CHAPTER - II
Chapter-2

NON-PERFORMING ASSETS IN SHORT TERM COOPERATIVE CREDIT STRUCTURE

2.1 Introduction

A strong, efficient, functionally diverse and geographically widespread financial system is a critical to the attainment of our objectives of creating a market driven, productive and competitive economy (GOI: 1998,p.1). Financial system with financial stability is sine-quo-non-for the sustained and rapid economic progress. Among the various indicators of financial stability, NPAs assumes critical importance since it reflects on the asset quality, credit risk and efficiency in the allocation of resources to productive sectors (Rajiv Ranjan and Sarat Chandra Dhal: www.rbi.org.in, p.l). The Committee on Banking Sector Reforms (1998) rightly pointed out the funds locked up in NPAs are not available for productive use or recycling (GOI: 1998,p.12).

2.2 NPAs and Banking Institutions in India

Inordinate delay in recovery of loans and advances builds up NPAs, which affect Banking Institutions adversely with respect to liquidity and impair their ability to render service to the maturing liabilities. The funds blocked in NPAs increase the cost of financial intermediation as Banking Institutions resort to raising deposits and borrowings at a high cost as a measure to minimize the imbalance between cash outflow and cash inflow. This has an adverse impact on the profitability of the banks both in the short and long run. The monies locked up in NPAs are not available for productive use and to the extent the banks seek to make provisions for NPAs or write them off, which claims share in their profits. To recover the same, banks have to charge their honest, diligent and productive customers a higher rate of interest. It thus becomes a tax on efficiency. The customer who use credit efficiently, subsidies those who use credit inefficiently, represented by NPAs. This also raises the transaction costs in the system. High level of NPAs also
reduces risk-taking ability and affects the image and credit rating of the Banking Institutions thereby restricting their ability to approach the public for capital subscription inflow (Tier I Capital¹). In any case, a low rating substantially increases the cost of raising funds even for Tier II Capital². No wonder, the Committee on Non-Performing Assets of Public Sector Banks (1998) rightly observed that ‘NPA is a double-edged knife that tells on a bank’s profitability. On one hand, banks cannot realize income (interest) on NPA accounts and on the other, it is a drain on bank’s profitability due to funding cost’. NPAs, in short, are not just a problem for banks but also to the economy and the society at large (NABARD: 2000-01, p.137). Hence, there is a paramount need to strengthen the balance sheet of the banking system which directly depends on the quality of its assets particularly loans and advances (Gopalakrishnan T.V, 2004:p.16).

2.3 Trends in NPAs in Rural Financial Institutions

The trend of NPAs in Rural Financial Institutions in India is given in the table 2.1(Annexure-2.1). Among the Banking Institutions CBs and RRBs had recorded decreasing trend in NPAs from 17.8 and 36.8 per cent (1996-97) to 5.1 and 8.5 per cent (2004-05). At present the level of NPAs of the CBs had been very close to the international level i.e., 4.8 per cent. CBs and RRBs had taken certain measures to curtail the growth of problematic assets by efficient risk management practices and various policy supports of the Government and the RBI. The important policy initiatives were in vogue to curtail the growth of NPAs included:

> One time settlement / compromise schemes was announced in July 2000, to the loans issued by Public Sector Banks for loans up to Rs.50000 issued to the small and marginal farmers up to March - 2002 and extended till March -2003 (RBI: 2004-05,p.223).
Table – 2.1

NPAs in Rural Financial Institutions in India – A Comparative Position

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<tbody>
<tr>
<td>CBs</td>
<td>17.8</td>
<td>16.0</td>
<td>15.9</td>
<td>14.0</td>
<td>12.4</td>
<td>11.1</td>
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<tr>
<td>RRBs</td>
<td>36.8</td>
<td>32.84</td>
<td>27.89</td>
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<td>SCBs</td>
<td>9.41</td>
<td>10.91</td>
<td>11.29</td>
<td>10.16</td>
<td>212.20</td>
<td>13.45</td>
<td>19.72</td>
<td>18.30</td>
<td>16.25</td>
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<td>DCCBs</td>
<td>19.70</td>
<td>17.56</td>
<td>17.38</td>
<td>16.69</td>
<td>18.38</td>
<td>19.77</td>
<td>19.38</td>
<td>23.45</td>
<td>19.87</td>
<td>22.13</td>
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<tr>
<td>SCARDBs</td>
<td>NA</td>
<td>19.41</td>
<td>20.16</td>
<td>18.73</td>
<td>15.17</td>
<td>18.40</td>
<td>21.08</td>
<td>26.62</td>
<td>31.26</td>
<td>38.25</td>
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<tr>
<td>PCARDBs</td>
<td>NA</td>
<td>17.48</td>
<td>22.52</td>
<td>20.45</td>
<td>24.57</td>
<td>30.42</td>
<td>33.12</td>
<td>34.05</td>
<td>31.88</td>
<td>40.35</td>
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Source:
5. NABARD – Key Statistics on RRBs for various years

Note: NA – Not Applicable
Lok Adalats, Debt Recovery Tribunals and formation of Credit Information Bureau to provide the information about the defaulters and enable the banks to take informed decisions before extending the line of credit (Pricewaterhouse Coopers: 2004,p.32).

Securitisation & Reconstruction of Financial Assets and Endorsement of Security Interest (SARFAESI) Act-2002 which could help the banks to realize the dues with out the intervention of the Courts or Tribunals. The formation of Assets Reconstructions Companies (ARC) and to transfer the problematic assets to the ARC and thus cleaning the balance sheet (Alok Pandey & Syamal K.Ghosh: 2005,p.69).

Chart 2.1

NPAs in Commercial Banks in India

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<td>In Percentage</td>
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Chart 2.2

NPAs in Regional Rural Banks in India

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<td>In Percentage</td>
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Increasing trend in NPAs of Cooperative Banks had become a major cause of concern. In SCBs and DCCBs the percentage of NPAs had increased upto 16.25 and 22 per cent as on 31st March 2006 from 9.41 and 19.70 per cent respectively as on 31st March 1997. During the year 2003-04, two-fold increase in NPAs was noticed at the SCBs level due to the low recovery in lower tiers. The percentage of NPAs in both in SCBs and DCCBs had been increasing through out the study period except the year 2003-04. On the other hand, the NPA percentage was very high in SCARDBs and PCARDBs showing 31.26 and 31.88 per cent in the year 2004-05 as against 19.41 and 17.48 per cent in 1997-98. The increasing trend in NPAs in Cooperative Banks had become major issue as it had crippled the image of the Cooperative Banks especially DCCBs. Many DCCBs incurred loss and could not comply with the provisions of the Section 11(1) of the BR Act 1949 (AACS) due to the growth in NPAs. Though there are lot of debates on the applicability of Prudential Norms in Cooperative Banks, It has become necessary to maintain international standards in accounting practices of banks, Hence, the understand the need for introduction of prudential norms in cooperative banks so as to understand their true financial health, the developments world over is analysed hereunder. The procedure for classification of assets and provisioning is discussed based on the circulars issued by RBI. Further, the likely impact on NPA is analysed to understand the seriousness of this issue.

