1.0. INTRODUCTION

It has been argued by a number of economists that a well-developed financial system enables smooth flow of savings and investments and hence, supports economic growth (King and Levine, 1993) [1]. A healthy financial system can help achieve efficient allocation of resources across time and space by reducing inefficiencies arising out of market frictions and other socio-economic factors. Amongst the various desirable characteristics of a well-functioning financial system, the maintenance of a few non-performing assets (NPA) is an important one. NPAs beyond a certain level are indeed cause for concern for everyone involved because credit is essential for economic growth and NPAs affect the smooth flow of credit. Banks raise resources not just on fresh deposits, but also by recycling the funds received from the borrowers. Thus, when a loan becomes non-performing, it affects recycling of credit and credit creation. Apart from this, NPAs affect profitability as well, since higher NPAs require higher provisioning, which means a large part of the profits needs to be kept aside as provision against bad loans. Therefore, the problem of NPAs is not the concern of the lenders alone but is, indeed, a concern for policy makers as well who are involved in putting economic growth on the fast track.

In India due to the social banking motto, the problem of bad loans did not receive priority from policy makers initially. However, with the reform of the financial sector and the adoption of international banking practices the issue of NPAs received due focus. Thus, in India, the concept of NPA came into the reckoning after reforms in the financial sector were introduced on the recommendations of the Report of the Committee on the Financial System (Narasimham, 1991)[2] and an appropriate accounting system was put in place.
The concept of Non Performing Assets was introduced following introduction of Income Recognition and Asset Classification (IRAC norms), in the year 1993. In view of the importance of the matter in terms of the concept which was new, introduction in Indian banking industry for the first time, its impact on profitability and image of the banks, need to take urgent steps to switch over to international norms particularly to move to Basel II norms, various authorities/authors/researchers have contributed to the literature on the subject. In order to understand various aspect of the subject and to avoid the duplication the review is divided in different aspects of the subject and the authors are listed topic wise. Views, which are common, are given under each head. Specific views of the authors, which need a special mention, are given separately.

Broadly speaking, NPA is defined as an advance where payment of interest or repayment of instalment of principal (in case of term loans) or both remains unpaid for a certain period. In India, the definition of NPAs has changed over time. According to the Narasimham Committee Report (1991), those assets (advances, bills discounted, overdrafts, cash credit etc.) for which the interest remains due for a period of four quarters (180 days) should be considered as NPAs. Subsequently, this period was reduced, and from March 1995 onwards the assets for which the interest has remained unpaid for 90 days were considered as NPAs. Though the NPA issue has received considerable attention in the post reform period, academic work on the subject in not adequate (Ghosh, 2005) [3].

1.1 BACKGROUND

Reddy (2009)[4], in his article “Reforming India’s Financial Sector-Changing Dimensions and Emerging Issues” has described the background for financial sector reforms as under: “India embarked on a strategy of economic reforms in the wake of a balance of payments crisis in 1991; a central plank of these was reforms in the financial sector and, with banks being the mainstay of financial intermediation, the banking sector. At the same time, reforms were also undertaken in various segments of financial markets to enable the banking sector to perform its intermediation role in an efficient manner. The thrust of these reforms was to promote a diversified, efficient and competitive financial system, with the ultimate objective of improving
the allocation efficiency of resources through operational flexibility, improved financial viability and institutional strengthening. The reform measures in the financial sector can be envisaged as having progressed along the following lines”.

Reddy (2009)[5], further states in his another article “Global Financial Turbulence and the Financial Sector in India: A Practitioner’s Perspective” as under: “The prudential norms relating to income recognition, asset classification and provisioning, introduced during 1992-93, are being continuously monitored and refined to bring them on par with international best practices. In keeping with this, several measures were initiated in 2005-06. The provisions for standard assets were revised progressively in stages in November 2005, May 2006 and January 2007, in view of the continued high credit growth in the real-estate sector, personal loans, credit card receivables, and loans and advances qualifying as capital market exposure and a higher default rate with regard to personal loans and credit receivables, which emerged as a matter of concern. The standard assets in the following categories of loans and advances attract a 2 per cent provisioning requirement:

a) Personal loans (including credit card receivables);
b) Loans and advances qualifying as capital market exposure;
c) Real-estate loans (excluding residential housing loans) and
d) Loans and advances to systematically important non-deposit accepting non-banking finance companies. In order to ensure continued and adequate availability of credit to the highly productive sectors of the economy, the provisioning requirement for all other loans and advances, classified as standard assets, was kept unchanged, viz., a) direct advances to the agricultural and SME sectors at 0.25 per cent and b) all other loans and advances at 0.4 per cent.”
1.2 ORIGIN AND CONCEPT OF NPAS

Report of the Committee on the Financial System: The Government of India had appointed a Committee in August 1991 on the financial system under the chairmanship of Shri M. Narasimham, the former Governor of Reserve Bank of India.

