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RBI NOW USES DIVERGENCE TO COMPEL BANKS TO IMPROVE THEIR LOAN-LOSS RATIOS

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

At least three public sector banks that have reported earnings for the January-March quarter have mentioned ‘divergence’ in bad loan recognition and have made provisions for such loans.

Divergence takes place when the Reserve Bank of India (RBI) finds that a lender has under-reported (or not reported at all) bad loans in a particular year and hence asks the lender to make disclosures if under-reporting is more than 10% of bad loans or the provisioning.

Three state-run banks — Union Bank of India, Indian Bank and Central Bank of India — had reported divergence while announcing the results. In all these banks, divergence was spotted for the financial year 2017-18.

Higher provisioning for divergence was one of the reasons for them to report losses for the quarter. Interestingly , divergence was identified not because these banks hadn’t classified the loan as non-performing assets (NPA) but because they were late in classifying them.

NPA classification

Since the date of classification as NPA had been pushed back, the banks had to make higher provisioning due to the ageing factor. In the first stage of NPA, which is the ‘sub-standard’ category, 15-20% provision is required and for next category, which is ‘doubtful’, a 40% provision is required.

“During the annual inspection, RBI supervisors pointed out that if one bank has identified an account as NPA six months earlier, for example, then why have other banks delayed in recognising the same. So, banks have been asked to classify the account as NPA on an earlier date, which means, increase in provisioning requirement due to ageing factor,” a top official from a public sector bank said.

Some bankers said the identification was pushed back by two years in some cases. Since banks had to increase their provisioning, this resulted in higher provision coverage ratios (PCR).

Central Bank of India’s provision coverage ratio had improved to 76.6% as on March 31, 2019, from 63.31% a year earlier, while Union Bank’s improved to 66.24% from 57.18%. Indian Bank’s provision coverage ratio was 65.72%. In 2009, RBI had mandated a 70% provision coverage ratio, which resulted in banks increasing their coverage. However, in April 2011, the mandate was withdrawn.

Provision coverage ratio

With the asset quality of banks starting to worsen from about 2013-2014, the PCR level of banks has fallen sharply.

Now, the banking regulator has found a way to increase the loan-loss ratio without mandating any particular level.

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