

## NPA Ordinance

### PSU Banks are Potential Prime Beneficiaries

#### **Lack of adequate implementation of NPA resolution options leads Finance Ministry to mull NPA Ordinance**

The Indian Banking system had a bouquet of adequate laws to deal with the NPA menace particularly The Insolvency and Bankruptcy Code, 2016 and the strengthened SARFAESI Act and DRT law. There were also RBI-led initiatives such as CDR, 5/25, SDR, S4A and JLF framework. However, the key was the adoption and implementation of the new Bankruptcy Code and other associated options by banks, which has not happened adequately so far.

Hence, the Indian Finance Ministry opined that the RBI needed to be further empowered to implement the Bankruptcy Code and related options as they feel necessary. It is in this regard that Union Government pressed ahead with the NPA Ordinance, which the President of India approved last night.

#### **RBI to be empowered to intervene effectively in the functioning of banks through modification of Section 35A of The Banking Regulation Act**

The NPA Ordinance seeks to modify Section 35A of The Banking Regulation Act, 1949, which is a section that empowered the RBI to intervene in the functioning of a bank and provide specific directions, if certain conditions are satisfied.

However, the Finance Ministry felt that language of Section 35A was inadequate as far empowering the RBI to act effectively is concerned.

Hence, in this regard, two incremental sections viz. 35AA and 35AB have been added to The Banking Regulation Act. Under Section 35AA, the GOI authorizes the RBI to initiate insolvency proceedings in cases it deems fit.

Section 35AB would empower the RBI to give directions to banks for resolution of specific stressed assets. It would also deal with matters that deal with specific accounts that may be under the aegis of the Oversight Committee..

#### **Finance Minister also mentions incremental rules for recapitalization of PSU Banks**

In the Press Conference on the NPA Ordinance held at 4 pm today, the Finance Minister of the Union Government outlined the aspects of the NPA Ordinance and went on to add that there would be incremental rules laid out for PSU Banks (through relevant MOUs) in order for them to receive capital from the Union Government.

This may prove to be a lever that the RBI can use, in collaboration with the GOI, to enable cooperation of the PSU Banks with RBI directives regarding initiation of bankruptcy proceedings against specific accounts.

#### **Impact on Banking Stocks**

##### **PSU Banks basket to be prime beneficiaries of new regulation**

We look specifically at PSU Banks since the Indian Banking sector's bad loan problem is concentrated in PSU Banks and also because RBI may be able to more readily intervene in the activities of PSU Banks since the NPA Ordinance is a Union Government initiative.

Ultimately, which banks benefit the most from the new regulation will depend on how each bank acts and which specific banks the RBI decides to intervene in more significant manner. A lot would also depend on the idiosyncratic differences in the borrower profile of each banks and the quality of collateral underlying respective loan books. However, suffice to say, PSU Banks as a basket would be prime beneficiaries, given the extent of their bad loan problem.

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### **SBI, Indian Bank, Vijaya Bank, BoB and PNB could be long-term beneficiaries**

Among PSU Banks, the banks with the lowest NNPA Ratio are State Bank of India, Vijaya Bank, Indian Bank and Bank of Baroda (4.2-5.4%) and are therefore, closer to fully providing for their bad loans compared with peers. Hence, these banks are theoretically closest to resolving legacy bad loan issues. If the NPA Ordinance enables these banks to reach complete resolution quickly, they would be able to focus on growth with renewed vigour and would thus be significant beneficiaries from a long-term perspective.

Punjab National Bank, which has an NNPA Ratio of 9.1%, could also be a key long-term beneficiary since the bank has significant loan book exposure to key stressed sectors like Power and Steel, some of which could be to large over-leveraged corporates who could come under pressure to carry out quick NPA resolution.

### **OBC, UBI, Bank of Maharashtra and IOB could see short-term re-rating**

It may also be interesting to note that the banks with the highest NNPA Ratios are Oriental Bank of Commerce, United Bank of India, Bank of Maharashtra and Indian Overseas Bank (9.7-14.3%). These banks therefore, in theory, have the highest potential for moving the needle on the NPA resolution front. Hence, it is possible that if these banks are able to utilize the new regulations effectively then they could see a short-term upward re-rating in valuations.

### **PSU Banks basket – Key metrics**

PSU Bank	Tier 1	NNPA Ratio	GNPA Ratio	RoA (Qtr)	CASA	NIM	Prov Cov
State Bank Of India	10.65	4.24	7.23	0.42	46.55	3.03	62.87
Indian Bank	12.20	4.39	7.47	0.59	38.71	2.52	58.14
Vijaya Bank	9.38	4.74	6.98	0.59	28.70	2.85	55.44
Bank Of Baroda	10.04	5.43	11.40	0.15	40.46	2.49	64.50
Syndicate Bank	9.32	5.63	8.69	0.12	31.00	2.16	54.05
Canara Bank	9.01	6.72	9.97	0.23	32.12	2.34	52.52
Punjab & Sind Bank	9.32	6.84	9.40	0.31			46.48
Union Bank Of India	8.51	6.95	11.70	0.09	36.80	2.04	50.62
Andhra Bank	8.36	6.98	11.88	0.10	31.55	2.66	52.12
Bank Of India	9.08	7.09	13.38	0.06	40.87	2.65	58.71
Corporation Bank	8.60	7.64	11.26	0.26	24.19	2.26	56.93
State Bank Of Travancore	8.84	8.03	12.22	-1.55			
State Bank Of Bikaner and Jaipur	9.14	8.26	11.19	0.20	47.30	3.04	49.27
Central Bank Of India	7.87	8.54	14.14	-0.79	40.75	2.27	54.95
Allahabad Bank	8.23	8.65	12.51	0.13			49.38
UCO Bank	8.20	8.99	17.18	-0.77	32.78	1.79	60.40
Punjab National Bank	8.84	9.09	13.70	0.12	47.09	2.76	54.96
State Bank Of Mysore		9.22	14.46	-0.09			51.22
Dena Bank	8.58	9.52	14.79	0.11			51.61
IDBI Bank Ltd.	8.52	9.61	15.16	-2.32	28.39	0.90	54.63
Oriental Bank Of Commerce	10.13	9.68	13.80	-0.21	32.25	2.14	49.44
United Bank of India	8.66	10.62	15.98	0.21	47.75	1.18	54.62
Bank Of Maharashtra	7.76	11.76	16.93	-1.09			
Indian Overseas Bank	8.28	14.32	22.42	-0.79	36.19	2.14	52.17