Chart –2.3

NPAs in District Central Cooperative Banks in India

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<tbody>
<tr>
<td>NPAs</td>
<td>10</td>
<td>15</td>
<td>20</td>
<td>25</td>
<td>15</td>
<td>10</td>
<td>5</td>
<td>10</td>
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2.4 The Basel Committee on Banking Supervision

The Bank for International Settlements (BIS)\(^1\) was established in 1930 at Basel in Switzerland. The BIS is the world’s oldest International Financial Institution and remains to this day the principal Centre for International Central Bank Cooperation (www.bis.org). In 1974, G10\(^4\) Central Bank Governors established the Basel Committee on Banking Supervision (BCBS) at Basel in Switzerland to promote the supervision of internationally active banks.

Through regular meetings, the BCBS brings together the Governors and Officials of the member Central Banks. The BCBS act as the prime forum for information exchange and cooperation among Central Banks worldwide. The Banking environment has undergone globally drastic changes and has turned risks inherent to banking operations and made them more complex. There were banking crisis like the collapse of the Bearings Bank and the South Asian Crisis. So, the need for the amendment and updation of the accord was felt during the year 1988.

The main objective of the BCBS was (www.geocities.com):

To strengthen the soundness and stability of the international banking system

^ The framework should be fair and have a high degree of consistency in its application to banks in different countries with a view to diminishing a source of competitive inequality among International Banks.

In 1988, the Committee published the document entitled “International Convergence of Capital Measurement and Capital Standards,” but became commonly known as the Basel Capital Accord -I. The 1988 Basel Capital Accord represented the agreement of its members on issues such as how capital is calculated, how the risks against which capital is held are evaluated,
what ratio of capital to risk should be, and a timetable during which international banks could progress toward meeting that ratio. These Capital Adequacy norms differ from bank-to-bank and country-to-country. The BCBS addressed the issue of standardization and provided a requisite framework. It defined components of capital, allotted risk weights to different types or categories of assets and the minimum ratio of capital to the sum total of risk-weighted assets. It also aims to improve safety and soundness in the financial system by placing more emphasis on Banks’ own Internal Control and Management, the Supervisory Review Process and Market Discipline.

The Basel Capital Accord is an agreement of the BCBS’s members. It does not have the force of law. The BCBS expected that the various member nations and even some nonmember nations would implement the standards through legislation or regulation.

2.4.1 Developments of Basel Capital Accord

Since 1988, from time to time the BCBS has issued a number of amendments relating to Basel Capital Accord. There are (www.bis.org):

> In November 1991, the BCBS issued an amendment clarifying that loan-loss reserves are counted as capital only if they were not held against identified problem assets.

> In April 1993, the BCBS issued an analysis of interest rate risk.

> In July 1994, the BCBS issued an amendment dealing with the credit risk of off-balance sheet items, and an amendment relating to which countries would be used to create certain types of risk weighting.

> In April 1995, the BCBS issued another amendment dealing with off-balance sheet items.

> And in January 1996, the BCBS issued an amendment to take market risks into account in capital requirements.
2.4.2 Basel Accord II

The banking industry world over has undergone a major transformation in the year 1988 when the Basel Capital Accord I was implemented. Especially, two specific changes - the expanded use of securitisation and derivatives in secondary markets and vastly improved risk management systems. As the banks have to operate on a global scale in all financial markets, Basel Capital Accord I has become outdated.

The BCBS proposed a new ‘Capital Adequacy’ framework (Basel II) in June 1999. It has recommended a more risk - sensitive minimum capital requirements for banking organizations. An extensive consultative process was initiated and the framework for Capital Adequacy was finalized with the approval of all the members of the BCBS in June 2004 (Rupa Rege Nitsure: 2005,p.1 162). The Report of the Committee was entitled ‘International Convergence of Capital Measurement and Capital Standards - A Revised Framework’. The Committee intended to implement it by the end of the year 2006. This second Basel Capital Accord was established with the basic objectives of:

- To revise the 1988 Accord and strengthen the soundness and stability of the banking system
- To promote the adoption of stronger risk management practices by banks.

The Basel Accord II is expected to establish a minimum level of capital for internationally active banks. National regulators are free to set higher standards for minimum capital (Sunanda Sen & Soumya Kanti Ghosh, 2005,p.ll69). The revised framework is perceived as more forward - looking approach. Basel II provides incentives for banks to invest and increase the sophistication of their internal risk management capabilities in order to gain
reductions in capital. This will help them to increase a bank’s lending which in turn will give higher returns and value to its shareholders (IIB: 2005, p.301).

2.4.3 Scope of Application for Basel Accord II

The Basel Accord II rests on three pillars. The first pillar gives greater freedom to individual banks to assess their own capital after taking account of risks, resulting in a degree of regulatory forbearance. The second pillar provides guidelines for supervisors for the risk management and the assessment of adequacy of capital. Third pillar deals with risk management practices and allocation of regulatory capital. These pillars help to strengthen market discipline as a compliment to supervisory efforts. Banks and supervisors are required to give due attention to the second and third pillars. The revised framework will be mainly applicable to internationally active banks (IIB: 2005, p.302). RBI’s association with the BCBS dates back to 1997, as India was among the non-member countries that were consulted in the drafting of the Basel Core Principles. RBI had been actively participating in the deliberations on the New Accord. The RBI had accepted to adopt the new accord in April 2003 itself and announced its Annual Policy Statement in May 2004. The deadline for implementing Basel II, originally set for March 31, 2007, has now been extended. Foreign banks in India and Indian banks operating abroad are to meet Basel II norms by March 31, 2008, while all other Scheduled Commercial Banks will have to adhere to the guidelines by March 31, 2009. But the decision to implement the guidelines remains unchanged. This is true even though the international exposure of even the major Indian banks is still limited.

2.5 The Committee on Financial System (1991)

In India, the decade beginning with 1990 saw the accumulation of the crisis of the regulated regime with the worsening of the external balance of payments, a low foreign exchange reserve, raging inflation and dwindling
Goss Net Product (GNP). It was felt that a major restructuring of the Indian economy was needed. On the external front, the signing of the General Agreement on Tariffs and Trade, (GATT) followed by membership of the World Trade Organization (WTO), paved way for global integration.

While the real sectors of the economy were being liberated by gradual loosening of controls, financial sector reforms was necessitated to move in tandem to support the restructuring process. The Government of India appointed a high-level Committee viz., ‘The Committee on Financial System’ (CFS) under the Chairmanship of Shri. M. Narasimham to examine all aspects relating to the structure, organization, functions and procedure of financial system on 14th August 1991 and the Committee submitted its report to the Union Minister of Finance on 8th November 1991. The Committee observed that proper system of income recognition and provision was fundamental to the strength and stability of the banking system (GOI: 1991, p: 54). Further, CFS suggested the prudential norms that are applicable to the banks in India, which aims to bring greater transparency in the financial statement of the banks. As a prelude, certain reform measures in the banking sector were the recommended by the CFS. They are viz.,

®* Phasing out/reduction of statutory pre-emption in the form of CRR and SLR.
Deregulation of interest rates.
Adoption of capital adequacy standards and prudential norms regarding income recognition, asset classification and provisioning, etc.

