

# Anatomy of NPA of Banks in India





# Introduction

NPAs reflect the performance of banks. A high level of NPAs suggests high probability of a large number of credit defaults that affect the profitability and net-worth of banks and also erodes the value of the asset. The NPA growth involves the necessity of provisions, which reduces the overall profits and shareholders value.

The issue of Non-Performing Assets has been discussed at length for financial system all over the world. The problem of NPAs is not only affecting the banks but also the whole economy. In fact high level of NPAs in Indian banks is nothing but a reflection of the state of health of the industry and trade. Non-performing assets are typically listed on the Balance Sheets of banks.

According to **Global Financial Stability Report-**

“India’s gross NPA stands at 9.6% of which infrastructure, aviation, basic metals, cement industry are the chief contributors to the mess.”

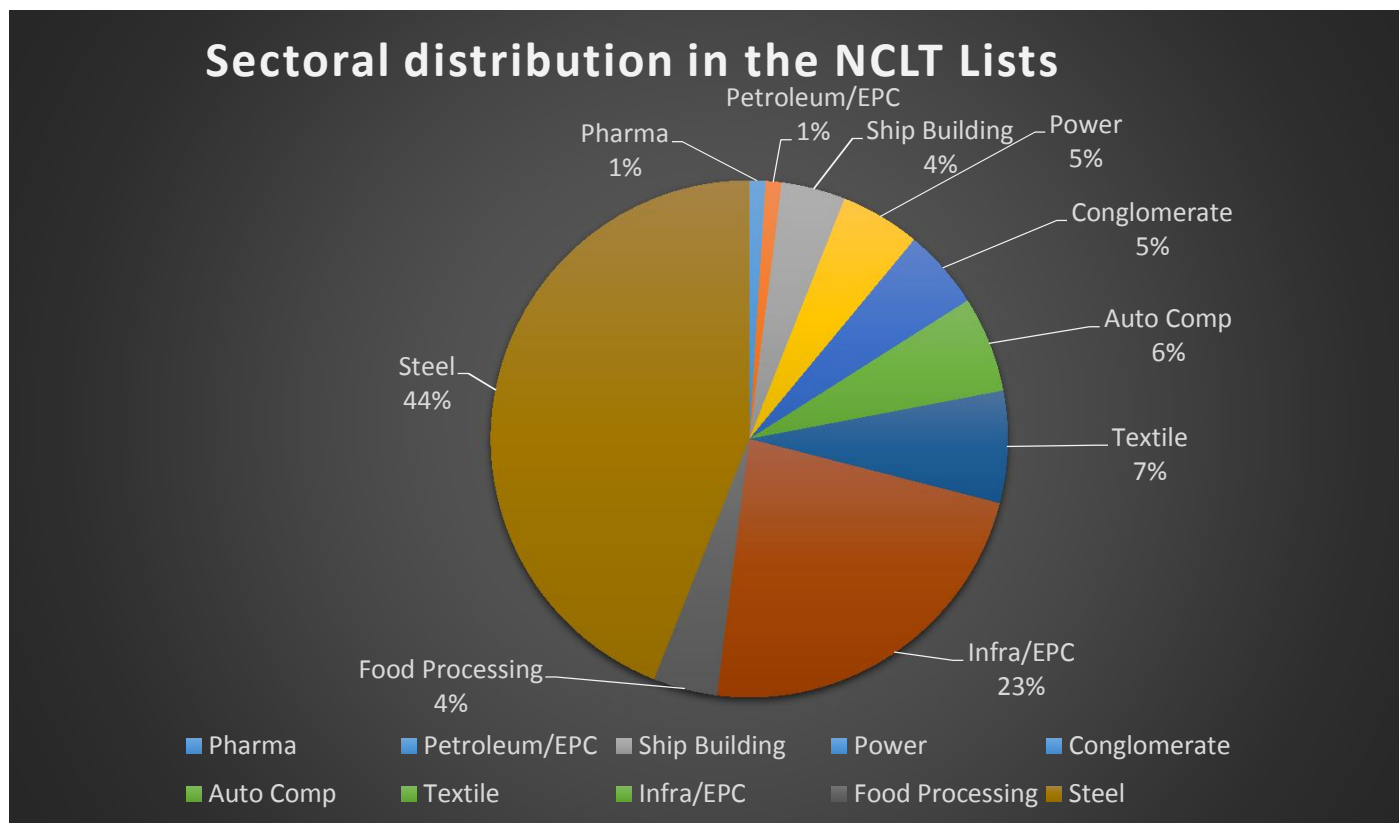


# Meaning

The assets of the banks which don't perform (that is – don't bring any return) are called Non Performing Assets (NPA) or bad loans. Bank's assets are the loans and advances given to customers. If customers don't pay either interest or part of principal or both, the loan turns into bad loan. According to RBI, terms loans on which interest or instalment of principal remain overdue for a period of more than 90 days from the end of a particular quarter is called a Non-performing Asset.

