RBI's Measure on Bad Loan Divergence

Why in news?

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RBI has passed orders to resolve the practice of bad loan divergence by banks.

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What is bad loan divergence?

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- Bad loan divergence is depicting a false picture of the financial position of the banks.
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- The banks do this by altering the numbers in its asset classification and bad loan provisions made as per RBI norms.
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- By unfairly modifying the numbers, the banks seek to make good their bad loans, which in reality brings more complexity into the issue.
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What are the concerns with bad loan divergences?

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- The bad loan divergences by banks put off the crucial issues like bad loans crisis, financial stress of borrower as they present a false picture hoping all issues will solve with time.
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- Unfair representation of restructured accounts increase the complexity of the RBI as it does not have a correct scenario to formulate policies accordingly.
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- Such sharp divergences spell doom when banks carry insufficient capital to absorb sudden losses on account of increase in bad loan provisioning.
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What are the steps taken by RBI to address this issue?

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- The RBI has been taking a series of measures to completely clean up the banks' balance sheets and to resolve other issues sprouting from this bad debt crisis.
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- It set up a committee to study the divergences and how these divergences are affecting its monetary policies.
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- This committee identified the slippages occurring from restructured accounts wherein the original terms and conditions of loans are relaxed to provide a breather to borrowers facing financial stress.
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- It then sent a circular stating the instances of divergences both in material and in provisioning and mandated the banks to provide true statements.
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- The RBI also laid down specific conditions on when the disclosures have to be made and on what formulae the debts have to be calculated.
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Source: Business Line

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