^ Entry of new banks in the private sector.
Functional autonomy for the banks

^ Transparency in accounting and disclosure.
Creation of an independent body for regulatory and supervisory control over the banks.

^ Setting up of Debt Recovery Tribunals.
Financial restructuring.

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After the submission of the report by the Ghosh Committee, there were some accounting standards announced by the International Accounting Standards Committee with regard to ‘Disclosure in the Financial Statements of Banks and Similar Financial Institutions’. The CFS also endorsed the recommendation of the Ghosh Committee on Financial Accounts in this regard (GOI: 1991,p.53). The CFS further recommended that all banks in the country should also introduce these standards immediately with regard to Capital Adequacy, Income Recognition, Assets Classification, and Provisioning. Based on these recommendations, the RBI undertook a serious measures relating to introduction of prudential norms to the Commercial Banks (CBs), Regional Rural Banks (RRBs) and extended to the Cooperative Banks (ST Term Credit Structure and LT Credit Structure) (Table - I.1).

2.6 Prudential Norms

These prudential norms were recommended by the Basle Committee on Bank Supervision (BCBS) as a measure for the assessment of the financial soundness through a set of common denominators and operational parameters for banks having national operations (GOI: 2000, p.1) The aim of the prudential norms was to reduce the risk of the systematic failures and avert the disruption caused by impending financial crises. These norms insist the following elements to be focused in Banking Institutions:

- Adequate Capitalization,
- Management of Risks,
- Adoption of proper Accounting system,
- Reporting true financial position and
- Effective supervision.

Further the application of the Prudential Norms is a tool which would help a bank to develop a sound and transparent base sustainability and to help in arresting deterioration in assets quality (Misra.D.P, Marathi Ram, V. &Sunder, R.: 2001,p. 160).
2.7 Applicability of Prudential Norms to Short-term Cooperative Credit Structure (STCCS)

The income recognition on realization basis and provisioning in respect of bad loans and advances were not totally new concepts to the STCCS. There exists a system in these organizations for recognizing income on actual realization basis and not on accrual basis. Further, in most of the States of India, the STCCS make provisions on a very conservative basis, which is more stringent than the present provisioning norms in some respects. However, prudential regulations have been extended to them with a view to emphasizing the need for them to function on sound lines at par with other Commercial Banking Institutions (GOI: 2000, p.1). The CFS 1991 did not examine and make any specific recommendation to cooperative banks with regard to the application of prudential norms. Later, the Committee on Banking Sector Reforms (1998) recommended the application of prudential norms in the Cooperative Banks (GOI: 1998, p.60 & 61). The Committee also recommended that:

- There should be no recourse to the scheme of debt waiver.
- Cooperative banks should reach Capital Adequacy of 8 per cent over a period of 5 years.
- Cooperative Credit Institutions should enhance their capital through subscription by members and not by Government.
- The present dual control over the cooperative credit institutions by State Governments and RBI / NABARD should be eliminated and all cooperative banking institutions should come under the discipline of B.R. Act by making suitable amendments of the said Act.

However, the Prudential Norms were introduced to SCBs and DCCBs vide RBI Circular No RPCD.No. BC. 155/07.37.02/95-96 dated 22 June 1996 from the accounting year 1996-97. As per the norms, advances on which
interest / installment of principal remained past due, for four quarters from the year ending 31.3.1997, for the three quarters for the year ended 31.3.1998, the two quarters for the year ending 31.3.1999 onwards, was treated as NPA. Due to improvement in the payment and settlement system, recovery climate, upgradation of technology in the banking system, etc., the concepts of past due were dispensed with effect from March 31st 2001. Thereafter NPA was defined as “a credit facility in respect of which interest and / or Installment of principal has remained overdue for a period of more than 180 days”, with effect from March 31st 2001 onwards (NABARD circular Ref.No.RF.BC.28/07.37.02/2000-01 dt. 10.10.2000). NPA shall be an advances where: (NABARD: Master Circular: 193/DoS.21/2002 dt. 17.08.2002)

- Interest and/or installment of principal remain overdue for a period of more than 180 days in respect of a Term Loan.
- The account remain ‘out of order’ for a period of more than 180 days in respect of an overdraft /cash credit.
- The bill remains overdue for more than 180 days in the case of bill purchased and discounted.
- Interest and/or installment of principal remains overdue for two harvest seasons or for a period not exceeding two half years in the case of an advances granted for agricultural purposes,
- Any amount to be received remains overdue for a period of more than 180 days in respect of other accounts.

Further, the RBI announced the Mid-term Review Credit Policy for the year 2002-03. The 90 days norms for income recognition of the loan impairment was extended to the SCBs and DCCBs from the year ending March 31,2006 (RBI Circular No.RPCD.No.RF.BC.39/07.37.02/2002-03 dt.30.12.2002). (Chart -2.4). Therefore, a NPA shall be a loan or advance where:
interest and/or installment of principal remain overdue for a period of more than 90 days in respect of a Term Loan.

The account remain ‘out of order’ for a period of more than 90 days in respect of an overdraft /cash credit.

Interest and/or installment of principal remains overdue for two harvest seasons or for a period not exceeding two half years in the case of an advances granted for agricultural purpose, and in respect of Agricultural loans, identification of NPAs would be done as on the basis of Non-Agricultural Advances.

Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts

The SCB/DCCBs should chalk out an appropriate transition path for smoothly moving over to the 90 days norm. As a felicitating measure, banks should move over to charging of interest on monthly basis by 1st April-2004 except the agricultural loans and loans for allied agricultural activities. However, the date of classification of advances as NPA should not be charged on account of interest at monthly rests. The banks should, therefore, continue to classify an account as NPA only if the interest charged during any quarter is not recovered fully with in 180 days from the end of the quarter.

Assets classification was extended to the STCCS in the year ended 31st March 1996. The NABARD guidelines on classification of the loan assets under four categories are given below (NABARD: Master Circular: 193/DoS.21/2002 dt. 17.08.2002) Chart: 2.5).

The Prudential norms on Capital Adequacy, Income Recognition, Assets Classification and Provisioning are the center around the concept of NPAs (Yashwant V.Dabir: 2000,p.34). The Prudential Norms have not only standardized the accounting procedures but also brought about the uniformity in maintenance and disclosure of financial information, which has facilitated
for an inter-bank comparison over a period. As per the recommendation of the CFS (1991) and RBI issued guidelines for Capital Adequacy, Income Recognition, Assets Classification and Provisioning for NPAs.

