CHAPTER – III

NON PERFORMING ASSETS – THE BASICS

3.1 RISK

Risk is the potentiality that both the expected and unexpected events may have an adverse impact on the bank’s capital or earnings. The expected loss is to be borne by the borrower and hence is taken care by adequately pricing the products through risk premium and reserves created out of the earnings. It is the amount expected to be lost due to changes in credit quality resulting in default.

On the other hand, the unexpected loss on account of individual exposure and the whole portfolio is entirely is to be borne by the bank itself and hence is to be taken care by the capital.

Banks are confronted with various kinds of financial and non-financial risks viz., credit, market, interest rate, foreign exchange, liquidity, equity price, legal, regulatory, reputation, operational etc. These risks are highly interdependent and events that affect one area of risk can have ramifications for a range of other risk categories.

The future of banking rests on risk management dynamics. Only those banks that have efficient risk management system will survive in the market in the long run. The effective management of credit risk is a critical component of comprehensive risk management essential for long-term success of a banking institution.
3.2 CREDIT RISK

Credit risk is the oldest and biggest risk that bank, by virtue of its very nature of business, inherits. This has, however, acquired a greater significance in the recent past for various reasons. Foremost among them is the wind of economic liberalization that is blowing across the globe. India is no exception to this swing towards market driven economy.

Competition from within and outside the country has intensified. This has resulted in multiplicity of risks both in number and volume resulting in volatile markets. A precursor to successful management of credit risk is a clear understanding about risks involved in lending, quantifications of risks within each item of the portfolio and reaching a conclusion as to the likely composite credit risk profile of a bank.

Credit Risk is the default by the borrower to repay money lent, and remains the most important risk to manage. The predominance of credit risk is even reflected in the composition of economic capital, which banks are required to keep aside for protection against various risks.

Quality borrowers (Tier-I borrowers) were able to access the capital market directly without going through the debt route. Hence, the credit route is now more open to lesser mortals (Tier-II borrowers).
With margin levels going down, banks are unable to absorb the level of loan losses. There has been very little effort to develop a method where risks could be identified and measured.

Loans and Advances, as assets of the bank, play an important part in gross earnings and net profits of banks. The share of advances in the total assets of the banks forms more than 60 percent and as such it is the backbone of banking structure.

Bank lending is very crucial for it make possible the financing of agricultural, industrial and commercial activities of the country. The strength and soundness of the banking system primarily depends upon health of the advances. In other words, improvement in assets quality is fundamental to strengthening working of banks and improving their financial viability.

3.3 NON-PERFORMING ASSETS

Banking businesses is mainly that of borrowing from the public and lending it to the needy persons and business at a premium. Lending of money involves a credit risk. When the loans and advances made by banks or financial institutions turnout as non-productive, non-rewarding and non-remunerative then they will become Non-Performing Assets (NPA).¹

Banks are exposed to credit risk, liquidity risk, interest risk, market risk, operational risk and management/ownership risk. It is the credit risk which stands out as the most dreaded one. Though often associated with lending, credit risk arises

¹ http://www.insipub.com/rjss/2008/4-12.pdf
whenever a party enters into an obligation to make payment or deliver value to the bank. The nature and extent of credit risk, therefore, depend on the quality of loan assets and soundness of investments.\(^2\)

Since 2000, Indian Banking in its attempt to integrate itself with the global banking has been facing lots of hurdles in its way due to its inherent weaknesses, despite its high sounding claims and lofty achievements. In a developing country like India, banking is seen as an important instrument of development; however, with the strenuous NPAs, banks have become helpless burden on the economy.

Looking to the changing scenario at the world level, the problem becomes more ironical because Indian banking cannot afford to remain unresponsive to the global requirements. The banks are, however, aware of the grim situation and are trying their level best to reduce the NPAs ever since the regulatory authorities - Reserve Bank of India and the Government of India - are seriously chasing up the issue.

### 3.4 IDENTIFICATION OF NON PERFORMING ASSETS

Action for enforcement of security interest can be initiated only if the secured asset is classified as Non-Performing Asset. Non-Performing Asset means an asset or account of borrower, which has been classified by bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the guidelines relating to assets classification issued by Reserve Bank of India.

