sharply, while the increases for the public sector banks were largely contained (Fig 3). In contrast, during these years, while the restructured to overall loan ratio of both the public and private sector banks rose, the increase was much sharper for the former than for the latter (Fig 4).

Fig 3: Private banks detected NPLs early

Source: Reserve Bank of India, Anand Rathi Research.

Fig 4: Public sector banks opted for more restructuring

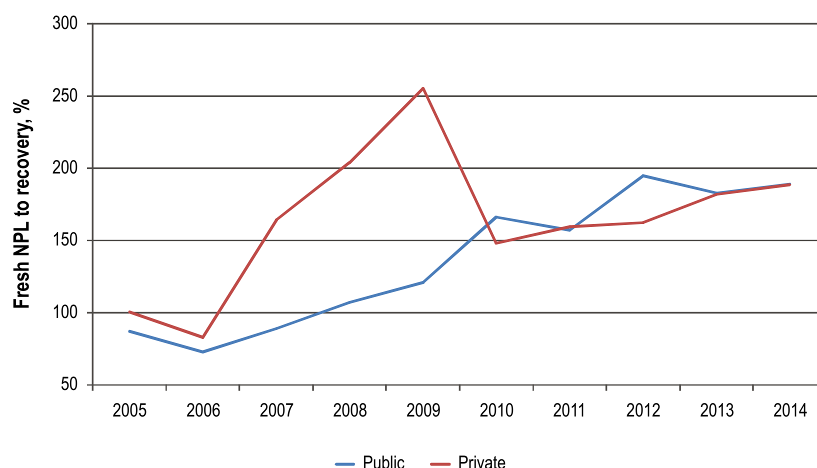


Source: Reserve Bank of India, Anand Rathi Research.

The 'V'-shaped economic growth recovery in 2010-11 helped the public sector banks to temporarily contain the rapid expansion of the stressed asset ratio. The subsequent double dip in economic growth, however, turned out to be a major blow from which the public sector banks have yet to recover. The stressed asset ratio of the public sector banks is rapidly worsening while the private sector banks managing the process in a much better manner.

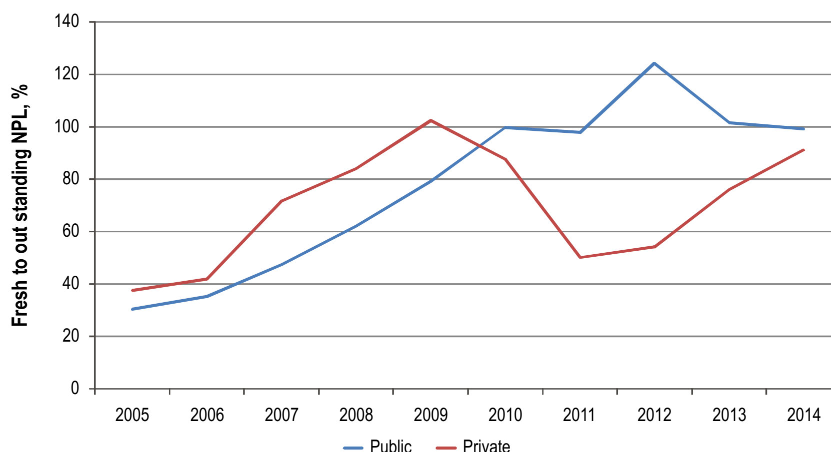
With relatively minor exceptions, during 2005-14 the fresh NPL additions to recovery ratios for the public sector banks were better than those for the private sector ones. Yet, for both the groups the ratios have consistently been more than 100% since 2008 (Fig 5). With the annual fresh additions to NPLs being higher than recoveries of past NPLs, outstanding NPLs began rising, reversing the falling trend over 2002-07. Interestingly, compared to the public sector banks, the growth in additions to the NPLs was higher for private sector banks until 2009; thereafter, it turned the other way around, with 2013 an exception (Fig 3). Similarly, the fresh to outstanding NPLs of the public sector banks were lower than those of the private sector banks until 2009, and reversed thereafter (Fig 6). All these once again seem to suggest that the private sector banks have been more pro-active in recognizing asset quality slippages early and taking the corrective measures. The unwillingness and/or inability of the public sector banks to do the same led to the huge bunching up of NPLs in later years.

Fig 5: NPL generation ahead to recover



Source: Reserve Bank of India, Anand Rathi Research.

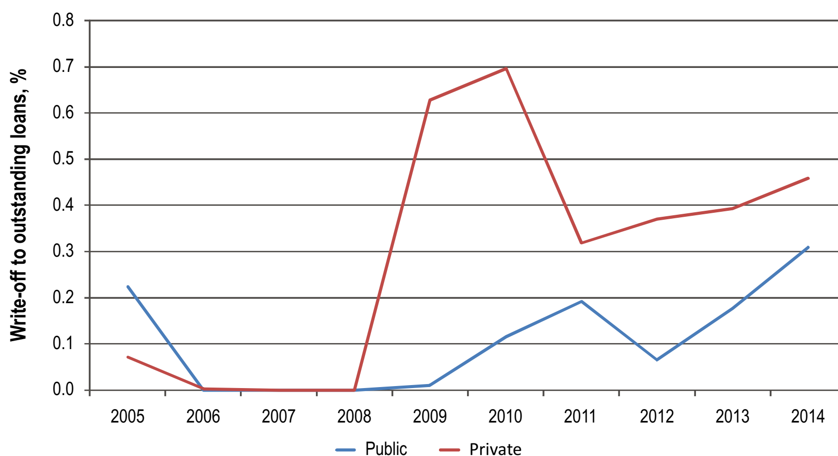
Fig 6: Private sector banks weathered the pain upfront



Source: Reserve Bank of India, Anand Rathi Research.

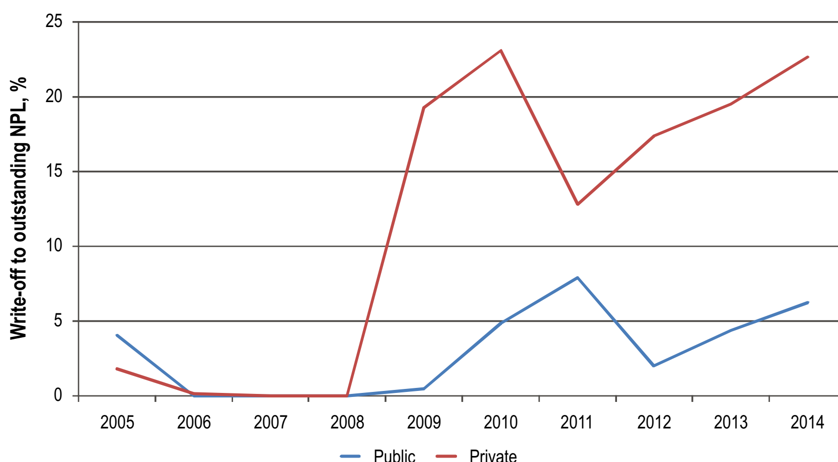
Another major difference between the public and private sector banks in NPL management has been the writing-off of bad loans. Over 2009-14, the written-off NPLs to outstanding loan ratio of the private sector banks, on average, was three times higher than that of public sector banks (Fig 7). As a proportion of outstanding NPLs, the write-off per year for the private sector banks, on average, was four times higher than that of the public sector ones (Fig 8). Consequently, while the public sector banks are carrying many past NPLs, private sector banks have scrubbed their loan books and moved ahead.

Fig 7: Private sector banks taking large write-offs



Source: Reserve Bank of India, Anand Rathi Research.

Fig 8: Public sector banks carrying past NPLs



Source: Reserve Bank of India, Anand Rathi Research.

Each private sector bank is not exactly similar, as also individual public sector banks. Some of the public sector ones, which, by and large, managed NPLs well, include, inter alia, Bank of Baroda, Canara Bank, Corporation Bank and Dena Bank. Similarly, of the private sector banks, some such as DCB, Dhanlaxmi Bank, Federal Bank and Lakshmi Vilas Bank were often faced with relatively high NLP ratios. Performances of private sector banks incorporated before the 1990s (the old private sector banks) have generally been worse than most new private sector banks. Yet, the following points show that, collectively as well as individually, the private sector banks (both old and new) managed their NPL ratios better than the public sector banks since 2011.

- During 2004-10, on average, five of the top-ten banks with the smallest NPL ratios were public sector banks. Since then, on average, not even two public sector banks have made it to this list.
- During 2004-10, on average, six of the worst-ten banks with the highest NPL ratios were private sector ones. Since then, on average, six of the worst banks have been from the public sector.
- In each year since 2005, the top-25 percent of the private sector banks had lower NPL ratios than the top-25 percent of the public sector banks.
- Since 2011, the private sector banks in each quartile did better in terms of the NPL ratio than the public sector banks in the corresponding quartiles.
- In recent years, none of the public sector banks have made it to the list of top-10 banks with the lowest NPL ratios, while the worst-10 list comprises almost exclusively the public sector banks.

First things first

The ownership structure of a bank can have a strong bearing on internal operations, including business objectives, strategies and practices. The external environment, including the institutional arrangements, on the other hand, is largely the same for all banks, irrespective of ownership structure. The decisively worse asset quality performance of the public sector banks in recent years than that of their private sector counterparts indicates the inferior qualities of credit appraisal, monitoring and recovery by the former group. This brings to the forefront the relationship between ownership structure and asset quality performance of banks. As demonstrated earlier, the stressed bank asset problem in India can almost exclusively be laid at the doors of the public sector banks. This unambiguous and marked influence of ownership structure on asset quality performance of banks has to be explicitly recognized and the appropriate corrective actions initiated to address the booming and looming problem.

The necessity to improve the institutional framework for bank loan recovery can hardly be over-emphasized. Yet, such steps, as also the re-capitalization of the public sector banks, are unlikely to structurally improve the asset quality problem of the Indian banking system unless the public sector banks, the predominant part of the banking system, mend their ways of conducting business. The implementation of the recommendations of the Committee to Review Governance of Boards of Banks in India, 2014, (Chairman: P. J. Nayak) for the public sector banks would address many of the constraints and challenges being faced by these banks at present. Improving the employee composition and empowerment of the personnel in the public sector banks for quick and professional decision making are also crucial. It is absolutely imperative that the authorities go after the willful defaulters, especially the big ones. Yet, unless the public sector banks are internally fully equipped/ empowered to guard against such transgressions, the recurrence of such episodes is unlikely to be halted any time soon.

Fresh NPL growth		
	Public	Private
2006	4.3	6.8
2007	17.4	44.5
2008	22.8	47.8
2009	30.6	66.3
2010	42.5	16.3
2011	29.9	-41.4
2012	60.0	13.7
2013	28.6	44.2
2014	36.8	34.9

Fresh NPL to recovery		
	Public	Private
2005	87.0	100.4
2006	72.8	82.9
2007	89.1	164.0
2008	107.1	203.7
2009	120.7	255.3
2010	166.3	148.3
2011	156.9	159.5
2012	194.5	162.3
2013	183.0	182.0
2014	189.2	188.7

Fresh to outstanding		
	Public	Private
2005	30.4	37.6
2006	35.1	41.8
2007	47.4	71.6
2008	62.0	84.1
2009	79.1	102.4
2010	99.7	87.7
2011	98.0	50.1
2012	124.3	54.1
2013	101.7	75.9
2014	99.3	91.2

Write-off to loans		
	Public	Private
2005	0.2	0.1
2006	-	0.0
2007	-	0.0
2008	-	0.0
2009	0.0	0.6
2010	0.1	0.7
2011	0.2	0.3
2012	0.1	0.4
2013	0.2	0.4
2014	0.3	0.5

Wrie-off to NPLs		
	Public	Private
2005	4.0	1.8
2006	-	0.2
2007	-	0.0
2008	-	0.0
2009	0.5	19.3
2010	4.8	23.1
2011	7.9	12.8
2012	2.0	17.4
2013	4.4	19.5
2014	6.2	22.7

Views expressed are personal and may not reflect those of his employer.

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NPA Management in Banks

Vinayak Bahuguna
CEO & MD, ARCIL (India) Ltd.

Execution is key, as is a sensible strategy: this is true for almost any job in the world, and applies equally to NPA management in banks. Napoleon did say famously once, "It's not the size of the weapon that counts, but the fury of the attack!"

So it must be for addressing the scourge of the NPA menace in the Indian banking sector.

Genesis

Almost all bad things have their beginnings in good times. The world saw a meltdown post the Lehman closure; India chose to respond with aggressive counter measures, considerably increasing infrastructure outlay. In a world dealing with the consequences of asset bubbles, we marched along, expanding credit significantly. High property prices, uncontrolled inflation, inappropriate government policies (first telecom, then coal licensing, GARR, retrospective taxation, unbridled State government populist policies et al.) and an unprepared banking system - working on hope & promise (under various pressure groups); a recipe for disaster as it turned out to be.

The consequence of this very difficult situation is many banks today don't have ability to fuel consumption demand and growth. The engine has stuttered and stalled, we are in a chaotic traffic pile up.

Challenges

The foremost requirement today is - recognition and acknowledgment. "Houston, we have a problem", fitting words from the crew of Apollo 13.

The "Ostrich" approach has never worked.

The fraud cases, the cancelled contracts, the holes created by the price crash in commodities - these are dead…gone. Recognize, write-off and move on. Let loose the scavengers to re-coup what they can.

Skills are a huge issue - if you don't know what caused the problem, how will you address it? Insolvent companies need a close and detailed examination. Evaluation is required to assess under which conditions and capital structure (along with any additional capital requirements) are needed to determine whether these companies stand a fair chance of survival. Stress testing, modeling, capital structuring and deal knitting skills are essential. In other cases, the liquidation scenario analysis needs to be market-conditions based and not mere theoretical exercises.

Collecting from NPLs is a hugely demanding and unrewarding job. Strangely but truly, the best talent is hardly ever used there; difficult borrowers, hostile enforcement environment and the "Damocles sword of Vigilance" enquiries about negligence and misconduct makes these jobs most vulnerable to criticism. Furthermore, the pay is never good nor the rewards. Life without incentives is like a boiled sweet sans sugar! Of interest to no-one! This needs fixing on priority basis.

These recovery teams end up negotiating against themselves when it comes to discussions with borrowers. The need of the day is empowered teams comprising collections personnel, legal resources and corporate finance professionals. This group needs to develop enterprise valuation skills and ability to evaluate optimal debt- equity swaps.

Time kills everything; collection teams often ignore that in the vested interest of self preservation. The holding value of loans needs to be understood in a broader context, as too the differentiation with 'Trading Values'.

Valuation jigsaw

The three fundamentals of pricing are - quantum of recoveries, time period likely for realization and working out a present value of the loan. Banks have to get much smarter and better in these three aspects.

Recoveries are fraught with risks - the state of the underlying asset condition, who is in possession of the asset, upkeep standards and market demand. Typically, for closed units the buyer profile is very often junk traders.

In many cases, in the absence of detailed drawings in possession, potential buyers cannot form an opinion of the usefulness, capacity or effectiveness of assets. The valuations have to reflect current market interest levels only and not be guided by written-down book valuation methodologies often used by valuation professionals as a starting point.

Other claims often delay or substantially depress actual realizations. Most significantly, the differentiation in pricing on two important counts needs to be adjusted in values - closed or operating units & working capital security (inventory & receivables) versus term loan securities (land, building and plant & machinery). Time to realization has to factor market conditions, contingent issues and legal challenges.