2.7.1 Capital Adequacy in STCCS

Capital Adequacy is considered as a tool and standard measure for gauging the financial strength of the banks. Capital Adequacy is measured in terms of percentage of capital employed by a bank in relation to value of its assets like loans and advances both funded and non-funded and investment as appearing in the balance sheet, by applying certain standard risk weights for arriving at their real values. A higher Capital Adequacy ratio means, the banks is sound and it has enough caution to take care of its loan loss provision and payment of liabilities, if demanded. Higher NPAs requiring provisioning and derecognition of interest tend to lowering of Capital Adequacy (Bidani, S.N. 2002: p. 142). CFS recommended that banks and financial institutions operating in the country should achieve capital adequacy ratio of 4 per cent in relation to risk weighted assets by March 1993 and reach a level of 8 per cent by March 1996 and 9 per cent by March 2000 (GOI: 1991, p.52). But the Capital adequacy is not applicable to Short Term Cooperative Credit Structure in India because of their weak financial position. Cooperative Banks may make a beginning to move in the direction of strengthening their capital base so that they could confirm the applicable norms over a period of time (GOI: 2000, p.30).

2.7.2 Income Recognition in STCCS

Prior to the Financial Sector Reforms, banks used to debit interest to the loan account on accrual basis and recognized the same as income even in account with poor record of recovery. Recognizing income on realizable basis in accounts where the realization is doubt is not a prudent practice. The prudential norms for Income recognition should be in objective and based on the record of recovery (GOI: 1991, p.55).
Norms for Assets wise Classification of the Loans and Advances

Loans and Advances

Performing Assets

Standard
Loans and Advances which are not NPA

Non-Performing Assets

Doubtful

Sub Standard
Overdue up to 3 years

Loss
Loss Assets identified by the bank/Auditor/RBI/NABARD Inspectors

Doubtful I
Overdue 3 to 4 years

Doubtful II
Overdue 4 to 6 years

Doubtful III
Overdue above 6 years
In the case of certain States where the State Cooperative Societies Act/Rules, Audit Manual provide for taking such unrealized interest to the income head in the profit and loss account, it is necessary for those SCBs and DCCBs to make full provisioning for equivalent amount by charging to profit and loss account. In other words the banks which are charging interest on all overdue loans and if such interest remains unrealized, the same may be taken to income account. Matching provision is fully made for the same by charging it to profit and loss account. Accrued interest taken to income account in the pervious years should also be provided for in full in case the same becomes overdue.

2.7.3 Assets Classifications in STCCS

The RBI, introduced the ‘Health Code system’\(^5\) (HCS) of classification of loan accounts in year 1985 to help the banks to assess the quality of their credit portfolio. Such classification however had nothing to do with the assessment of provisioning requirements against bad and doubtful loan accounts, which was being assessed on the basis of shortfall in realizable value of securities charged to the banks when compared to the amount of loan outstanding. In this background, the CFS suggested that the loan accounts may be grouped under four categories viz., 1.Standard, 2.Substandard, 3.Doubtful and 4.Loss assets (GOI: 1991, p.56). The RBI circular No.RPCD.No.BC 155/07.37.02/95-96 dated 22 June 1996 addressed that all SCBs and DCCBs should classify their loans and advances in to above four categories on the basis of age of overdue as under:

2.7.3.1 Standard

Standard asset is one, which does not disclose any recovery or interest generating problems and which does not carry more than the normal risk attached to business. Thus, in general all the current loans, ST agricultural and non agricultural loans which have not become NPA may be treated as standard assets.
2.73.2 Sub Standard

A sub standard asset is a credit facility, which remains overdue for a period of not exceeding three years. All the substandard assets are treated as NPA. The following is used to classify Sub standard assets:

> An assets which has remained overdue for a period not exceeding 3 years in respect of both agricultural and non agricultural loans should be treated as substandard asset.

> In case of all types of term loans, where installments are overdue for a period not exceeding 3 years, the entire outstanding in term loan should be treated as substandard asset.

> An asset, where the terms and conditions of the loans regarding the payment of interest and/or payment of principal have been renegotiated or rescheduled, after commencement of production, should be classified as substandard asset.

2.7.3.3 Doubtful assets

An asset, which has remained overdue for a period exceeding 3 years in respect of both agricultural and non-agricultural loans, should be treated as Doubtful asset. In the case of all types of term loans, where installments are overdue for more than 3 years, the entire outstanding in term loans should be treated as doubtful asset. As in case of sub standard asset, rescheduling does not entitle a bank to upgrade the quality of advance automatically. For the purpose of provisioning, doubtful assets are again classified in to the following three sub categories:

Table-2.2

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<thead>
<tr>
<th>Category</th>
<th>Criteria</th>
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<tbody>
<tr>
<td>Doubtful -I</td>
<td>Overdue above 3 years not exceeding 4 years</td>
</tr>
<tr>
<td>Doubtful -II</td>
<td>Overdue above 4 years but not exceeding 6 years</td>
</tr>
<tr>
<td>Doubtful -III</td>
<td>Overdue exceeding 6 years</td>
</tr>
</tbody>
</table>
An NPA need not go through the various stages of classification in cases of serious credit impairment and such assets should be straightaway classified as doubtful or loss asset as applicable. Erosion in the value of security can be reckoned as significant when the realizable value of the security is less than 50 per cent of the value assessed by the bank or accepted by RBI /NABARD at the time of last inspection. Such NPAs may be straightaway classified under doubtful category and provisioning should be made as applicable to doubtful assets.

2.7.3.4 Loss Assets

Loss assets are those credit facilities where loss is identified by the bank/auditor/RBI/NABARD Inspectors but the amount has not been written of wholly or partly. In other words, a loan asset, which is considered unrealizable and / or of such little value that its continuance as a doubtful asset is not worthwhile, should be treated as a loss asset. Such loss assets will include overdue loans as detailed below:

- a) Where decrees or execution petitions have become time barred or documents are lost or no other legal proof is available to claim the debt,
- b) Where the members or their sureties are declared insolvent, or have died leaving no tangible realizable assets,
- c) Where the members have left the area of operation of the bank (refers to the borrower in whose name the respective Loan Account with SCB/CCB) leaving no property and their sureties have also no means to pay the dues
- d) Where the loan is fictitious or when gross misutilisation is noticed and
- e) The amount, which cannot be recovered from the liquidated societies

The classification of assets in to above categories should be done taking in to account after the degree of well - defined credit weakness and the extent of dependence on collateral security for the realization of dues. SCBs/DCCBs
should establish appropriate internal systems to eliminate the tendency to delay or postpone the identification of NPAs, especially in respect of high value accounts.

2.8 Account regularized near about the balance sheet date

The asset classification of loans and advances where a single or a few credits are recorded before the balance sheet date should be handled with care and without scope for subjectivity. Where the loan account indicates inherent weakness on the basis of the data available, the account should be deemed to be a NPA. In other genuine cases, the banks must furnish satisfactory evidence to the statutory Auditors/Inspecting Officers about the manner of regularization of the account to eliminate doubts on their performing status. Thus, if these accounts of the borrowers have been regularized by the repayment of all overdue amounts, such accounts need not be treated as NPA and straightaway they may be upgraded to standard category. The status of an NPA account in doubtful category cannot be changed on account of part payment of dues.

Thus, All the credit facilities granted by bank to one and the same borrower will have to be treated as NPA and not that the particular credit facility or part thereof which has become irregular.

