

RBI begins simultaneous annual financial inspections for banks

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Abhijit Lele & Anup Roy | Mumbai August 01, 2018 Last Updated at 05:34 IST



The Reserve Bank of India (RBI) has begun simultaneous Annual Financial Inspections (AFIs) for banks for the 2017-18 financial year with an aim to collate a system-wide note on how much banks are underreporting on bad assets.

The review of asset quality is a key element in this exercise. The central bank has its own yardstick on gauging a bad asset, which may differ from a bank's interpretation of bad debt. For example, a bank may think an asset healthy, but RBI may not. If such divergence in reporting becomes more than 15 per cent of what the bank has declared as non-performing asset in its books, then it has to be disclosed.

Since the central bank was doing financial inspections at different points in banks, the divergence numbers were getting reported at various points. The central bank wanted to streamline that and make every bank declare their divergence in one quarter.

The divergence lists for individual banks have been handed over to the lenders, and the banks are in discussion with the RBI on NPA interpretation. "It is a routine affair that happens every year. There is no industry wide list as such. Probably, this year, RBI wants to get a consolidated view of industry on NPA and provisioning," said a senior Bank of India official. RBI has flagged certain accounts for discussions to know their treatment in books and

provisions being made. This is not a list sent by RBI asking to take accounts for NCLT, a SBI executive said.

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The fact that divergences are coming up even now indicates that the economy has not recovered properly and companies are slipping into non-performing assets. At this point, most of the NPA is getting accumulated from the power sector. But banks are also getting active in recovering their dues through a number of initiatives. Some banks have also started dedicated one-time settlement schemes in which promoters are coming to settle their dues. Aggressive asset sales to asset reconstruction companies (ARCs) and putting accounts into insolvency code are also gaining pace.

Global rating agency Standard and Poor's said another year of high provisioning was likely as public sector banks clean up their balance sheets and provide for losses on their stressed assets. Other drags on earnings include lower treasury income amid rising interest rates.

A turnaround in the earning performance of India's banks should take place in fiscal 2020 (ending March 31, 2020). This turnaround could be delayed if large unexpected NPLs materialise in the agriculture sector. The loan-against-property segment may also be vulnerable, S&P said in statement on Tuesday.

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Banks categorised an increasing proportion of weak loans as NPLs due to more stringent requirements by RBI and government. This realistic recognition, coupled with rebounding corporate profits, and quicker resolution of nonperforming assets under the new bankruptcy law, will help banks recover from a protracted bad-debt cycle. The RBI's strengthening norms and stringent timelines mean banks will find it more difficult to window-dress accounts to hide the true level of weak assets.

After RBI shifted to risk-based supervision, much of work on AFI is offsite backed by information technology system and data base. Based on inputs and assessment, RBI executives decide to dig deep into through on-site inspection.

RBI's supervisory processes include evaluation of banks' performance covering banks' financial condition and performance, asset quality, solvency and capital adequacy, earnings performance and liquidity.

It also gets into issues of management and operating conditions focusing on management (board and senior management), systems and internal controls, including risk management strategies; compliance to regulations including integrity of reporting and compliance to guidelines also figures in inspection.