

Loan loss provisioning at PSBs more pro-cyclical compared to private banks, says study

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Loan loss provisioning by public sector banks (PSBs) is more pro-cyclical compared to private sector banks (PVBs), according to a study published in the Reserve Bank of India's latest monthly bulletin.

Pro-cyclical provisioning refers to the building up of more loan loss provisions when business cycles turn and economic conditions deteriorate, while reducing the same during good times.

The study titled ‘Determinants of Loan Loss Provisions: The Case of Indian Banks’, observed that PSBs with high non-performing assets (NPA) ratio tend to be more pro-cyclical in terms of provisioning across business cycles compared to PVBs.

As per the study, an efficient loan loss provision management entails that banks should build up loan loss reserves during good times to provide a cushion for times of economic cyclical downturns. Its findings suggest that India’s loan loss provisioning is pro-cyclical which can amplify the business cycles.

The study was conducted by Rekha Misra and Radheshyam Verma of RBI’s Department of Economic and Policy Research, along with Samudra Biswas (Research Intern during February-July 2018) .

“In this context, the implementation of Indian Accounting Standards (Ind-AS), which requires banks to make provisions for expected credit losses from the time a loan is originated rather than awaiting ‘trigger events’ signalling imminent losses, is expected to help address this issue,” said the authors of the study

They underscored that recognising and providing for actual and potential loan losses at an earlier stage in the credit cycle could potentially reduce pro-cyclicity and foster financial stability as Ind-AS requires a dynamic approach to provisioning based on expected credit losses, instead of the current system which is based on days-past-due.

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COMMENTS