2.9 Assets classification to be done at branch level

An asset classification has to be done at the branch level as the lending is done by the branches of the bank and relevant records are maintained at the branch level. However, provisioning is to be done at bank head office level as preparation of the financial statements for the entire bank is done at the head office level.
2.11) Treatment of different Credit facilities to borrower as NPA (On Lending System)

Short-term agricultural advances are granted by SCBs to DCCBs and DCCBs to PACBs for the purpose of on lending. In respect of such advances as well as advances for other purposes, if any, granted under the on lending system, it must be noted that one particular facility which became irregular alone should be treated as NPA. The other facilities granted to them need not be classified as NPAs. Crop loan for each session, Viz. Rabi and Kharif have to be treated as separate account.

2.11 Agricultural Advances

In respect of advances granted for agricultural purposes where interest and/or installment of principal remains unpaid after it has become overdue for two harvest seasons but for a period not exceeding two half-years, such an advance should be treated as NPA. The above norms should be made applicable to all direct agricultural advances listed below:

1. Direct agricultural finance to farmers include:
   i. Short-term loans for raising crops (Crop loans). In addition, advances up to one lakh to farmers against pledge / hypothecations of agricultural produces for a period not exceeding 6 months.
   ii. Medium & Long term loans for
       ^ Purchase of Agricultural implements and machinery
       ^ Development of irrigation potentials
       ^ Reclamation and land development schemes
       ^ Constructions of farm houses and structures etc.,
           Constructions of storage facilities
       ^ Production and processing of hybrid seeds for crops
       ^ Payment of irrigation charges etc.,
   iii. Other types of direct finance to the farmers:
       a. Short term loans
- To tradition / non tradition plantations and horticultural

b. Medium term and long term loans
   - Development loans to all plantations, horticulture, forestry and watershed

In respect of other agricultural advances including allied agricultural activities, assessment of NPA would be done as in the case of non-agricultural advances.

In cases of conversion or re-scheduling, the term loan as well as fresh short-term loan may be treated as current dues and need not be classified as NPA. The asset classification of these loans would thereafter be governed by the revised terms and conditions and would be treated as NPA if interest and/or installment of principal remains unpaid, after it has become overdue, for two harvest seasons but for a period not exceeding two half years. However, term loans, which have been rephased/rescheduled after they have become NPA, should continue to be classified in the same category.

2.12 Loans with moratorium for payment of interest

In the case of bank finance given for industrial projects or for agricultural plantations, where moratorium is available for payment of interest, payment of interest becomes ‘due’ only after the moratorium or gestation period is over. Therefore, such amounts of interest do not become overdue or NPA, with reference to the date of debit of interest. They become overdue after due date for the payment of interest is uncollected.

In the case of housing loan or similar advances granted to staff members where interest is payable after recovery of principal, interest need not be considered as overdue from the first quarter onwards. Such loans/advances should be classified as NPA only when there is a default in repayment of installment of principal or payment of interest on the respective due dates.
2.13 Government Guaranteed Advances

In case of the credit facilities backed by guarantee of the State Government, though overdue may be treated as NPA only when the Government repudiates its guarantee when invoked. This exemption from classification of Government guaranteed advances as NPAs is not for the purpose of recognition of income. With effect from 1st April 2000, advances sanctioned against State Government guarantees should be classified as NPA and should be fully provided for in that year, if the guarantee is invoked and remains in default for more than 180 days. As regards advances guaranteed by State Govt., which stood invoked as on 31 March 2000 but were not honoured by the State Govt, and continue to be in default for more than 180 days, provisioning shall be made with a minimum of 25 per cent each year during the period 31 March 2000 to 2003. Advance guaranteed by State Governments where the guarantee has been invoked on or after 1st April 2000 and has remained in default for more than two quarters should be classified as NPAs with effect from 1st April 2000.

2.14 Provisioning against the NPA in STCCS

Banks are lending loans and advances which in some cases may not be recoverable fully or partially and therefore, may require provisioning against such assets in their balance sheet. Till March 1992, banks had been making provisions in case of bad and doubtful loan assets on the basis of short fall in the realizable values of security when compared to the outstanding amount in a loan account. This practice followed by the banks in assessing the provisions was not considered prudent, as mere existence of security should not be the determining factor for realization of the loan granted to the borrowers without considering erosion in the value of security. It was in this context, the RBI instructed banks to make provisions in the loan accounts by applying norms as advised by them depending upon classification of their assets.
Provisioning is necessary considering the erosion in the value of security charged to the banks over a period of time (RBI Circular No RPCD.No. BC. 155/07.37.02/95-96 dated 22 June 1996). In order to give some time to STCCS to implement the prudential norms, phasing of provision is suggested to the STCCS (Table - 2.2) (RBI Circular No.RPCD.No.BC. 1/07.37.02 / 97-98 dt. 2 July 1998). (Chart: 2.6)

Table-2.3

Phasing of Provisioning Norms Applicable to STCCS

<table>
<thead>
<tr>
<th>Year</th>
<th>Provisioning Norms</th>
</tr>
</thead>
<tbody>
<tr>
<td>First Year</td>
<td>&gt; 100 per cent in respect of loss Assets</td>
</tr>
<tr>
<td></td>
<td>&gt; Not less than 30 per cent of provisioning needed in respect of Doubtful and loss assets</td>
</tr>
<tr>
<td>Second Year</td>
<td>&gt; 100 per cent in respect of loss Assets</td>
</tr>
<tr>
<td></td>
<td>&gt; 20 per cent of residual amount of provisioning needed in respect of substandard and doubtful assets and</td>
</tr>
<tr>
<td></td>
<td>&gt; Current provision in respect of such assets as classified in second year</td>
</tr>
<tr>
<td>Third year</td>
<td>&gt; 100 per cent in respect of loss Assets</td>
</tr>
<tr>
<td></td>
<td>&gt; 20 per cent of residual amount of provisioning needed in respect of substandard and doubtful assets and</td>
</tr>
<tr>
<td></td>
<td>&gt; Current provision in respect of such assets as classified in third year</td>
</tr>
<tr>
<td>Fourth year</td>
<td>&gt; 100 per cent in respect of loss Assets</td>
</tr>
<tr>
<td></td>
<td>&gt; 20 per cent of residual amount of provisioning needed in respect of substandard and doubtful assets and</td>
</tr>
<tr>
<td></td>
<td>&gt; Current provision in respect of such assets as classified in fourth year</td>
</tr>
</tbody>
</table>

Chart – 2.6
Provisioning Norms for Assets Classification

**Type of Assets**

- **Standard**
- **Sub Standard**
- **Doubtful**
- **Loss**

**Provisions Required**
(Percentage of Loan outstanding)
- Nil Provision (from 31st March 1997 to 31st March 1999), 0.25 percent (from the year 1st April 1999 to 31st March 2007)
- 0.40 percent (1st April 2007 onwards)

**Period**

- Overdue 3 – 4 years
- Overdue 4 – 6 years
- Overdue above 6 years

**Secured**
- 20 percent
- 30 percent
- 50 percent

**Unsecured**
- 100 percent
- 100 percent
- 100 percent

100 percent

When the Prudential norms were introduced in the year 1996-97, no provisioning was required in respect of standard assets. From the year ended 31st March 2000, banks are required to make provision on Standard Assets also at a minimum of 0.25 per cent of the total outstanding in this category. The provision made on Standard Assets may not be reckoned as erosion in the value of assets and will form part of owned funds of the bank. The advances granted against Term Deposits, National Saving Certificate (NSC) eligible for surrender, Kisan Vikas Patra (KVP), Indira Vikas Patra (IVP), Life Insurance polices, Staff Loans would attract provision of 0.25 per cent prescribed for Standard Assets. The provision towards standard assets need not be netted from gross advances and should be shown separately as “Contingent Provision Against Standard Assets” under “Other liabilities and provisions others” (RBI Circular No. NB.DoS.HO.POL/6990/p.57/2003-03 dt. 19th February 2003).