Suhas S. Sahasrabudhe (2003)[6], in his article “Review of Important Aspects of NPAs of Banks in India in The Post Reform Period” has mentioned the terms of reference of the committee as under:

The terms of reference of the Committee included the following

i) Examination of the existing structure of the financial system and its various components and to make recommendations, to improve the efficiency and effectiveness of the system with particularly reference to the economy of operations, accountability and profitability of the commercial banks and financial institutions.

ii) Recommending measures for infusing greater competitive vitality into the system so as to enable the bank and financial institutions to respond more effectively to the emerging credit needs of the economy.

iii) Examination of the cost, composition and adequacy of the capital structure of various financial institutions and recommendations regarding review of relative roles of different types of financial institution in the financial system and to make recommendations for their balanced growth.

iv) Review of existing supervisory arrangements relating to various entities in financial sector and to make recommendations for ensuring appropriate and effective supervision.

v) Review of existing legislative framework and to suggest necessary amendments for implementing the recommendations.

The Committee submitted the summary of its Report on November 8, 1991 and its Main Report on November 16, 1991 to Government. The main recommendations of the committee were:
1. In regard to income recognition the committee recommends that in respect of banks and financial institutions which are following the accrual system of accounting, no income should be recognized in the accounts in respect of non-performing assets. An asset would be considered non-performing assets if interest on such assets remains past due for a period exceeding 180 days at the balance sheet date. The Committee further recommends that banks and financial institution be given a period of three years to move towards the above norms in a phased manner beginning with the current year.

2. For the purpose of provisioning, the committee recommends that using the health code classification which is already in vogue in banks and financial institutions the assets should be classified into four categories namely, Standard, Sub-standard, Doubtful & Loss Assets. In regard to Sub-standard Assets, a general provision should be created equal to 10 percent of the total outstanding under this category. In respect of Doubtful Debts, provision should be created to the extent of 100 percent of the security shortfall. In respect of the secured portion of some Doubtful Debts, further provision should be created, ranging from 20 percent to 50 percent, depending on the period for which such assets remain in the doubtful category loss assets should either be fully written off or provision be created to the extent of 100 percent. The committee is of the view that a period of 4 years should be given to the banks and financial institutions to conform to these provisioning requirements. The movements towards these norms should be done in a phased manner beginning with the current year. However, it is necessary for banks and financial institutions to ensure that in respect of doubtful debts 100 percent of the security shortfall is fully provided for in the shortest possible time.

3. The Committee believes that the balance sheet of banks and financial institutions should be made transparent and full disclosures made in the balance sheets as recommended by the International Accounting standards Committee. This should be done in a phased manner commencing with the current year. The Reserve Bank, however may defer implementation of such parts of the standards as it consider appropriate during the transitional period.
until the norms regarding income recognition and provisioning are fully implemented.

4. Banks at present experience considerable difficulties in recoveries of loans and enforcement of security charged to them. The delays that characterize our legal system have resulted in the blocking of a significant portion of the funds of banks in unproductive assets, the value of which determinate with the passage of time. The Committee therefore considers that there is urgent need to work out a suitable mechanism through which the dues to the credit institutions could be realized without delays and strongly recommends that special Tribunals on the pattern recommended by the Tiwari Committee on the subject be set up to speed up the process of recovery. The introduction of legislation for this purpose is long overdue and should be preceded with immediately.

1.3 INTERPRETATION AND VIEWS ON RBI GUIDELINES

Joshi (2003)[7], in his article “Non-Performing Assets - Causes, Extent and Remedies” has observed conceptual irregularities in the guidelines issued by the Central Bank as under:

The NPA position in Indian Banking is exaggerated, although called non-performing assets (NPAs) the ratio of non-performing credit is related to credit and not to assets. In fact, the internationally accepted norm is to relate the ratio to total assets. In our country loans form barely 52 per cent of the total credit-deposit ratio being around 54 per cent. The remaining 48 per cent of the assets are held in CRR (5 per cent) and actual SLR (38 per cent) 5 per cent being other assets. 43 per cent of the assets (CRR+SLR) are the safest and risk free being funds with the RBI and in gilt-edged securities. If the ratio is related to total assets the net NPA ratio in the Indian Banking System falls sharply by more than 50 per cent from 5.5 per cent.

