NPA - Meaning, Types and Causes

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One of the most important questions asked in bank interviews is "Why NPA is so high in PSU banks ?"

If you are going to appear for even clerk interviews then you should learn this concept.

NPA Full Form : Non-performing Assets

What is NPA

NPA Meaning (Non-performing Assets) - All those assets which don't generate regular income are known as NPA.

Types of assets

Standard assets :- Assets which are generating regular income to the bank

Sub-standard assets :- An asset which is overdue for a period of more than 90 days but less than 12 months

Doubtful assets :- An asset which is overdue for a period of more than 12 months.

Loss assets :- Assets which are doubtful and considered as non-recoverable by bank, internal or external auditor or central bank inspectors

Sub-standard assets, Doubtful assets and Loss assets are NPA.

Causes of NPA

Default - One of the main reason behind NPA is default by borrowers.

Economic conditions - The Economic condition of a region affected by natural calamities or any other reason may cause NPA.

No more proper risk management - Speculation is one of the major reason behind default. Sometimes banks provide loans to borrowers with bad credit history. There is a high probability of default in these cases.

Mis-management - Often ill-minded borrowers bribe bank officials to get loans with an intention of default.

Diversion of funds - Many times borrowers divert the borrowed funds to purposes other than mentioned in loan documents. It is very hard to recover from this kind of borrowers.

In case you have any query or you want to add anything then comment below. If I find any comment is adding value to the post then I will add that comment to the post.

Non-performing Assets (NPAs)

Non-Performing Assets are loans given by a Bank or financial intuitions where the borrower defaults or delays interest or principal payments

According to RBI, any loan repayment which is delayed beyond 90 days in continuation has to be identified as an NPA.

NPA’s are further sub-classified into

- **Sub-Standard Assets** are those which are non-performing for a period not exceeding two years.

- **Doubtful Assets** are those loans which have remained non-performing for a period exceeding two years but which are not considered as loss assets.
- **Loss Assets** is one where loss has been identified but the amount has not been written off, wholly or partly. In other words, such as asset is considered non-recoverable.

NPA - All you need to Know

Today's piece focuses on NPAs and Asset Classification. Every banker worth his salt should have the basic knowledge of the second most important aspect of banking – giving loans and then whatever happens when a loan turns bad!!

Why second most important? 'Cause accepting deposits is the most important function of banks! If you don't have the money, how will you give the loans?

I'm gonna straight away start with NPAs and not waste any of our precious study time!

1. *What are NPAs?*

NPA stands for Non-Performing Assets. Loans given by Banks are its assets. Banks have the right to receive the amount back from the loan taker – right? – thus, 'Loans and Advances' given by banks are their assets.

When such asset does not perform it becomes an NPA. Simple enough?!

2. ***<u>What is meant by loans/assets not performing?</u>***

When we talk from a Bank's point of view, what is a loan account supposed to do?

It is supposed to given the Bank regular instalments of principal and interest on such principal. Thus for a Bank, a loan account is 'functioning' or 'performing' its required task when it is regularly receiving credits of the instalment amounts.

When the credits stop – i.e., when the customer stops paying instalments – the loan account stops 'functioning or performing'.

3. ***<u>And when does it become an NPA?</u>***

Such a non-performing loan account is 'officially' denoted or classified as NPA when the account has remained non-performing for a period of more than 90 days.

That is the loan account has not received any credit towards instalment (interest and/or principal) for more than 90 days – which automatically means –
the **<u>interest/principal</u>** is **<u>OVERDUE for a period more than 90 days</u>**.

Guys, please note and remember the phrase, '<u>overdue for a period more than 90 days</u>' – important to appreciate the word ‘overdue’.

When you get October month’s telephone bill (which you have to pay by 1st December 2014) in the first week of November, the amount is said to be due. When that amount of October month’s telephone bill is still unpaid till January 2015 it is said to be overdue!

Same way - when instalment is ‘overdue’ only then do the Banks classifies them as NPAs. They give time till 90 days and wait and watch and even hope that the customer pays something – and when 90 days are up the account becomes an NPA automatically.

So – overdue for more than 90 days.

4. ***Why do the Banks ‘hope’ for the customer to pay back?***

Because, any asset becoming bad is the asset owner’s loss, right?

Thus if a loan account goes bad – defunct – NPA – it is the Bank’s loss!

And trust me the officers in charge of the loans and advances and the branch managers lose a lot of hair when audit season comes and they have to deal with large NPAs – not a good sight!

5. ***What happens when accounts become NPA?***

First – it is the starting sign that things could get worse – I'll explain in the next point!

Bookishly though – the implications of an account being classified as an NPA are these:

(i) Banks cannot credit income to their profit and loss account in with corresponding debit of the NPA loan account unless any recovery takes place.

Bank's income is the 'interest amount' it receives on loans – and Banks practice charging interest to the loan account and crediting their Profit and Loss account when the interest becomes 'due'. Since the loan account has become NPA, now the Banks cannot 'due' anymore interest charges.

Sort of like, after being classified as an NPA, the telephone company cannot send the customer anymore bills for due amount!

