THE BIG BAD LOAN PROBLEM

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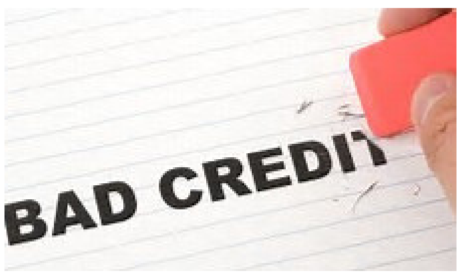
INTRODUCTION

Since the past few months newspapers are flooded with rising bad loans in the Indian Banking sector and how government is planning to get this situation sorted. This bad loan crisis that has gripped India's US $ 28.5 trillion banking sector didn't happen overnight. The writing was on the wall; just that no one wanted to acknowledge it.
Ever since the nationalization of banks, governments has treated these public sector banks as their extended arms and used them for populist measures. While these banks were caught in the competition to increase their total business, very little attention was paid to the quality of assets.



Here's all you need to know how these assets which have now turned into bad loans are becoming a threat to the Indian economy.

WHAT ARE BAD LOANS?

- Bad Loans or Non Performing Assets are loans made by a bank or Finance company on which repayments or interest payments are not being made on time. These assets are not creating any income for the bank.

- The loan is considered to be a NPA once the borrower fails to make interest or principal payment within 90 days.

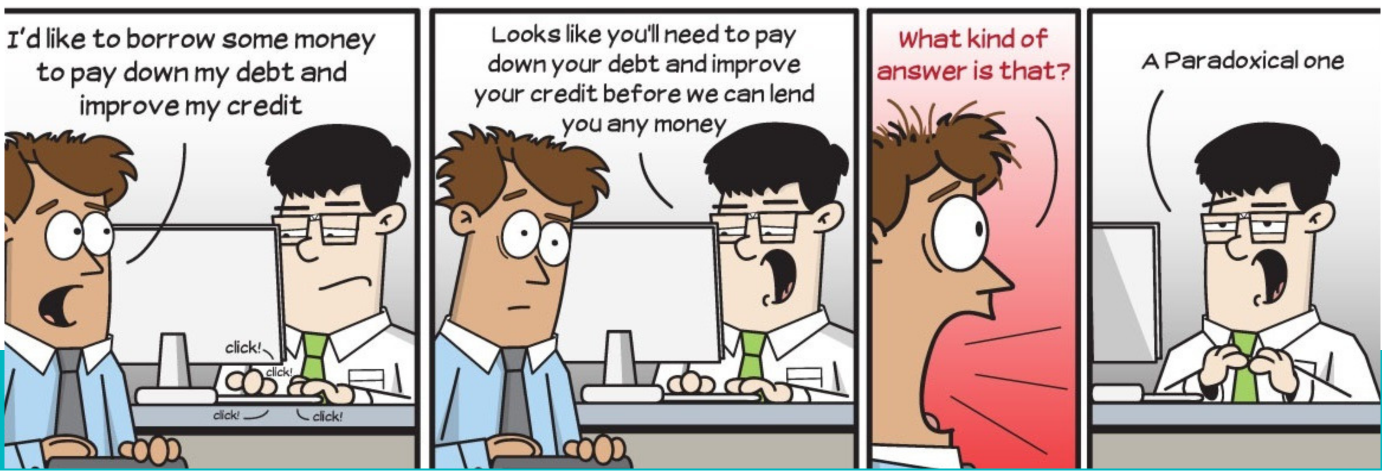
CONTRIBUTORS TO BAD LOANS

There are 2 groups of defaulters who have majorly contributed to this.

1 Big companies and corporate houses:
Public Banks, possibly under political and economic pressure gave loans to a lot of companies which turn into NPAs because of the following reasons:

- Under financing
- Willful defaulters, fraud, mismanagement and misappropriation of funds
- Delay in completing the project.
- Business failures

2 Farmers:
The directed loans system under which commercial banks are required to prescribe a certain percentage of their credit (40%) to priority sectors as agriculture. Since 2012, despite a lot of farm loan waiver schemes, the agriculture sector has led to high NPA.



Bad loans — or non-performing assets (NPAs) amount to a staggering 16% of all loans and nearly 20% of loans at Public Sector Banks

CURRENT SCENARIO

In June 2017, the Reserve Bank of India 's internal advisory committee (IAC) identified 12 accounts that covered about 25 per cent of the banking system's non-performing assets for immediate resolution under the Insolvency and Bankruptcy Code.
Banks which were earlier reluctant to even acknowledge bad loans, started provisioning for them in the aftermath of RBI's stricter NPA recognition norms.

IMPACT ON INDIAN ECONOMY

Banks are the agents of financial intermediation and play a major role in fulfillment of government's social agendas

1 NPAs lead to asset contraction for banks. Due to the presence of NPAs, the banks follow low interest policy on deposits and high interest policy on advances provided. Thus, this act puts a pressure on recycling of funds and further creates a problem in getting new buyers.

2 Rise in NPAs reduces the customer's confidence on the banks. Rise in the NPAs affects the profitability of the bank which further hinders the returns to be received by the customers. A rise in NPAs not only affects the performance of the banks but also affects the economy as a whole.

3 Bad loans imply redirecting of funds from good projects to bad ones. Hence, the economy suffers due to loss of good projects and failure of bad investments

The government amended the RBI Act, giving powers to the central bank to direct banks to take action against individual accounts under the IBC.

Provisioning of NPAs:

Provisioning basically means that the banks estimate that a particular borrower may not be able to pay back the loan in full and hence make a provision of the amount they could loose (as in that won't be paid back to banks). Banks start creating provisions on a loan given when the borrower starts defaulting on his repayment installments.

Measures to be taken by Banks for managing NPAs

Banks today have a herculean task of both effectively managing the NPA's as well as keeping their profitability intact.

1 In order to achieve this, the banks need a well-established credit monitoring system. Since, lending forms a major segment of bank's transactions thus they need to properly evaluate the credit proposals they receive.

2 Bad loans imply redirecting of funds from good projects to bad ones. Hence, the economy suffers due to loss of good projects and failure of bad investments.

3 A centralized model for sanctioning and recovery of loans should be setup. Staff with specialized skills in credit risk management must be hired.

4 Timely watch on the performance of the borrowers must be kept so that recovery of installments becomes easy.