It is heartening to note that Dr. Bimal Jalan, Governor, Reserve Bank of India in his inaugural address at the Bank Economists’ Conference (in Bangalore December 1998)[8], had observed, “In terms of percentage to total assets, gross and net non-performing assets have declined to 7 per cent and 3.3 per cent respectively
by March 1998. I think, the present statistics are not unfavorable for the banking system as a whole.” Public Sector and Old Private Banks relate their NPA ratios to “Credit” as per RBI guidelines, while the New Private Sector Banks relate them to ingeniously invented concept viz. “Customer Credit” or “Credit like Instruments”, which include non-SLR investments. It is necessary to take a policy decision to relate NPAs to total assets and not to credit as at present. This will facilitate international comparisons.

NPAs are classified into (a) sub-standard, (b) doubtful and (c) loss assets. Loss assets are fully provided as per the guidelines of the RBI. There is hardly any need to show two different ratios of gross and net NPAs. Banks should be advised to disclose the total provisions held (outstanding) against the NPAs and not only provision made from the current year’s profit and loss account. This will give confidence to the shareholders about the magnitude of provisions held against problem accounts. It is also necessary for the banks to give disaggregated data of NPAs such as ‘sub-standard’, ‘doubtful’ and ‘loss assets’, which will throw more light on the quality of assets. For instance, two banks have the same NPA ratio of 10 per cent. The disaggregated data of Bank ‘A’ shows that the ‘sub-standard’ accounts for 2 per cent, ‘doubtful’ for 1 per cent and ‘loss asset’ for the remaining 7 per cent. In Bank ‘B’, the figures are 8 per cent, 1 per cent and 1 per cent respectively. Thus, though their NPA ratio is the same (10 per cent), clearly Bank ‘B’ is considerably better off than Bank ‘A’ because of its low ‘loss assets’ figure. The recently introduced disclosure, “Movement in NPAs” conveys precious little.

Bachhawat (2001)[9] “Management of Non-Performing Assets in Commercial Bank” has stated as under: The prudential norm of 90 days for classifying the A/cs as NPA is very much strict looking to the Indian conditions where whole of economy is still based on Agriculture and Agri is based on Monsoon and which is uncertain and erratic, instead of this Bank’s should recruit technical/field officers for vigorous follow up and supervision of such accounts. RBI should reassess to bring fresh policy for recruitment of field staff for follow-up and supervision to control NPAs. NPA norms for agriculture advances should be relaxed to two years criteria and not two seasons i.e. one year, as in our country in most of
the areas main crops are grown / cultivated once in a year, hence these norms are not fruitful to large sections of farmers who have availed the credit facility.

In case of relief measures for natural calamities provided to the affected farmers on his own request should be provided in such a manner that benefit of relief reaches to ground level in real sense and after replacement and reschedulement of the loan the same should immediately be considered as Standard Asset and such accounts should not be put under watch, period for which is one year for sub standard asset and two years for Bad & Doubtful assets. Banks is allowed to treat such rephrased / rescheduled NPA accounts as standard assets during same financial year.

1.4 REASONS FOR NPAS: A.T.PANNIRSELVAM COMMITTEE FINDINGS

Any NPA Management policy has to identify the causes for the occurrence of NPAs. These causes may be attributed to either the borrower or the bank itself or may be due to factors beyond the control of both. Again these may be internal or external for either the borrower or the bank. Causes attributable to borrowers:

1.4.1 Internal

1. Wrong / Improper borrower identification.
2. Wilful defaults.
3. Incompetent management.
5. Non-submission of requisite data or submission of wrong/inadequate data/information.
6. Time / Cost overruns due to delayed project implementation, etc.
7. Differences / disputes among Company promoters or controlling family members.
8. Technological obsolescence and low priority to technology upgradation.
9. Inadequate attention to R & D.

10. Poor Location choice.

1.4.2 External

1. Poor stake / contribution of borrower.

2. Poor Inventory / Receivable management (W.C.dries up).

3. Delayed settlement of receivables of borrower by large Industrial houses, Govt. Depts., PSUs, etc.

4. Inability to compete in the market because of smaller size and new brand name.

5. Entry into business at an inappropriate time of business cycle.

6. Adverse exchange fluctuations.

7. Non-availability / Irregular supply of critical raw materials or other inputs.

8. Transport bottlenecks.

1.5 Causes Attributable to Banks

1.5.1 Internal

1. Poor pre-sanction appraisal / unrealistic projections.

2. Poor assessment of commercial viability (due to lack of inadequate data / knowledge on market industry).

3. Delayed decision-making at operative level itself or due to multiplication of processing tiers (without real value addition).

