View: Getting proactive on identifying NPAs may de-risk the future of banks

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A much-flogged statistic on the stress in the Indian banking system is that the 1,000 largest accounts tot up to half of the non-performing assets (NPAs). Less analysed, however, is the fact that about 15,000 to 20,000 large accounts (with credit limits over Rs 5 crore) could account for as much as 35% of the balance NPAs. (Source: Crisil/ market estimates) Evidently, the bad loan problem is way more entrenched, and widely dispersed, than where the focus of the popular narrative is.

To clean the Augean stables is never easy, but banks need to do four things to start structurally derisking the lending ecosystem and deter delinquent behaviour:

1. Change the monitoring approach, make it more holistic: Currently, the focus of senior staff at banks is disproportionately on the biggest accounts, both in terms of recoveries and preventing delinquencies. This focus needs to widen materially, and include more of the smaller (but still large in terms of exposure) accounts, which also form a chunk of the bad loans.

2. Go proactive to manage delinquencies better: Today, monitoring teams have little to no foresight on which accounts are likely to become delinquent because the focus is on managing NPAs than preventing one. That's like trying to fill water in a pot with a hole at the bottom. The approach needs to be reversed, to one where they nip incipient stress in the bud.

3. React to lead indicators, not lagged data: Banks normally review loan accounts on an annual, or at best quarterly, basis. That means the ground reality of many borrowers would have very well deteriorated by the time alarm bells rang. Instead, banks need to invest in and institutionalise stress alerts.

4. Harness the power of exponentially increasing information: While technology has permeated the customer-facing side of banks well, its usage in portfolio monitoring and management is inadequate. Consequently, banks are unable to leverage significant sources of internal and external information available to monitor account performance granularly. All of that can be done if banks have access to real-time, proactive, unemotional, and automated earlywarning portfolio management systems (EWS).

A robust EWS is a comprehensive set of signals on each borrower, delivered electronically. The efficacy of these signals, and their triggers or thresholds, depend on how the EWS generates the picture of a borrower’s propensity to default.

Data for the triggers could be from a variety of information sources, available within or outside the bank, and could come in both structured and unstructured forms.

Internal data sources include core banking, loan origination, internal rating, collections, credit administration and the likes. It goes without saying this should be collated automatically to the extent possible, for doing it manually would defeat the objective of real-time monitoring.

A lot of unstructured data on borrowers and micro-markets are gathered by the bank field staff. This understated, but extremely powerful, on-ground information is often the best early warning signal for the SME segment, where information is typically scarce.

Unstructured information from public databases/ paid databases also has early warning potential — such as information on litigations and cross-ownership structures. It’s possible to mine these today with the emergence of Big Data analytics, and a good EWS system would afford that.

CUSTOMISING FOR MARKETS AND BORROWERS

Triggers and thresholds in EWS also need to be aligned to the nuances of lending to specific segments because their characteristics vary. This calls for differentiated monitoring. For instance, if the number of ‘cheques issued by the borrower that bounced’ is a trigger, its threshold would differ for a large, well-rated corporate (very low tolerance) compared with a small enterprise (high tolerance). And in some cases, the choice of the trigger itself could change depending on the credit segment.

A good EWS system would minimise potential delinquencies by identifying the challenges early and thus help solve it.

ACTIONABLE INSIGHTS MAKE IT A KILLER APP

While EWS frameworks can have strong intellectual underpinnings, they also need good transition ability to convert knowledge and alerts into actionable insights. Which means, the signaling set-up should not be limited to identifying potential stressed accounts; it must ensure adequate oversight through automated workflows so that resolutions are ensured. If the analytics component in EWS is strong, it will also ensure potential trends in a portfolio get factored into lending decisions for new accounts.

BRACING FOR THE DATA DELUGE

The government’s digital initiatives, including through the Goods and Services Tax Networkand the Jan-Dhan, Aadhaar and mobile trinity, are exponentially increasing sources of structured and unstructured data, and changing the paradigm of information flows.

Banks will have to harness that gusher, and re-calibrate their approach. They can begin by re-tuning legacy systems and mating them to scalable EWS solutions that have the modularity to add new information fields on-the- fly. Early adoption, therefore, will make a huge difference.