But if the customer pays 'any amount', i.e., after the loan amount becoming NPA, if the customer pays any amount to its credit – then such an amount can be taken as an income for the bank and credited to its P & L A/c.

(ii) Provision will have to be made – which reduces the banks profits.

Banking norms mandate that when there is possibility that loss can happen in future, provision for the loss is to be made in the present.

Think – if you had a child who's very intelligent and ambitious and wants to go to USA to become an astronaut in future – you will needs funds when the time comes.

So you start putting some money aside/provisioning for the future NASA astronaut from today – which means your saving/the real income is getting less today, because you made a provision for an expense/loss you think will most definitely happen in the future!

Same thing, the Banks now know that the customer has not paid for more than 90 days now – but what if the customer does not pay at all and the outstanding amount is Rs.10,00,000!

It's a Rs.10,00,000 loss to the Bank in the future!

And according to provisioning norms, the Banks will have to create a provision for this 'possible loss' and provision is made against income (try to understand with the NASA example).

So this would mean that a Bank's profits will become less due *to the heavy provisioning on NPA accounts.*

And when profits decrease – loan officers/ branch manager/ regional managers/ zonal managers all face the heat from GMs/AGMs/DGMs/MDs and the shareholders and the stock markets! Phew!

(iii) All the loan accounts of the same customer, in the other branches of the same bank will be classified as NPAs too (even if they are regular and instalments are being credited to them!)

Too bad, huh?

Imagine if a customer has loan accounts in 5 branches of the same bank and all are over crores – that is the real life scenario – 'cause businesses take large loans. The bank gets NPAs in all those 5 accounts!

And there are many such customers!

6. ***Asset Classification?***

Asset classification, in other words loan classification, is an important thing to learn along with NPAs…exams may not have these, but it is a sure thing in interviews!

So this table for your pleasure reading!

Asset Classified as	% of Provisioning required	Period…	Important points
1. Standard Asset	Separate rates are prescribed for different types of loans such as 0.25%, 1%... (*why risk? Make a provision just in case they go wrong!)*	*Not applicable*	Are those assets which are 'regular' and have no defaulting in instalment payments – they are the good assets!
2. Sub Standard Assets **- Secured** **- Unsecured**	**- 15%** **- 25%**	Has been classified as NPA for a period not exceeding 12 months	i.e., these accounts have spent 1 – 12 months after being classified as NPA and has remained NPA during the said period. Secured are those which are secured against any

			security/ECGC/DICGC…
3. Doubtful Assets which are doubtful **- upto 1 year** **- above 1 year and upto 3 years** **- above 3 years**	**- 25%** **- 40%** **-100%**	Are those assets which has remained sub-standard for more than 12 months	Thus, sub –standard is NPA from 1-12 months. Doubtful is sub-standard for more than 12 months.
4. Loss Assets	- 100%	*Not applicable*	Loss assets are those which have been 'classified' as loss assets by the Bank/Internal Auditors of the Bank/External or Statutory Auditors/RBI inspectors…

SARFAESI Act, 2002

- The SARFAESI Act provides for setting up of asset reconstruction companies for acquiring financial assets including NPAs which helps in clearing balance sheet of banks.
- The most important provision of the Act is regarding the enforcement of security interest of banks without interventions of courts.

To enforce the security as aforesaid, the following conditions need to be fulfilled

1. The borrower has committed a default in payment and account is classified as NPA.
2. The secured creditor has given a notice in writing to the borrower to discharge his liabilities within 60 days from the date of receipt of such notice.
3. The borrower has failed to comply with the said notice.
4. The amount due from the borrowers in more than Rs. 1 lakh.

In case the borrower fails to discharge his ability in fully within the stipulated period of 60 days, the secured creditor may take recourse to one or more of the following measures.

1. By taking possession of the secured assets including the right to transfer by way of lease, assignment or sale for releasing the secured assets.
2. By taking over the management of the secured assets.
3. By appointing a manager to manage the secured assets.
4. By requiring any third party who has acquired the secured assets from borrower.

- In case of a consortium advance, the aforesaid actions can be taken only when secured creditors representing 75% or more in value agree for such action.
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IMPORTANT QUESTIONS

1. What is a balance on Current Account?
A country's receipt minus payment for current account transactions equals the balance of trade plus net inflows of transfer payments.

2. What area ways and means advances?
Ways and means advances are the short-term credit from the central bank (RBI) to the government which allows the government to meet its immediate requirements. If the government wants money above this it will have to borrow by issuing bonds, which are auctioned by RBI.

3. Who was the first Governor of Reserve Bank of India?
Sir Osborne Smith was the first governor of RBI of India.

4. What is board for Financial Supervision?
The Reserve Bank of India performs the function of financial supervision under the guidance of the Financial Supervision Board (BFS). The board was constituted in November 1994, as a Committee of the Central Board of Directors of the Reserve Bank of India.

5. What is Islamic Banking?

Islamic Banking refers to a system of banking or banking activity that is consistent with Islamic (sharia) law principles and guided by Islamic Economies. In particular, Islamic Law prohibits unsury, the collection and payment of interest. India’s first Islamic bank was first opened in Kerala.