ARC ‘cure’ may compound NPA disease

RADHIKA MERWIN

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Low provisioning for security receipts against stressed assets could hurt banks

BL RESEARCH BUREAU

Banks, which are already groaning under the burden of non-performing assets (NPAs) imposed on them by the steel, power, infrastructure and manufacturing industries, may be in for yet more bad news.

And this time, it may be because asset reconstruction companies (ARCs), which were intended to take the bad loans off the banks' books, may not be able to recover all the stressed assets.

Typically, ARCs 'buy' banks' bad loans, pay a portion as cash upfront, and issue so-called security receipts (SRs) for the balance, which can be redeemed when the stressed assets are recovered.

If, however, the ARCs' recovery of such assets is poor, banks may have to take a hair-cut on these SRs.

Based on the information available across 27 banks' annual reports for FY18, the total book value of SRs held by the lenders as on March 31, 2018 was about ₹44,000 crore. Strikingly, banks have made an average provisioning of just 16-17 per cent against these SRs. Given that the recovery rate on SRs so far has been just 30-40 per cent, banks may be in for more pain ahead.

PROVISIONALLY SHORT

(in ₹ cr)

	Book value of investments in security receipts (SRs)*	Provisioning against SRs
State Bank of India	10,505.94	167.02
ICICI Bank*	3,995.00	1,558.00
Indian Overseas Bank	3,963.00	196.70
Axis Bank	2,923.97	0
Indian Bank	2,268.60	1,197.00
YES Bank	2,137.79	253.34
Canara Bank	1,973.27	955.63
Allahabad Bank	1,909.19	683.62
UCO Bank	1,788.11	235.77
South Indian Bank	1,339.22	252.39
Andhra Bank	1,213.45	583.71
Syndicate Bank	1,124.50	67.01
United Bank of India	813.49	90.88
Bank of Baroda	698.22	325.27
[illegible]	[illegible]	[illegible]

Karnataka Bank	[illegible]	[illegible]
Oriental Bank of Commerce	429.73	0
Lakshmi Vilas Bank	341.59	47.23
Bank of Maharashtra	215.44	6.43
HDFC Bank	203.77	0
DCB Bank	62.93	1.63

as on March 31, 2018 *latest info available only for FY17

Banks stop recording the assets sold to ARCs as bad loans in their books, and do not make provisions for them. Instead, they record the SR portion as investments, which are rated every year by rating agencies. Based on the amount expected to be recovered on the loans, banks need to do a mark-to-market provisioning every year.

The level of provisioning on SRs (*see table: Provisionally short*) varies across banks, from 2 to 50 per cent. For instance, at Canara Bank, Indian Bank, Bank of Baroda and Andhra Bank, the provisioning on outstanding SRs is upwards of 40 per cent. But SBI, against its SR investments of about ₹10,506 crore, has made a provisioning of just ₹167 crore, or less than 2 per cent.

Such provisioning is in line with the RBI's guidelines, said Venkat Nageshwar, Deputy Managing Director, Global Markets, SBI. "Agencies rate the SRs every six months based on the realisable value of the assets and the expected cash flows. ARCs then arrive at the SR's net asset value (NAV)," he explained.

Other bankers who did not wish to be quoted also attributed the frugal provisioning to the fact that the SRs' NAV are, in fact, close to the book value, implying that the underlying assets have a high probability of recovery.

Poor recovery

But an Assocham-Crisil report notes that the recovery rate till now has been poor, at 36-38 per cent. Bankers and ARCs say the sale of bad loans to ARCs under the 5/95 (cash/SR) structure until 2014 (requiring low upfront payment) led ARCs to grab assets without adequate thought to resolution.

In August 2014, the RBI mandated 15 per cent upfront payment, which led to a more realistic pricing of assets and infused hope that the recovery rate would improve. But even at 44-48 per cent recovery rate, banks' provisioning on SRs may be inadequate. A Canara Bank spokesperson said that rather than take the SRs' NAVs at face value, bankers must exercise prudence and make additional provisioning.

Issuances of SRs could, however, come down, in line with the RBI's new rule requiring higher provisioning if banks invest more than 10 per cent in SRs backed by their own NPAs with effect from April 1, 2018.

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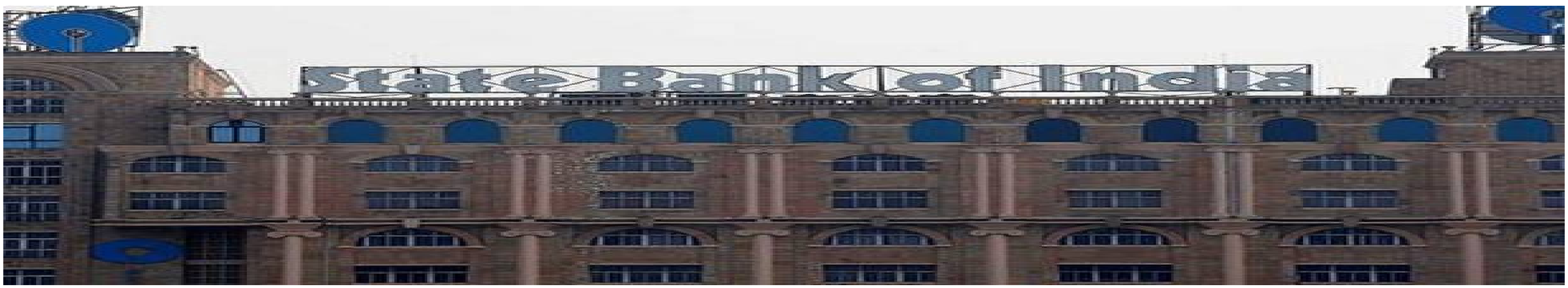

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