# Centre of attraction

**Steel assets have the highest share among stressed assets but is also seeing a lot of interest from bidders**





# Causes of NPA

NPA arises due to a number of factors or causes like:-

1. **Speculation**: Investing in high risk assets to earn high income.
2. **Default**: Willful default by the borrowers.
3. **Fraudulent Practices**: Fraudulent Practices like advancing loans to ineligible persons, advances without security or references, etc.
4. **Diversion of Funds**: Most of the funds are diverted for unnecessary expansion and diversion of business or for utilized for personal purpose.
5. **Internal Reasons**: Many internal reasons like inefficient management, inappropriate technology, labour problems, marketing failure, etc. resulting in poor performance of the companies.
6. **External Reasons**: External reasons like a recession in the economy, infrastructural problems, price rise, delay in release of sanctioned limits by banks, delays in settlements of payments by government, natural calamities, etc.



# Snapshot of Banking Scams that shook the Nation and the Financial System of India

Sr. No.	Case Name	Amount Involved (approx.) (Rs. In Crores)	Brief Facts & Reasons for asset turning to NPA
1	Zoom Developers Pvt. Ltd. – PNB Bank	3,000	<ul style="list-style-type: none"> <li>Zoom used to sign contracts with aggregators to get international orders and to execute projects for third parties</li> <li>The aggregators would make advance payments to Zoom and used bank guarantee from an Indian bank of an equal amount issued to the company as security</li> <li>These aggregators were not independent companies, rather these companies were controlled by director of Zoom Developers via trust set up by him - Beverin Stiftung</li> <li>These contracts did not have any clause of final payment- some contracts did not have name of the third party for which the work was being commissioned</li> <li>Despite of these loopholes, banks issued to guarantees to the company</li> <li>Zoom Developers diverted at least 35% of the borrowed money to subsidiaries.</li> <li>Another 15% was siphoned off to shell companies such as Bebra Engineers P Ltd and Zio Technologies Pvt Ltd.</li> <li>Zoom diverted at least Rs 287 crore out of the Rs 410 crore borrowed from Punjab National Bank for projects in China and Singapore</li> </ul>
2	Winsome Diamonds & Jewelleries Ltd.	6,800	<ul style="list-style-type: none"> <li>Winsome Diamonds imported lots of gold from the international suppliers for which banks issued Letter of Credit on behalf of Winsome Diamonds.</li> <li>The company converted imported gold into diamonds &amp; then sold or exported the same to 13 companies located in Sarjahan, which were ultimately Winsome group companies.</li> <li>Banks gave buyer's credit of Rs. 4366 crores to not only Winsome, but also to its group companies- Rs. 1932 crores to Forever Precious Jewelleries &amp; Diamonds and Rs. 283 crores to Su-Raj Diamonds also</li> <li>Winsome was not able to pay the amount the company's customers, which were in Sarjahan, lost \$1 Billion in derivatives, which was not the actual case- the ultimate purpose was to commit fraud</li> <li>Fake companies were created as Sarjahan has least import duty and money laundering laws &amp; KYC norms are much simpler</li> <li>This fraud continued from 2012 to 2017</li> </ul>

