Trends and Progress of Banking in India 2023-24

For Prelims: **Reserve Bank of India**, **Non-performing assets**, **Capital Adequacy Ratios**, **Urban Co-operative Banks**, **Dark patterns**, **Central Consumer Protection Authority**

For Mains: Impact of Unsecured Loans on the Indian Economy, Financial Stability and Inflation Management, Economic Consequences of Loan Defaults and NPAs

Source: TH

Why in News?

The **Reserve Bank of India (RBI)** has raised alarms over the **increasing reliance on unsecured lending and private credit,** calling for enhanced vigilance in its annual ***Trends and Progress of Banking in India 2023-24 report.***

- Despite the steady decline in **gross non-performing assets (GNPA)** **and sustained profitability of banks**, the central bank emphasized the need to address emerging risks in the financial ecosystem.

What are the Key Highlights of RBI's Trends and Progress of Banking Report?

- **Decline in NPAs:** **GNPAs reached a 13-year low of 2.7% in March 2024**, further dropping to 2.5% by September 2024.
    - The Retail Loan Segment had the lowest GNPA ratio at 1.2% in September 2024, while **agriculture loans had the highest GNPA ratio at 6.2%.**
    - The GNPA ratios for education loans improved significantly, declining from 5.8% in March 2023 to 2.7% by September 2024, though they remain the highest among retail segments.
- **Profitability:** Banks' profitability continued to rise with **return on assets (RoA) at 1.4% (first half of 2024-25) and return on equity (RoE) at 14.6%** in FY24, marking six consecutive years of profit growth.
    - The NBFC sector exhibited **double-digit credit growth**, with improved asset quality and strong **Capital Adequacy Ratios (CRAR).**
    - The consolidated balance sheet of **Scheduled Commercial Banks (SCBs)** showed strong growth in credit and deposits, and **Urban Co-operative Banks (UCBs)** saw improvements in asset quality, capital buffers, and profitability.
- **Rising Share of Unsecured Loans:** The share of unsecured loans in SCBs' total credit rose to **25.5% in March 2023** before slightly declining to 25.3% in March 2024.
    - In response, the RBI introduced stricter norms in November 2024, raising **risk weights** and **setting exposure limits** (maximum lending to a borrower or group).
    - The RBI also expressed concerns **over top-up loans,** often approved with minimal due diligence and lax adherence to guidelines, with reports of misuse, including redirection to the stock market.
        - In 2023, the RBI mandated **top-up loans against depreciating movable assets** to be treated as unsecured loans.

- **Rise of Dark Patterns:** The report highlights concerns over **dark patterns,** the **Central Consumer Protection Authority (CCPA)** issued guidelines to regulate such practices, and RBI is evaluating the prevalence of dark patterns among regulated entities (REs).
- **High Employee Attrition:** Employee attrition (employees leaving organizations) rates have **surged to 25% in the past three years,** raising concerns about operational risks such as service disruption, loss of institutional knowledge, and higher recruitment costs.
- **Slippage Ratio:** The slippage ratio improved in 2023-24. For the third consecutive year, **private sector banks (PVBs)** had a higher slippage ratio than **public sector banks (PSBs)** due to larger fresh accretions to NPAs in PVBs.
- **RBI's Recommendations:**
  - RBI recommended banks to **adopt strategies such as improved onboarding,** training, mentorship, competitive benefits, and fostering a supportive workplace culture **to curb attrition.**
  - RBI urged banks to ensure better compliance with credit appraisal processes and prudential guidelines, particularly in light of rising risks regarding unsecured loans

Key Terms

- **Return on Assets (RoA):** Measures a business's profitability relative to its total assets.
- **Return on Equity (RoE):** Measures a company's annual return (net income) relative to its total shareholders' equity.
- **Capital Adequacy Ratios (CRAR):** Measures a **bank's ability to absorb losses** and ensure stability, protecting depositors and promoting financial system efficiency.
- **Slippage Ratio:** Measures new accretions to NPAs as a share of standard advances at the beginning of the year.
- **Dark Patterns:** Dark Patterns are unethical **user interface (UI)/user experience (UX)** tactics designed to deceive users into actions they don't intend, benefiting the company.
  - These practices limit user control and transparency, such as hidden costs, difficult cancellation options, misleading ads, or auto-charging after free trials.
  - **Examples**: Fake countdowns, disguised ads, and forced account creation for transactions.

What is the Impact of Rising Unsecured Loans on India's Economy?

- **Higher Default Rates and Financial Stress:** As more unsecured loans are issued, the risk of **defaults rises,** leading to increased **non-performing assets (NPAs)** and financial strain on banks and NBFCs.
- **Inflationary Pressure:** Rising defaults and higher interest rates reduce disposable income, curbing discretionary spending, **increasing inflation**, and slowing economic growth.
- **Effect on Consumers:** For consumers, the availability of unsecured loans can provide easier access to credit.
  - However, it also means **higher interest rates** and potential **debt traps** if not managed responsibly
- **Rural and Urban Impact:** Both rural and urban consumers face financial instability due to the rise in high-cost loans, contributing to lower consumer confidence.

Way Forward

- **Tighten Lending Practices**: Strengthen credit appraisal processes using technology and **Artificial Intelligence (AI)** to assess borrower risk and reduce defaults.
- **Enhance Consumer Protection**: Focus on **financial literacy,** transparency in loan products, and strict regulation of dark patterns in lending.
- **Manage Inflationary Pressures**: Balance interest rates with economic growth to control inflation and protect disposable income.
- **Strengthen Asset Quality**: Proactively monitor loan portfolios, build stronger capital buffers, and conduct stress testing to mitigate risk.
- **Improve Regulatory Oversight**: Ensure rigorous enforcement of prudent lending practices and regular audits to maintain financial stability.

Drishti Mains Question:

Discuss the impact of rising unsecured loans on the Indian banking sector and the broader economy. How can the Reserve Bank of India address these emerging risks?

UPSC Civil Services Examination, Previous Year Questions (PYQs)

Prelims

Q. Which of the following statements is/are correct regarding the Monetary Policy Committee (MPC)? (2017)

1. It decides the RBI's benchmark interest rates.
2. It is a 12-member body including the Governor of RBI and is reconstituted every year.
3. It functions under the chairmanship of the Union Finance Minister.

Select the correct answer using the code given below:

(a) 1 only
(b) 1 and 2 only
(c) 3 only
(d) 2 and 3 only

Ans: A

If the RBI decides to adopt an expansionist monetary policy, which of the following would it not do? (2020)

1. Cut and optimize the Statutory Liquidity Ratio
2. Increase the Marginal Standing Facility Rate
3. Cut the Bank Rate and Repo Rate

Select the correct answer using the code given below:

(a) 1 and 2 only
(b) 2 only
(c) 1 and 3 only
(d) 1, 2 and 3

Ans: B

Mains

Q. The product diversification of financial institutions and insurance companies, resulting in overlapping of products and services strengthens the case for the merger of the two regulatory agencies, namely SEBI and IRDA. Justify. **(2013)**