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NON-PERFORMING LOANS OF THE BANKING SECTOR DECLINE SHARPLY

The State Bank of Pakistan has revised and updated its methodology for recording classification and dissemination of non-performing loans (NPLs) of banks and Development Finance Institutions (DFIs) in order to incorporate the results of actions taken so far to clean up the portfolios of the banks, to represent an accurate and true picture of NPLs in line with the best international practices and to provide clear guidelines for the banks to adopt uniform procedures in strict consonance with the SBP regulations and Supreme Court rulings.

The State Bank of Pakistan, in continuation of its efforts to adopt the best international practices, undertook a detailed exercise to ascertain the banks' methods and practices for recording and reporting of loans & advances, accrued mark-up and non-performing loans. The exercise revealed that banks were following divergent practices, particularly in case of recording unrealized mark-up on non-performing loans. Some of them were charging their customers mark-up on mark-up which was a clear violation of the Supreme Court rulings and the SBP regulations on this subject. Others were adopting calculation procedures which were clearly detrimental to the interests of the borrowers. In some cases, contractual rates of mark-up were changed arbitrarily without proper disclosure or seeking the consent of the borrowers and then penal rates were imposed on the top of it. These methods wrongly inflated the value of the assets and size of the non-performing loans by aggregating this unjustified amount of accrual of mark-up with principal amounts. Instances have come to the notice of the SBP Resolution Committee where the accrued mark-up represented as much as ten times of the original principal amount, thus placing an undue burden on the borrower's capacity to settle the NPL.

On the other hand, several banks with overseas operations did not report the full current market value of their foreign currency NPLs, thus understating the total volume of NPLs. It was also discovered by SBP inspections that some banks were reporting only the overdue portion of the loans and not the entire loan amount in NPLs.

Similarly, the rescheduled and restructured loans were subtracted from the total NPLs.

With a view to avoid these practices, ensure standardization and also to adopt the best international practices the State Bank, after consultations with the Institute of Chartered Accountants of Pakistan and Pakistan Banks Association, has issued guidelines for reporting NPLs to the banks and DFIs under the revised methodology. A copy of this revised methodology is available to the general public and can be accessed through the SBP website.

Under the new guidelines and methodology of the State Bank, banks and DFIs will no longer club accrued mark-up with the principal loans & advances. Instead, accrued mark-up on performing loans will be shown under other assets. This is in line with best international practices as the Audit and Accounting Guides issued by the American Institute of Certified Public Accountants (AICPA) categorizes interest receivable under other assets. The banks and DFIs will place their non-performing loans on non-accrual status in accordance with consultative paper of Basel Committee on Sound Practices for Loan Accounting and Disclosure. Therefore, the un-realized mark-up on such loans will be kept in the memorandum account and will not become part of non-performing loans. The scope of coverage of NPLs data that will be released by the SBP has been enhanced by including NPLs of overseas operations at their current market value in rupees. Further, the rescheduled and restructured loans would now be added and shown as NPLs unless they are reclassified as regular loans on meeting the one year criterion of satisfactory performance.

The actions taken so far by the SBP to clean up the portfolios of the banks consisted of (a) accelerating the pace of recovery (b) the increased loan loss provisions (c) realizing the forced sale value of circumstantial defaulted loans in loss category for last three years and waiving off the difference if any (d) selling some of the irrecoverable loans to CIRC at a discount (e) referring the cases of willful defaulters to NAB for prosecution. These actions have brought about some positive results as cash recovery during 2003 was Rs 32.2 billion i.e., about 14.5 percent of the total NPLs. Provisions held by the banks against NPLs have risen to a coverage ratio of almost 64.3 percent of the entire stock of gross NPLs outstanding of all the banks and DFIs from 60.7 percent in December 2002. Net NPLs to net loans ratio has improved from 10.3 percent to 7.0 percent during the last one year.

Based on the revised methodology, the aggregate NPLs of banks and DFIs as of quarter ended December 31, 2003 depict a reduction of Rs 5.4 billion to Rs.222.7 billion from Rs.228.1 billion in the previous quarter that ended on September 30, 2003. The year-on-year position of NPLs (on comparable basis) also registers a decline of around Rs 24 billion over December 31, 2002. In December, 2002, the NPLs figure of banking sector stood at Rs 247 billion.

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