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3	Bhushan Steel	46,062	<ul style="list-style-type: none"><li>• Bhushan Steel's control over availability, quality and cost of input steel was very limited. And thus, in 2003, they decided to build an integrated steel plant in Odisha</li><li>• Banks were eager to lend to a company with an impressive order book of clients like Maruti Suzuki, Mahindra and Mahindra, and Tata Motors</li><li>• The company was promised a ready supply of iron-ore and coal needed to make steel.</li><li>• Steel is a cyclical business, and as Chinese demand tapered after the 2008 Olympics, prices plummeted as fast as they had once peaked</li><li>• By 2010, Bhushan Steel was already shouldering loans worth Rs 11,404 crore. Still, the company went on a borrowing spree to finance the next phase of construction.</li><li>• By 2012, the steel industry was slipping behind on interest payments as steel prices fell to \$300/tonne that December from a 2008 peak of \$1265/tonne</li><li>• The company was spending more than Rs 1,600 crore a year in interest payments alone, according to Bhushan's 2014 annual report. Still, banks had extended almost Rs18,000 crore in fresh loans and working capital. Many of those loans were secured against the company's stock</li><li>• The bank further extended a credit limit of Rs. 100 crore that was beyond their credibility via middlemen</li><li>• The company was not able to repay the amount and thus the loans were converted in to NPA.</li></ul>

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Sr. No.	Case Name	Amount Involved (approx.) (Rs. In Crores)	Brief Facts & Reasons for asset turning to NPA
4	Kingfisher Airlines	9,000	<ul style="list-style-type: none"><li>• Kingfisher never made profit since its launch in 2005, yet banks were willing to give loans to Kingfisher</li><li>• For once, United Bank classified him as willful defaulter, but then it had to withdraw the tag the Kolkata bank's decision.</li><li>• Declared as NPA in January, 2012 by SBI, along with 17-bank consortium, in later months, five more lenders classified Kingfisher as NPA.</li><li>• Its license was cancelled in December, 2012.</li><li>• The company didn't focus on profitability and focused more on becoming major air carrier in a short span- included many luxurious facilities at low cost as compared to other air carriers</li><li>• lack of delegation was also seen as the airline had no long term CEO</li><li>• One of the reasons was also that fuel prices, airport charges, etc. was high because of Recession that was set in 2008 that affected the whole world</li><li>• Kingfisher also wanted to become an international air carrier at the initial stage, but as it was allowed that a domestic airline can go international on completion of 5 years</li><li>• Kingfisher acquired a loss-making Air Deccan at high price. Later on lack of synergy between the two was observed</li></ul>
5	The Nirav Modi Scandal	14,000	<ul style="list-style-type: none"><li>• Initially in 2011, LoU(s) of around Rs.800 crore were issued against counterfeit stock and books of accounts unauthorized via SWIFT, sanctioning loans to be disbursed abroad</li><li>• To execute this scam Nirav Modi acquired some counterfeit companies abroad to siphon off the money</li><li>• Bogus transactions were made with the sister concerns of Nirav Modi's firms to show the business operations of the firm</li><li>• This issuing of LoUs continued on behalf of some companies belonging to Nirav Modi Group viz. Solar Exports, Stellar Diamonds and Diamond R US for availing buyers credit from overseas branches of Indian banks for almost 8 years without being detected</li><li>• None of these issuing of LOUs were routed through CBS</li><li>• Initially, at the time of issuing of small amount of LoU, the transaction was routed through CBS</li><li>• Subsequently the LoUs amount were enhanced and these transactions were not recorded on CBS hence avoiding detection</li><li>• To settle the dues of the firm more LoU's were issued by PNB</li></ul>

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6	Rotomac Global Pvt. Ltd.	3,695	<ul style="list-style-type: none"><li>• As per Investigation findings, Rotomac allegedly cheated a consortium of banks to the tune of Rs.3695 crore from 2008 to 2013</li><li>• The company had taken loans from 7 banks including BOB, Bank of Maharashtra, IOB, UBI, Allahabad Bank, OBC for executing export order</li><li>• While no execution of export orders took place which is a violation of FEMA guidelines and complete breach of trust.</li><li>• The money disbursed by the bank for procurement of goods and some other export materials were utilized for purpose other than executing export orders.</li><li>• Most of the transactions routed through the loan account where made to/ from sister concerns or seemed that the transactions were not genuine in operations.</li><li>• Credit sanctioned for a particular export order was diverted to a different offshore company and then later the money was routed back to Rotomac without executing export orders.</li></ul>
7	RP Info System	515	<ul style="list-style-type: none"><li>• According to the complaint filed by Canara Bank, RP Info System has cheated Canara bank and 9 other members of a consortium to the tune of Rs. 515.15 crore</li><li>• The company has committed fraudulent transactions through the borrowal accounts of the member banks of the consortium consisting of Canara Bank, State Bank of India, State Bank of Bikaner &amp; Jaipur, Union Bank of India, Allahabad Bank, Oriental Bank of Commerce, Central Bank of India, Punjab National Bank, State Bank of Patiala, and Federal Bank.</li><li>• These funds availed from these banks were obtained by counterfeit stock/ debtor statements hence inflating the drawing power also by providing forged documents.</li><li>• The sale proceeds from the operations of the business were not routed through these borrowal accounts and siphoned off the funds</li><li>• Also, manipulated financial statements were provided to the bank.</li><li>• These accounts have now turned NPA.</li></ul>