Finally, the art of setting a market price is key - do banks really have a well-oiled collection machinery of trained and motivated staff with the right incentives? Often that is not the case. The holding cost of bad loans needs to be examined in totality; a valuation based on the three factors enumerated above is the starting point - add to that the overall holding costs: ongoing collection costs, SLR-associated costs and sub-economic priority sector assets commensurate with loan book values. Other benefits or costs need to be factored in as well, particularly the tax impact.

A strategic view then needs to be taken – in-house versus sell-down? Generally a prudent mix of both would be proper. Collections need to be a core competency in banks, but it's not something that is easily achieved; training and resourcing, adequate compensation/incentives, along with strong process and controls are a pre-requisite.

Empowerment and decisiveness is key - if that is not guaranteed, then sell down through a competitive bidding process enables both price discovery & transparency. The choice of the discount rate is critical for a market sales approach - it cannot be the holding cost (deposit rate or opportunity to lend) rate.

Choosing a Discounting rate

The asset is being marketed to potential investors - important to remember that investor expectations are driven by the asset class and issues like uncertainty, probable loss, illiquidity and alternate asset investment opportunities.

What return on NPLs is aligned with market norms? Has to be above lending rates, right? (Because the investor has the option to invest in non-NPL debt at those rates and earns regular interest income and get periodic amortizations).

Public equity is clean and unsecured, but at least liquid. It also is reasonably well supported by widely-available information (declaration of financial results for instance) and market coverage by brokers. So should not the rate of return on NPLs be higher than public equity returns?

Illiquidity, unknown claims, the unknown state of underlying assets and an underdeveloped 'after market' in the machineries etc., means the perceived risks of failure to realize value and the corresponding time-horizon make a case for a higher discounting rate! These rates are typically at least above 20%.

These are the rates required to be used when banks fix their clearing Reserve Prices!

Transaction Overview

A sale decision at banks' level needs to consider the Reserve Price hurdle and additional benefits.

For example - in a case of INR 100 loan value whereas estimated recovery is 5 years away and the holding cost rate is 10% and Net Book Value is 50%, an offer price of 25% of loan value means: the selling bank books a loss of INR 25 but gains immediate income tax savings of approximately INR 23 and further saves INR 25 (holding cost savings) over 5 years! It actually makes a lot of sense to sell then, isn't it?

In the current market with ARCs bidding for assets at minimum 15% cash down payments and balance tied to realizations through Security Receipt (SR) instruments, the benefit of the high discounting rate comes in to play beautifully. The bank can book a loss (if applicable), get the tax benefit of the write-off and then over the next few years expect to earn investment return on the SRs issued at the higher discounting rates. Win-win, let's play!

***Disclaimer**: The author is the CEO & Managing Director of Asset Reconstruction Company (India) Limited and the views expressed are his own; may not represent the views of the organization.*

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Mr. Bahuguna is a seasoned professional with over two and a half decades of experience across the banking sector in Indian and African markets. During his professional journey, Mr. Bahuguna captained several functions at globally reputed banks. A Chartered Accountant by profession, Mr. Bahuguna commenced his career in 1985 in the Corporate Treasury function of an engineering Company. In 1987, he forayed into the banking sector, with ANZ Grindlays Bank. Post an eleven-year stint with the Bank, Mr. Bahuguna moved to Standard Chartered Bank where he headed several corporate banking functions in the next fourteen years. His last job was the head of Alternate investments in India and Nigeria, leading the business in Distressed debt investing. In 2012, he set up his own financial consultancy firm-Vie Capital, offering boutique solutions in stressed assets and mezzanine financing to mid-tier corporates. Mr. Bahuguna joined Arcil in June 2015 as the CEO & Managing Director.

NPA Management in Banks

D R Dogra
Managing Director and CEO of CARE Ratings

The quantum and growth in gross NPA of banks has been inhibiting not just banks profitability, growth, health & solvency but also the overall investments and economic progress of the country. With NPAs surpassing the growth in credit off-take, the deterioration in bank asset quality has emerged as the key issue plaguing the country's banks, surpassing its various other challenges.

The fallout of the bad loan situation of the banks is felt economy wide. The high levels of stressed assets has prompted banks to go slow in their lending and keeping interest rates high. This has been a key reason for credit growth falling to multiyear lows, the direct fallout of which has been the lackluster pick up in investments and tepid economic growth, despite the favorable sentiments the country carries. In case of the banking sector, the increased provisioning that NPAs necessitate has been impacting their overall profitability, liquidity and eroding their capital base especially for public sector banks. It also curtails fresh lending and thereby the future profits from foregone opportunities. Moreover, high NPA levels of banks dent their credibility and highlight the misallocation of funds by banks. It also impacts its market value which has become important as all of them would have to keep accessing the market to meet capital requirements under Basel III. Further, the shortfalls in liquidity add to the costs and operational difficulties for banks.

The increase in bank NPAs (from 2.4% in Mar'11 to 4.6% in Mar'15) can be attributed to both external and internal factors. If the quantum of restructured assets is added, the number would be in two digits. The persistent weakness in global and domestic demand conditions in recent years coupled with domestic administrative and governance issues have resulted in the buildup of stressed assets in various sector such as steel, power, aviation, real estate, mining to name a few. These being exogenous factors, banks have limited control over them. On the other hand the inefficiencies in the collection & recovery process of banks, flawed lending practices, inadequate post disbursal monitoring, willful defaults by borrowers, shortfalls in the credit appraisal & risk management practices and administrative shortcomings are some of the issue internal to the banks that have been contributing to the buildup of stressed assets of banks, all of which require to be addressed in a time bound manner.

Although at the aggregate level, the NPA and stressed asset levels are high for the Indian Banking system, the same is not uniform across the bank groups (public and private banks) in the country. It is notably higher in the case of public sector banks. The public sector banks, owing to their large size and domination position in the banking space carry larger NPA burden than private sector banks as they have also tended to lend more to the non-retail segment which involves larger investments and hence higher exposures which become vulnerable to business cycle. Also, the debt management policies, practices and administration adopted by the private and public banks differ significantly, and can be in part credited for the private banks having lower NPAs.

Adequately addressing and managing the stressed assets of the banks is essential for the health of the country's banking system. The banking sector is in a way the barometer of the economy and any revival in the latter hinges on the health of its banking sector.

Tackling NPAs

With banks having the liberty to devise their own policies and framework for the debt management and recovery, a multi-pronged approach and strategies need to be adopted to deal with NPAs. At the policy level too i.e. RBI and government, concerted efforts need to be taken to improve the situation. Although various regulatory and policy initiatives have been taken, the implementation of these need to be focused upon.

All the measures in essence should be effective in preventing assets from turning bad and offer remedial and corrective solutions. Although all banks do have in place measures in preventing and dealing with NPA, at times they are found to be inept.

Enumerated here are some of the ways for dealing with banks NPAs

1. Scrutiny and Appraisal

As NPAs reflect the quality of loans extended, banks need to have a detailed scrutiny and appraisal of the client profile as well as the project for which loan is being extended. Inadequacies in the appraisal process have been one of the main factors leading to NPA. In case of project appraisal, banks are found to be in need of adequate relevant technical expertise. Banks should develop this. Some banks have been relying progressively on the credit ratings given by the external credit rating agencies, which is pragmatic as it offers an independent view on the credit worthiness of the borrower which is free from commercial bias. Banks should also have a mechanism for strict monitoring of the end-use of credit and curtail the diversion of funds borrowed from banks for activities other than for which it was sanctioned.

2. Early Identification of stress

Regular monitoring of the performance of the loan account could help in the early identification of stress and suitable measures can be undertaken for the recovery of bank dues and revival/restructuring of the account. Efficient MIS systems of banks should be designed and maintained. Banks need to recognize the benefits of early identification as it would mean detecting the problems before they set in. again here the monitoring done by the credit rating agencies through the surveillance exercise could be a useful pointer for banks.

3. Addressing default effectively

While willful defaulters need to be dealt with strict and tough actions, defaults that are due to genuine constraints need to be treated differently and addressed in sensitive and responsive manner. Banks should use their resources (staff who possess expertise in evaluation/investigation of the financial transaction and factors that have led to stress and prospects for revival) to identify the borrowers with genuine commitments

and those who carry potential for revival, extend their support in a prompt and timely manner by way of additional funds/ restructuring to help in their revival. For non-viable cases, banks should device appropriate compromise and recovery solution. This may involve selling of asset, adjustment with collaterals, partial write-off and taking over the management (converting debt to equity)

4. Risk Management

Risk management in banks should involve proper quantification of risk (expected and unexpected) and the pricing of risk should have a sound scientific basis. For effective credit risk management, banks should conduct at period intervals in-depth industry studies have credit audits of borrowers, visits to client business/ plant sites and conduct periodic review meetings for assets, all of which should have the active involvement of the top management. The risk management should also focus on the proper (realistic) structuring of the loan and advances based on an analysis of the cash flows of individual clients. This would greatly facilitate in timely repayment by borrowers. Having a standardized structure for all clients of the banks would not be in the interest of banks or the clients. In case of long term loans the bank would do well to have flexible structuring with option of refinance from time to time as well as to accommodate cost overruns.

5. Debt recovery

Debt recovery has all along been a challenge for banks, more so during troubled economic times. Data shows that banks do not recover more than 20% of the NPV when a default takes place. The recovery policies of banks should be based on the reasons for the loan turning bad rather than adopting a uniform policy for all stressed assets. In cases where recovery is not possible, they should look to exiting the account. Bank can choose to tap legal options as a means of exit. They could also arrive at a comprise and decide on a settlement which could involve write-off. This option should only be exercise as a last resort and such settlement should be done in a transparent manner. Bank management should have a policy which frames the conditions and circumstances for write-offs.

6. Restructuring

Restructuring of loans is the most sought option in dealing with stressed assets. It should essentially be used only for those borrowers who were faced with financial constraints on account of factors (internal and external) out of their control. Restructuring should involve an in-depth evaluation of the viability and potential for revival of the account. Only following a thorough and objective assessment, banks should take upon the restructuring. The aim of restructuring should be to facilitate the revival of viable entities and thereby lower the losses to lenders.

7. Selling to ARCs and other financial institutions

Banks can sell their NPAs to other financial institutions viz. others banks, securitization and asset reconstruction companies (ARCs) who have the expertise in recovering and dealing with stressed assets and thereby reducing the level of NPAs in the banking system. ARCs by buying stressed debt of banks help them improve their balance sheets and also make available funds to banks. There has been an increase in the sale of bank NPA's in the last 2 fiscals (from around Rs.10,000 crs to around Rs.50,000 crs). Although ARCs and securitization companies help banks with their stressed loans, owing to their low capital base and difficulty in raising capital provide for limited relief- the net worth of ARCs is around Rs.4000 crs while the NPAs of Scheduled Commercial Banks was Rs.3,09,408 crs as of Mar'15. Also, the high acquisition cost of assets, which has nearly doubled in the last 2 years, has been an inhibiting factor. Purchase by these companies (ARC and Securitization) accounted for only around 16% of bank NPAs.

8. Undertake Credit Rating of clients

Credit ratings evaluate the debt servicing ability of borrowers and serve as an effective and vital tool for risk measurement. Credit Rating, treat the debt as being in default/stressed (and subsequently downgrade the rating to default category) if the debt servicing is delayed by even a single day, as opposed to banks who have a 90 day timeframe and thus can provide for the early warning signals to banks about weakness in asset.

The bank loan rating (BLR) undertaken by credit rating agencies is used by banks to determine risk weights for their loan exposures, as per the RBIs capital adequacy framework. Bank stand to earn capital relief by getting the exposures rated, provided the rating falls in the investment grade. This in turn helps banks save on cost incurred for raising capital to meet its capital adequacy requirements. In addition, banks can leverage the additional capital and earn margins on such lending

The rating exercise assesses future cash generation capability and their adequacy to meet debt obligations as per the repayment terms. It also covers the analysis of the fundamentals of the business and the industry and the probabilities of change in these fundamentals, which could affect the creditworthiness of the borrower. In addition to this, qualitative factors such as management capabilities too are analyzed. The credit rating thus arrived at is a superior indicator of the credit quality of the borrower/account.

The bank loan rating by credit rating agencies typically includes the rating of all fund-based and non-fund based facilities sanctioned by Banks (this include cash credit, working capital demand loans, Letter of Credit, Bank guarantees, Bill discounting, Project loans, Loans for general corporate purposes etc.).

9. Debt recovery tribunals

Banks have the option of approaching the debt recovery tribunals and apply the SARFESI Act (Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act) when the other methods of debt recovery and management fail.

10. Information sharing

Sharing of information about borrowers with other lenders (other banks and financial institutions) will help in the management of stressed assets at the system level.

Concluding remarks

The delays in processes viz. judicial, results in delays in the resolution of NPAs, which is also a factor that has come in the way of India's rank in the ease of doing business. The country needs to have a bankruptcy framework, which the government is currently working on. The proposed bankruptcy law does enumerate a way out whereby all creditors are involved which take a decision on such companies. A resolution process would run for 180 days after which a majority view of 75% of creditors would come into force. What is of essence is that banks must have in place processes to ensure that NPAs do not get created through careful credit appraisal and monitoring until the loans is repaid. At the government and institution level, there need to be strictures in place to ensure that these NPAs do not proliferate and that when they do, are addressed through suitable resolution measures, as in the bankruptcy code. This is essential to maintain the sanctity of the banking system.

D R Dogra
Managing Director and CEO of CARE Ratings

D R Dogra is Managing Director and CEO of CARE Ratings, which is the second largest credit rating agency in India in terms of rating income. After a stint of 15 years in Dena Bank, he joined CARE in 1993.

Born in September 1954, he has over 37 years of experience in the financial sector in the areas of banking and credit rating. He has been instrumental in driving CARE Ratings to the position which it has attained in the last few years and has also taken the company to the bourses where it got listed in December 2012. Several initiatives have been successfully taken under his leadership such as acquisition of Kalypto Risk Technologies (a risk management solutions company), opening of first global branch in the Republic of Maldives, setting up the first credit rating agency in Mauritius, forging ties with other global rating agencies in creation of a global rating agency, ARC Ratings (with partners from Brazil, Malaysia, Portugal and South Africa). He also worked closely with the Ministry of Finance, where CARE has prepared a dossier on the Indian Economy as well as white papers on both the equity and debt markets for the Ministry.

By means of qualification, he holds a Bachelor's and a Master's degree in Agriculture from Himachal Pradesh University and MBA from Faculty of Management Studies, University of Delhi. He is a certified associate of the Indian Institute of Bankers.

Agenda for a rebound in public-sector banking

Ashu Suyash
Managing Director &
Chief Executive Officer of CRISIL

Indian banks have been stuck in an abyss for the last few years, with things getting worse progressively and asset quality belying every expectation of improvement. However, the jury is out on how deep the abyss is and what can be done to get the banks out of it and back on track.

Impaired asset quality has meant a sharp increase in provisioning that, in turn, has severely impacted profitability. And poor profitability has resulted in low capital accrual, especially for public sector banks (PSBs). The inability of PSBs to raise capital at attractive valuations has meant they continue to depend on the Government of India for growth money. And this pressure on accretion comes at a time when banks are required to increase their capital base to meet Basel III regulations. The upshot of it all is that PSBs have turned chary of lending, especially to stressed sectors.

In the past, gross non-performing assets (NPAs) data were an adequate reflection of the asset quality of a bank. That, however, is no longer a sufficient yardstick because stressed assets are benefiting from classifications afforded through various schemes permitted by the Reserve Bank of India (RBI). To be sure, not all assets under these schemes are likely to degenerate into NPAs, so while simply adding them up does not paint a true picture of stress, consid-

ering them to be absolutely safe would also be a mistake.