3.4.1 “past due” concept

With a view to move towards internationally accepted norms for asset classification and income recognition, RBI has been “tightening” the definition of NPAs in a phased manner. Thus, from the norm of classifying only those assets as non-performing which are four quarters past due, which was applicable until 1993, RBI moved to the norm of three quarters past due in 1994 and then to two quarters (180 days) past due in 1995.

3.4.2 Dropping of “past due” concept3

Due to the improvement in the payment and settlement system, recovery climate, upgradation of technology in the banking system etc, it was decided to dispense with “past due “concept, with effect from 31st March 2001. Accordingly as from that date, a Non - Performing Asset shall be an advance where

1. Interest and/or instalment of principal remain overdue for a period of more than 180 days in respect of a term loan,

2. The account remains ‘out of order ‘ for a period of more than 180 days in respect of an overdraft/cash credit (OD/CC)

3. The bill remains overdue for a period of more than 180 days in case of bill purchased or discounted.

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4. Interest and/or principal remains overdue for two harvest season but for a period not exceeding two half years in case of an advance granted for agricultural purpose, and

5. Any amount to be received remains overdue for a period of more than 180 days in respect of other accounts.

3.4.3 Ninety days overdue norm

Again, it was decided to adopt ‘90 days overdue’ norms for identification of NPAs. This change is done in order to move towards international best practices and to ensure greater transparency.

From the year ending 31st March 2004, a Non-Performing Asset shall be a loan or an advance where

1. Interest and/or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan;

2. In respect of an Overdraft or Cash Credit advance, the account remains “out of order”, i.e. if the outstanding balance exceeds the sanctioned limit/drawing power continuously for a period of 90 days, or if there are no credits continuously for 90 days as on the date of balance-sheet, or if the credits are not adequate to cover the interest due during the same period;

3. The bill remains overdue for a period of more than 90 days in case of bill purchased or discounted.

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Ibid.,
4. In respect of agricultural advances for short duration crops, where the instalment of principal or interest remains overdue for 2 crop seasons;

5. In respect of agricultural advances for long duration crops, where the principal or interest remains overdue for one crop season.

3.4.4 Out of order

An account should be treated as out of order if the outstanding balance remains continuously in excess of sanctioned limit /drawing power. In case where the outstanding balance in the principal operating account is less than the sanctioned amount /drawing power, but there are no credits continuously for six months as on the date of balance sheet or credit are not enough to cover the interest debited during the same period, these account should be treated as ‘out of order’.

3.4.5 Overdue

Any amount due to the bank under any credit facility is ‘overdue’ if it is not paid on due date fixed by the bank.

As a facilitating measure for smooth transition to 90 days norm, banks have been advised to move over to charging of interest at monthly rests, by 1st April 2002. However, the date of classification of an advance as NPA should not be changed on account of charging of interest at monthly rests. Banks should, therefore, continue to classify an account as NPA only if the interest charged during any quarter is not serviced fully within 180 days from the end of the quarter with effect from 1st April 2002 and 90 days from at the end of the quarter with effect from 31st March, 2004.
3.5 INCOME RECOGNITION NORMS

NPAs have turned out to be a major stumbling factor affecting the profitability of Indian banks. Before 1992, banks did not disclose the bad debts sustained by them and the provision made by them fearing that it may have an adverse impact. The banks used to take income even on NPAs on accrual basis. This helped them to disclose false profits.

Indian banks have, for a long time, treated all the sticky loan assets as Non-performing Assets (NPAs). The accrual concept of accounting convention has also been followed without reckoning the amount actually realized.

The word “realized” is noteworthy, which is distinct from the word “reliability”. It means that if a loan given by a bank fails to fetch a return in the form of interest realized from the borrower, the Bank has no right to debit the borrower account with the interest chargeable following the accrual principle.

In that event, it then truly signifies that the asset is not performing i.e., not yielding any income to the bank. This is the essence of income recognition norms, based on the recommendation of the Narasimhan Committee on Financial sector reforms adopted by Indian banks.