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Sr. No.	Case Name	Amount Involved (approx.) (Rs. In Crores)	Brief Facts & Reasons for asset turning to NPA
8	Simbhaoli Sugar Mills Ltd.	200	<ul style="list-style-type: none"><li>• The company was reportedly found fraudulently diverting funds obtained from banks for purpose other than which the funds were obtained</li><li>• The Reserve bank of India extended its support by facilitating priority-sector lending for individual farmers and self-help groups</li><li>• A MOU was signed between the bank and the company in 2012 as per which the company would act as a corporate guarantor of the farmers, providing them seeds, fertilizers and equipment for which the Oriental Bank of Commerce disbursed around Rs.148 crores</li><li>• Fraudulently around Rs. 97.85 crore were transferred from the account of Oriental bank of Commerce by Simbhaoli to its another bank accounts with State Bank of India, Punjab National Bank, and UCO bank</li><li>• These funds were used to clear off the dues of the company to its suppliers</li><li>• The loan account was converted into NPA on 31st March,2015</li><li>• Further, additional loan worth Rs.110 crore was issued to the company by a consortium of banks led by SBI which was utilized to clear off its previous dues</li><li>• Later this corporate loan account also turned NPA in November, 2016.</li></ul>



# Impact on Indian Economy (Micro as well as Macro Factors)

- ❖ Restriction on cash flows done by bank due to provisions of fund made against NPA
- ❖ Low interest on deposits and high interest on loans- banks are required to reserve more money as provision against the possibility of default, banks have less money to lend and have to pay huge interest on deposits
- ❖ Affects the liquidity position of the banks
- ❖ Higher the amount of NPA of a bank, weaker the bank's revenue stream.
- ❖ Stakeholders of bank will lose money.
- ❖ Lower growth, higher inflation in the economy.



# Actions taken by Government due to rising NPA in banking system of India-

- ❖ Capital Infusion in Public Sector Banks by Government by-
- ❖ Budgetary allocations
- ❖ Raising funds through market by issue of equity shares
- ❖ Issue of Recapitalization bonds by Government
- ❖ Implementing Insolvency and Bankruptcy Code
- ❖ Ban on Restructuring of Loans
- ❖ Focus on Asset Quality Review to identify NPAs correctly.
- ❖ Ban on fresh lending by public sector banks under Prompt Corrective Action (PCA) Framework.
- ❖ Reduced Political Interference in Bank Governance
- ❖ Banks spared from classifying certain assets as NPAs for two more years
- ❖ Bank Led Resolution Approach (BLRA) for loans between Rs 50 and Rs 500 crore. Under the BLRA approach, financial institutions will enter into an inter-creditor agreement to authorize the lead bank to implement a resolution plan in 180 days.



## Challenges to CA

- ❖ High use of technology in banking makes it difficult for a CA to understand backend processes, when bank staffs itself is not fully aware about backend processes taking place in bank's IT System.
- ❖ Complex financial transactions involving international financial systems.
- ❖ Very less time available for auditing bank's financials
- ❖ Many a times, bank's record keeping is not up to date. Record keeping is not fully digitized.
- ❖ Hostile approach of bank management towards auditors.



# Recommendations

- ❖ More use of automated credit rating tools
- ❖ Better feasibility and promoter background study and better risk management practices
- ❖ More training to operational staff regarding backend processes in bank's core banking system.
- ❖ Early appointment of auditors
- ❖ Training of auditors by ICAI and other professional bodies for banking technology and bank audits.
- ❖ Recapitalization of banks by Government of India based on achievement of clearly defined performance targets.
- ❖ Zero tolerance on corruption cases through fast and fare legal system.
- ❖ Bank Boards should be professionally managed without political interference.