At CRISIL, therefore, when evaluating the asset quality of a bank, we use a proprietary framework to calculate what we call 'weak assets'. What we do is add a portion of assets classified under various schemes that we believe could turn non-performing over time, to the current NPAs. 'Weak assets' is the sum of current NPAs + 35% of outstanding restructured assets (excluding state power utilities and Air India) + 75% of investments in security receipts of NPAs sold by banks + 15% of assets flexibly structured under the 5/25 scheme.

With weak assets expected to increase 20 basis points to 6.3% (or Rs 5.3 lakh crore) in fiscal 2016 from 6.1% at the end of last fiscal, we expect asset quality pressures to persist in the short term. The relentless stress on asset quality stems from high slippages following withdrawal of regulatory forbearance on restructuring from April 1, 2015, and high slippages from the stock of restructured assets (40% of assets restructured between 2011 and 2014 have backslid into NPAs). We expect slippages to touch Rs 2.3 lakh crore (~3.2%) this fiscal.

We expect gross NPAs to increase by 30 basis points to 4.6% (Rs 3.9 lakh crore) by the end of this fiscal. This would have been more but for the leeway afforded by the RBI to banks through schemes such as flexible structuring of long-term loans (the 5/25 scheme) to existing and new projects, and conversion of debt to equity under strategic debt restructuring (SDR). At the start of the current fiscal, CRISIL had expected Rs 80,000 crore of stressed assets to be structured under the 5/25 scheme, but banks are expected to top that - using both the 5/25 and SDR routes - in the first nine months itself.

Today, more than 60% of bank exposure is to large corporates and SMEs that are dependent on a turnaround in the economy, so any meaningful improvement in asset quality will hinge on the timing and pace of that rebound.

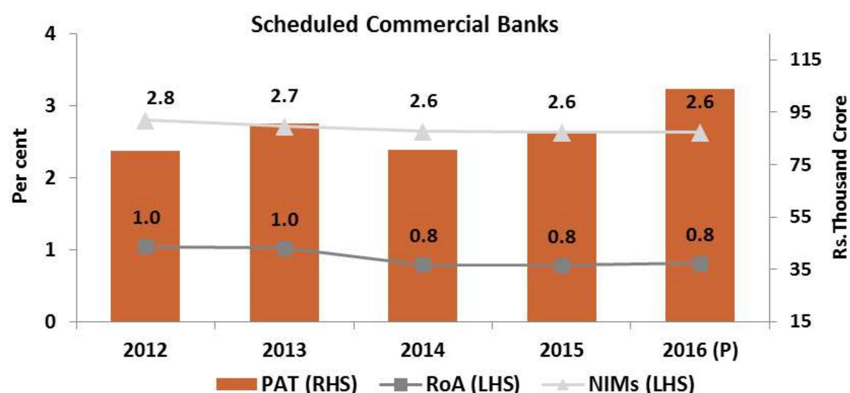
Profitability of banks to remain under pressure in the near-term

Because of asset quality challenges, CRISIL believes profitability of the banking sector will remain under pressure this fiscal with return on assets (RoA) flat around 0.8%. Net interest margin (NIM) will also remain more or less flat at 2.6%, while provisioning costs are expected to stay high.

While banks have benefited because of the RBI schemes, inability to sort out stressed assets will only mean delaying recognition of NPAs and a spike in provisioning down the road. This means profitability of banks could remain subdued over the next few years. The RBI directive asking banks to calculate their base rate using marginal cost of funds instead of average cost will put additional pressure on profitability starting next fiscal.

Trends in asset quality of Indian banks

	Mar-12	Mar-13	Mar-14	Mar-15	Mar-16 (P)
Gross NPAs (as % of gross advances)	2.90%	3.30%	3.90%	4.30%	4.60%
RSA (as % of gross advances)	4.6%	5.10%	5.20%	5.50%	4.10%
RSA ex-SPUs (as % of gross advances)	3.3%	3.50%	3.90%	4.30%	3.10%
Weak assets(as % of gross advances)	4.10%	4.30%	5.20%	6.10%	6.30%
Gross advances (Rs lakh crore)	51.6	59.9	68.8	75.7	85



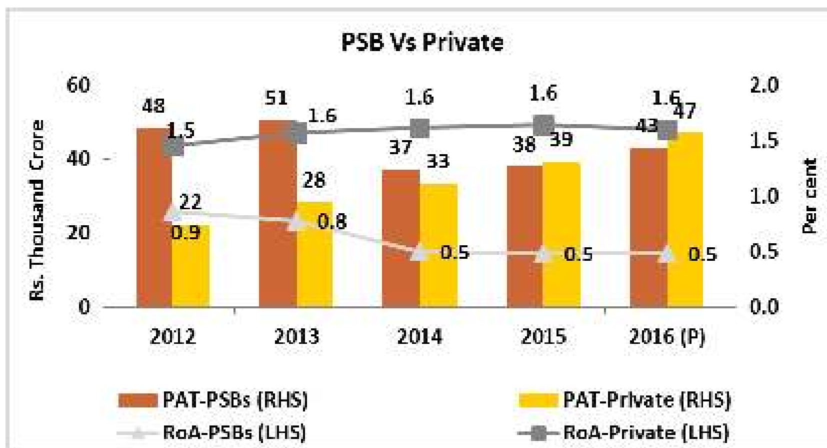
Source : RBI, CRISIL

Big Divergence in asset quality and profitability of public and private banks to continue

By the end of this fiscal, weak assets of PSBs are expected to be 7.3% compared with 2.8% for private sector banks. And RoA for private banks is seen around 1.6% -- driven by better NIM and fee income -- compared with 0.5% for PSBs. Private sector banks have performed better due to their lower exposure to infrastructure, power, steel and other cyclical sectors and higher exposure to the less-affected retail sector (¬40% of advances against ¬18% for PSBs), apart from having a better liability profile. CRISIL expects private sector banks to continue outperforming public sector peers in this fiscal.

For PSBs, while the Government of India will continue to provide capital support (Rs 0.70 trillion committed over the next 4 years), there are indications the finance ministry has asked banks to start tapping other channels to raise equity. But that won't be easy given their muted profitability and difficulty in diluting government's stake because of poor valuations. Further, because of the riskier contours of non-equity Tier I instruments, investor appetite will decide how much money is raised through this route. Consequently, CRISIL expect PSBs to grow at significantly slower pace than private sector banks over the next four years.

Indradhanush, the Government of India's seven-rayed plan to revamp PSBs launched a few months back is a step in the right direction as it takes cognisance of - and tries to address the critical problems impacting - performance including governance reforms, especially accountability and capitalisation. The success of the plan though will depend on relentless implementation over the medium-term.



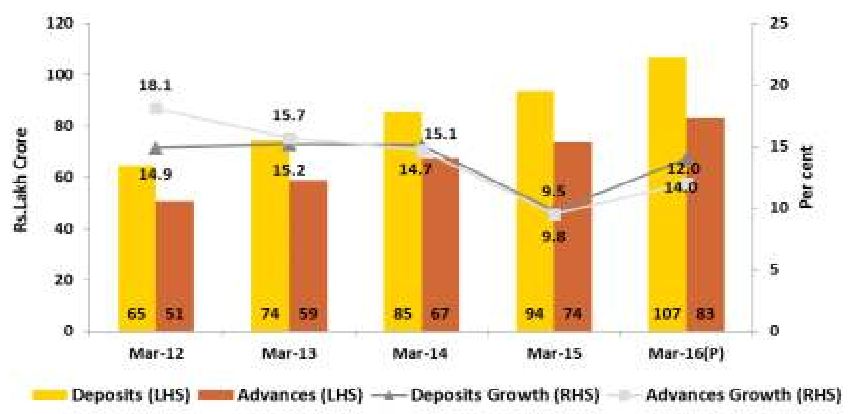
Growth will remain subdued

Credit growth in the last fiscal was at decadal low of ~9.5% mainly due to significant slowdown in lending to the corporate sector given the slow off-take in projects and negligible capital expenditure. Growth continues to be muted around low single digits in the first half of the current fiscal. CRISIL expects credit growth to stay subdued at ~11-12% this fiscal, riding on retail, agriculture and small and medium enterprises. Political will to undertake big-ticket reforms, and improvement in capacity utilisation signalling uptick in demand will be the key drivers for corporate investments in the near term. This, in turn, will result higher credit growth over the medium term.

We are also likely to see a widening of the gap in credit growth between private and public sector banks over the next few years. That's because the capital position of PSBs has weakened in recent years due to low accrual. And given their weak equity valuations, capital raising from external markets will be limited. As a result, CRISIL expects PSBs to grow much slower ~12% between 2015 and 2019 - or half the pace of private sector banks.

Capitalisation adequate, but capital raising challenge tougher for PSBs

Banks are currently adequately capitalised with Tier I capital ratio and overall capital ratio at 10.9% and 13.4%, respectively as on March 31, 2015. However, the cushion over regulatory minimum capital is thinning and hence banks will need to raise a significant amount of capital- Rs 4.7 trillion till March 31, 2019, to meet Basel III norms -- Rs 2.6 trillion by PSBs and Rs 1.1 trillion by private banks up to March 2019. Of this, Rs 1 trillion has been raised so far.



Changes in the regulatory landscape can lead to structural improvement over the longer term

The operating and regulatory landscape of banks has witnessed several changes that are likely to result in structural improvement over the long term. The RBI has taken many critical measures to structurally strengthen the credit risk profile of banks. These include setting up of the Central Repository of Information on Large Credits, the Joint Lenders' Forum, guidelines on reporting of Special Mention Accounts reporting, 5/25 structuring, structural debt restructuring, and the wilful defaulter framework.

What can be done to come out of the quagmire?

These challenging times raise several key lessons which, if imbibed and implemented, can lessen the pain for banks to a considerable extent over time.

Taking prudent call on oversize exposures

During economic upturns, banks chase greater returns through large-ticket corporate lending and get trapped. Taking exposure (even with topnotch corporates) disproportionate to capital has been the bane of banks in India. Such large exposures, when under stress, severely impact profitability for two reasons: no income is generated out of them, and the bank has to make provisions for those accounts. Further, inordinate amount of time is spent by banks in recovery, which could otherwise have been used for other productive purposes. In addition, mid and small size banks do not have the ability to efficiently recover dues from large borrowers. Being part of large consortia, these banks are normally bound by the decisions of larger peers that may not entirely be in their favour. Therefore, limiting the size of advances as well as the number of such accounts will go a long way in reducing concentration risk.

PSBs need to increase retail focus

Typically, PSB branches are not designed to lure retail loans, but they are good at deposit mobilisation given their halo of safety. Retail loans, on the other hand, are more granular so the risk is better distributed. Branch-based retail loans not only push up the growth rate but also help build a relatively safer portfolio. Not surprisingly, the share of retail advances of private banks is far higher than that of PSBs. While PSBs have, of late, turned their focus to the retail sector, adequate systems and processes and credit controls are needed -- and must be adhered to - else such programmed lending driven by branches can become a major source of delinquency.

System to generate early warning signals an imperative

A crucial requirement for recovery of loans is nimble-footedness. The old adage of 'Well begun is half done' applies very well to recovery of loans. A well-designed loan monitoring system capable of closely tracking key developments in the borrower's business as well in the industry, and their impact on business and financial health of borrowers is essential. Besides, the mechanism should provide for timely transmission of these signals to the bank and facilitate decision-making.

Need for tighter legislation for loan recovery

Multiplicity of laws and archaic provisions make the legal route for loan recovery extremely cumbersome and frustrating for lenders. Completion of legal procedures within a defined timeframe will instill a sense of discipline among borrowers to play the game as per rules. The proposed bankruptcy law, we believe, is a step in the right direction.

Higher functional independence of top management coupled with accountability

Giving senior leadership of banks longer tenures and greater autonomy in decision-making, while holding them accountable for decisions are among the desirable changes that can substantially improve the performance of PSBs. In addition, having a majority of independent directors on boards will improve corporate governance practices. In that sense, the Indradhanush plan includes all the right steps.

Ashu Suyash
Managing Director &
Chief Executive Officer of CRISIL

Ms. Suyash oversees all of CRISIL's domestic and global businesses and leads CRISIL's efforts to deliver high-quality analyses, opinions and solutions to its rich and diversified client base, which ranges from small enterprises to large corporations, investors, financial institutions, governments and policymakers based in India and around the world.

She has over 26 years of experience in the financial services sector. Prior to joining CRISIL in June 2015, she served as the Chief Executive Officer of L&T Investment Management Ltd. Prior to that, she was the Managing Director & Country Head of Fidelity's Indian asset management business. Earlier, Ashu was the Head of Strategy and Business Development at Citibank India.

Over the years, Ms. Suyash has been recognised among the Top 50 Women in business in India and in Asia several times by various publications.

She has a keen interest in the education sector and is associated with the Board of Studies at NMIMS, with N M College and is on the advisory boards of the Chartered Institute for Securities & Investment and Aseema Charitable Trust, an NGO with a mission to provide education to the underprivileged children.

NPA Management in Banks

Sandeep Kumar Gupta
Partner, Dhir & Dhir Associates,
Advocates & Solicitors

Introduction

One cannot comprehend an economic and industrial growth without a healthy banking industry. The banking sector acts as the catalyst for the country's economy playing an instrumental role in providing financial resources especially to capital-intensive sectors such as infrastructure, automobiles, iron and steel, pharmaceuticals, healthcare etc. From the Indian perspective, the economy was on the upside during the period 2002 to 2008, which saw a credit growth of around 22% pursuant to by all the banks/FIs across various verticals. The scenario continued to be healthy until the economic slowdown across the globe from 2009 and onwards, which adversely impacted Business across the globe and the Indian economy was no exception. The continued slow down resulted in a speedy deterioration of financial health of companies leading to failures in meeting their debt obligations to the Banks/FIs, and the resultant growth in the NPAs of Banks/FIs. Apart from global slowdown, the increase in NPAs is also attributable to reckless lending by some banks in the past, improper monitoring of borrowers' accounts, higher interest rates etc. The menace of NPAs is ever growing as companies across various verticals which have amassed huge debts are not in a position to service the same.

Since March 2011, NPAs of the banks

have been increasing; at the end of March 2015, the gross NPAs of the domestic banking system were 4.62 per cent of gross advances as compared to 2.36 percent of gross advances as at March 2011. The total stressed assets in the banking system (which includes GNPAs and restructured standard assets) as at March 2015 made up 11.06 per cent of the total advances of the banks up from 10.7 per cent in September 2014. In absolute terms, 40 listed Indian banks were having GNPAs of more than Rs. 3 trillion at the end of March 2015[1]. NPAs for the Indian banking system are likely to deteriorate further as a large number of restructured advances are likely to slip into the NPA net, specially the Infrastructure (mainly power, telecom & roads) sector loans. The infrastructure sector constitutes 31% of the total NPAs of Public Sector Banks whereas it constitutes 18 percent of the total NPAs of Private Sector Banks.

Continued domestic economic weakness and the liquidity crunch has had a twofold impact on the banking industry, viz. reduced growth in the advances and a surge in the growth rate of NPAs, which has accelerated the stress in the Indian banking system and in the event the economic situation does not improve, the health of the Indian banking sector may further get adversely affected.