4. Delayed disbursements.

5. Non-compliance of terms of sanction.


7. Inadequate supervision, absence of effective monitoring (post disbursement) & delays in detection of symptoms & initiation of remedial measures.
8. Over-stress on long relationships / family / group connections even at the cost of commercial viability of projects.

9. Ritualistic reviews (i.e. without proper or objective assessment of risks & requirements).

10. Non-availability of audited financial statements in time and too much reliance on provisional / un-audited data.

11. Lack of Networking / Information Systems amongst branches / Banks enabling borrowers to misuse Bank funds.

1.5.2 External

1. Changes in regulatory prescriptions causing change in norms for classification.

2. Long drawn legal processes for recovery of loan.

3. Delay in action for rehabilitation of accounts and finalisation of rehabilitation package either at the Bank level or at the BIFR level.

4. Non-compliance or delay in compliance of terms of rehabilitation package by borrower.

5. Lack of exchange of information / coordination between financial institutions & Bank.

6. Non-availability of powers for enforcing securities (possession & sale) unlike those enjoyed by SFCs.

1.6 CAUSES BEYOND BOTH THE BORROWER AND THE BANK


2. Depressed capital markets and consequent delay in arrangement of funds for the project.

3. Frequent adverse changes in the govt. policies, excise and customs duties, decategorisation of items reserved for SSI, price preferences, cash incentives, product reservation quota system, etc.
4. Changes in policies regarding pollution control including legal decisions as in case of aquaculture and few chemical industries, which virtually ruined them, resulting in huge NPA with banks.

5. Isolated or general law and order problem resulting in stoppage of industrial production and movement of goods.

6. Inadequacy of infrastructure, in particular power resulting in high cost of production and hence lesser marketability of products.

7. Political uncertainties.

8. Ineffective functioning of BIFR / DRT.

9. Outdated laws, labour unrest, Riots, Lockouts, Strikes, etc.

10. Cascading effect of debt Relief Schemes resulting in poor loan repayment environment.

11. Insensitivity of Govt. towards non-payment of dues by PSUs and procedural delays in invocation of govt. guarantees.

12. Slow disposal of recovery cases.

13. Poor selection of schemes and proponents under Govt. Sponsored schemes by the different govt. agencies.

14. Delayed release / Non-payment of subsidies allocated by Central / State Govt. etc. which have been factored into the project cost at the time of appraisal.

15. Adverse Court Judgment.

16. Adverse market conditions.

1.7 CAUSES OF NPAS UNDER THE PRIORITY SECTOR

1. Lack of experience / managerial expertise / technical competence.

2. Infrastructure constraints and non-availability of adequate and timely extension of support from the Govt. agencies and public bodies.
3. Slow disposal of recovery cases under the public Debt Recovery Act or non-enactment of the relevant Act in some of the states.

4. Adverse effect of general waiver of loans by the Govt. on the repayment culture, resulting in a large number of willful defaulters.

5. Unrealistically ambitious targets set under directed priority sector lending.

6. Non-settlement / Rejection of DICGC / ECGC claims by the corporation on flimsy grounds.

7. Delay in realization of supply bills by small units for supplies made to larger units.

1.8 CAUSES OF NPA

Joshi (2003)[10], in his article “Non-Performing Assets Causes, Extent and Remedies” observed that: A number of factors have contributed to the high level of NPAs in banking particularly in the public sector banking system. They are enumerated below.

1. PSU banks and DFIs have been used as instrument of public policy. Landings under populist schemes like ‘loan melas’, directed lending to certain sectors like mini-steel, mini paper, mini-cement units, sugar and cotton spinning cooperative are examples. Most of these loans have joined the ranks of NPAs.

2. Projects financed in the pre-reforms era, with high earnings, low promote, stake with viability based on high tariffs and fiscal concessions have turned sick.

3. The largest to join the ranks of NPAs will be some of the large projects in the core sector financed after opening to private investments.

4. Three decades of government ownership have rendered banks organizationally weak. Faulty appraisals, absence of effective post sanction monitoring, lack of initiative to take timely action against wilful defaulters, indecision on existing out of bad loans through OTS due to fear of investigation agencies like CBI.
5. All contributed in no small measures to the worsening situation on NPA front.