Source: ACE Equity; Greyed cells are Q4FY17 data; Remaining data is for Q3FY17

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### ICICI Bank and Axis Bank could also be beneficiaries from the private sector basket

ICICI Bank and Axis Bank have significant loan book exposure to key stressed sectors like Power and Steel, some of which could be to large over-leveraged corporates who could come under pressure to carry out quick NPA resolution.

### Private sector Banks basket – Key metrics

Private Sector Bank	Tier 1	NNPA Ratio	GNPA Ratio	RoA (Qtr)	CASA	NIM	Prov Cov
HDFC Bank Ltd.	12.80	0.33	1.05	0.48	NA	4.31	NA
IndusInd Bank Ltd.	14.72	0.39	0.93	1.74	36.90	4.00	58.00
RBL Bank Ltd.	11.31	0.64	1.20	1.20	23.20	3.38	60.96
DCB Bank Ltd.	11.87	0.79	1.59	0.90	24.31	4.04	73.80
Yes Bank Ltd.	13.30	0.81	1.52	1.80	36.30	3.60	64.90
IDFC Bank Ltd.	17.98	1.14	2.99	0.63	3.30	2.10	NA
Kotak Mahindra Bank Ltd.	14.90	1.26	2.59	0.47	42.00	4.48	NA
The Federal Bank Ltd.	11.63	1.28	2.33	0.24	34.66	3.32	71.01
Karur Vysya Bank Ltd.	11.05	1.68	2.66	0.74	30.80	3.68	67.06
City Union Bank Ltd.	14.39	1.72	2.98	1.45	23.93	4.16	62.00
The Lakshmi Vilas Bank Ltd.	NA	1.76	2.67	0.63	21.42	2.72	62.21
Axis Bank Ltd.	12.43	2.11	5.04	0.84	48.00	3.43	64.00
The South Indian Bank Ltd.	9.40	2.52	3.98	0.63	34.00	2.70	50.20
Dhanlaxmi Bank Ltd.	NA	2.90	7.59	-0.27	NA	NA	78.02
The Karnataka Bank Ltd.	11.86	2.99	4.30	0.44	30.22	2.54	NA
ICICI Bank Ltd.	12.55	4.89	7.89	1.10	49.90	3.12	57.10
The Jammu & Kashmir Bank Ltd.	8.99	5.99	11.84	-2.43	47.42	2.99	61.73

Source: ACE Equity; Greyed cells are Q4FY17 data; Remaining data is for Q3FY17

## Appendix

### I. On the pre-existing Bankruptcy Code

#### ***Thrust on improving speed of NPA resolution***

The primary thrust of the Bankruptcy Code was to improve the speed of resolution by limiting the time period of Insolvency Resolution Process (IRP) to 180 days with a clause for possible extension by 90 days.

#### ***Streamlining process of NPA resolution***

The process of resolution was also streamlined by the introduction of an insolvency regulator viz. Insolvency and Bankruptcy Board of India (IBBI) which, in turn, would regulate Insolvency Professional Agencies (IPAs), Insolvency Professionals (IPs; who would work for IPAs) and Information Utilities (IUs), which would serve as information providers on companies under administration.

#### ***Adjudication responsibilities for NPA resolution***

The National Company Law Tribunal (NCLT) and the Debt Recovery Tribunal (DRT) would be the relevant courts that would deal with cases related to companies and individuals, respectively.

### II. On the SARFAESI Act, 2002 pre-dating the Bankruptcy Code

#### ***Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002***

Under this Act, before the expiry of period of limitation, a creditor can serve a written notice to the borrower for repayment of dues in full.

If the borrower does not discharge his duties within 60 days, then, without the intervention of any court, the creditor can seize the collateral from the borrower.

For the SARFAESI Act, 2002 to be applicable the said loan has to be Secured, declared as NPA by the lender, have a ticket size in excess of INR 1 lac, remaining portion in excess of 20% of original principal and the collateral is not agricultural land.

This Act also provided for the establishment of Asset Reconstruction Companies (ARCs).

### III. Other key Bankruptcy-related laws pre-dating the Bankruptcy Code

#### ***Recovery of Debts Due to Banks and Financial Institutions (RDDBFI) Act, 1993***

The Debt Recovery Tribunals (DRT) were set up under the aegis of this Act.

#### ***The Sick Industrial Companies (Special Provisions) Act (SICA), 1985***

Under the SICA, two quasi-judicial bodies were set up viz. Board for Industrial and Financial Reconstruction (BIFR) and Appellate Authority for Industrial and Financial Reconstruction (AAIFR).

The BIFR would serve to revive sick units and liquidate the ones deemed unviable. The AAIFR would hear appeals against BIFR orders.

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