An asset, which ceases to yield income for the bank, should be treated as NPA, and any income from loan assets should not be booked as income until it is actually recovered. So, banks, which charge interests to loan Accounts Park it in
“Interest Not Collected Account” (INCA) until recovery, and on recovery, reverse it from INCA and credit interest account.

The Narasimham committee recommendations suggested that loans and advances in banks should be classified into performing and non performing on the basis of the health of the loan assets and the record of adherence to repayment of installments and interest on due dates. The committee also recommended that the banks be allowed to book income by way of interest debited to an account only when it was found realizable within a given time frame.

The committee suggested that the banks should make provision for all NPAs on the basis of classification of such assets based on the age of irregularity, security cover available etc. The RBI accepted the recommendations of the committee with regard to introduction of norms for income recognition and asset classification and provisioning and advised the banks to implement the same in a phased manner beginning 1st April 1992.

The introduction of prudential norms to strengthen the banks financial position and enhance transparency is considered as a milestone measure in the financial sector reforms. These prudential norms, which relate to income recognition, asset classification, provisioning for bad and doubtful debt and capital adequacy serve three great purposes.

1. Income recognition norms reflect a true picture of the income and expenditure of the bank.
2. The asset classification and provisioning norms help in assessing the quality of the asset portfolio of the bank.

3. They also act as tool of financial discipline and compel banks to look at the quality of loans assets and the risk attached to the lending

3.6 MAIN CAUSES OF NON-PERFORMING ASSETS

One of the main causes of NPAs in the banking sector is the directed loans system under which commercial banks are required to supply a prescribed percentage of their credit (40 percent) to priority sectors.

Loans to weaker sections of society under State subsidy schemes have led borrowers to expect that like a nonrefundable State subsidy, bank loans need not be repaid. Directed loans supplied to the “micro sector” are problematic of recoveries especially when some of its units become sick or weak.

As the directed credit component of the priority sectors arises from loan schemes requiring Government approval of beneficiaries, banks’ selection standards with regard to eligible borrowers are being interfered with.

Government subsidy schemes were intended originally to prompt bankers to lend to weaker sectors. But as the directed credit component became partly politicized and bureaucratized, the realization has grown that priority sector bank credit should operate with the required degree of risk management.

http://www.adb.org/Documents/Books/Rising_to_the_Challenge/India/india_bnk.pdf
Besides directed lending, the reasons that are fundamentally responsible for the problem of Non-Performing Assets are outlined below:

3.6.1 The Legal Framework

The RBI considers NPAs in the Indian banking sector as a historic legacy due to lacunae in credit recovery, largely and arising from inadequate legal provisions on foreclosure and bankruptcy, long drawn legal procedures and difficulties in execution of the decrees awarded by the court. At the end of March 1998, about 46 per cent of NPAs were in respect of suit filed accounts (Filed by 27 public sector and 6 private sector banks) where the recovery was as low as 4.3 per cent and significant portion of suits have been pending for more than a decade.

3.6.2 Political interference

The Indian banking system has been extensively misused for political reasons in the past. A large part of their bad debts are a legacy of this misuse. The NPAs in priority sector advances of public sector banks are 46 - 49 per cent of their overall NPAs while priority sector advances form only 30 - 32 per cent of them total advances. In addition, the large-scale loan write-off ordered by politicians promote a culture of indiscipline and lawlessness among borrowers. This adds to the problems of banks already functioning in a hostile legal environment.

3.6.3 Competitions and Liberalization

The winds of liberalization have opened up new vistas in the banking industry resulting in the generation of an intensely competitive environment. The banking
arena has been almost flooded with new entrants including private banks, foreign banks, non-banking finance companies merchant bankers, chit funds etc.

Heavy weight foreign banks with huge capital base, latest technology innovative and globally tested products are spreading their wings and wooing away customers from the Indian banks that are steeped in a tradition of inefficiency and lethargy. These banks enjoy a competitive edge in providing services, which are competitively priced and have better quality, wider range of products and specialized services. They are technology driven and have locational advantages.

3.6.4 Inadequate Risk Management Practices

The banks are exposed to a much greater degree of risk primarily arising out of the potential loss on an asset or a portfolio. For this, the banks have to develop skills to identify assess and minimize the risks and enhance the returns.