6. The mandatory referral to BIFR provides ideal sanctuary to wilful defaulters.

7. Large corporate usually delayed payments to SSI and contributed indirectly to the NPA of SSI units.

8. If any instalments or interest is not received from creditors at that time bank does not renewed within time in case of cash credit or overdrafts accounts.

9. NPA accounts information is not sent by branch officer to the head office. As a result NPA figures of the head office become smaller.

10. NPA categories are not considered from time to time.

Any NPA management policy has to identify the suitable strategy for recovery.

These causes may be due to factors beyond the control of both. Again these may be internal or external for either borrower or banks.

1.9 IMPACT OF NPAS

Vora (2007)[11] in his study entitled “Management of Non-Performing Assets and Asset Reconstruction Company” observed the impact of NPAs.

The effect of NPA on the bank is as under-

- There is loss of interest income.
- The current profit is reduced, as banks have to make provision for NPA.
- Capital adequacy ratio is also affected as it is directly related to the quality of assets.
- It also affects the liquidity position of bank as also recycling of funds due to asset liability mismatch.
- Banks at times have to borrow at high cost to fulfill their commitment/obligations, which increases the cost of funds.
• The high level of non-performing assets also affects the image of the bank in the public. The credit rating of the bank also affected due to high NPA and consequently business prospects in the country & abroad.

• The NPA has effect on the moral of the staff and may shy away from doing credit business due to fear of NPA.

• The bank cannot remain competitive in the market due to various adverse effects on the balance sheet and profit.

1.10 PREVENTION OF NPAS

Monitoring and Follow Up Measures

With the Income Recognition and Asset Classification Norms becoming stricter, Branches are required to be more alert and proactive in monitoring the accounts. For this purpose, monthly interest application has become a useful tool to tackle potential delinquencies or defaults in standard accounts. To retain the asset quality, it is necessary for bank branches to:

• Recover the over dues or at least the critical amount through active follow up with borrowers.

• Put the accounts under holding on operations in case of temporary cash flow mismatches.

• Reschedule the repayment terms as per expected cash flows.

• Restructure the dues in keeping with the expected cash flows and gaps in cash flows, if any as per guidelines of the bank in their recovery policy.

• Measures for follow up of NPAs / potential NPAs for recovery

The various means of monitoring / resolving NPAs available to the Banks are listed below:

A) Before the account becoming NPA

• Regular monitoring to maintain asset quality.
• Reminders to be sent where irregularities crop up.

• Periodic inspection of the unit and charged assets along with analysis of financial data.

• In the initial stages of sickness, rescheduling, restructuring, rehabilitation under Bank’s Restructuring Policy, CDR mechanism,

• BIFR approved rehabilitation etc. schemes shall be attempted to improve the health of the unit.

1.11 RECOVERY MEASURES-LEGAL MEASURES

• Recovery through courts
• Debt recovery tribunal
• Corporate debt restructuring
• National company law tribunal
• Asst reconstruction companies
• Lok Adalats
• RRC Act of state Government
• Recovery Action
• Innovations by banks
• Research/reports etc.

All these means have to be effectively pursued for resolution of NPAs.

Upadhyay (1994)[12] in “Recovery through SEIZURE: Some Aspects” has stated that the legal actions involve high cost and long time. Even after settlement of the case, the decree has to be filed and executed periodically as per the term which is an unpleasant and difficult task. This process also slows down the speed of follow up and results in lethargic attitude by banker. The advocates also do not cooperate as much in execution of decree as they cooperate in filing of suits. The rate of recovery after initiating legal actions has remained very low and, therefore, few banks in the state of Gujarat have adopted a procedure of seizure of the vehicles. These vehicles are trucks, matadors, autorickshaw and tractors. The only advantage and biggest benefit is that the recovery of large overdues could be made very speedily at a very
low cost. The procedure also has a demonstrative effect and the other borrowers in the village voluntarily come forward to repay their dues.

**Rajiv Aggarwal (1991)**[13] in his study entitled “Designing Effective Credit Recovery Management and Control System” To ensure effective follow up and timely repayment, organizational set up and systems, the quality of existing credit portfolio, the organizational culture and the public image of banks need improvement. Credit recovery seminars would have to be organized with an aim of changing beliefs, attitudes and behavior of officers at various levels of management.