The RBI announced Mid -Term Review of Annual Policy Statement for the year 2005-06, where it has been decided that the general provision requirement for ‘Standard Advances’ shall be 0.40 per cent from the present level of 0.25 per cent with effect from the financial year beginning of 1st April, 2007 (RBI Circular No. RPCD.RF.BC.55/07.37.02/2005-06 dt. 20th, December 2005).

2.14.2 Provisions against Sub Standard Assets in STCCS

A general provision of 10 per cent of total outstanding in this category should be provided.

2.14.3 Provisions against Doubtful Assets in STCCS

Loan assets under this category generally have all the weakness, which will make the collection and liquidation of the loan highly questionable since such accounts had remained overdue for a period exceeding 3 years. In such accounts, depending upon as to how long these remained in doubtful category
and the bifurcation of the loan amount under secured and unsecured, the provisions are required to be made as under:

> 100 per cent of the amount of advances, which is not covered by the realizable value of security, i.e., to the extent of short fall in the realizable value of security in the account.

> Further, the provisions of 20 per cent, 30 per cent, 50 per cent of the secured portion i.e., estimated realizable value of securities over and above item, the depending upon the period for which the asset has remained doubtful is also required to be made on the following basis:

Table -2.4

**Provision on the Secured Portion of Doubtful Assets**

<table>
<thead>
<tr>
<th>Period for which the advances has remained under doubtful category</th>
<th>Percentage of provision on the secured portion of the advances</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overdue above 3 years - up to 4 years</td>
<td>20</td>
</tr>
<tr>
<td>Overdue above 4 years but not exceeding 6 years</td>
<td>30</td>
</tr>
<tr>
<td>Overdue exceeding 6 years</td>
<td>50</td>
</tr>
</tbody>
</table>

The enactment of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 and the extent of recovery of an assets reducing over a period of time, it is essential that banks expedite recovery of NPA. The annual policy statement for the year 2004-05 stated that in the SCBs/DCCBs for, all advances classified as ‘Doubtful for more than three years’ the provision requirement would be as under: (The RBI Circular No.RPCD.RF.BC.No.82/07.37.02/2004-05 dt. 1st March, 2005)

2.14.4 Unsecured Advances

The provisioning for the unsecured advances should be as mentioned in the table 2.5
Table 2.5

Provision on the Unsecured Portion of Doubtful Assets

<table>
<thead>
<tr>
<th>Period for which the advances has remained under doubtful category</th>
<th>Percentage of provision on the secured portion of the advances</th>
</tr>
</thead>
</table>
| Outstanding stock of NPAs classified as doubtful for more than three years as on 31st March, 2007 | 60 per cent as on 31st March, 2008  
75 per cent as on 31st March, 2009  
100 per cent as on 31st March, 2010 |
| Advances classified as ‘doubtful more than three years’ on or after April 1st 2007 | 100 per cent |

2.14.5 Provisions against Loss Assets in STCCS

The entire assets should be written off after obtaining necessary approval from the competent authority and as per the provisions of the Cooperative societies Act/Rules. If the assets are permitted to remain in the books for any reasons, 100 per cent of the outstanding should be provided for. In respect of an asset identified as a loss asset, full provision at 100 per cent should be made if the expected salvage value of the security is negligible.

2.15 Factors Causing NPA

For efficient handling of NPAs, it is important to identify the factors which are responsible for creation of NPAs in Banks. They can be classified into three broad categories viz., External factors, Internal factors and Borrower related factors. The external factors are the factors, which are outside the control the banks whereas the internal factors are within the control of the banks. The borrower related factors arise not only due to the influence of external and internal factors but also the inability of the borrowers to repay and their attitude towards the settlement of loans.

of loans (Mazumdar D.K & Baruah H.K: 1999, p.2), willful default (Ravichandran K: 2000, p. 164), low agricultural productivity (Sidhu et.al: 2002, p. 137), adverse effects of Debt Relief Schemes (Ravichandran K: 2000, p. 139 and Joshi G.V: 2002, p.25) were the reasons attributed to the increase of overdue in Cooperatives. The cumulative result is that the members, who are mostly borrowers, have little or no sense on their stake in the cooperatives or any accountability in ensuring prudent management of funds. On the contrary, the Government policies (loan and interest waivers, delaying recoveries, the loans carrying State Guarantees) have, in a way, led the borrowers to presume that they could with impunity, delay or even fail to meet, their repayment obligations (GOI: 2004, p.53).

The study conducted by Anil Suryawanshi (2003, p.19) identified that misutilisation of the loans by beneficiaries, low income generation from the activity undertaken, natural calamities, intentional non-repayment of dues, non-adherence to lending norms/ sanctioned norms / conditions were the reasons at the borrower level. Selection of unsuitable scheme, political interference and wilful default were the reasons for the poor recovery (Ranjit Kumar Das: 2002, p.10). Poor planning, delay in communication, ignorance of credit risk and commercial risks, overlooking of operational irregularities are the causes for the creation of the NPAs apart from the abrupt changes in Government policies, cost and time overruns, natural calamities which tend to mounting in NPAs (Malyadri P.& Sirisha S :2003, p.7).