If there is a mismatch between assets and liabilities, the banks may be exposed to interest rate risk, liquidity risk and foreign exchange risk, credit risk and price risk. Narasimham Committee II has also addressed this issue bringing into focus the dangers to liquidity and solvency due to mismatches.

3.6.5 Lack of prudential Norms

Risk management practices can be effective only when financial statements present accurate picture of the level of risk. The income recognition norms being followed by banks prior to 1992-93 involved recognition of income earned on bad debts in their books on accrual basis. Thus, these financial statements did not reflect
the level of bad debts and presented a misleading rosy picture of their health. This allowed the situation to degenerate considerably before it was detected\(^6\).

### 3.6.6 Liberalization of economy/removal of restrictions/reduction of tariffs

A large number of NPA borrowers were unable to compete in a competitive market in which lower prices and greater choices were available to consumers. Further, borrowers operating in specific industries have suffered due to political, fiscal and social compulsions, compounding pressures from liberalization.

### 3.6.7 Tax monitoring of credits and failure to recognize Early Warning Signals

It has been stated that approval of loan proposals is generally thorough and each proposal passes through many levels before approval is granted. However, the monitoring of complex credit files has not received the attention it needed, which meant that early warning signals were not recognized and standard assets slipped to NPA category without banks being able to take proactive measures to prevent this. Partly due to this reason, adverse trends in borrowers’ performance were not noted and the position further deteriorated before action was taken.

### 3.6.8 Over optimistic promoters

Promoters were often optimistic in setting up large projects and in some cases were not fully above board in their intentions. Screening procedures did not always highlight these issues. Often, projects were set up with the expectation that part of the funding would be arranged from the capital markets, which were booming at the time

\(^6\) http://www.scribd.com/doc/29193201/Non-Performing-Assets
of the project appraisal. When the capital markets subsequently crashed, the requisite funds could never be raised, promoters often lost interest and lenders were left stranded with incomplete/unviable projects.

3.6.9 Funding mismatch

There are said to be many cases where loans granted for short terms were used to fund long term transactions and had ended as NPAs.

3.6.10 High Cost of Funds

Interest rates as high as 20% were not uncommon. Coupled with high leveraging and falling demand, borrowers could not continue to service high cost debt.

3.6.11 Willful Defaulters

There are a number of borrowers who have strategically defaulted on their debt service obligations realizing that the legal recourse available to creditors is slow in achieving results.

3.7 FACTORS CONTRIBUTING TO NPAs IN INDIA

A close scrutiny of the various factors influencing the NPA level of banks in India would reveal certain concrete circumstances as given below.

♦ Industrial sickness

Improper project handling, ineffective management, lack of adequate resources, lack of advance technology, day to day changing govt. Policies
give birth to industrial sickness. Hence the banks that finance those industries ultimately end up with a low recovery of their loans reducing their profit and liquidity.

♦ **Improper SWOT analysis**

  The improper strength, weakness, opportunity and threat analysis is another reason for rise in NPAs.

♦ **Poor credit appraisal system**

  Poor credit appraisal is another factor for the rise in NPAs. Due to poor credit appraisal the bank gives advances to those who are not able to repay it back.

♦ **Absence of regular industrial visit**

  The irregularities in spot visit also increases the NPAs. Absence of regular visit of bank officials to the customer point decreases the collection of interest and principals on the loan.

♦ **Re loaning process**

  Non remittance of recoveries to higher financing agencies and re loaning of the same have already affected the smooth operation of the credit cycle. Due to re loaning to the defaulters, the NPAs of Other Scheduled Commercial Banks are increasing day by day.
An internal study conducted by RBI shows that in the order of prominence, the following factors contribute to NPAs.

3.7.1 Internal Factors

**Diversion of funds for**

- Expansion/diversification/modernization
- Taking up new projects
- Helping/promoting associate concerns time/cost overrun during the project implementation stage
- Business (product, marketing, etc.) failure
- Inefficiency in management
- Slackness in credit management and monitoring
- Inappropriate technology/technical problems
- Lack of co-ordination among lenders

3.7.2 External Factors

- Recession
- Input/power shortage
- Price escalation
- Exchange rate fluctuation
- Accidents and natural calamities, etc.
- Changes in Government policies in excise/ import duties, pollution control orders, etc.

