Tech solutions for bank NPAs

The Reserve Bank of India (RBI) has recently suggested that the twin balance-sheet problem of non-performing assets (NPAs) and credit growth may be over for India. A number of NPA recovery tools are currently being used by the banking system, including Lok Adalats based on RBI guidelines of 2001, Debt Resolution and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, (SARFAESI) Act, 2002, and Debt Recovery Tribunals as special courts and Credit Information Bureaus to track defaulters and recover NPAs.

Fintech & bad loans

However, India continues to be in the undesirable league of nations with high NPAs. Interestingly, financial technology companies (fintech) can play an important role in alleviating this problem. Technology can play a critical role in helping banks, especially public sector banks, reduce NPAs and lower their staggering losses. While public and private sector banks seem to have optimally harnessed the capability of technology in retail banking, the same technological rigor is clearly missing in the case of NPAs. There are at least three ways by which technology can come to the rescue of our fragile banking system that is reeling under the pressure of mounting NPAs. These include robotic process automation (RPA) and early warning system (EWS) based on it, blockchain or distributed ledger technology (DLT) and legal management systems (LMS) that banks can take advantage of.

For instance, banks can use RPA to generate dashboards to provide deeper insights about their borrowers. This will evidently minimise human errors linked to NPAs, mostly in the form of assessment and appraisal of loans. RPA would help in standardising and streamlining the current processes leading to clear accountability, customisable notifications, valuable insights and faster turnaround time. For now, the outcomes of RPA could be used to develop EWS—a set of pre-defined rules and processes based on patterns observed in the data of customers who have already defaulted.

A comprehensive EWS can help the banks detect and flag probable defaulters proactively much in advance, leading to early follow-up. This will ultimately reduce banks’ exposure to NPAs.

These systems fall squarely under the RBI’s revised framework which requires early identification and reporting of incipient stress building up in banks. The apex authority now requires banks to classify stressed assets under categories (SMA-0, SMA-1 and SMA-2) based on a principal or interest that is wholly or partly overdue between 1-30, 31-60 and 61-90 days. Based on closer scrutiny of the borrower’s portfolio and commitments, EWS has the potential to minimise the probability of default by a borrower.

Risk modelling

Based on EWS, banks can exte adopt a more granular approach towards verifying credentials, creditworthiness and overall financial health of prospective borrowers.

The pre-requisite to having these desired outcomes from RPA and EWS is comprehensive data, which has been the Achilles’ heel of policymaking in India. Traditionally, analytics at banks are limited to data gathered internally, mostly collected from disparate, disjointed systems and seem to provide arbitrage to current borrowers. Technology can be leveraged to build a common big-data platform that collates data from multiple sources, including company files, bulletins, news feeds, public sources and many other qualitative data. Big data analysis and machine learning algorithms complement traditional credit assessment methods that are mostly based only on Credit Information Bureau (India) Limited, or CIBIL, scores and financial documentation review. This will provide a more holistic, proactive risk assessment instead of the prevailing system based on reactive assessment.

Do it with blockchain

Blockchain is another disruptive technology that can help solve the NPA problem. Since information on a blockchain exists as a shared and continuously reconciled database, it allows participants to contribute and inspect the reconciled ledger.

Another area of application is in management of court cases and litigation, called legal management systems (LMS). It is a software-based automation of loan recovery mechanisms.

LMS also relies on tapping qualitative and quantitative data about loan seekers and borrowers to handle legal proceedings more effectively, including intimation to defaulters and structuring court hearings. Regulatory bodies can leverage this to care about general developments in fintech they are connected to traditional banks in many ways.

These include investments in and incubation of fintech by banks, formal partnerships for packaging of bank loans to lenders of fintech, fee-based referral arrangements, acquisition of fintech by banks, and banks launching their own fintech solutions to compete with startups. The Indian banking sector realises the importance of incorporating fintech innovations in assessing and managing risk. Even though traditional banks are somewhat lagging behind in the technological race, the opportunities they face are significant. India is perhaps second to China in fintech adoption by consumers among major economies, with India’s fintech market alone predicted to touch $2.5 billion by next year.

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