The need of the hour is to have robust mechanisms in place which are capacitated in improving the system's ability to deal with menace of NPAs and which encompass both preventive and remedial measures, to be able to contain the surging NPAs and to plug its inherent evils of drain on the Banks' profitability and loss of value to all stake holders.

The impetus of the Banks/FIs should be firstly to adopt proactive preventive mechanisms which at the first instance curb any fresh generation of NPAs and if thereafter there are

slippages, for external reasons or reasons beyond the control of the Banks, necessary remedial measures should be adopted by the lenders for managing its NPAs.

Preventive Measures:

Improving the credit appraisal standards is the key to a healthy credit portfolio and consequent prevention of NPAs. In the past, reckless lending by banks without appropriate credit appraisal of the project and its financial needs has been one of the significant reasons for the present state of NPAs. The viability assessment parameters need to be strengthened and stress should be laid on carrying out an independent techno economic viability study of a project before the banks proceed to carry out any kind of lending. The banks should strive to enhance their in-house capabilities for the same and if required should engage independent experts and professionals in the field for establishing the techno economic viability of the project. The Banks should also keep a more realistic approach while stipulating repayment schedule which should be solely based on the expected cash flows of the project rather than on the basis of a thumb rule which may be applicable to all and sundry. The banks need to come out of their thought process of `one size fits all' and accordingly stipulate realistic repayment schedules. In many cases it has been observed that due to delays in completion and commencement of projects the repayment commences even before the facility has actually commenced commercial productions which itself marks the beginning of stress in the accounts right from inception. In line with the above perception the Reserve Bank of India in July 2014, introduced a flexible financing scheme allowing banks to extend long term loans of 20-25 years to match the cash flows of projects while refinancing them every five or seven years (commonly known as 5-25 scheme). Further during the course of appraisal it is imperative to factor in any contingency credit facility to enable the company to finance the cost over runs / project delays which may arise in future. In the absence of such a mechanism it is seen that in many cases, either there are delays in sanctioning of additional loans to meet the cost over runs or such loans are not sanctioned and the borrower utilizes the working capital funds for meeting its long term fund requirements which marks the commencement of vicious circle of working capital depletions, under utilizations of capacities, non generation of sufficient EBIDTA and non servicing of Banks' interest etc.

[1] Source – Compiled from the data at Indian Banks' Association's website

Another important measure is to strengthen the monitoring of the credit extended by the Banks which may include meaningful site inspections, quarterly audits, in depth analysis of the financial results of the borrower on a quarterly basis stricter norms for stock audit and audit of receivables etc. which may help the lender in detecting warning signals at an early date lest the issues assume monstrous proportions.

Strategic Debt Restructuring:

To further address the issue of growing NPAs and with the underlying objective that `equity stake holders should bear the first loss than the debt holders' the RBI came up with fresh guidelines, in June 2015 enabling a change in the management of the borrower companies, when the operational/ managerial inefficiencies are observed to be one of the reasons behind the continuation or aggravation in the stress being felt at the borrower company. The guidelines stipulate provisions for transferring equity of the company by promoters to the lenders as compensation for their sacrifices, further infusion of promoter-equity and transfer of the promoters' equity holdings to a security trustee/held in an escrow till 'turn-around' of company.

Under the strategic debt restructuring (SDR) mechanism in order to achieve the change of ownership/management at the borrower company, the consortium of banks and financial institutions / lenders under the JLF may collectively become the majority shareholder by converting their dues into equity, subject to the statutory limit set under the Banking Regulation Act, 1949. Supporting the efforts and through prompt inter-regulatory coordination, the Securities and Exchange Board of India (SEBI) has issued notification regarding fixing of conversion price and lock-in period and providing for necessary exemptions for banks from the takeover rules thus allowing them to convert debt to equity of companies, under SDR, without having to make mandatory tender offers to minority shareholders. The shares so acquired to be divested by the lenders in favor of a `new promoter' at the earliest.

The SDR gives an incentive to the lenders to maintain a `status quo' to asset classification for a period of 18 months from the date of invocation of SDR by the JLF and also a breather from making further provisions for the sated period of 18 months. Upon divestment of the shares in favour of the new promoter the lenders may also consider re-financing the debt which shall be considered as a `Standard Asset'. SDR addresses both the issues of safeguarding value of assets of viable entities by ensuring continuity of operations, albeit under a new management, while at the same time it also addresses the lenders concern w.r.t. the NPA status of an advance account as any change under the SDR will not be considered as a restructuring. To further strengthen the Banks, the RBI issued fresh guidelines, in September 2015 permitting the lenders, to effect a Change of Management outside of SDR, by invocation of pledge of shares of the borrower entity.

Remedial Measures

1. Restructuring of Debt:

Despite the best possible preventive measures being in place, a slippage in the account cannot be ruled out which may be attributed to several reasons beyond anybody's control. Once the account starts showing signs of slippage or mortality the Banks, in genuine delinquent cases affected by external factors and keeping the wilful defaulters at bay, should actively consider restructuring of the same in order to arrest the slippage and keep alive the hopes of revival of the account. Till March 2015 the Banks were keen to restructure the potential NPAs as the RBI guidelines provided regulatory forbearance and such restructured accounts were not to be classified as NPAs, subject to fulfilment of certain conditions. However, post March 2015 there has been a marked reluctance on part of the Banks to undertake restructuring as the incentive of asset classification as `Standard' is no more available, which is evident from the fact that since March 2015, no accounts were referred to CDR Cell by Banks. There is an urgent need to bring a change in such a thought process as preserving economic value of assets in case of viable units and minimizing the loss to the stake holders is of larger importance for the overall economic growth as compared to `Asset Classification' and `Provisioning' to be made in the banks' financial statements.

2. Corporate Debt Restructuring Mechanism:

Presently the restructuring of debts is undertaken either on bilateral basis or through the CDR forum (in case of multiple banking and aggregate debt being in excess of Rs.10.00 crore). However the success rate of structuring undertaken by the CDR is not very encouraging. The CDR restructurings have only been reduced to `mere ever greening' of accounts rather than addressing the real problem. Most of the CDR schemes are vanilla schemes encompassing deferment of repayments, reduction in interest, part conversion of debt into Equity/Preference Capital or any other debt instruments etc. as such the same has also not been able to fully accomplish the end for which it was envisaged.

3. Joint Lenders' Forum and the Corrective Action Plan:

The RBI came up with a fresh set of guidelines in February 2015 `Framework for Revitalizing Distressed Assets in the Economy' which recommended setting up of Joint Lenders' Forum (JLFs) for early identification of stressed assets and formulation of corrective action plan (CAP) to bail out viable units which are presently under stress and to initiate recovery action against the un-viable ones in order to arrest any further depletion in value.

Exit Route

The Banks should have a clear cut exit policy and should lay down definitive parameters which may be applied to the various bad loan accounts, which are incapable of being revived, depending upon the merit of each case. The banks may resort to either court driven or out of court measures to ensure the recovery of amounts from NPAs.

1. Compromises and Settlements:

The banks may resort to compromises and settlements with the defaulting borrowers and stipulate he repayment terms in accordance with the RBI guidelines and the respective bank's internal settlement policy. The same ensures a legal and dispute free resolution of NPA both for the borrower.

2. Sale of NPAs to Asset Recon struction Companies:

For an effective resolution of distressed assets, debt aggregation capability and necessary skill sets for resolution are decisive. ARCs with ability to aggregate debt of different classes are in a better position to tackle complexities of recovering from a bad loan. ARCs have access to SARFAESI Act to take necessary steps for recovery and resolution of bad loans acquired from banks. Thus, ARCs with focus and domain expertise in resolution and the statutory/ regulatory empowerments for resolution are in a better position to implement timely resolution strategy thereby enhancing the value of stakeholders. Of late the RBI has issued several guidelines relating to the functioning and operations of the ARCs with an overall intent to equip the system to handle the enlarged stress assets base. The various guidelines issued by the RBI w.r.t. ARCs include an increase in the minimum threshold investment of ARC in the SRs from the initial level of 5% to 15%. The increased stake would encourage better due diligence on part of the ARCs and more realistic pricing of the debt which in the opinion of the ARC is actually doable. Further, the limit of FDI investment in an ARC has been raised from 49% to 74% (under Automatic route) to give further leverage to ARCs to strengthen their capital base to be able to effect more meaningful acquisition of large asset accounts. The ARCs have also been permitted to convert a portion of their debt into equity and also acquire a debt from another ARC. The RBI has permitted an extension of resolution period from 5 years to 8 years to enable the ARCs to give an extended re-structuring period to the borrowers who have entered into a restructuring arrangement with the ARCs post acquisition of their debts. To improve the financial ability of the ARCs, those ARCs which have acquired assets worth Rs.500.00 crore and above have been permitted to float a fund (to be subscribed by QIBs) and utilize up to 25% of the same for restructuring of the debts acquired.

3. Recovery Action

If the banks are of the view that the restructuring is not a viable option with respect to a particular stressed account then they may initiate recovery proceedings against the defaulting borrower by filing a suit for recovery before the Debt Recovery Tribunal or the Banks may proceed to take Possession of the secured assets under the provisions of SARFAESI Act 2002 and thereafter proceed to sell the same in a transparent manner, to be able to realize the best possible returns. In order to give a further impetus to recoveries, the percentage outstanding of the lenders to be eligible to initiate recovery action under SARFAESI Act 2002 from 75% to 60%

Insolvency and Bankruptcy Bill 2015

The judicial delays and a weak insolvency resolution procedure in the country also triggered the growth of NPAs with large number of borrowers taking shelter under the inefficiencies of the system thereby defeating even the best intended policies initiated by the Government/Regulator. The insolvency regime in the country is all set to undergo a sea change with the introduction of the Insolvency and Bankruptcy Bill 2015,(IBB) which is yet to be table before the Houses of the Parliament. As per the provisions of the IBB, the Financial Creditors of a defaulting borrower entity will call the shots in the entire proceedings. If the financial creditors are of the view that the entity can be revived then they may collectively (by a super majority) decided to restructure the dues and file a revival package before the adjudicating authority and if they decide otherwise, the entity will be liquidated. As such under the new rules of the game, it is the collective wisdom of the lenders which will prevail over the entire proceedings. The IBB also stipulates that any revival package, if envisaged, should be approved within a maximum of 180 days, extendable by another 90 days, failing which liquidation would be the only fate of the entity.

Conclusion:

Although the Government and the Regulator have taken several initiatives for creating an effective NPA management regime, but the success story is not very encouraging. As always said that `Prevention is better than Cure' so greater stress should be laid on developing in-house capabilities for an effective credit appraisal system and subsequent more efficient monitoring capabilities which should be able to raise a red flag upon observing signs of delinquency in any borrower account and as such the problem may be addresses at the nascent stage without waiting for it to assume huge proportions. It is always better to nip the problem in the bud itself.

On the remedial side, the ARCs mechanism should be to further strengthen to be more participative and productive in the overall management of NPAs. Looking to the availability of huge amount of NPAs which have been put on block by the lenders, for acquisition by the ARCs, the capital available with the ARCs is meagre. The ARCs should have higher accessibility to funds for investment in the SRs. Possibilities should be explored for the ARCs to have access to capital markets for raising funds. Further, there is a dire need for the banks to be more realistic while assigning a price to the NPA which are put on block. It is time for the banks to face the reality and `take the bull by its horns' by exiting from un-productive loans by quickly selling the distressed assets to ARCs at the competitive prices/ possession and sale under SARFAESI, even if that tantamount to increased losses in the short term. At least the monies locked up in such un-productive assets will be released which could be utilized for more effective usage in the medium and long term.

With robust systems in place, the growing NPAs can be managed effectively which would help in unlocking of good money blocked into un-productive assets and give a much needed boost to the sagging economy in general and the banking sector in particular.

Sandeep Kumar Gupta
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Sandeep Kumar Gupta is a Partner in Dhir & Dhir Associates, Advocates & Solicitors. He is a qualified Chartered Accountant with extensive experience of around 20 plus years in banking, project finance and debt restructuring of entities in distress, both through the CDR mechanism and on bilateral basis. He is a part of the corporate consultancy team of the firm, advising clients on matters related to settlements with lenders and other insolvency-related issues.

Stressing on distress

Abizer Diwanji,
Partner and National Leader – Financial Services and Restructuring Services, EY India

Much has been talked and done about the Bank loans situation in Indian Banks. At the core, is the debate that are banks merely holders of bad loans or are the cause of it. The answer lies in the excesses caused by easy credit followed by a delayed recognition of the problems on hand once the world slowed down. Somewhere in between the slowdown in government decision making added to the problem.

The Non performing loans issue in banks has mainly resulted from under capitalised projects, continued focus on expansions by over optimistic promoters who generally believed that India is decoupled from global trends (global overcapacities in commodities and fall in demand esp with China slowdown and the US lack of consumption), undercapitalised banks which led to popularising delayed recognition of stress situations which led to a debt trap (borrowings mainly to fund interest) and policy paralysis caused by an over zealous vigilance and court system especially around 2G, Coal, environment clearances and government spending. The combination of the above, has led to the situation being grave where the banking system holds close to 10.2% of Non-Performing Assets (NPA).

Indian banks need prompt and systemic approaches to ensure recovery of their dues. Mutual trust between promoters, borrowers and external stakeholders is critical to the process. Whilst there have been many steps taken by the RBI for recognition and resolution, there is little being

done in terms of financial packages or addressing industry issues. A co-ordinated effort across would lead to a more constructive solution.

Causes of stress in the system

The increase in stressed assets could be attributed in part to macro-economic slowdown as well as excesses of the boom period manifested in terms of excessive leverage. However, there are certain sector specific issues particularly in five sectors namely infrastructure, iron & steel, textiles, aviation and mining which together contributed around 51% of total stressed assets.

Sector	Stressed Assets in Sensitive Sectors (% of GNPA + Restructured advances)					
	FY 10	FY 11	FY 12	FY 13	FY 14	Dec-14
Infrastructure	8.8	8.4	21.2	27.6	29.4	29.8
Iron & Steel	7.8	7.7	6.7	8.1	10.8	10.2
Textiles	11.6	12.2	8.9	7.4	7.7	7.3
Aviation	1.1	1.8	6.3	3.5	3.3	2.4
Mining	0.2	0.4	0.4	0.5	0.9	1.4
Total	29.5	30.5	43.5	47.1	52.0	51.1

Source: RBI

As can be seen in the above chart, around 30% of stressed loans in the banking system are from the infrastructure sector followed by Iron and Steel and textiles. For airlines the issues revolves around one or two bad credits, while Mining is partly subsumed in Iron and Steel. RBI in its draft guidelines has proposed some concessions, some measures targeted at these sectors are needed apart from Monitoring and NPA recognition guidelines

- Major portion of restructured loans exposure is to government controlled entities: A major share of power sector exposure accounting for around 4% of total banking system credit is to government controlled entities such as state distribution companies, power companies and central utilities. In addition, exposure to Air India accounts for a large portion of restructured assets in the aviation sector. A comprehensive operational and financial restructuring is required for these. A live example in today's times in the municipal corporation of Detroit which is undergoing a similar restructuring. Whilst in these, we believe privatisation is taboo, the move has not been well explored by the government. In these times when there is overall recognition that 'Government has no business to be in Business' privatisation would not only result in turnaround, but would result in overall improvement of employee well-being.
- Lack of fuel linkages is a major roadblock in some power projects: Certain power projects particularly gas based power plants (accounting for 9% of total power capacity) are operating at very low utilization levels. Plants operating low levels of plant load factor (PLF) do not have enough cash flows to service their debt and in these cases restructuring would only provide temporary relief. Also, delay in environmental clearances for captive coal mines has led to change in cost estimations for several projects. Faster clearances for captive mines are needed to ensure coal availability to make these projects viable.
- Deteriorating financial health of state electricity boards (SEBs): Exposure to SEBs forms around 25% of total restructured loans. Several discoms as part of the special restructuring package have already taken tariff hikes, issued state government guaranteed bonds and have been granted moratorium of three years. However, concerted efforts by certain state governments to significantly increase power tariffs and reduce subsidy burden on discoms over next few years could restore the financial health of the SEBs.
- Lack of timely payments by the government especially in the Construction Segment: The Construction and EPC segment which has largely grown on the back of government projects in the infrastructure segment has seen many government claims being delayed. Litigation awards have been granted and contested in the courts for decades putting a large financial drain on Infrastructure services and projects companies. The bank guarantee devolvement risk too looms large.

