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

**Prelims and Mains focus:** about the bad loan crisis in the Indian banking system and the reasons for it; its implications and measures taken by the govt.

**News:** Bank stocks have been among the top performers so far this year compared with the broad market trend. This exuberance comes from the fact that **bad loans have fallen in absolute terms.**

**How?**

Since dud assets have reduced, the **propensity to earn interest increases** for lenders. Logically, as earnings increase, the estimates of earnings per share for banks would also be raised.

**What is the reality about reduction in bad loans**

- But investors should look closely at how banks have been able to hack down their bad loan stock. As the accompanying chart shows, **write-offs have contributed in a big way to the fall in bad loans.**
- In the first six months of FY20, banks wrote off more than Rs.80,000 crore of loans. In the past two years, this ran close to Rs.2 trillion.
- In essence, the lenders could not recover any money and were resigned to just forget about it in these cases.

**But why have banks given up? Or have they?**

- Bankers argue write-offs do not mean they have washed their hands of these borrowers. **Efforts at the branch level are made to get the money back.**
- **But the track record of recoveries from written-off accounts shows otherwise.** State Bank of India, the largest lender and one with heft, has recovered a measly Rs.3,222 crore in the first half of FY20 from written off accounts. If the largest lender cannot increase its recovery rate, the chances of other banks doing so are slim.
- To be sure, **banks historically have not been able to recover much from written-off accounts.**

**WHY?** The reasons are varied:

In an economic downturn, it is difficult to press for repayments from companies given that their earnings are hurt.
Also, the infrastructure, such as courts or recovery mechanisms, were not robust enough to help banks recover written-off loans.

- In a disappointment, even the Insolvency and Bankruptcy Code (IBC) has failed to notch up recoveries, barring a few marquee cases. IBC may have resulted in many promoters being ousted from their companies owing to non-repayment of loans.
- But banks are yet to ratchet up their risk-management practices to assess and price loans. As such, even today banks are unable to get back what they have lent in many cases, leave alone the time value of the money, which is interest.
- Write-offs are akin to giving up. Indian banks have been giving up for long now. Add the fact that banks have been lax in their assessment of bad loans, investors should be worried. As a Mint story points out, as many as 10 banks under-reported bad loans for FY19, according to a Reserve Bank of India audit. Both these factors show banks' risk management in poor light.