

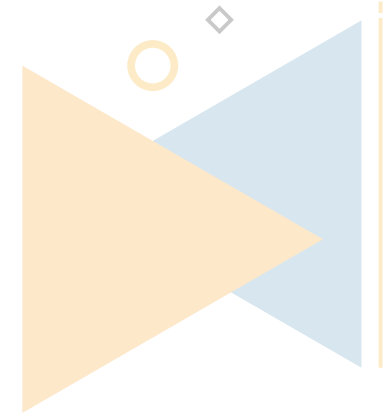
Controlling NPAs With Effective Early Warnings



ABSTRACT

Non-performing Assets (or NPA) have become an alarming concern for the banking systems across the globe, and particularly for the Indian Banks. The soaring numbers of NPA remain high to an extent that folding arms and taking no action is not an option anymore for the government, regulatory bodies or the banks themselves. Considering the fact that a global economic slowdown is imminent, many customer segments (i.e. agriculture, infrastructure, MSMEs) in the banking portfolio will be impacted as a result of growing NPAs.

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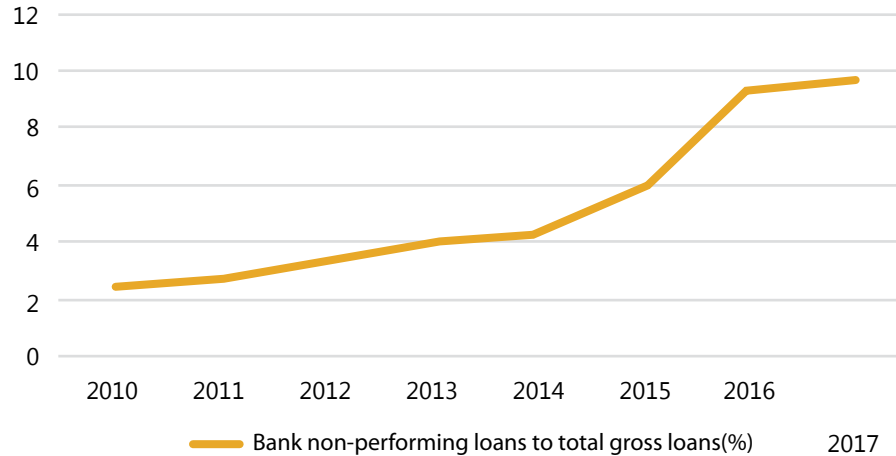
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Introduction

The increasing concerns around Non-performing Assets (NPAs) has put the entire financial system under stress. An immense need to strategize and implement a comprehensive approach to managing NPAs has risen. Automated tools must be deployed to strengthen the bank's loan origination system using early warning signals, extensive dashboards for decision making. Rather than treating NPAs after they've already occurred, preventive measures to control them must be adopted.

However, there are various challenges lying ahead for credit monitoring capabilities of the Indian banking system. It is required that they are polished one by one, while prioritising on capabilities such as default management, legal policy reinforcement and building an effective early warning system.

NPA Trend - 2010-2017 (India)



Source: [World Bank](#)

Early Warning Systems in Banks

As banking solutions partner for many banks in India, Sesame believes that having an all-inclusive NPA management software with in-built Early Warning Solution can substantially lower NPA in banks.

An ideal early warning system identifies possible risks in advance and helps the bank's management forecast default before it is too late. It enables them to take necessary measures to ensure that loans are recovered timely, thus maintaining the asset quality of the bank.

A sound credit monitoring approach can help organisations limit their loan-losses by **10 to 20%**, thereby giving a higher ROE, capital yield and risk appetite. (Source: McKinsey and Company)

An Early Warning solution can:

- Reduce the possibility of future NPAs
- Minimise defaults through regular evaluation of customer portfolios
- Limit piling up of NPA stocks
- Help make effective decisions to limit exposure in default-prone segments
- Maximise loan recovery through timely action
- Utilise capital effectively.

Early Warning System (EWS) Indicators

Any borrowed loan gives certain warning signs when it is on the verge of becoming delinquent or has already become one. As per the tendencies noted, these signs may be categorised as **geographic, behavioural, financial, perception and industry** types. A bank must clearly segregate and define the EWS indicators, specific to their portfolio, to identify loans that might turn bad. This may depend on various factors such as customer segments, industry/sector, type of investment, repayment capacity etc.

Some examples of EWS indicators as per the different categories are provided below.



Geographic indicators

The indicators specific to a particular region are used to get warning signs about bad loans and defaults. Examples include:

- Slow economic growth in a region
- Money laundering practices in a particular country
- Increasing sovereign bond yield.



Behavioural indicators

The warning signals that give clues about the borrowers' intent and will to repay the loan amount. These indicators may be:

- Misrepresented facts/records about borrowers
- Lack of communication and responses
- Continued delay in payments

Early Warning System (EWS) Indicators (Cont.)



Financial indicators

Financial indicators are the most critical ones and give an in-depth view on the financial conditions of borrowers. They can be:

- Sudden anomalies in borrower's credit history
- Pending dues for prolonged durations
- Downfall in creditworthiness.