- Global price falls, increase in overall capacities, indiscriminate expansion and reversing of mine allocations have root cause of stress in the Iron and steel sector: The Iron and steel sector has faced many issues. Apart from a depressed prices, which seems to be a long cycle, the cost of production has gone up given cancellation of coal block licensing, internal logistics costs and indiscriminate expansion. Also, the leverages have grown unsustainable due to the debt trap of borrowing to pay interest, especially in the last 4- 5 years.

" Textiles industry has seen indiscriminate expansion to unsustainable capacities and diversification: The Textiles industry, including the spinning, weaving and ready to use apparel businesses have seen expansion over the large decade with sectors like polyester and weaving having lost significant ground due to higher expansion, increased labour costs compared to other destinations and forward and backward integration moves which have backfired. Also, a few have ventured into real estate which has not yielded the desired result. Further, they too have been in a debt trap for the past 3-4 years.

RBI has taken effective measures at monitoring and empowering banks

Corporate Debt Restructuring ('CDR')

If an account was restructured under CDR, it was classified as Standard and banks held only a 5% provision as long as promoter contribution was brought in to meet bankers sacrifice. Though well intended, CDR was used as a delaying mechanism and did not motivate banks to recognise the fact that there could be excess debt in the system which is unserviceable. Effective March 2015, RBI has taken away the provisioning concession offered to CDR. This has made CDR not being a preferred option. This move will go a long way in making sure we have more meaningful restructurings than just delayed payments.

Special mention accounts

RBI has asked banks to create a new asset classification called 'Special Mention Accounts' (SMA) to identify early signs of stress in an account based on tangible events or indicators. This will improve transparency and increase accountability from banks and promoters alike. Early warning and resolution will also result in a higher probability of consolidation, turnaround or timely asset sell off.

Also the banks as well as systemically important NBFCs will have to report SMA accounts (with exposure of above Rs 50mn) to the newly proposed Central Repository of Information on Large Credits (CRILC) to be set-up and maintained by RBI.

Once an account is reported as SMA-2, all lenders including NBFCs have to form a Joint Lenders Forum (JLF) to formulate a corrective action plan (CAP). Unlike consortium lending in case of multiple banking arrangements, arriving at an effective resolution under a committee structure such as JLF could be a challenge as different banks may have exposures of varying tenures with different underlying collateral.

Whilst new guidelines will put large procedural burden on banks in terms of monitoring and reporting requirements, it would also lead to greater transparency and timely resolution plans to recover loans and enable rationalisation in the industry. RBI is now using this to make sure there is uniform recognition of NPAs across a corporate in all Banks.

However, given that JLFs did not require attendance of senior management of banks, the process has not been as effective, Whilst RBI has mandated senior level involvement and has mandated the presence of senior personnel from SBI and ICICI in all JLFs, the process may not be effective.

Strategic Debt Restructuring

In line with its thought process that promoters who are unable to perform need to be replaced, RBI introduced a Strategic Debt Restructuring provision which enabled banks to collectively take a 51% stake and over an 18 month moratorium period, find

a new buyer and restructure a loan. Whilst the RBI has allowed banks to take a stake and SEBI has granted an open offer waiver, there are many conditions including those under the Companies Act and various other laws that than stall its implementation. Also, banks are not fully confident of finding buyers in these times and hence these are implemented primarily with promoter consent and when a willing buyer is identified or in sight. The initiatives would be more effective under the bankruptcy code when implemented.

A suggestion would be taking the top 50 to 100 exposures in the system and getting ED level bankers involved in proposing resolutions. Further, there is need for the government to recognise that these are complex situations and officials involved should be allowed to take decisions which are best for the circumstances as long as a clear and transparent process is followed. The excessive fear of vigilance at times results in sub optimal decision making.

Formal mechanism to deal with distressed companies is required

Bankruptcy laws in India with regards to corporate insolvency are not very clear. The law only provides for liquidation of companies which is currently under the jurisdiction of courts. Board for Industrial and Financial Reconstruction (BIFR) was created in 1987 under Ministry of Finance to revive sick industrial companies or to undertake sale of distressed companies. However, BIFR has failed in its stated objective as prolonged proceedings have led to unviable companies continuing to operate for years on government support and in some cases allowing unscrupulous promoters to divert funds from sick companies.

Government has in some instances taken decisive action to save distressed companies. After the fraud was uncovered at Satyam, government stepped in and dissolved the original board within two days. Also, it appointed a new board consisting of eminent personalities including Kiran Karnik, Deepak Parekh and C Achuthan as well as extended liquidity support to restore confidence in the viability of the company. Few months later the company was successfully auctioned off to Tech Mahindra indicating the strength of the underlying business. Satyam case highlights how quick government action helped the company to maintain its ongoing business and ward off liquidation.

I was involved in winding down the India operations of Lehman Brothers and MF Global in India. Whilst the resolutions deferred, it does goes to prove that bankruptcy laws would lead to constructive winding down or revival for the interest of the creditors. Also, there is a perception that Winding down spreads widespread instability. This has been proved wrong be it Satyam or MF Global, where the businesses were well transitioned to new owners.

A similar mechanism needs to be institutionalized whereby in case of highly distressed companies or grossly mismanaged sick companies, a government agency can step in to appoint a new board and take steps to revive the underlying business in a time bound manner.

Frankly the proposed Bankruptcy law is a step in the right direction. However, it needs adoption in the right spirit. Apart from legal viewpoints, a big contributor would be the use of commercial professionals in turnaround or liquidation decisions. Bankruptcy or revival is a purely commercial decision to be operated within the ambit of law under full accountability to the creditors and the courts. This, along with the fact that time is of essence in any liquidation or revival, the proposed law would prove very helpful to our system. We also need to fully develop a new set of professionals who are corporate recovery specialists and accredit them as such, as is done overseas.

Conclusion

India has taken the bad debt issue very seriously. We have seen the RBI take the lead but we now need an institutionalised law (Bankruptcy code), a co-ordinated effort among bankers at a senior level to enable resolution and industry specific turnaround strategies to make sure the problem is not solely resolved only through financial and operating parameters but also supported by appropriate policy initiatives. Further, the efforts of the Ministry of Finance around Indraprastha (improvement of PSU bank performance), the government's efforts to set up a National Asset Reconstruction Company and augment Capital outside of the budgetary system.

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Abizer is a Chartered Accountant, and a Commerce Graduate from the University of Mumbai.

- Abizer is part of Transaction Advisory Services and specializes in Financial Services. He has extensive experience in assisting buyers and sellers of businesses in evaluating the risks and opportunities of their intended transactions. He has managed and led a number of high profile and complex transactions and thus has a deep understanding and practical experience of dealing with issues that arise in Indian transactions
- During his career, Abizer has been involved in approximately 100 private equity transactions on the transactions support side in Financial Services, IT, BPO, Pharma and Oil and Gas.

Indian Banks and Non-Performing Assets: Looking Beyond the Pain

Shinjini Kumar
Banking & Capital Markets Leader &
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PwC India

The saga of non-performing assets in Indian banks is becoming annoyingly stretched. But the story continues as increasingly larger and unsettling volumes of bad debt are reported. It is not pretty to explore the details tumbling out of the messy cupboards of banks; overflowing with bad, semi bad, structured or semi structured assets. Worse still, there is palpable fear about what we do not know and how much harm the 'unknown' will cause as it chips away subtly at the trust and high esteem in which we hold our banking institutions.

In the long run, it will not be all gloom and doom. Arguably, macroeconomic recovery and growth are beyond the influence of banks, even factoring in the impact of monetary transmission, because more stubborn local and external factors may be at play. But it is quite clear that policy initiatives of this era will constitute the groundwork for a stable regime of bank lending and recovery as the dust clears on the current NPA problem.

The agenda of banking reforms is an old and continuing one in post liberalization India. Indeed, financial services are unique in that a significant body of work exists to support policymakers to help pursue reforms. Ideas ranging from licensing and consolidation to governance, human resource, productivity, stability or resolution have been taken up by various committees and detailed recommendations have been put out in public

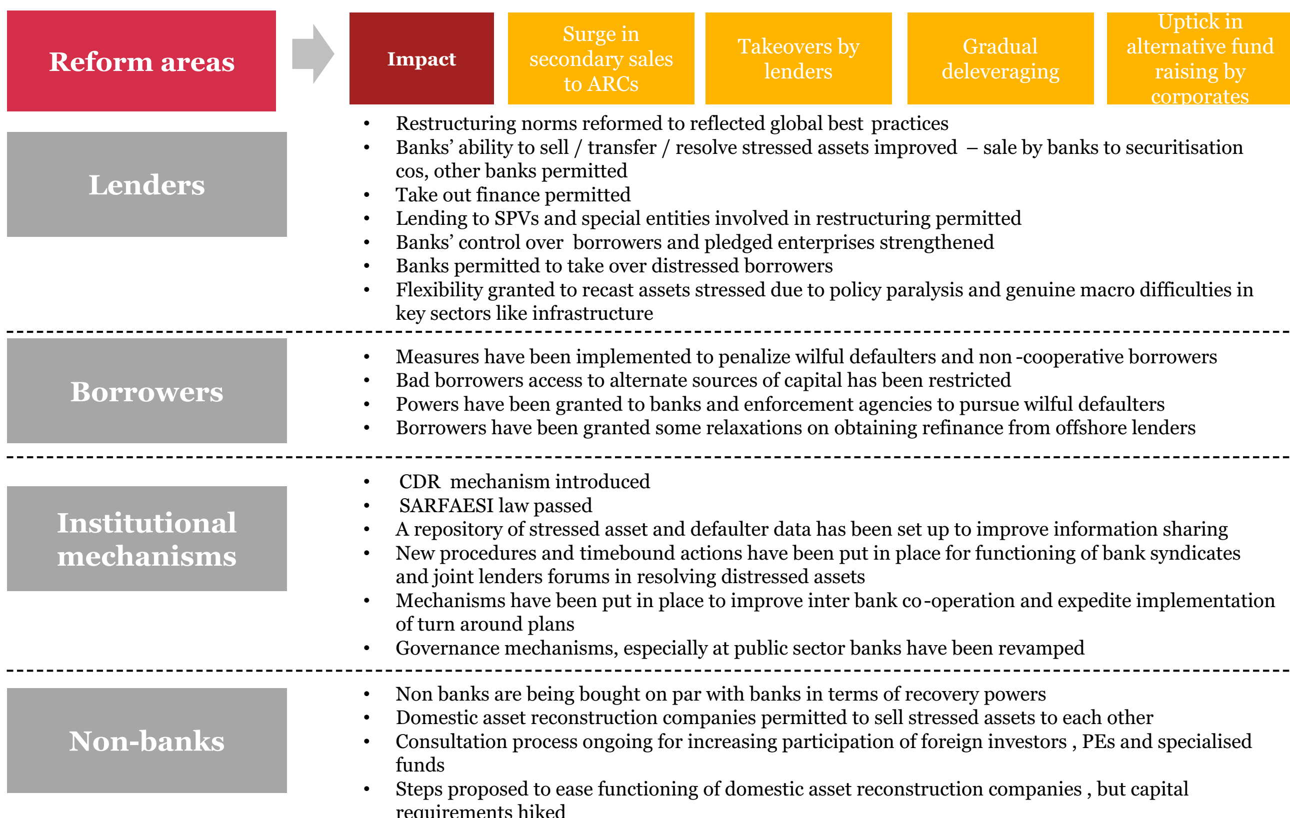
domain. Some recommendations, such as the Indian Financial Code or Bank Holding Company formation are slower to get off the ground, while others are at different stages of implementation. Rising non-performing assets and consequent capital requirement have brought relentless focus on policy reforms relating to lender empowerment, borrower discipline and bankruptcy laws, restructuring and resolution as well as development of an ecosystem for dealing in bad debt.

So far, large parts of the banking system have not shown a sense of urgency to deal with the problem of bad loans and worse borrowers. To begin with, change in government last year created a sense of hope and expectation of magical recovery that would revive projects sitting ugly on the lenders' books. However, solutions have largely evaded the industry so far and with each day the expectation of magic wears away. For banks at this stage, it is clear that they cannot wish the problem away on hopes of macroeconomic recovery and that they need to deal with it beyond looking for ways to hide, park or defer. NPAs stink. And how! They cost more by way of provisions and are harder to get rid of as they age and lead to erosion of asset and collateral value. They also contaminate the organizational culture and capacity for lending by distorting the risk reward framework. In the context of Indian public sector banks, that problem is already complicated with the well-meaning but arbitrarily implemented trinity of CBI, CAG and CVC.

Capital requirements for the banking system were estimated by Nayak Committee at a whopping INR 2.1 to 5.87 lakh crore till the year 2018 under different provisioning and forbearance scenarios. Unexpected bounty from declining oil prices may have contributed to loss of urgency to move ahead on economic recovery; but for the banking system, this means slow respite from the curse of bad loans. New asset creation will not pick up to make the NPA to Advances ratio look better and even when recovery happens, loans will need to wait for the statutory period of one year before being reclassified as standard. In the meantime, they will continue to block capital, balance sheet growth and profitability. In the absence of government capitalizing public sector banks liberally, this will lead to a sense of urgency to work with regulators and courts to clean up and move on.

Strengthening the framework of recovery-the journey so far

Summary of regulatory reforms



The prudential framework for stressed assets and restructuring was put in place by the RBI way back in 2001. A modern Corporate Debt Restructuring ('CDR') mechanism was introduced in the same year and was soon followed by the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI), 2002. These measures served banks well initially; but over time, certain inefficiencies have crept into implementation, leading to large build-up of pending cases and unsatisfactory recovery. Even before the situation of NPAs in banks began to look alarming, the central bank had taken initiatives to ensure better management of asset quality and allocation of capital.

The Mahapatra Committee report in 2012 contained forward-looking recommendations aimed at bringing the RBI's present prudential guidelines on restructuring of advances in line with the international prudential norms in a time-bound manner; and gradually develop the restructuring guidelines to the needs of a globalised economy. It also contained contemporary recommendations to address moral hazard issues arising out of special forbearance, and pushed lenders to exercise rigorous due diligence on one hand and encouraged borrowers to curb excessive risk taking and lax business practices on the other.

By June 2014, INR 4,795 billion worth of projects were stalled and NPA levels reached 4.3% gross assets of the banking system. Earlier that year, RBI had notified the 'Framework for revitalizing distressed assets in the economy' ('Framework') containing several measures targeting recovery mechanisms, restructuring norms, functioning of the CDR mechanism, sale and transfer of stressed assets, borrower discipline and institutional mechanisms for collating stressed asset data.

