NPA: Non-Performing Assets

In the finance world, banks are often looked as the backbone of our system. They not only provide a financial safety to the public but also lend a hand in the stressful times by giving out loans when needed. But what happens when these loans are not repaid? This is where Non-Performing Assets come in. They are one of the biggest challenges countries have been battling for decades but are yet to solve. Today, we will discuss NPAs, how do they function, the types, and the measures taken to keep these challenges in check.

What are NPAs?

For instance, there is an individual who took a loan from a bank for ₹5,00,000 for two years for an interest rate of 13%. After paying some monthly installments, he immediately stops paying the principal amount along with the interest amount for more than 90 days. This way, the loan stops generating income for the loan. This is called a Non-Performing Asset. Non-Performing Assets are those assets whose principal amount with the interest has not been paid for generally 90 days by the borrower to the lender. Unpaid loans, credit card debt, business loans are one of the most common examples of Non-Performing Assets. Let us now dive into how exactly NPAs function.

How do NPAs work?

Borrowers, irrespective if they are individual or institutional, secure a loan from a bank with a decided principal amount, loan tenure, and an interest rate. Somehow they default their monthly installment, which includes both principal amount as well as the interest amount, by more than 90 days. Their loan is then automatically known as a Non-Performing Asset. Now that we've come to the topic, let us understand how NPAs affect banks.

What impact do NPAs have on banks?

Banks receive the most damage when it comes to NPAs in ways such as:

- **Lesser Profits:** Loan Interests are one of the primary sources of income of a bank. Whenever these interests along with the principal amount are defaulted, it impacts their overall profitability.
- **Impact on Credit Ratings**: Businesses and individuals aren't the only borrowers in the economy, but banks too. Just like the credit rating is essential for us to avail loans more conveniently, it is also crucial for banks. High NPAs can significantly harm a bank's credit score, making it difficult for them to raise capital.
- **Higher Interest Rates:** In order to cover up the losses made by other defaulters, banks may increase interest rates on other loans, making it difficult for others to avail affordable loans.

What are the types of NPAs?

There are mainly three types of Non-Performing Assets, such as:

- **Sub-Standard Assets**: When an asset remains as an NPA for less than or equal to 12 months, it is known as a Sub-Standard Asset.
- **Doubtful Assets**: When an asset remains as an NPA for more than 12 months, it is called a Doubtful Asset.
- **Loss Assets**: As we can collect by the name, when an asset has very minimal chances of being recovered, it is classified as a Loss Asset.

What are the top NPA Metrics?

Whenever we discuss the metrics of Non-Performing Assets, we should always discuss these following metrics:

- **Gross Non-Performing Assets Ratio (GNPAR):** We can calculate GNPAR by calculating the percentage of a bank's total loans that are classified as non-performing. Its formula is Gross NPAs / Gross Advances) * 100
- **Net Non-Performing Assets Ratio (NNPAR):** The percentage of a bank's net advances, i.e. Gross Advances-Provisions that are classified as non-performing. Its formula is : (Net NPAs / Net Advances) * 100

How to keep NPAs in check?

The Reserve bank of India and the Government of India has put in a lot of efforts to bring this problem to an end, some of which are:

- **Debt Recovery Tribunal 2013**: Regulated under the Recovery of Debt due to Banks and Financial Institutions Act, 1993, this was created to decrease the time required for settling cases.
- **Credit Information Bureau 2000**: The Credit Information Bureau, popularly known by its abbreviation CIBIL, collects data related to credit about an individual or a business and creates a score ranging from 300 to 900. The higher the CIBIL Score, the more convenient your loan process will be.
- **Joint Lenders Forum 2014:** Set up by the Reserve Bank of India in 2014, the JLF provides a well-structured procedure for lenders to come together can find out a solution for their assets they think are turning into NPAs.

Summing up

Non-Performing Assets are coming out to become a huge threat to the financial system of India. They're basically the default loan assets whose principal amount plus the interest has not been paid for more than three months on a general basis. NPAs can be further classified into three types namely, Sub-Standard, Doubtful, and Loss Assets. Apart from this, the most popular metrics to calculate the NPAs of a bank are the Gross NPA Ratio and the Net NPA Ratio. The government has come together with the RBI to bring out measures like the Joint Lenders Forum, Credit Information Bureau, and the Debt Recovery Tribunal. Although the government is actively taking measures to solve them, NPAs still remain to be one of the biggest threats.

Frequently Asked Questions (FAQs)

Q. What does GNPAR stand for?

GNPAR stands for Gross Non-Performing Assets Ratio, a metric used to calculate the percentage of NPA in a bank.

Q. Is the government taking any measures to reduce NPAs in India?

Yes, the government and the RBI have brought measures in form of communities such as the Joint Lenders Forum, Credit Information Bureau, and more.