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3.8 INTERNATIONAL COMPARISON OF NPA LEVELS

Comparison of the problem loan levels in the Indian banking system vis-à-vis those in other countries, particularly those in developed economies, is often made, more so in the context of the opening up of our financial sector.

The data in respect of NPAs level of banking system available for countries like USA, Japan, Hong Kong, Korea, Taiwan & Malaysia reveal that it ranged from 1 percent to 8.1 percent during 1993-94, 0.9 percent to 5.5 percent during 1994-95, 0.6 to 3.0 percent during 2000 as against 23.6 percent, 19.5 percent and 14 percent respectively for Indian banks during this year.¹⁸

The NPAs level in Japan is at 3.3 percent of total loans; it is 3.1 percent in Hong Kong, 7.6 percent in Thailand, 11.2 percent in Indonesia, and 8.2 percent in Malaysia during 94-95, whereas the corresponding figure for India is very high at 19.5 percent.⁹

According to Ernst & Young,¹⁰ the actual level of NPAs of banks in India is around $40 billion, much higher than the government own estimates of $16.7 billion.¹¹ This difference is largely due to the discrepancy in the accounting of NPAs followed by India and rest of the world.

¹⁸ [www.SomeAspectandIssuesRelatingToNPAsInCommercialBanks.htm](http://www.SomeAspectandIssuesRelatingToNPAsInCommercialBanks.htm)


¹¹ Ibid.,
According to Ernst & Young, the accounting norms in India are less stringent than those of the developed economies. Furthermore, Indian banks also have the tendency to extend past due loans. Considering India’s GDP of around $470 billion, NPAs were around 8 percent of the GDP which was better than many Asian economic power houses. In China, NPAs were around 45 percent of GDP, while equivalent figure for Japan was around 28 percent and the level of NPAs for Malaysia was around 42 percent. On an aggregate level, Asia’s NPAs have increased from $1.5 trillion in 2000 to $2 trillion in 2002- an increase of 33 percent. This accounts for 29 percent of the Asian’s countries total GDP. As per the E & Y’s Asian NPL report for 2002, the global slowdown, government heisting and inconsistency in dealing with the NPAs problem and lender complacency have caused the region’s NPAs problem to increase.\(^ {12}\)

**3.9 PROBLEMS DUE TO NPA**

The repercussions of the growing Non-Performing Assets of the banks in India can be summarized as presented below.

1. Owners do not receive a market return on their capital. In the worst case, if the banks fails, owners lose their assets. In modern times, this may affect a broad pool of shareholders.

2. Depositors do not receive a market return on saving. In the worst case, if the bank fails, depositors lose their assets or uninsured balance.

\(^ {12}\) Ibid.,
3. Banks redistribute losses to other borrowers by charging higher interest rates, lower deposit rates and higher lending rates repress saving and financial market, which hamper economic growth.

4. Non-performing loans epitomize bad investment. They misallocate credit from good projects, which do not receive funding, to failed projects. Bad investment ends up in misallocation of capital, and by extension, labour and natural resources.

5. Non-performing asset may spill over the banking system and contract the money stock, which may lead to economic contraction. This spillover effect can channelize through liquidity or bank insolvency

   a) When many borrowers fail to pay interest, banks may experience liquidity shortage. This can jam payment across the country.

   b) Illiquidity constraints banks in paying depositors.

   c) Under capitalized banks exceeds the banks’ capital base.

3.10 TYPES OF NPAS

The Non-Performing Assets are of two types: a, Gross NPAs and b, Net NPAs

3.10.1 Gross NPAs

Gross NPAs are the sum total of all loan assets that are classified as NPAs as per RBI guidelines as on Balance Sheet date. Gross NPA reflects the quality of the
loans made by banks. It consists of all the non-standard assets like as sub standard, doubtful, and loss assets.

3.10.2 Net NPAs

Net NPAs are those type of NPAs in which the bank has deducted the provision regarding NPAs. Net NPA shows the actual burden of banks. Since in India, bank balance sheets contain a huge amount of NPAs and the process of recovery and write off of loans is very time consuming, the provisions the banks have to make against the NPAs according to the central bank guidelines, are quite significant.