For banks, the framework included revised asset classification norms, and introduction of Special Mention Accounts ('SMA') to capture incipient stress in loans prior to becoming NPA. Accelerated provisioning was introduced to penalize banks failing to classify stressed assets properly. The functioning of the CDR mechanism and the Joint Lenders Forum ('JLF') was reviewed and streamlined to include time bound decision making and recovery actions by lenders. Restructuring norms were clarified, with relaxations in classification, provisioning and permission to provide refinance and take out finance. A Central Repository for Information on Large Credits ('CRILC') was introduced to collate and disseminate information on large SMAs of banks and NBFCs.

RBI followed this up by expanding the list of permissible restructuring schemes - notably the 5:25 scheme and the Strategic Debt Restructuring scheme ('SDR'). The notification of SDR in June 2015, in conjunction with relaxations for to SEBI ICDR regulations issued in May 2015, was an important first as it enabled the conversion of outstanding corporate debt into equity, permitting lenders to take over control. While the ability of banks to efficiently administer and turnaround is debatable, they have already invoked SDR in seven cases with outstanding debt of Rs. 424 billion. The outcome will be a key milestone in the history of Indian banking.

The Framework also liberalized the functioning of Asset Reconstruction Companies ('ARCs'), permitting sale of assets between ARCs for debt consolidation, utilization of 25% of funds raised towards restructuring and lowering the threshold for lenders' approval for debt to equity conversion from 75% to 60%. Measures were also introduced to boost fund flows to ARCs. These relaxations were balanced with stringent prudential norms, increasing mandatory investment in Security Receipts from 5% to 15%.

Following the notification of the Framework, banks' asset sales to ARCs increased five-fold from 2013 to 2014, quickly overwhelming most ARCs balance sheets. Capital adequacy, shareholding restrictions and revised subscription requirements have led to a capital crunch for ARCs. To absorb the pool of NPAs at the current acquisition cost to book value ratio of 44%, ARCs will need an additional INR 186 billion capital against their current capitalisation of INR 34 billion.

The RBI also looked to increase the participation of non-banks and foreign players in the distressed market, by bringing NBFCs under the SARFAESI Act and permitting leveraged buyout to specialized institutions. However, foreign investors to date have remained shy of the distressed market, concerned about legal complexities and the lack of a comprehensive bankruptcy framework. Amendment notification on SARFAESI coverage to NBFCs is still awaited.

This is an overwhelming pace of change and parts of it are still under implementation, untested or unworkable. But together, this constitutes a whole new ecosystem of legal and regulatory tools that may finally lead to the emergence of a holistic ecosystem of debt resolution and secondary market in non-performing assets.

Changing lender-borrower dynamics. There has been a rather strident articulation of the fundamental asymmetry between rights of lenders and obligations of borrowers. The roots of this are not only in the general lack of discipline, but also in the way Indian industry and banking have grown post liberalization. India has few really large conglomerates and many small businesses. The number of large or medium corporates has not grown at a consistent pace and financing small businesses continues to be major challenge in the absence of quality credit data. To make it

worse, the crony capitalist nature of growth has meant that rise and growth of a new business house is often co related to the rise and growth of certain political parties or politicians.

The large corporates thus acquire disproportionate market power, especially in high liquidity scenarios, when banks must lend. With an increasing number of foreign bank branches, overseas lenders and domestic NBFCs and funds, access to credit is high for such borrowers, regardless of the inherent viability of the project or expansion plans.

Skewed power dynamics has actually resulted in situations where the borrower wields the power to determine rates, collateral or other terms of lending and often arbitrages between different lenders. It is not uncommon to find banks waiving pre conditions to sanctions because of apprehension that client will draw down a competitor's loan. In that sense, the lenders are left with all the responsibility and the borrowers almost have the right to acceptance of their terms, which is an unfortunate inversion of roles.

While the structure of the industry may not change, two things will empower borrowers; availability of information through the CRILC database and enhanced ability to lend to smaller businesses using digital data platforms. But more importantly, the supervisory shift from assessing quality of appraisal, diversity of portfolio and adequacy of provisions to assessing credit monitoring and detection of early warning symptoms will drive behaviour in banks that have lagged behind on post credit supervision. Government's Indradhanush initiative for public sector banks to improve governance and decision making, if effective will also lead to improvement in overall discipline and empowerment.

Addressing the equity issue. Another feature of the Indian banking system has been the lenders (banks) taking equity risk, in the absence of broad base of equity and privileged promoters. With restrictions on promoter financing and banks' ability to take equity exposure, restructuring of loans has not been effective and in many cases, served as a tool to defer the problem rather than deal with it. There is a co-incidence of many factors at this juncture that may lead to changes over the long term. Provisions of new Companies Act and bankruptcy laws are two major building blocks, but access to wider range of investors may also eventually happen as the AIF regime gets implemented and securities market regulators continue to drive transparency and good governance.

To conclude, when the dark cloud of NPAs clears up, the lessons of our times will leave a long lasting legacy that will be a more robust banking sys-

tem. This will be aided by the compulsion for banks to go to market to raise capital. That will lead to much needed differentiation, where banks, particularly public sector banks will have to stand on their own and compete with each other. Corollary to this is the expectation of consolidation. Surely, with licensing of more banks in the private sector, share of private sector banks will grow and that growth may not just be linear, given that ability to access capital and talent will vary between public and private sector banks. With new banks, new norms for change in shareholding and government's encouragement to public sector banks to look for consolidation, we may have a very different banking sector a decade from now. While that will be a result of the slow and steady reform agenda, the criticality of dealing with NPAs may just have made that endgame possible.

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Shinjini Kumar has 25 years of experience in banking and financial services in India. Prior to joining PwC in 2010 where she currently leads the banking and capital markets practice, Shinjini has held senior positions at the Reserve Bank of India (RBI) and Bank of America-Merrill Lynch. Her experience with the regulator and industry across a broad range of subjects gives her the distinctive opportunity to engage with industry bodies, media and clients on important issues affecting the industry. She writes regularly on banking, digital and payments initiatives and participates in conference and seminars in India and overseas.

Experience Highlights:

In her seventeen-year stint at the Reserve Bank of India (1990-2007), Shinjini worked in the Departments of Currency Management, Foreign Exchange, Non Banking and Banking Supervision. Among others, she worked as frontline Manager in the Foreign Direct Investments Division at RBI, New Delhi (1995-1998) and as Principal Inspecting Officer for P&S Bank, IFCI, NHB, HSBC, Standard Chartered Bank, JP Morgan Chase Bank, Deutsche Bank and Scotiabank at RBI New Delhi and Mumbai (2001-2007).

As country compliance head at Bank of America Merill Lynch, shinjini successfully handled regulatory aspects of the merger of Bank of America and DSP Merill Lynch. She was part of the country management team, new products and customer service committees and money laundering reporting officer (MLRO) of the bank. She also handled corporate social responsibility, and corporate communication for Bank of America in India.

At PwC, her clients include multinational banks and financial institutions that seek to establish or grow their presence in India or align their compliance, governance, product governance or anti money laundering frameworks with local regulations. In addition, Shinjini has been involved with acquisitions, due diligence, investments and business plans for NBFCs, global payments companies, small and payments banks applicants. She has authored many reports, including the PwC Foreign Bank Survey, Logging into Digital Banking, Disrupting Cash, Banking on Non Banking Companies and others. She was part of PwC's 'Financial Services Future Leaders program (2014-15) meant to groom future leaders for the global network.

Education:

M. A. In English Literature (Delhi University), M.A. in Public Policy (LBJ School, University of Texas at Austin, Texas), Certificate in financial journalism (Times Centre for Media Studies, Delhi).

FICCI – Data Centre

Economy Watch

State of the Economy

Our latest assessment on India's economic situation indicates not much deviation from the evaluation as presented in the last edition. The economy remains on recovery course; however, signs of a firm turnaround are yet to emerge.

Weak demand situation persists to be one of the key downside risks. The global economy is yet to gain traction which is reflected in our persistently declining exports. Further on domestic front, there has been an evident moderation in rural demand on the back of two consecutive years of below normal rainfall. Persistently weak demand is also demonstrated in the sub optimal capacity utilization rates of the companies across sectors.

At this juncture, the economy stands at a point where positive signals are emerging but these remain scattered.

Gross Domestic Product

Latest data for the second quarter of current fiscal year announced in November 2015 reported a GDP growth of 7.4%. This was an uptick from 7.0% growth reported in Q1 of 2015-16 and marginally down from 7.5% growth noted in Q4 of 2014-15.

The improvement in growth numbers in the second quarter was supported by a better than expected performance of the agriculture and allied activities sector. The sector reported a growth of 2.2% in Q2 2015-16, vis-à-vis 1.9% growth in Q1 2015-16 and (-)1.4% growth in Q4 2014-15. The uptick was surprising given the below normal rainfall this monsoon season. Also, the recovery in industry and services sector remained by and large intact.

However, the recently released Mid-year Review of the Economy by Ministry of Finance revised the GDP growth projection for the current fiscal year to 7.0%-7.5%. This is a downward revision from the earlier estimate of 8.0%-8.5% growth indicated in the Economic Survey 2014-15. The Mid-year review states, "understanding the real economy and the pace and strength of economic recovery is unusually difficult this year for two reasons: GDP data can be subject to a degree of uncertainty (on account of large changes in relative prices), and second, the economy is sending mixed signals with different indicators not always pointing in the same positive direction".

This expectation of a moderation in growth is also corroborated in the results of FICCI's latest Economic Outlook Survey, which puts across a GDP estimate of 7.4% for the current fiscal year, a downward revision from 7.6% growth projected in the previous round. The median estimate for GVA was also revised to 7.4% for the current fiscal year (from 7.7% in the previous round); with estimates for agriculture and allied activities, industry and services segment at 2.0%, 6.9% and 9.9% respectively.

Table 1: GDP Growth (in %)

	GDP	GVA at basic prices	Agriculture, forestry and fishing	Industry	Services
Jun-14	6.7	7.4	2.6	7.7	8.7
Sep-14	8.4	8.4	2.1	7.6	10.4
Dec-14	6.6	6.8	-1.1	3.6	12.6
Mar-15	7.5	6.2	-1.4	5.6	9.2
Jun-15	7.0	7.1	1.9	6.5	8.9
Sep-15	7.4	7.4	2.2	6.9	8.8

Source: CMIE

Index of Industrial Production (IIP)

The latest IIP data reported a remarkable recovery, indicating a growth of 9.8% in the month of October 2015. This growth comes on the back of a low base and a pickup noted due to increase in festive demand. The corresponding IIP growth in September 2015 and October 2014 was 3.8% and (-) 2.6% respectively.

As per economic activity wise classification, manufacturing growth was reported at 10.6% - the highest in over four years. Seventeen out of twenty two manufacturing sub segments reported positive growth in October 2015. A pickup was noted in segments like motor vehicles, textiles and chemical and chemical products; however commodities like steel, aluminum, and cement remained under strain. Further, the electricity segment also reported moderation in growth numbers.

The capital goods segment witnessed double digit growth for the fourth consecutive month in October 2015.

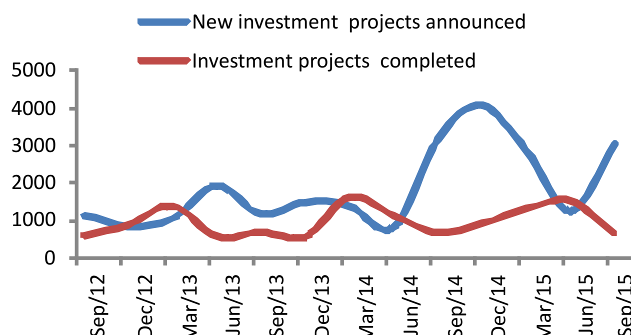
Table 2: IIP Growth (in %)

% growth rate	Oct-14	Jul-15	Aug-15	Sep-15	Oct-15
Index of Industrial Production	-2.7	4.3	6.3	3.8	9.8
Sectoral					
Mining	4.6	1.3	4.2	3.0	4.7
Manufacturing	-5.6	4.8	6.6	2.9	10.7
Electricity	13.7	3.5	5.6	11.5	9.0
Use-base industry classification					
Basic goods	9.7	5.4	3.5	4.2	4.1
Intermediate goods	-3.4	2.0	3.1	2.1	6.7
Capital goods	-3.2	10.1	21.4	10.3	16.1
Consumer durable goods	-35.2	10.6	17.0	8.5	42.2
Consumer non-durable goods	-3.7	-4.4	-1.0	-3.5	4.7

Source: CMIE

The latest CMIE data on new private investment projects announced also reported a pickup in the quarter ending September 2015. But what remains imperative is the actualization of these projects. In fact, the data on completed private investment projects continued to report a decline for the second consecutive quarter for the three months ending September 2015.

Chart 1: Investments (Rs billion): Private Sector



Source: CMIE

The consumer goods segment posted a growth of 18.4% in October 2015, vis-à-vis 1.2% growth in September this year. The jump in the consumer goods segment growth was led by an increase in consumer durables (42.2% in October 2015), which can be attributed to festive demand.

However, these data points Will have to be further monitored to draw any firm conclusions.

The prognosis from FICCI's latest Business Confidence Survey indicates that corporates continue to face a difficult time with regard to key operational parameters. A decline has been noted in the proportion of respondents foreseeing an improvement in parameters such as investment, sales, profits, exports and employment over the period October 2015 to March 2016; while the proportion of participants anticipating no change in the situation or a further deterioration noted an increase. This is a worrying trend as the performance of the corporate sector is not gaining momentum.

Inflation

Both WPI and CPI data continued to edge up in the month of November 2015. This was primarily on account of pressure arising from the food segment.

The WPI inflation rate was reported at (-) 1.9% in November 2015, vis-à-vis (-) 3.8% inflation rate in October 2015 and 1.7% in October 2014. The food articles segment prices reported an inflation of 5.2%, vis-à-vis 2.4% growth in October 2015. While pulses prices continued to soar, the vegetable prices also registered double digit growth.

Table 3: WPI based Food Articles Inflation: Growth (in %)

Month	Nov-14	Oct-15	Nov-15
Food Articles	0.7	2.4	5.2
Foodgrains	2.6	9.2	10.8
Fruits & vegetables	-11.8	-1.2	5.9
Milk	10.2	1.8	1.6
Eggs, meat & fish	3.9	-3.4	-2.2
Condiments & spices	19.2	14.3	18.9

Source: CMIE

CPI based retail inflation increased to 5.4% in November 2015, from 5.0% in the previous month. Food and beverages segment which constitutes for 46% of the index, reported an inflation rate of 6.1% in November 2015, vis-à-vis an increase of 5.3% noted in October 2015 and 2.0% noted in the same month last year.

Furthermore, the latest data on area under cultivation for Rabi season reported a fall, with the decline being most evident in case of rice, wheat and coarse cereals like bajra and ragi.

Poor soil moisture and delayed onset of winter has affected the sowing. Also, the unexpected flooding in Chennai has had an impact on rice and sugarcane production.

The Government has been cautious of the situation and has undertaken a slew of measures to keep food prices under check over the course of past eighteen months. These have helped ease the situation. However, it remains a continuous challenge to manage the food situation on account of seasonal variations and supply side bottlenecks. Addressing these two issues remains imperative to have a grip on the situation in the long run.

Nonetheless, the overall situation with regard to prices is expected to remain benign and there doesn't seem to be an immediate risk with global commodity prices too remaining subdued.

