

# EARLY WARNING SIGNALS (EWS) IN LOAN ACCOUNTS



EARLY DETECTION SAVES

**Concept:** EWS are red flags that appear 6–12 months before an account turns NPA. Detecting them early saves the bank; detecting them late leads to written-off assets.



LATE DETECTION LEADS TO WRITE-OFFS

### 1. Account Transaction Signals (The First Indicator)

These are visible directly in the CBS statement.

- Poor Credit Summation:** The credit summation (money coming in) falls below the projected turnover or drawing power.
- Routing Through Other Banks:** Sales proceeds are not coming to your OD/CC account but are being diverted to current accounts in other banks.
- Cash Withdrawals:** Heavy cash withdrawal for business payments instead of using RTGS/NEFT (implies lack of transparency).
- Rapid Funds Transfer:** Money comes in and is immediately transferred to unrelated parties or personal accounts (round-tripping).
- Frequent Returns:** Inward or outward cheque returns due to "insufficient funds."

### 2. Financial & Operational Signals

These require analysis of stock statements and balance sheets.

- Inventory Pile-up:** Stock levels are increasing, but sales remain flat (dead stock or slow-moving goods).
- Declining Margins:** Sales are happening, but the Net Profit Margin is shrinking drastically.
- Receivables Ageing:** Debtors are not paying on time (debtors > 90 days increasing).
- Statutory Defaults:** Delay in paying GST, EPF, or TDS. (If they can't pay the government, they won't pay the bank).

### 3. Business & Market Signals

Visible during unit inspections.

- Machinery Breakdown:** Critical machinery is under repair frequently, stopping production.
- Loss of Key Customers:** If a borrower relies on 1-2 big clients and loses them, cash flow will crash.
- Labor Unrest:** Frequent strikes or high employee turnover.
- Industry Downturn:** The specific sector (e.g., textiles or steel) is facing a global crisis.

### 4. Borrower Behavioral Signals (The "Gut Feeling")

- Non-Cooperation:** Refusing to let bank officials inspect the unit or stock.
- Lifestyle Mismatch:** The borrower is buying luxury cars or properties personally, while the business claims a cash crunch.
- Vague Answers:** Giving unclear reasons for delays in submission of stock statements or renewal data.
- Frequent Ad-hoc Requests:** Constantly asking for temporary over-limits (TOL) without justifying the need.

### CRITICAL ADDITION: Signals of Fund Diversion

This is the most dangerous EWS.

- Related Party Transactions:** Transferring loan funds to subsidiary companies or relatives.
- Investment in Capital Market:** Using CC limits to invest in shares or mutual funds.
- Long-term Use of Short-term Funds:** Using CC/OD limits to buy machinery or land (funds assume a permanent nature).

### What a Smart Banker Should Do?

- Spot Check:** Don't just rely on stock statements; visit the godown unannounced.
- Verify End Use:** Check bank statements of the counter-parties where big amounts are transferred.
- Control Drawings:** If EWS is severe, freeze the account debits or restrict to 80% of DP.
- Legal Audit:** Check if the collateral properties are still unencumbered.

**The Smart Banker Quote:** "A standard asset with EWS today is the NPA of tomorrow. Act now, or provision later."

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### The SMA Slide (From Good to NPA)

*If Early Warning Signals are ignored, the account officially enters the SMA category based on overdue days:*

- **SMA-0:** Overdue for **1–30 days** (Immediate reminder calls required).
- **SMA-1:** Overdue for **31–60 days** (Physical visit & notice required).
- **SMA-2:** Overdue for **61–90 days** (Critical Zone – Last chance to save).
- **NPA:** Overdue for **> 90 days** (Asset classification changes).

**Rule:** Real monitoring happens at **SMA-0**. If you wait for SMA-2, it is usually too late.

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