NPAs, Write-Offs and Recoveries

Why in news?

Recently, Gross Non-Performing Assets(NPAs) have fallen, but emergence of fresh NPAs and unsatisfactory recoveries needs banks intervention.

What are NPAs?

- **NPA -** An asset becomes non-performing when it ceases to generate income for the bank.
- It is a loan or advance for which the principal or interest payment remained overdue for a period of 90 days.
- **Types** - Banks are required to classify NPAs into Substandard, Doubtful and Loss assets.
    1. **Substandard assets** - Assets which has remained NPA for a period *less than or equal to 12 months.*
    2. **Doubtful assets -** An asset would be classified as doubtful if it has remained in the substandard category for a *period of 12 months.*
    3. **Loss assets** - Loss asset is considered *uncollectible* and of such little value that its continuance as a bankable asset is not warranted, although there may be some salvage or recovery value.

What is the trend in NPAs?

- There is a *decline in gross non-performing assets (GNPA)* ratio of Indian banks.
- In 2017-18, this ratio was as high as 11.2 % raising concerns on the stability of the banking system.
- In 2022-23 GNPA ratio declined to ***3.9%,*** there has been significant write-offs since 2016-17 amounting to ₹10 lakh crore.
- During last three years (2019-22) alone fresh NPAs add up to ***₹10.61 lakh crore***

NPA movement

Year	Gross NPA (in ₹ lakh crore)	GNPA % to credit	New NPA	Recovery & upgrades	Write-off	Net NPA %
			(in ₹ lakh crore)			
2022-23		3.90				1
2021-22	7.43	4.30	2.83	1.95	1.79	1.70
2020-21	8.35	7.30	4	1.18	2.08	2.40
2019-20	8.99	8.20	3.78	1.57	2.37	2.80
2018-19	9.36	9.10	3.14	1.79	2.36	3.70
2017-18	10.3	11.20	6.04	1.28	1.62	6.00
2016-17	7.9	9.30	4.15	1.2	1.08	5.30

What is loan write-off?

- A loan write-off is a tool used by banks to *clean up their balance-sheets.* It is applied in the cases of bad loans or non-performing assets (NPA).
- If a loan turns bad on the account of the repayment defaults for ***at least three consecutive quarters,*** the loan can be written off.
- By writing-off a loan, the banks set free the money parked for the provisioning and utilise the amount for business (it will no longer be counted as an asset).
- Lost inventory, unpaid debt obligation, bad debts, and unpaid receivables are also written off.
- In the cases of NPA, 100 % provisioning is required in accordance with the Basel-III norms.
- Some recent data show that *private banks have been more active in writing off NPAs* than public sector banks (PSBs).

To know more loan write-off click here.

What is the significance of loan write-off?

- **Tax benefits-** Lenders become eligible for a tax rebate on the total loan value by writing them off.
- **Loan provisioning-** By writing-off loans, lenders don't need to release the remaining limit to defaulting borrowers.
- Doing this helps them release funds previously blocked for a borrower.
- They can use these to provide loans to others in need or for their business.
- **Right to recover-** Lenders don't lose the right to recover outstanding loans even after writing them off.
- They can use the means necessary to recover the full or partial loan amount.
- **Governance-**Writing-off loans help lenders maintain a clean and updated balance sheet, it results in significant decline in NPAs.

How to prevent NPA accumulation?

- **Revisit business models-** Banks needs to revisit business models as fault-lines would

lead to higher NPAs and credit losses.
- Ideally, from lending perspective, banks need as many business models as credit segments and customer segments.
- **Governance -** The layers of governance such as business, risk and operational governance must be regulated along with corporate governance.
- **Fine tune risk appetite-** It is the amount of risk the lender is willing to undertake.
- It needs to be aligned with risk culture, underwriting skills in a particular domain and risk tolerance.
- **Check fund diversion-** The diversion of funds in corporate lending is more widespread and intense.
- Bank collaboration is needed to detect the practice and find a remedial solution for the same.
- **Increase NPA recoveries**- NPA recoveries is low around 25 % of the claim amount.
- Even under the Insolvency Bankruptcy Code 2016, regime the recovery rate has fallen from 45 % to 23.8 %.
- The government, regulators and lenders need to rework these recovery/resolution frameworks.
- **Need of skilled expertise-** Underwriting skills and turnaround skills require high expertise because the changes in industry and real economy are quite fast and global.

References

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2. India today| Loan write-off
3. Investopedia| What is write-off