The following are deducted from gross NPA to arrive at net NPA.

a) Balance in Interest Suspense account, if applicable;

b) Deposit Insurance Guaranty Corporation / Export Credit Guarantee Corporation claim receive and pending adjustment;

c) Part payment received and kept in Suspense account;

d) Total provisions held excluding technical write off made at Head Office and provision of standard assets.

3.11 CLASSIFICATIONS OF NPAS

Banks are required to classify Non-Performing Assets further into the following three categories based on the period for which the asset has remained Non-Performing:
(1) Sub-standard Assets

(2) Doubtful Assets

(3) Loss Assets

3.11.1 Sub-standard Assets

With effect from 31st March 2005, a sub-standard asset would be one, which has remained NPA for a period less than or equal to 12 months. The following features are exhibited by sub-standard asset: the current net worth of the borrowers/guarantor or the current market value of the security charged is not enough to ensure recovery of the dues to the banks in full; and the asset has well-defined credit weaknesses that jeopardize the liquidation of the debt and are characterized by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.

3.11.2 Doubtful Assets

A loan classified as doubtful has all the weaknesses inherent in assets that were classified as sub-standard, with the added characteristic that the weaknesses make collection or liquidation in full, - on the basis of currently known facts conditions and values- highly questionable and improbable. With effect from 31st March 2005, an asset would be classified as doubtful if it remained in the sub-standard category for 12 months.
3.11.3 Loss Assets

A loss assets is one which considered uncollectible and of such little value that its continuance as bankable asset is not warranted- although there may be some salvage or recovery value. Also, these assets would have been identified as ‘loss assets’ by the bank or internal or external auditors or the RBI inspection but the amount would not have been written-off wholly.

3.12 PROVISIONING NORMS FOR NPAs

In conformity with prudential norms, provisions should be made on the Non-Performing Assets on the basis of classification of assets into prescribed categories. Taking into account the time lag between an account becoming doubtful of recovery, its recognition as such, the realization of the security and the erosion over time in value of security charged to the bank, the banks should make provision against sub-standard assets, doubtful assets and loss assets.

3.12.1 Provision for Sub-standard Assets

A general provision of 10% on total outstanding should be made without making any allowance for DICGC/ECGC guarantee cover and securities available.

3.12.2 Provision for Doubtful Assets

100 per cent of the extent to which the advance is not covered by the realizable value of the security to which the bank has a valid recourse and the realizable value is estimated on a realistic basis.
In regard to the secured portion, provision may be made on the following basis, at the rates ranging from 20%-50% of the secured portion depending upon the period for which an asset has remained doubtful.

The provision requirement for doubtful assets can be summarized in the following table.

**TABLE – 3.1**

**PROVISION FOR DOUBTFUL ASSETS**

<table>
<thead>
<tr>
<th>Period for which the advance has been considered as doubtful</th>
<th>Provision requirement (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to one year</td>
<td>20</td>
</tr>
<tr>
<td>One to three years</td>
<td>30</td>
</tr>
<tr>
<td>More than three years</td>
<td>60% with effect from 31st March 2005</td>
</tr>
<tr>
<td>1. Outstanding stock of NPAs as on 31st March, 2004.</td>
<td>75% effect from 31st March 2006</td>
</tr>
<tr>
<td>2. Advances classified as ‘doubtful’ more than three years on or after 1st April 2004.</td>
<td>100% with effect from 31st March 2007.</td>
</tr>
</tbody>
</table>

Additional provisioning consequent upon the change in the definition of doubtful assets effective from 31st March 2003 has to be made in phases as under:
As on 31<sup>st</sup> March 2003, 50% of the additional provisioning requirement on the assets which became doubtful on account of new norm of 18 months for transition from sub-standard asset to doubtful category.

As on 31<sup>st</sup> March 2002, balance of the provisions not made during the previous year, in addition to the provisions needed, as on 31<sup>st</sup> March.

Banks are permitted to phase the additional provisioning consequent upon the reduction in the transition period from substandard to doubtful asset from 18 to 12 months over a four year period commencing from the year ending 31<sup>st</sup> March 2005, with a minimum of 20% each year.

