Evergreening of Loans

Why in news?

The Reserve Bank of India (RBI) Governor Shaktikanta Das raised red flags over banks adopting innovative methods for evergreening of loans.

What does evergreening of loans mean?

- The evergreening of loans is a term in which banks try to revive a loan that is on the verge of default by granting further loans to the same borrower.
- It is a form of zombie lending in which banks provide more loans to the borrowers to stop them from turning into huge non-performing assets (NPAs).
- The process of evergreening of loans is typically a temporary fix for a bank covering up the real status of stressed loans.

A loan turns into a nonperforming asset (NPA) if the interest or instalment remains unpaid even after the due date and remains unpaid for a period of more than 90 days.

Why do banks follow evergreening of loans?

- If an account turns into a non-performing asset (NPA), banks are required to make higher provisions which will impact their profitability.
- To avoid classifying a loan as an NPA, banks adopt the evergreening of loans.
- Banks offer fresh loans to borrowers on the verge of default to ensure they repay an old loan.
- Banks delay the recognition of losses through evergreening process.
- Banks also avoid provisioning to cover loan losses and increase their liquidity.

What are the evergreening methods?

- Bringing two lenders together to evergreen each other's loans by sale and buyback of loans or debt instruments.
- Good borrowers being persuaded to enter into structured deals with a stressed borrower to conceal the stress.
- Use of internal or office accounts to adjust borrower's repayment obligations.
- Renewal of loans or disbursement of new/additional loans to the stressed borrower or related entities closer to the repayment date of the earlier loans.

What do bankers say?

- It is difficult for banks to indulge in the evergreening of loans as the RBI monitors each

and every loan on a regular basis.
- Once an account is classified as an NPA, the situation will become worse.
- By evergreening, banks try to save a borrower from becoming NPA by extending temporary liquidity.

What is the problem with evergreening?

- Bad loans are made to look good at the risk of additional lending to unviable borrowers.
- Evergreening of loans put lenders at risk of huge amounts of default.
- The RBI does not approve of evergreen loans and it is going against its norms.
- This is a misgovernance in banking.

How can evergreening be stopped?

- The audit committee needs to be particularly vigilant.
- A significant evergreening is assumed to be wilful, with support from sections of the senior management of the bank.
- It then becomes necessary to levy penalties and action against the erring officers. Few are -
- Penalties should be levied through cancellations of unvested stock options.
- Claw-back of monetary bonuses on officers concerned and on all whole-time directors.
- The Chairman of the audit committee could be asked to step down from the board.

Quick Facts

Evergreen Loans - A type of loan

- An evergreen loan is a type of interest-only loan in which principal payment is deferred.
- Typically, the repayment of principal is only expected at the end of the loan term.
- Until the interest is paid, the repayment of principal can be delayed indefinitely and it works like *revolving credit*.

References

1. IE - Are banks, corporates still window-dressing loans?
2. Zee Business - Evergreening of loans

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