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# RBI governor Shaktikanta Das cautions against evergreening of loans: Are banks, corporates still window-dressing loans?

The process of evergreening of loans, a form of zombie lending, is typically a temporary fix for a bank. If an account turns into a non-performing asset (NPA), banks are required to make higher provisions which will impact their profitability.

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 **NewsGuard**



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Shaktikanta Das, Governor of RBI, at the CII Annual Session 2023 in Delhi. (Express Photo by Gajendra Yadav)

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On Monday, **Reserve Bank of India (RBI) Governor Shaktikanta Das raised red flags** over banks adopting innovative methods for evergreening of loans – covering up the real status of stressed loans of corporates – to project an artificial clean image in cahoots with corporates. However, bankers differ, saying that sometimes it is practical to extend liquidity support to companies that are genuinely facing issues.

### What did the Governor say?

During the supervision of banks, the RBI noticed certain instances wherein banks were using innovative ways to conceal the real status of stressed loans, Governor Das said in his address to the board of directors of public sector and private lenders.

Such (evergreening) methods include “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,” Das said. The RBI has come across cases where one method of evergreening, after being pointed out by the regulator, was replaced by another method.

The existence of any such wilful and significant evergreening suggests that the board, CEO and the audit committees are not adequately vigilant.

### What does evergreening of loans mean?

The process of evergreening of loans, a form of zombie lending, is typically a temporary fix for a bank. If an account turns into a **non-performing asset (NPA)**, banks are required to make higher provisions which will impact their profitability. A loan turns into a nonperforming asset, or NPA, if the interest or instalment remains unpaid even after the due date — and remains unpaid for a period of more than 90 days.

So, to avoid classifying a loan as an NPA, banks adopt the evergreening of loans. In the past, many banks had indulged in dressing up bad loans and given additional funds to companies who didn't have the capacity to repay.

Banks delay the recognition of losses due to loan defaults and engage in evergreening, which is essentially the rolling over of debts of unviable borrowers that would have otherwise defaulted. This is purely misgovernance, so that bad loans are made to look good many a time by additional lending to troubled borrowers.

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Some banks have even extended such loans to wilful defaulters to keep them out of the defaulters' books. When the then RBI Governor Raghuram Rajan ordered an asset quality review in 2014, a host of concealed bad loans or NPAs surfaced. Poor

project appraisal management by banks, especially public sector banks, and some shady promoters who were known for fund diversion, joined hands to evergreen loans.

### When do banks evergreen loans?

There is sufficient evidence, anecdotal and otherwise, that restructuring is often used by banks for 'evergreening' problem accounts to keep the reported NPA levels low. Corporates were allowed to opt for the liberal restructuring route between 2000 and 2014, when a host of companies used fresh loans from banks to evergreen their loan books. However, with the enactment of the bankruptcy code, evergreening has declined but recovery has remained abysmally low.

RBI Governor's latest warning indicates that evergreening is still going on, implying that all is not hunky-dory in the banking system. It normally happens due to the unholy relationship between bankers and borrowers.

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An accommodative monetary policy creates an enabling environment for weak banks to evergreen loans to zombies and keeps them alive. The RBI has been following an accommodative policy since March 2020 when the pandemic struck the country. Most of the evergreening has happened in public sector banks which subsequently led to a jump in NPAs. The CBI had detected several cases of fund

diversion by promoters of companies from loans advanced again and again by banks in the last couple of years.

### What do bankers say?

Bankers said that it is difficult for banks to indulge in the evergreening of loans as the RBI monitors each and every loan on a regular basis. “This could be an interpretation issue also. What the RBI thinks as postponement of NPA (by evergreening), could be a real case of a bank trying to save a borrower from becoming NPA by extending temporary liquidity,” said a private sector lender.

If temporary funding can help a borrower from becoming NPA, it is good for banks also, he said, adding, “By calling somebody an NPA, you are just giving a dog a bad name and hanging it. Once an account is classified as an NPA, the situation will become worse.”

### Could the zombies crowd out good borrowers?

There was evidence of indirect evergreening in India – weak firms increase leverage by borrowing through related parties from weak banks, but decrease real investment – which often goes undetected. Such resource misallocation supports the crowding-out effects ascribed to zombies, according to an RBI paper on Zombies and the Process of Creative Destruction. It results in credit being diverted to weak entities – which is ultimately diverted for other purposes or it becomes a bad loan – depriving the genuine credit needs of good borrowers.

### Are loan write-offs another means of evergreening?

Loans written off by the banks are removed from the NPA books. However, these loans continue as NPAs in another form. The mega write-off exercise has enabled banks to reduce their non-performing assets, or defaulted loans, by Rs 10,09,510 crore (\$123.86 billion) in the last five years, according to data furnished by the Reserve Bank of India (RBI) in its reply to the Right to Information (RTI) request filed by *The Indian Express*.

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Aided by this huge write-off, the banking sector reported a decline in gross NPAs to Rs 7.29 lakh crore, or 5.9 per cent of the total advances, as of March 2022 and Rs 5.5 lakh crore in March 2023. Gross NPAs were 11.2 per cent in 2017-18.

## How can evergreening be stopped?

Wherever significant evergreening in a bank is detected by the RBI, penalties should be levied through cancellations of unvested stock options and claw-back of monetary bonuses on officers concerned and on all whole-time directors, and the Chairman of the audit committee be asked to step down from the board, said the Committee to Review Governance of Boards of Banks in India headed by PJ Nayak.

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The primary defence against evergreening must however come from the CEO, the audit committee and the board. The audit committee, in particular, needs to be particularly vigilant. If significant evergreening is detected by RBI supervisors, it must mean that evergreening is 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.

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