**3.12.3 Provision for Loss Assets**

The entire assets should be written off. If the assets are permitted to remain in the books for any reason, 100 percent of the outstanding should be provided for.

To sum up, provisions are made for NPAs as per the extant guidelines prescribed by the regulatory authorities, subject to minimum provisions as prescribed below by the RBI:

Substandard Assets

i. A general provision of 10%

ii. Additional provision of 10% for exposures which are unsecured ab-initio (where realisable value of security is not more than 10 percent ab-initio)
Doubtful Assets

– Secured portion

i. Upto one year – 20%

ii. One to three years – 30%

iii. More than three years – 100%

– Unsecured portion 100%

Loss Assets : 100%

In respect of foreign offices, provisions for non performing advances are made as per the local regulations or as per the norms of RBI, whichever is higher.

The sale of NPAs is accounted as per guidelines prescribed by the RBI, which requires provisions to be made for any deficit (where sale price is lower than the net book value), while surplus (where sale price is higher than the net book value) is ignored. Net book value is outstanding as reduced by specific provisions held and ECGC claims received.

For restructured/rescheduled assets, provisions are made in accordance with the guidelines issued by RBI, which requires that the present value of future interest due as per the original loan agreement, compared with the present value of the interest expected to be earned under the restructuring package, be provided in addition to provision for NPAs. The provision for interest sacrifice, arising out of the above, is reduced from advances.
In addition to the specific provision on NPAs, general provisions are also made for standard assets as per the extant guidelines prescribed by the RBI. The provisions on standard assets are not reckoned for arriving at net NPAs. These provisions are reflected in Schedule 5 of the balance sheet under the head “Other Liabilities & Provisions – Others.”

3.12.4 Floating Provisions

In accordance with the Reserve Bank of India guidelines, the bank has an approved policy for creation and utilization of floating provisions separately for advances, investments and general purpose. The quantum of floating provisions to be created would be assessed at the end of each financial year. The floating provisions would be utilized only for contingencies under extraordinary circumstances specified in the policy with prior permission of Reserve Bank of India.

3.12.4.1 Floating Provisions - Revised Norms

The broad features of revised guidelines issued in June 2006 in respect of utilization, accounting and disclosures of floating provisions are set out below:

1. The floating provisions should not be used for making specific provisions in respect of non-performing assets or for making regulatory provisions for standard assets but can be used only for contingencies under extraordinary circumstances, for making specific provisions in impaired accounts with prior permission of the Reserve Bank.
2. The board of directors of the bank may lay down a policy as to what circumstances would be considered extraordinary for making specific provisions in impaired accounts with prior permission of the Reserve Bank.

3. Bank’s board of directors should lay down approved policy regarding the level to which the floating provisions can be created.

4. Bank should hold floating provisions for advances and investments separately and the guidelines prescribed will be applicable to floating provisions held for both advances and investment portfolios.

5. Floating provisions cannot be reversed by credit to the profit and loss account.

6. Until utilization for contingencies, as stated above, these provisions can be netted off from gross NPAs to arrive at disclosure of net NPAs or they can be treated as part of Tier II capital within the overall ceiling of 1.25 per cent of total risk-weighted assets.

7. Banks should make comprehensive disclosures on floating provisions in the notes on accounts to the balance sheet on

   a) opening balance in the floating provisions account;

   b) the quantum of floating provisions made in the accounting year;

   c) purpose and amount of drawdown made during the accounting year;

   and

   d) closing balance in the floating provisions account.
8. Specific provisions for advances at rates which are higher than the rates prescribed under existing regulations are not to be treated as floating provisions.

To review, in a developing country like India, banking is seen as an important instrument of development; however, with the strenuous NPAs, banks have become helpless burden on the economy. One of the main causes of NPAs in the banking sector is the directed loans system under which commercial banks are required to supply a prescribed percentage of their credit (40 percent) to priority sectors.

Banks are required to classify Non-Performing Assets further into the following three categories based on the period for which the asset has remained Non-Performing: Sub-standard Assets, Doubtful Assets and Loss Assets. In conformity with prudential norms, provisions should be made on the Non-Performing Assets on the basis of classification of assets into prescribed categories.