2.16 Ratio Analysis and the NPA Management in STCCS

During the study period, it was found that the gross and net NPA levels of STCCS remained constant in percentage terms, but in absolute terms the NPA level was increasing. It had been possible because of rapid growth in gross credit advanced. Therefore the criteria gross NPA as well as net NPA percentage could not be the only yardsticks for measurement of a banks’ financial strength or performance with regard to the NPA management. Therefore, to assess the financial strength, the quality of the loan assets and defectiveness of NPA management at the bank level, it was necessary to analysis various parameters with respect to NPA (Banambar Sahoo: 2002,
Ratios serve an important financial analysis. Ratios are the small numerical expressions facilitating to examine the relationship between two variables. The following ratios can be used to measure the effectiveness of NPA management:

Table - 2.6
**Factors Causing NPA**

<table>
<thead>
<tr>
<th>External Factors</th>
<th>Internal factors at Institutional Level</th>
<th>Borrower related factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Natural calamities like floods, cyclones, earthquakes, drought etc.,</td>
<td>• Improper identification of borrowers.</td>
<td>• Misutilisation of loans.</td>
</tr>
<tr>
<td>• Non-Cooperation/inaction of Government agencies in recovery.</td>
<td>• Defective credit appraisal and lending.</td>
<td>• Diversion of funds for other low productive purposes.</td>
</tr>
<tr>
<td>• Target oriented approach under Government sponsored programmes</td>
<td>• Delay in credit disbursement.</td>
<td>• Lack of technical and managerial skills.</td>
</tr>
<tr>
<td>• Changes in Government policies.</td>
<td>• Under financing as well as over financing.</td>
<td>• Poor maintenance of assets created out of borrowing funds.</td>
</tr>
<tr>
<td>• Political interference like supersession of elected board</td>
<td>• In sufficient gestation or repayment period.</td>
<td>• Attitude to default willfully.</td>
</tr>
<tr>
<td>• Loan waiver scheme, loan mela, interest waiver, subsidy, and ban on recovery of Cooperative dues.</td>
<td>• Lack of post disbursement follow-up supervision</td>
<td>• Personal accident, death, etc.,</td>
</tr>
<tr>
<td>• Lack of conducive legal system for loan recover</td>
<td>• Lack of borrower - lender contact and poor understanding of rural members</td>
<td>• Traditional types of crop cultivation.</td>
</tr>
<tr>
<td>• Slow process of initiating legal proceedings through arbitration and civil suits</td>
<td>• Poor management information system.</td>
<td>• Lack of basic education.</td>
</tr>
<tr>
<td></td>
<td>• Lack of supervision and training.</td>
<td>• Migration</td>
</tr>
</tbody>
</table>
2.21.1 NPA Ratio
2.21.2 Net NPA Ratio
2.21.3 Gross problem Assets Ratio
2.21.4 Gross Net problem Assets Ratio
2.21.5 Substandard Assets Ratio
2.21.6 Doubtful Assets Ratio
2.21.7 Loss Assets Ratio
2.21.8 Provision Ratio

2.16.1 Gross NPA Ratio

The Gross NPA is the better indicator than net NPA of the quality of the loan portfolio (Indira Rajaraman & GarimaVasishha: 2002, p.434). Gross NPA is the sum total of all loan assets that are classified as NPA as per the RBI guidelines as on the balance sheet date. The Committee on Banking Sector Reforms (GOI: 1998, p.24) suggested that those banks with an international presence the minimum objective should be to reduce the Gross NPA level below 5 per cent and 3 per cent in the year 2000 and 2002 respectively.

\[
\text{Gross NPAs} \\
\text{Gross NPA Ratio} = \frac{...}{\times 100} \\
\text{Gross Advances}
\]

Gross NPA indicates the quality of credit portfolio of the bank. High gross NPA ratio indicates low quality credit portfolio.

2.16.2 Net NPA Ratio

The Net NPA ratio is the ratio of Net NPA to net advances expressed in terms of percentage. It indicates the degree of riskiness in the credit portfolio of the bank. Net NPA is determined by deducting provisions from gross NPA. The Committee on Banking Sector Reforms (1998, p.24) suggested that those banks with an international presence the minimum objective should be to
reduce the Net NPAs to 3 per cent and 0 per cent in the year 2000 and 2002 respectively. The formula to calculate net NPA ratio is given below.

\[
\text{Net NPA Ratio} = \frac{\text{Net NPAs}}{\text{Net Advances}} \times 100 \quad \text{i.e.,}
\]
\[
\text{Net NPA Ratio} = \frac{\text{Gross NPAs – Provisions}}{\text{Gross Advances – Provisions}} \times 100
\]

High Net NPAs indicates the existence of highly risky loans in the bank for which no adequate provision has been made. As per the international standard, the Net NPA should be below 2.5 per cent.

2.16.3 Gross Problem Assets Ratio

The Gross Problem Assets ratio analysis indicates the relationship between Gross NPA to total Assets. It indicates the liquidity risk management of the bank.

\[
\text{Gross Problem Assets Ratio} = \frac{\text{Gross NPAs}}{\text{Total Assets}} \times 100
\]

High Ratio means high solid assets; low ratio means high liquid assets of the bank.

2.16.4 Net Problem Assets Ratio

This ratio expresses the relationship between Net NPAs and total assets of the bank. It indicates the proportion of the risky assets that a bank carries, for which no adequate provision has been made.
2.16.5 Sub Standard Assets Ratio

It is the ratio of total sub-standard assets to gross NPAs of the bank. It indicates the scope for upgradation of NPA to standard assets.

\[
\text{Net NPAs} \\
\text{Net Problem Assets Ratio} = \frac{\text{Total Sub - Standard Assets}}{\text{Gross NPAs}} \times 100
\]

If this ratio is increasing, it indicates that there is high level of degradation in performing assets. However, there is no prescribed limit at the International level.

2.16.6 Doubtful Assets Ratio

It is the ratio of total doubtful assets to gross NPA of the bank. It indicates the scope of compromise for NPA reduction.

\[
\text{Total Doubtful Assets Ratio} \\
\text{Doubtful Assets Ratio} = \frac{\text{Total Doubtful Assets}}{\text{Gross NPA}} \times 100
\]

If the ratio is increasing, it indicates that the management of non-performing loans in the bank is poor.

2.16.7 Loss Assets Ratio

It is the ratio of total loss assets to gross NPAs of the bank.
Total Loss Assets
Loss Assets Ratio = \ldots \times 100
Gross NPAs

This ratio should be much lower. If this ratio increases, it indicates that there is incidence of high erosion of securities of the loan assets.

2.16.8 Provision Ratio

It is the ratio of total Provisions held in respect of gross NPAs of the bank. It indicates the degree of safety measures adopted by the banks. It has direct bearing on profitability of the bank.

\[
\text{Provision ratio} = \frac{\text{Total Provisions}}{\text{Gross NPAs}} \times 100
\]

If the provision ratio is less, it indicates that the bank has not made adequate provisions for problematic loan assets. The upward movement of the provision ratio indicates that the bank is adopting adequate measures for the future loan losses.

2.17 Impact of Prudential Norms in STCCS

The impacts of Prudential Norms in STCCS are discussed hereunder.

2.17.1 Impact on profitability

After introduction of the prudential norms, the profitability of the STCCS is severely affected by NPAs as:

\[ \text{NPAs do not generate any income} \]

Provision is required at the rate of 10 per cent to 100 per cent depending upon the quality of assets (RBI Circular No RPCD.No. BC. 155/07.37.02/95-96 dated 22 June 1996).
Banks are required to meet the cost of funding these unproductive assets. Banks also incur expenses for maintenance of NPAs.

2.17.2 Impact on Recycling of funds

Recycling of funds is severely affected due to high NPAs and the net worth of the several banks are negative (See also table 3.14). The share capital and reserves constitute the total net worth of the bank. In course of time, a portion of NPA is also irrecoverable thereby eroding the net worth of some banks, which will become negative.

