Syllabus subtopic: Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

Prelims and Mains focus: about the problem of NPAs in the banking sector; types of NPAs; loan write off and waiver

News: Indian banks have been facing a tough time getting back their monies from recalcitrant borrowers for long now. But their biggest hurdle in getting back dues is time. As time stretched, bad loans have only got worse and banks have had to keep increasing their provisions at the cost of profits.

Background

• The Insolvency and Bankruptcy Code (IBC) came into force in June 2016 and was expected to boost banks’ efforts to recover dues. Even after three years after the code’s implementation, recoveries have not improved significantly.
• The objective of the IBC was to provide resolution swiftly so that the value of the asset is not eroded. The fact that bad loans have only got worse in the past three years shows that the code has had limited success in enabling quick resolution.

The following chart shows the surge in various types of bad loans.

Types of NPAs

• Labelling an errant borrower as bad is only the first step by a bank. The real challenge begins when the borrower is either unable or unwilling to clear dues for a long period.
• According to the Reserve Bank of India (RBI), a loan is non-performing if dues are unpaid for 90 days or more.
• A non-performing loan may bounce back to being standard if the borrower restarts regular payments, or it could slip further to being sub-standard and doubtful to finally a loss asset.
• Loss assets are invariably written off.
• Doubtful assets are those that have been bad for more than a year. These
assets formed 6.4% of bank loans as of March 2019, a sharp rise from 4.4% in FY16.

**How are banks dealing with the Bad loan situation?**

- Though the stock of bad loans has come down but banks have been bringing down their bad loan pile *largely through write-offs*.
- The surge in doubtful assets portends a rise in write-offs, going ahead.

**Way ahead**

The enabling conditions for a bad loan to become standard are absent. The economy is in *protracted slowdown* and several stressed sectors are yet to emerge out of their problems. Even as fresh stress has been piling onto bank balance sheets, past pain is only getting intense and this does not augur well for future recoveries.

**What is a loan write-off and how is it different from loan waiver?**

- **Writing off** a loan or asset means considering that it does not have future value or no longer serves the purpose. A *non-performing asset is written off* after all avenues of recovery are exhausted and chances of recovery of due loan seem remote. To clear the balance sheet, all such kind of loans are written off once for all.

- It is a regular exercise that banks conduct in order to clean their balance sheet as well as to achieve tax efficiency. *Although bad loans are written off, borrowers of such loans remain liable for repayment*. There are several cases when such bad accounts were written off but loan recovery was done. Recovery of such accounts, however, happens on ongoing basis under the legal mechanism.

- **Loan waiver** is quite different from writing off a loan as it is the *cancellation of recovery or refraining from claiming the dues*.
- In simpler terms, banks will completely give up on such loans and no recovery will be made.
- **While in cases of writing off, recovery can be made:**
- Waiving a loan is a relief that is *normally provided to farmers*, who are in severe distress due to abnormal conditions such as crop failures, poor
monsoon, floods, earthquake, draught etc that are considered as natural calamities. These are the conditions, which are beyond control, and result in borrowers unable to pay back to banks.

- However, waiving farmers’ loan has **now become a political move** as a catching device for votes.