Banks face triple whammy: Nirav Modi, NPAs & rising yields

By *Mayur Shetty*, TNN | Updated: Mar 26, 2018, 02.57 PM IST

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MUMBAI: As one of the most eventful quarters for banks comes to a close, lenders' balance sheets are hit by a triple whammy that could take them a while to recover.

The most obvious loss during the quarter has been due to the Nirav Modi fraud. Typically, banks wait for 90 days until repayment becomes due before classifying a loan as a non-performing asset (NPA). But in the case of a fraud, they have to immediately classify it as an NPA. In the Nirav Modi/Mehul Choksi scam, the total exposure of lenders either through loans against unauthorised Letters of Undertaking (LoUs) or credit limits is over Rs 20,000 crore.

The second hit is due to rise in bond yields. According to ratings agency ICRA, 18 public sector banks (PSBs) lost Rs 11,100 crore due to fall in the value of their bond portfolio. Their overall treasury losses stood at Rs 5,600 crore. With bond yields rising 40bps (100 basis points =1 percentage point) in the fourth quarter, losses on portfolio are expected to be over Rs 12,000 crore. According to Deep Mukherjee, risk management expert and visiting faculty at Indian Institute of Management-Kolkata, interest rates will trail global rates. This will have consequences on equity and forex markets as well. "Recovery of Indian banks faces headwinds from higher interest rates, pressure of exchange rates and possible pressure on corporates," he said.

The third and the biggest imponderable is the provision towards NPAs. Banks entered the fourth quarter with much optimism, stating that most of the NPA woes are behind them and huge recoveries are likely as they sell multi-billion dollar companies of defaulters under the Insolvency and Bankruptcy Code (IBC). However, two developments since have crashed their hopes.

The RBI on February 12 asked lenders to scrap all restructuring programmes and ensure that all defaulters were classified as NPAs. This meant that banks can no longer hide defaults under schemes like corporate debt restructuring (CDR), flexible restructuring of long-term project loans (5:25 scheme), strategic debt restructuring (SDR) and scheme for sustainable recast of stressed assets (S4A). Henceforth, if a default is not resolved soon, banks will have to initiate insolvency proceedings after classifying the account as an NPA.

According to analysts, the unrecognised stressed assets are about Rs 3.5 lakh crore.

Finally, to add to banks' distress during the quarter is the fact that the expected resolution of large defaults have not taken place under the IBC. Several large accounts, including Binani Cement, Bhushan Power and Electrosteel, are facing litigation. Reliance Communications, which was expected to sell over Rs 20,000 crore of assets to Reliance Jio, has been unable to do so because of litigation by equipment supplier Ericsson.

Lenders were also optimistic that few of the 12 accounts that they had referred to the Insolvency and Bankruptcy Court would be resolved in this quarter, which would improve their bottom line by several thousand crores of rupees. None of that has happened.

"The current level of NPA provision coverage would have enabled the banking system to have taken a haircut of 47% without any further provision or capital requirement. This is a somewhat optimistic scenario that implies 53% recovery and Rs 4.8 lakh crore of equity flowing into the NPA corporates — a massive amount by any standard," said Mukherjee. Global experience suggests that from peak delinquency levels, it takes seven to 10 years to normalise banking operations, he added.