2.17.3 Impact on Image of the bank

All SCBs/DCCBs have to comply with the Section 11(1) of the Banking Regulation Act, 1949(AACS) It stipulates that “the real or exchangeable value of paid up capital and reserves shall not be less than Rs.1.00 lakh” (BR Act 1949: p. 93). Those banks having higher percentage of NPAs could not comply the above section of the BR Act 1949 (AACS) which seriously affect the image of the bank.

2.17.4 Impact on Refinance from higher financing agencies

The high level of NPAs impairs capacity of the banks to raise more resources from the higher financing agencies such as NABARD (GOI: 2000,p.30). This is particularly relevant to Cooperative Banks having low level of their own resources. The low level of deposits increases their dependence on one hand and at the same time the low recovery impairs their capacity to obtain refinance from NABARD, as recovery performance constitutes an influential item in the eligibility criterion for availing of refinance (GOI: 2004,p.38).
2.17.5. **Effect on financial cost**

The funds blocked in NPAs increase the cost of financial intermediation as cooperatives resort to raise deposits and borrowings at a higher cost as a measure to minimize the imbalance between cash inflow and cash outflow arising out of the NPAs (NABARD : 2000-2001, p. 137).

2.17.6 **Effect on credibility of the cooperative banking**

High level of NPAs is the serious blow on the credibility of the Banking system. It shakes the confidence of the general public on the soundness of the banking operations and indirectly affects the capacity of the bank to mobilize more deposits and also prevents the bank to enter in to new schemes.

2.18 **Conclusion**

The above analysis found that the problem of NPAs was neutral among the loan accounts. There seems to be every chance that any further loan account could become NPA to the banks. The increasing trend in NPA questions the liquidity, solvency and profitability of the banks. Under these circumstances and due to the globalization the question: whether Prudential Norms are applicable to cooperative banks, becomes nullified. The real question should be: How to address the problem of NPA? Because the monies locked up NPAs are not available for further loan, which ultimately blocks institutional credit especially for agriculture. For example agricultural credit as percentage to total credit has come down from 20.1 in 1980’s to 10.5 per cent in 2001-02. Consequently the share of moneylenders in rural credit had increased from 36.8 per cent to 42.9 per cent during the same period. Hence, NPA is not just problem for banks, but also to the economy and the society at large. With this background the next chapter analysis the level and extent of NPAs at DCCBs level in India.
As per the RBI circular No. BP.BC.1 17/21.01.002.92 dt.22 April 1992

1. Tier I Capital is core capital provides the most permanent and readily support to a bank against unexpected losses. Tier I Capital would consists of
   > Paid up Capital
   > Statutory Reserves
   > Other Disclosed free reserves
   > Capital Reserves representing surplus arising out of sale proceeds of assets.

2. Tier II Capital is less permanent in nature or less readily available. Tier II Capital would consists of
   > Un disclosed free reserves and cumulative perpetual preference shares
   > General Provisions and loss reserves
   > Hybrid Debt Capital Instruments (Certain characteristics of equity and certain characteristics of debt)

3. The BIS was established in the contest of the Young Plan (1930) which dealt with the issues of the reparation payments imposed on Germany by the Treaty of Versailles. The new bank was to take over the functions previously performed by the Agent General for Reparations in Berlin and to act as a trustee for the Dawes and Young Loans. In addition, the BIS was to promote Central Bank cooperation in general. The reparations issue quickly faded into the background, focusing the Bank’s activities entirely on cooperation among Central Banks and increasingly, other agencies in pursuit of monetary and financial stability. The Bank’s main tasks, as they have developed over the past 70 years, can be summarized as follow;

   a) The BIS provides a forum for Central Bank cooperation. Through regular meetings, bringing together governors and officials of its member Central Banks. The BIS acts as the prime forum for information exchange and cooperation among Central Banks worldwide. Central Bank cooperation at the BIS aimed at defending the Bretton Woods system in the 1960s and early 1970s, and managing capital flows following the two oil crises and the international debt crisis in the 1980s. More recently, the thrust has been to foster financial stability in the wake of economic integration and globalization.

   b) With in the framework of international cooperation, the BIS conducts research contributing to monetary and financial stability, collects and publishes statistical material on international finance and -through
committees of national experts-formulates recommendations to the financial community aimed at strengthening the international financial system.

c) The BIS performs traditional banking functions, such as reserve management and gold transactions, for the account of Central Bank customers and international organizations. The total of currency deposits placed with the BIS amounted to USS128 billion at 31 March 2000, representing around 7 percent of world foreign exchange reserves. In addition, the BIS has performed trustee and agency functions. Thus, the BIS was the agent for the European Payments Union (EPU, 1950-58), helping the European currencies restore convertibility after the Second World War. Likewise, the BIS has acted as the agent for various European exchange rate arrangements, including the European Monetary System (EMS, 1979-94) which preceded the move to a single currency.

d) Finally, the BIS has also provided or organized emergency financing to support the international monetary system when needed. During the 1931-33 financial crisis, the BIS organized support credits for both the Austrian and the German Central Bank. In the 1960s, the BIS arranged special support credits for the Italian lira (1964) and for the French franc (1968) and two so-called group Arrangements (1968 and 1969) to support sterling. The BIS has provided finance in the context of IMF-led stabilization programmes (eg for Mexico in 1982 and for Brazil in 1998).


5 Health Code System (HCS) is a grading system suggested by RBI. The HCS served as a comprehensive system for assessing the quality of individual advances, and to effectively monitor the financial systems from the year 1985. The RBI had advised the banks to uniformly adopt a grading system depending upon the health and quality of individual advances known as Health Code System (HCS) (GOI: 1991, p. 54). As per the HCS, the banks started to classify their borrowal accounts in to eight categories based on their financial health viz., Satisfactory (HC-1), Irregular (HC-2), Sick but viable (HC-3), Sick and Non-viable (HC-4), Suit filed (HC-6), Decreed (HC-7), Bad and Doubtful (HC-8) (Bidani, S.N.: 2002, p.38-40)
6. If the realizable value of the security, as assessed by the bank/approved valuers /RBI /NABARD is less than 10 per cent of the outstanding in the borrowal accounts, the existence of security should be ignored and the asset should be straightaway classified as loss asset. It may be either written off or fully provided by the bank.

References


6. GOI (1949), Banking Regulation Act (As Applicable to Cooperative Societies), p.93.


11. GOI (2004), Task Force on Revival of Cooperative Credit Institutions, p.38


22. *NABARD Master Circular No: 193/DoS.21/2002 dt. 17.08.2002*


27. RBI (1954), *All India Rural Credit Survey Committee*, p.62.


32. RBI Circular No RPCD.No. BC. 155/07.37.02/95-96 dated 22.6.1996.


35. RBI Circular No.RPCD.No.BC. 1/07.37.02 797-98 dt. 2.07. 1998.


41. The RBI Circular No.RPCD.RF.BC.No. 82/07.37.02/2004-05 dt. 1.03. 2005.

42. www.bis.org

43. www.geocities.com