Foreign Trade

Both exports and imports remained in the negative zone for the twelfth consecutive month indicating a persisting difficult situation on the trade front. Exports declined by (-) 24.4% in November 2015 and imports by (-) 30.3%. With both exports and imports declining, the trade deficit was reported at US$ 9.8 billion.

In absolute terms exports stood at US$ 20.01 billion which is a five year low. The global recovery is yet to gather pace and low commodity prices have been impacting our export growth. Petroleum & crude products exports which account for a little less than a fifth of our total exports declined by 54% y-o-y in November 2015.

In fact, the decline in exports has been broad based with major commodities like engineering goods, electronics, gems & jewellery, ores & minerals and organic & inorganic chemicals witnessing contraction during November 2015.

Imports on the other hand stood at US$ 29.8 billion in November 2015 and the decline in imports was also broad based. Except for pulses, electronics and fruits and vegetables, all commodities reported a decline in imports.

Way Ahead

At present, there seems no imminent risk that can heavily weigh down growth over the near term. What remains vital is to consolidate the efforts made so far, in order to make sure that these are translated into tangible gains. Government's commitment to reforms has been unrelenting and the readiness displayed towards implementing the announced reforms is encouraging.

The Reserve Bank of India has cut the repo rate by 125 bps in the year 2015. However, just about half of the policy rate reduction of 125 basis points has been transmitted by the banks till now.

We would like banks to pass on the full benefits in the form of lower lending rates for both consumers and investors. This is important for kick starting overall demand in the economy and hence investments.

Also, the constant uncertainty on account of US Federal Reserve increasing the interest rates has been finally put to rest. The Fed Reserve reversed its stance and hiked the rates by 25 percentage points in mid December 2015 for the first time since 2006.

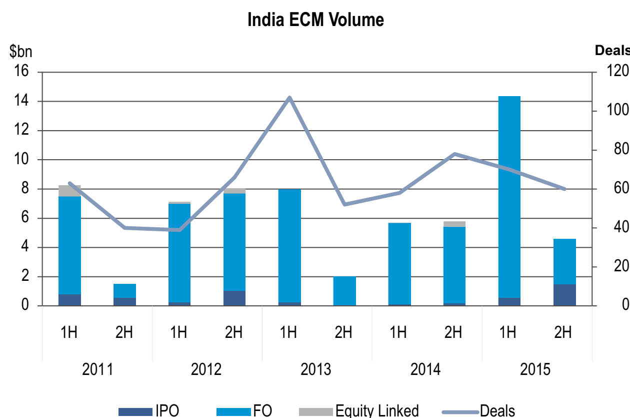
With the Union Budget 2016-17 round the corner, all eyes are set on same. We hope that the budget would further strengthen the growth momentum and would lay out a framework that would stimulate both consumption ad investment demand in the economy.

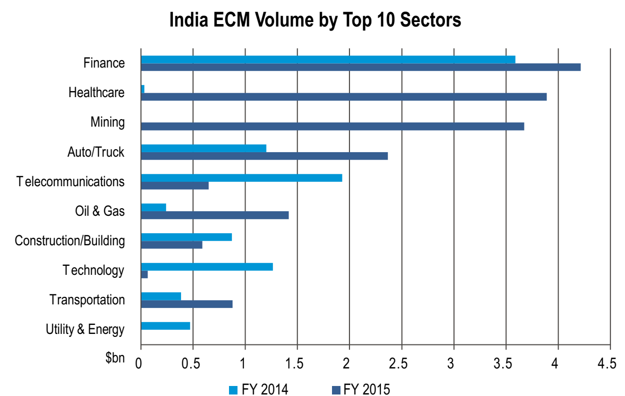
Key Policy Announcements (October-December 2015)	
November 24, 2015	Central government has provided in direct tax incentives to the ship building industry. The purchase of raw materials and parts used in the manufacturing of ships will be exempted from customs and central excise duties.
November 20, 2015	Ministry of Power launched the Ujwal Discom Assurance Yojna (UDAY) scheme.
November 19, 2015	Technology Acquisition and Development Fund launched to provide financial assistance to MSMEs.
November 10, 2015	FDI put under automatic route in a slew of sectors.
November 5, 2015	Gold Monetization Scheme launched
November 4, 2015	Draft Insolvency and Bankruptcy code placed for public comments
October 30, 2015	Draft Civil National Aviation Policy announced

Equity Capital Markets

- **Indian ECM** volume stood at $19.0bn (via 130 deals) for 2015, up 65% on the $11.5bn (via 136 deals) raised in 2014
- IPO volume totaled $2.1bn (via 60 deals) for 2015, compared to $282m (via 47 deals) for 2014. There were no convertibles issued for 2015
  - Follow-on volume for 2015 increased 56% to $16.9bn (via 70 deals) from the $10.8bn (via 85 deals) for 2014
- **Coal India Ltd's** $3.7 bn follow-on via book runners **BAML, Credit Suisse, Deutsche Bank, Goldman, JM Financial, Kotak and SBI** is the largest ECM transaction for 2015

In association with





Top 10 ECM Deals-FY 2015					
Date	**Issuer**	**Sector**	**Deal Type**	**Deal Value ($m)**	**Bookrunners**
30-Jan	Coal India Ltd	Mining	FO	3,675	BAML, CS, DB, GS, JM
21-Apr	Sun Pharmaceutical	Healthcare	FO	3,203	GS
24-Aug	Indian Oil Corp Ltd	Oil & Gas	FO	1,416	CITI, DB, JM Financial, Kotak, NOM
5-Feb	HDFC Bank	Finance	FO	1,271	BAML, CS, JPM, MS,BAR, NOM, GS, UBS
7-May	Tata Motors Ltd	Auto/Truck	FO	1,179	CITI, BAML, CS, HSBC, JPM
30-Jun	IndusInd Bank	Finance	FO	681	BAML, CS, JPM, JM Financial, MS, BAR, GS, NOM, UBS
11-Sep	Indiabulls Housing	Finance	FO	601	BAML, CITIC, SBI, AXIS
30-Oct	InterGlobe Aviation	Transportation	IPO	464	CITI, JPM, MS, BAR, KOTAK, UBS
5-Feb	HDFC Bank	Finance	FO	324	BAML, CS, JM Financial, JPM, MS, BAR, GS, NOM, UBS
26-Feb	Bharti Infratel Ltd	Telecommunications	FO	311	BAML, UBS

Equity Capital Markets Tables

Asia Pacific ECM Volume by Nation FY 2015				
Pos.	Nationality	Deal Value ($m)	No.	% Share
1	China	188,361	847	53.5
2	Japan	47,348	262	13.4
3	Australia	43,513	621	12.4
4	India	18,963	130	5.4
5	Hong Kong	14,777	384	4.2
6	South Korea	10,676	135	3.0
7	Taiwan	7,478	174	2.1
8	Thailand	4,367	42	1.2
9	Malaysia	4,082	106	1.2
10	Indonesia	3,861	29	1.1

India ECM Volume FY 2015				
Pos.	Bookrunner Parent	Deal Value ($m)	No.	% Share
1	Goldman Sachs	4,280	6	22.6
2	Citi	1,732	13	9.1
3	JM Financial Ltd	1,450	11	7.7
4	Kotak Mahindra Bank Ltd	1,333	15	7.0
5	Bank of America Merrill Lynch	1,303	7	6.9
6	Credit Suisse	1,142	7	6.0
7	State Bank of India	1,012	11	5.3
8	Axis Bank	885	19	4.7
9	Deutsche Bank	828	3	4.4
10	JPMorgan	678	7	3.6

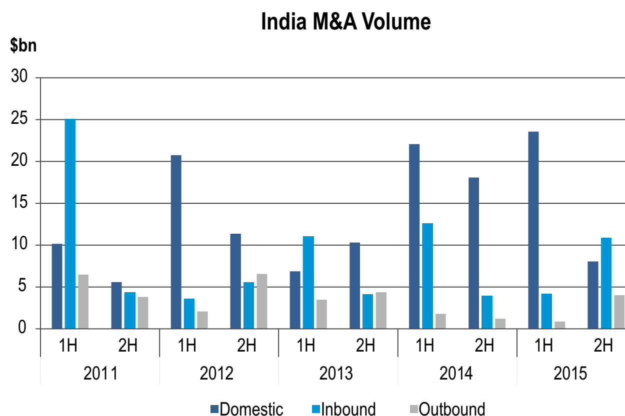
India IPO Volume FY 2015				
Pos.	Bookrunner Parent	Deal Value ($m)	No.	% Share
1	Kotak Mahindra Bank Ltd	290	9	14.1
2	Axis Bank	236	7	11.5
3	Citi	201	4	9.8
4	Edelweiss Financial Services Ltd	184	6	9.0
5	JP Morgan	128	2	6.2
6	ICICI Bank	111	4	5.4
7	Morgan Stanley	106	2	5.2
8	Barclays	77	1	3.8
9	UBS	77	1	3.8
10	Yes Bank Ltd	71	2	3.5

India IPO Volume FY 2015				
Pos.	Bookrunner Parent	Deal Value ($m)	No.	% Share
1	Goldman Sachs	4,280	6	25.3
2	Citi 1,531 9 9.1			
3	JM Financial Ltd	1,411	10	8.4
4	Bank of America Merrill Lynch	1,261	6	7.5
5	Credit Suisse	1,113	6	6.6
6	Kotak Mahindra Bank Ltd	1,043	6	6.2
7	State Bank of India	963	9	5.7
8	Deutsche Bank	808	2	4.8
9	Axis Bank	649	12	3.8
10	JP Morgan	550	5	3.3

India Withdrawn/ Postponed Deals FY 2015						
Withdrawn/ Postponed Date	Issuer	Total Value $m	Deal Type	Industry	Bookrunner	Withdrawn/ Postponed Comment
8-Jan-15	NCML Industries Ltd	8	IPO	Consumer Products	Corporate Strategic Allianz Ltd	Unsatisfactory market response
2-Dec-15	Shree Shubham Logistics Ltd	34	IPO	Transportation	FFSI, CITI, IDFC Sec. Ltd.	Market conditions

Mergers & Acquisitions

- India slipped to the sixth targeted nation in Asia Pacific region for 2015 with $47.1bn, down 14% on the $54.5bn announced for 2014
- India Outbound M&A volume increased 62% to $4.9bn for 2015 compared to $3.0bn for 2014
- India Inbound M&A volume dropped 9% to $15.1bn for 2015 from the $16.6bn for 2014
- Domestic M&A volume dropped 21% to $31.6bn for 2015, compared to $40.2bn for 2014
- Indian Government's sale of blocks of telecom spectrum through auction, for a combined total of $10.4bn in March, to Bharti Airtel, Reliance Industries and Vodafone pushed the M&A volume for India in 2015

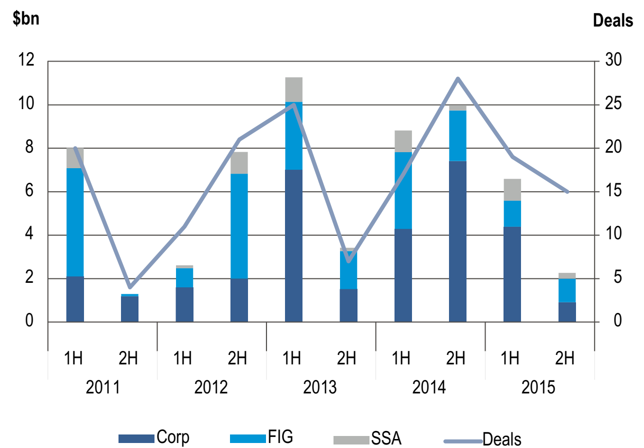


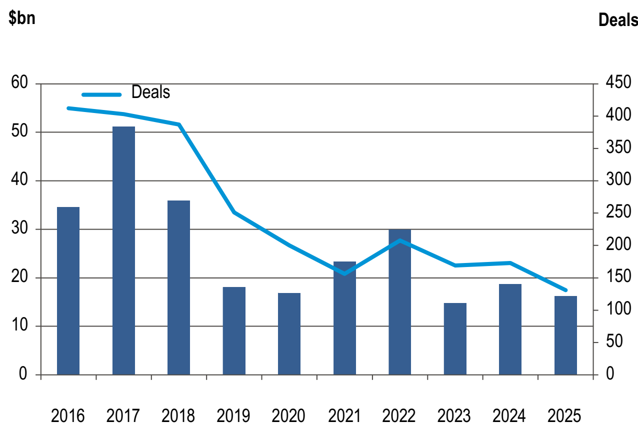
India Announced M&A Advisory Ranking FY 2015				
Pos.	**Advisor**	**Value $m**	**# Deals**	**% Share**
1	Citi	5,845	11	12.5
2	JM Financial Ltd	5,040	4	10.8
3	Rothschild	4,710	4	10.1
4	Credit Suisse	3,626	4	7.8
5	Kotak Mahindra Bank Ltd	3,393	12	7.3
6	Morgan Stanley	3,059	6	6.6
7	Axis Bank	3,047	8	6.5
8	PwC	2,778	11	5.9
9	JP Morgan	2,745	5	5.9
10	Macquarie Group	2,428	2	5.2

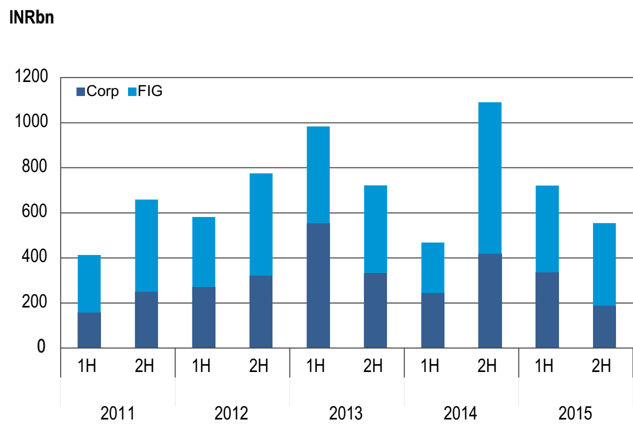
India Announced M&A Advisory Ranking FY 2015				
Pos.	**Attorney**	**Value $m**	**# Deals**	**% Share**
1	AZB & Partners	10,788	102	23.1
2	Khaitan & Co	5,876	51	12.6
3	Cyril Amarchand Mangaldas	4,951	28	10.6
4	J Sagar Associates	3,873	56	8.3
5	Luthra & Luthra 3,020 5 6.5			
6	Shardul Amarchand Mangaldas & Co	2,481	20	5.3
7	Singhi & Co	2,428	2	5.2
8	Ashurst	2,277	1	4.9
9	Clifford Chance LLP	2,064	1	4.4
10	Amarchand Mangaldas	1,393	12	3.0

Debt Capital Markets

- India DCM issuance for 2015 reached $37.5bn (via 355 deals), down 28% on the $51.8bn (via 452 deals) raised in 2014
- Corporate IG and Agency bonds accounted for 54% and 24% of the total DCM volume with $20.4bn and $8.9bn, respectively for2015
    - Reliance Industries Ltd. led the offshore issuer table for 2015 with a 24.4% share, while Power Finance Corp Ltd. topped the domestic issuer ranking with a 19.1% share
- India Domestic DCM volume reached INR1.82tr for 2015, down 9% on the INR2.01tr raised in 2014. Activity decreased to 321 deals during 2015 from the 406 recorded for 2014
- International issuance for 2015 reached $8.9bn, down 53% on the 2014 volume of $18.8bn. Activity decreased to 34 deals compared to 45 deals for 2014