Perception indicators

These are the indicators that signify a perception about the borrower or their company/brand. They include:

- Lack of awareness about the borrower (identity/brand)
- Negative image in media
- Souring business relationships



Industry indicators

Industry-specific warning signs can be identified using triggers such as:

- Steady or stagnant industry growth
- Business threats
- Dynamic consumer behaviour and changing preferences.

Preventive Measures for NPAs

In order to prevent amassment of non-performing assets in financial institutions, certain strict yet realistic measures must be taken. Some of the most effective precautionary efforts are:

- They must ensure special care at the pre-disbursement stage and consider all aspects such as economic, geographic, technical, financial, organisational etc. to assess the borrower(s).
- They must fix more realistic and feasible repayment schedules considering the frequency of instalments and the recovery period.
- They must maintain constant communication with the borrowers to have an idea of their present debt-related security concerns and financial conditions.
- They must identify behavioural patterns to identify possible red flags as early warning signals.

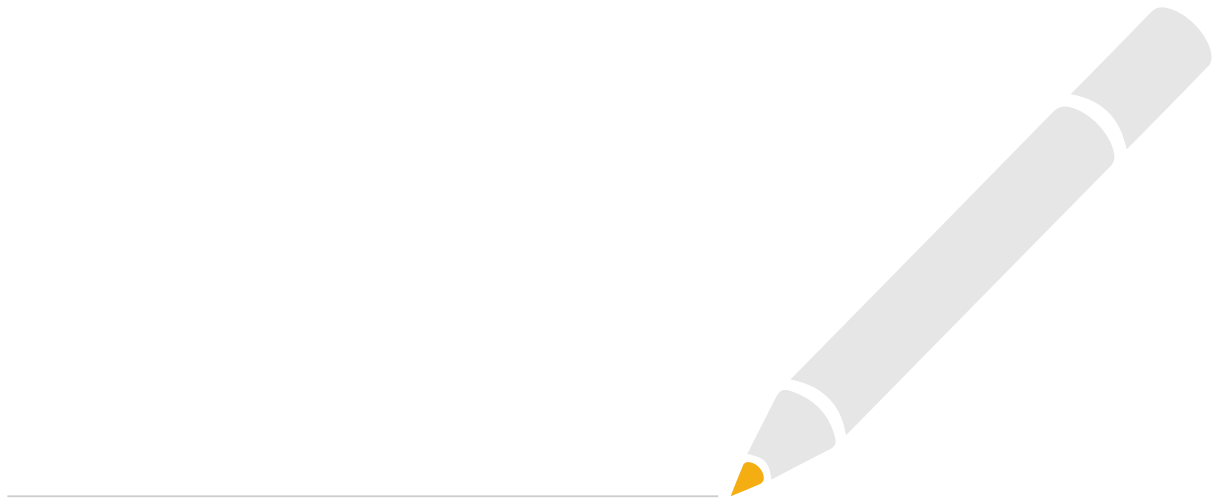
Over and above the measures mentioned, banks and credit societies can strategize their own approach for disbursing loans, recovering instalments and thus keeping the NPA levels in control.

Conclusion – The Way Forward

Banks constantly face numerous challenges, the most distressing one being the Non-performing Assets and their mounting numbers. Financial institutions must invest in IT systems to automate operations for monitoring bad loans and mitigating risks associated with them. These systems will help in effectively providing early warning signals to reduce NPA.

Looking at the rising trend of NPAs in credit institutions, even regulatory bodies are demanding for deployment of Early Warning Systems (EWS) for early detection of possible loan defaults.

It is merely a matter of time unless these new systems are in place for financial institutions to monitor and tackle credit risks effectively.



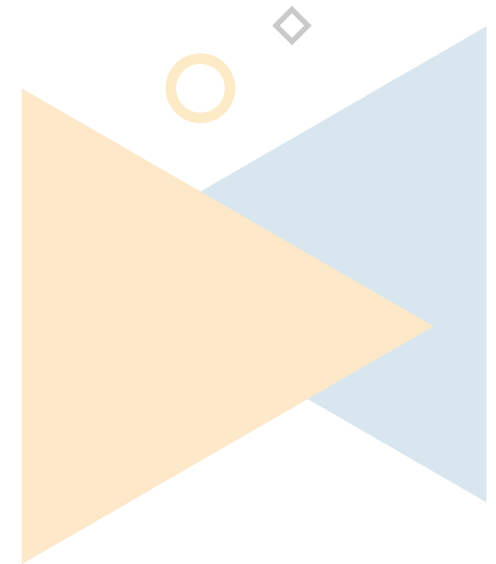
About Sesame

Sesame, a premier banking solutions provider based in India has been serving financial institutions of varied sizes for over 24 years. Identified as a leader in providing top-notch core banking applications, Sesame provides various banking software solutions.

Its services are availed by many other nationalised and cooperative banks across the country in the states of Tamil Nadu, Karnataka, and Maharashtra etc.

As a long time industry veteran, Sesame's innovative range of products are successfully helping **200+ clients** today. Its unique and high-performing offering named **Delinkure** is doing wonders in assisting financial institutions control and bring down NPA. It comes with extensive features like Early Warning Signals, Loan Originating System, Analytical Dashboard, Legal Advisory under SARFAESI and more.

To know more about Sesame and its products, please visit <http://sesameindia.com>



THANK YOU

