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# Problem of Bad Loans

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### Why in News?

In December 2022, Finance Minister Nirmala Sitharaman told Parliament that banks had written off bad loans worth ?10,09,511 crore during the last five financial years. A National Asset Reconstruction Company Ltd. (NARCL) was announced in the Union Budget for 2021-2022 to resolve stressed loans amounting to about ?2 lakh crore in phases.

### What is National Asset Reconstruction Company Ltd. (NARCL)?

The Hon'ble Finance Minister, in the Union Budget 2021 announced the formation of an ARC-AMC structure, comprising of two entities viz. National Asset Reconstruction Company Limited (NARCL), and India Debt Resolution Company Limited (IDRCL) for aggregation and resolution of Non-Performing Assets (NPAs) in the Banking Industry.

NARCL a government entity, has been incorporated on 7th July 2021 with majority stake held by Public Sector Banks and balance by private banks with Canara Bank being the sponsor bank. It is registered with the Reserve Bank of India as an Asset Reconstruction Company under Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

### What are Non-Performing Assets?

NPA refers to a classification for loans or advances that are in default or are in arrears on scheduled payments of principal or interest. In most cases, debt is classified as non-performing, when the loan payments have not been made for a minimum period of 90 days.

Gross non-performing assets are the sum of all the loans that have been defaulted by the individuals who have acquired loans from the financial institution. Net non-performing assets are the amount that is realised after provision amount has been deducted from the gross non-performing assets.

### What is NPA as per RBI?

Non-Performing assets in respect to banks are defined as the loans on which interest or principle is not being paid for 90 days. However, in terms of Agriculture / Farm Loans; the NPA is defined as under:

- For short duration crop if the loan (instalment / interest) is not paid for 2 crop seasons it would be termed as a NPA.
- For Long Duration Crops, the above would be 1 Crop season from the due date.

### What is the Problem of Bad Loan?

- Banks have to keep aside cash to provide cover for these loans. This reduces their capacity to give more loans and thus hampers their growth.
- Bessel norms requires stringent Capital Adequacy Ratio which increases burden on banks

- For economy, it is disadvantageous as banks become more circumspect in giving loans which affect the credit offtake in economy. India is still an economy which is largely dependent on banks to raise capital as the bond market is not that well developed. This leads to declining Gross Capital Formation affecting economic growth.
- Rising of NPAs will lead to a crisis of confidence in the market. The price of loans, i.e. the interest rates will shoot up. Shooting of interest rates will directly impact the investors who wish to take loans for setting up infrastructural, industrial projects etc.
- It will also impact the retail consumers like us, who will have to shell out a higher interest rate for a loan.
- This will hurt the overall demand in the Indian economy which will lead to lower growth rates and of course higher inflation because of the higher cost of capital.
- The trend may continue in a vicious circle and deepen the crisis.

**What are the traditional ways to tackle NPAs?**

- Appointment of nodal officers in banks for recovery at their head office, zonal office.
- Thrust on recovery of loss assets by banks.
- Close watch on NPA by picking up early warning signals and ensuring corrective action.
- Directing state level bankers to be more proactive in resolving issues with state govt.
- Designating ARC as resolution agent of banks.

**What are the legal provisions related to recovery of NPAs?**

- SARFAESI – The Act empowers Banks/ Financial Institutions to recover their NPAs without the intervention of the court, through acquiring and disposing secured assets without the intervention of the court in case of outstanding amounts greater than 1 lakh. SARFAESI, it is accused, has been used only against the small borrowers primarily from MSME sector.
- Recovery of Debts Due to Banks and Financial Institutions (DRT) Act: The Act provides setting up of Debt Recovery Tribunals (DRTs) and Debt Recovery Appellate Tribunals (DRATs) for expeditious and exclusive disposal of suits filed by banks / FIs for recovery of their dues in NPA accounts with outstanding amount of Rs. 10 lac and above. DRTs are overburdened leading to slow disposal of cases.
- Lok Adalats:Section 89 of the Civil Procedure Code provides resolution of disputes through ADR methods such as Arbitration, Conciliation, Lok Adalats and Mediation. Lok Adalat mechanism offers expeditious, in-expensive and mutually acceptable way of settlement of dispute.
- Under banking regulation act 1949, RBI is empowered to monitor the asset quality of banks by inspecting record books.

**What is mean by Write-off?**

? A write-off is an accounting action that reduces the value of an asset while simultaneously debiting a liabilities account. It is primarily used in its most literal sense by businesses seeking to account for unpaid loan obligations, unpaid receivables, or losses on stored inventory. Generally, it can also be referred to broadly as something that helps to lower an annual tax bill.

Generally accepted accounting principles (GAAP) detail the accounting entries required for a write-off. The two most common business accounting methods for write-offs include the direct write-off method and the allowance method. The entries will usually vary depending on each individual scenario. Three of the most common scenarios for business write-offs include unpaid bank loans, unpaid receivables, and losses on stored inventory.