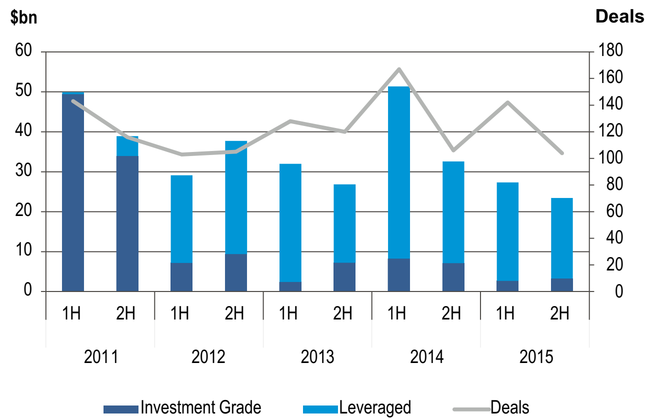


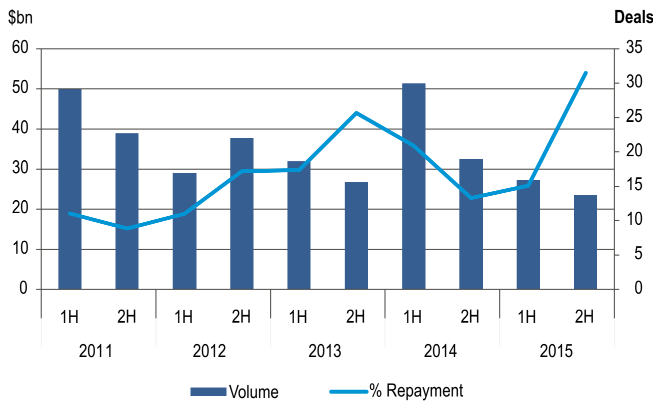


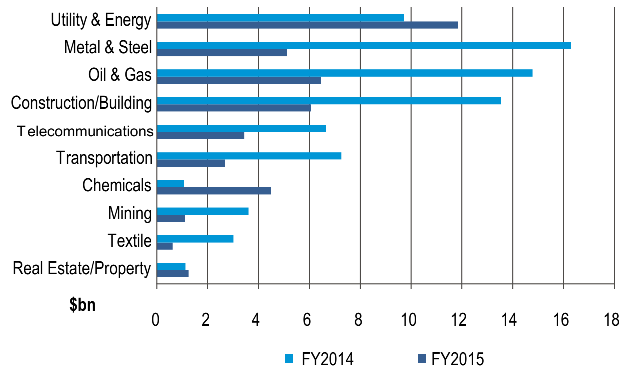


Loan Markets

- **India loan** volume reached $50.8bn (via 246 deals) for 2015, down 40% on the $84.0bn (via 273 deals) for 2014
  - **Leveraged** loan volume decreased drastically to $44.8bn via 225 deals, compared to $68.6bn (via 240 deals) for 2014
  - **Investment grade** loan volume decreased 61% to $5.9bn (via 21 deals) versus $15.3bn (via 33 deals) for 2014
- Among the corporate borrowers, **Utility & Energy** sector topped the industry ranking for 2015 ($11.8bn) with a 25.6% share
- **ONGC Petro-]additions Ltd.'s** $2.6bn leveraged deal in April arranged by **SBI**, is the largest loan transaction for 2015







Project Finance

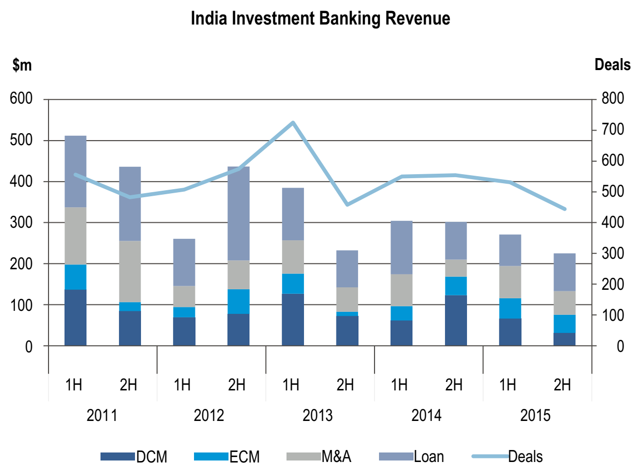
India Project Finance Loans Ranking FY 2015				
Pos.	Mandated Lead Arranger	Value $m	# Deals	% Share
1	State Bank of India	18,401	73	53.6
2	Axis Bank Ltd	5,728	26	16.7
3	Rural Electrification Corp Ltd	1,650	12	4.8
4	IDBI Bank Ltd	1,397	10	4.1
5	Power Finance Corp Ltd	1,222	10	3.6
6	IDFC Securities Ltd	779	10	2.3
7	ICICI Bank Ltd	459	7	1.3
8	India Infrastructure Finance Co Ltd	424	11	1.2
9	Oriental Bank of Commerce	334	1	1.0
10	Syndicate Bank Ltd	254	3	0.7

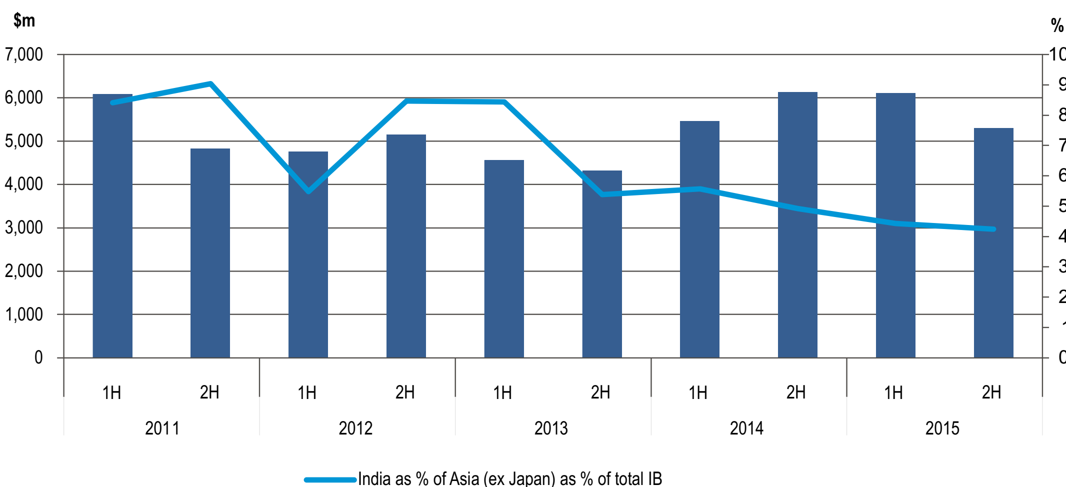
India Sponsor Ranking for Project Finance FY 2015				
Pos.	Sponsor	Value $m	# Deals	% Share
1	Adani Group	3,916	9	9.3
2	Aditya Birla Group	1,946	2	4.6
3	Hindalco Industries Ltd	1,854	4	4.4
4	Jaiprakash Associates Ltd	1,417	4	3.4
5	GAIL (India) Ltd	1,319	1	3.1
6	Oil & Natural Gas Corp Ltd-ONGC	1,319	1	3.1
7	Vedanta Resources plc	1,319	3	3.1
8	JSW Steel Ltd	1,296	3	3.1
9	IRB Infrastructure Developers Ltd	1,125	3	2.7
10	Essar Group	1,097	5	2.6

Top 10 Indian Project Finance Deals FY 2015				
Financial Close Date	Borrower	Project Name	Sector	Value $m
23-Apr	ONGC Petro-additions Ltd	Opal SEZ Petrochemical Complex Refinancing	Petrochemical/Chemical Plant	2,639
29-Jun	Teesta Urja Ltd	Teesta III Hydroelectric Power Plant PPP Amendment	Renewable fuel	1,792
26-Aug	Hindalco Industries Ltd	Aditya Aluminium Smelter Project and Power Plant Refinancing 2015	Processing plant	1,479
28-Nov	Vedanta Ltd	Vedanta Aluminium Smelter & Refinery Refinancing	Power	1,199
8-Oct	Himachal Baspa Power Co Ltd	Karcham Wangtoo and Baspa HydroPPP Projects Acquisition	Renewable fuel	1,161
30-Apr	Jaypee Infratech Ltd	Noida to Agra Expressway Project	Road	1,070
28-Feb	RattanIndia Nasik Power Ltd	Nasik Thermal Power Project Phase I	Power	1,006
9-Dec	Adani Power Ltd	Mundra Thermal Power Project Phase 4 Refinancing	Power	880
28-Mar	Krishnapatnam Port Co Ltd	Krishnapatnam Port PPP Refinancing	Port	821
17-Nov	HPCL Shapoorji Energy Pvt Ltd	HPCL Shapoorji LNG PPP Project Oil Refinery/LNG and LPG	Plants	820

IB Revenue

- India IB revenue reached $496m for 2015, down 18% on 2014 ($606m). Revenue for 2H 2015 ($225m) was also down by 25% compared with 2H 2014 ($302m)
- Syndicated Loan fees was down by 24% to $169m during 2015 versus $222m for 2014
- DCM revenue accounted for 20% of total India IB revenue for 2015 with $97m which is down by 47% on the $185m for 2014
- M&A fees accounted for 27% of the total India IB revenue for 2015 with $136m which is up by 13% on $120m for 2014
- ECM fees accounting for 19% of the total India IB revenue, increased 17% to $94m in 2015 from the $80m for 2014





Synopsis of Past Events

FINCON 2016

17th Annual Insurance Conference

January 22, 2016 - Trident, Nariman Point, Mumbai

(L to R- Mr. G Srinivasan, Co-chair, FICCI Committee on Insurance and Pensions and Chairman and Managing Director, The New India Assurance Co Ltd; **Mr. Rashesh Shah**, Vice President, FICCI and Chairman and Chief Executive Officer; **Mr T S Vijayan**, Chairman, Insurance Regulatory and Development Authority of India (IRDAI); **Mr T S Vijayan**, Chairman, Insurance Regulatory and Development Authority of India (IRDAI))

FICCI organized its 17th Annual Insurance Conference - **FINCON 2016**, on January 22, 2016 in Mumbai. The theme of this year's conference was 'The Changing Face of Indian Insurance'. Based on this theme, the Chief Guest of the event - Mr T S Vijayan, Chairman, Insurance Regulatory and Development Authority of India (IRDAI) released the FICCI - **BCG knowledge paper: 'The Changing Face of Indian Insurance - In Pursuit of Profitable and Sustainable Growth'**. The report has attempted to provide a roadmap along with a 14-point action plan for the Indian insurance companies to enable them sustain growth in the present challenging environment.

Other dignitaries present at the Inaugural Session of the programme were **Mr. Rashesh Shah**, Vice President, FICCI and Chairman and Chief Executive Officer, Edelweiss Group, **Mr. Amitabh Chaudhry**, Chair, FICCI Committee on Insurance and Pensions and Managing Director & Chief Executive Officer, HDFC Standard Life Insurance Co. Ltd and **Mr. G Srinivasan**, Co-chair, FICCI Committee on Insurance and Pensions and Chairman & Managing Director, The New India Assurance Co Ltd.

Mr Vijayan focused on the three main aspects of insurance: products, technology and customer grievances. He highlighted the changes sweeping the insurance sector in India, the Insurance Act being the most significant among these and how these changes have made it imperative for the regulator to respond in an appropriate manner. Though the industry is very buoyant, there is potential for growth. He further advised the Indian insurers to focus on building new business models rather than focusing on the old ones. Speaking on the customer grievances, he emphasised that insurance is a service and not a product and customers should be aware of their rights. He also expressed concern for the people working in the sector as it employs more than 20 lakh people.

Industry captains comprising CEOs and MDs of leading Life and Non-Life insurance companies discussed various other sector-related aspects at the forum which included digitization in insurance - a trend for the present or for future, the need for the next gen leaders and whether the industry is doing enough to groom next gen talent, the approach that insurers must adopt in terms of operations excellence, and the emergence of next gen insurance products, catering to the evolving consumers' needs.

A special session was also organized for the technology solutions providers in which leading and upcoming technology firms like Blue Prism, Kloutix Solutions, Vixta Communications and AccelTree Software made their presentations before the audience, showcasing how technological solutions can help insurance companies enhance performance and achieve operations excellence.

The conference also witnessed a very robust participation from insurance companies, brokers, agents, bancassurance executives and other executives from the financial services sector, law/audit firms and academic institutes.

Conference on
Pensions Sector in India
Growth Opportunities and Challenges
December 9, 2015 at FICCI, Federation House, New Delhi

(L to R- **Mr. Amitabh Chaudhry**, Chair, FICCI Committee on Insurance and Pensions and Managing Director & Chief Executive Officer, HDFC Standard Life Insurance Co. Ltd; **Mr. Hemant Contractor**, Chairman, Pension Fund Regulatory and Development Authority (PFRDA); **Mr. G N Bajpai**, Former Chairman-Securities and Exchange Board of India (SEBI) and Life Insurance Corporation of India (LIC); **Ms. Parizad Sirwalla**, Partner and Head, Global Mobility Services, Tax, KPMG in India)

FICCI organized a conference on the **Pensions Sector in India, on December 09, 2015 at FICCI**, Federation House, New Delhi. The theme of the conference was 'Growth Opportunities and Challenges'. The chief guest at the conference, Mr. Hemant Contractor, Chairman, Pension Fund Regulatory and Development Authority (PFRDA) released a FICCI-KPMG Knowledge Paper titled 'Employee pensions in India - Current practices, challenges and prospects'. The FICCI-KPMG white paper provides a comparative analysis of employer pension plans like EPF, NPS and Superannuation Funds and lists factors that have a bearing on growth of these plans. The paper also presents views of employers on factors that could help improve the pension coverage in the country. The complete report is available at http://ficci.in/sector.asp?secid=23.

Other dignitaries present at the Inaugural Session of the programme were **Mr. G N Bajpai**, Former Chairman-Securities and Exchange Board of India (SEBI) and Life Insurance Corporation of India (LIC), **Mr. Amitabh Chaudhry**, Chair, FICCI Committee on Insurance and Pensions and Managing Director & Chief Executive Officer, HDFC Standard Life Insurance Co. Ltd and **Ms. Parizad Sirwalla**, Partner and Head, Global Mobility Services, Tax, KPMG in India.

Mr. Hemant Contractor in his inaugural address said that the government's Atal Pension Scheme had received a good response and it had been able to attract many individuals from the lower strata of society. However, he mentioned that the government needs to create a social scheme for the people below the poverty line, who do not have the capacity to join a voluntary pension scheme and which would provide them coverage when they turn senior citizens. He also said that the government and PFRDA were working towards developing pension schemes that were flexible, portable and transparent in terms of financial implications. He added that the sector needs to be regulated to safeguard the interest of the people from the lower income group.

Mr. G N Bajpai, Former Chairman-Securities and Exchange Board of India (SEBI) and Life Insurance Corporation of India (LIC) another key speaker at the event, said that pension schemes in India like other financial products is a push product, of which a majority of the people are not aware about. He added that there was a lack of ownership about the customer as well and once a person joins a pension scheme there is no agency accountable to attend to the needs and grievances of a customer.

The event provided a platform to the stakeholders to deliberate on the various challenges and issues faced by the pension sector in India, identify the growth opportunities that exist for the sector and explore various ways to broaden and deepen the pension coverage in India.

The event was attended by CHROs, CFOs, Pension Fund Managers, POPs, Insurance Companies, Mutual Funds and members of academia.

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