**Govil (2000)**[14], in his article “Need for Revival of Loss Making Branches” says that Recovery management is useful in following strategies.

a) When we are associated with lending for government sponsored schemes, branches will have to insist on the government agencies to help in the enforcement of recovery. In each meeting, we will have to reinforce our point and invite their involvement in recovery.

b) ABC analysis of the overdue by categorizing the quantum of overdue where by more attention can be paid on such chronic accounts. Segregation of overdue where the quantum of expected recovery is high and the branch is willing.

c) The recovery drive should be planned well in advance.

**Kulkarni (2003)**[15], in “Management of Non-Performing Assets” stated the non legal Recovery Measures include-

1. Reminders Visits
2. Personal contacts
3. Rehabilitation of sick units / replacement
4. Loan compromise
5. Recovery Camps

**Darshan (2001)**[16], in “The Secret of Recovery” stated that the ‘Elusive’ recovery thus forms the core topic of this paper included

i) Eliciting relevant / required information
ii) Maintain close rapport with the borrowers

iii) Database

iv) Ensuring end utilization.

**Chakraborty (2005)[17]** in “Management of NPAs Trends and Challenges” has stated that the banks have to face several challenges in managing NPAs. Besides ensuring better scrutiny of the credit proposals before sanction, banks need to watch closely and monitor the assets from the selection of borrowers. A continuous and consistent monitoring mechanism is a must for ensuring the best quality of the assets. Symptoms of any sickness should be addressed immediately and appropriate remedial action implemented. Despite the availability of various avenues of recovery in ultimate analysis it is the borrowers’ willingness to repay rather than his ability to repay. The mindset of the borrowers from the beginning should be tuned in such a way that he is willing to repay rather than turn into a willful defaulter.

**Kannan (2001)[18]** “Creation of Performing Assets from NPA to PA” has highlighted the expertise required and the mismatch of assets & liabilities, restrained banks from steaming ahead. Hence there is a need to workout a ‘Loan Policy’ with risk limits as to rate, duration, security and follow up and refinance if needed by securitization of the assets. Special branches rather than all branches dealing with all products, catering to needs of specialized customers were felt necessary, help in generating special data about the customers and also helps centralized control on delinquency. The strategy should be decided by each bank based its strength, area of operation, type of customer quality of staff. The policy should decide which are to be financed (Industry-big / small) Trade, Individuals (housing, car, other white goods) etc. how many customer maximum amount of loan with repayment and follow up mechanism necessary.

**Kumar M.K., Reddy C.M. and Muktha K.C. (2004)[19]** in their article “Causes of NPAs and Remedial Measures” observed that the Bank’s bottom line improvement largely depends on reduction in NPA and preventing NPAs would also help to improve the profitability of Banks. However good the credit dispensation process may be total elimination of NPAs is not possible in banking business owing to externalities but their incidence can be minimized.
The following steps may be taken to reduce NPAs

1. Massive recovery campaigns are launched.
2. Infrastructure / adequate machinery are provided to branch to render a helping hand.
3. Branch managers are exhorted to exercise extraordinary care in the selection of fresh borrowers so that new borrowal accounts does not enter in NPA list.
4. Lot off understanding needed among bank staff and customers to address themselves to the problem of recovery.
5. Prompt control / follow up/ monitoring measures help to prove borrowal accounts becoming irregular.

Mohan Reddy and D. L. Narayana Reddy (2004)[20], write in their paper “Non-Performing Assets in Regional Rural Banks: A Study of Rayalaseema Grameena Bank” tries to analyze the status and trend of non performing assets in Reyalseema Grameena Bank (RGB) through multidimensional classification of NPAs. It also examines the recovery strategy of the RGB and offers certain remedial measures for the effective reduction of NPAs in the Bank. A new credit insurance scheme for priority sector lending, substantially improved legal system, meticulous loan documentation, and gradual shift from bank based to market based system and sound credit management skills will enable the Bank to meet the challenges in business environment and kept its nonperforming assets low.

Sas Try S.R. (1996)[21] in “Recovery Management” stated that the recoveries are an essential / integral part of operations of all financial institutions, without which these get into liquidity problems, as recycling of funds is adversely affected. Owing to adoption of mercantile system of accounting, which placed overemphasis on security, recovery did not get in the past its due recognitions and bankers were more complacent in view of the availability of enough security to cover the risk of default in repayment. It is only through constant recoveries (of interest / installment) that the proportion of performing assets in the total portfolio could be kept in high. This alone can ensure better balance sheet.
Sharma R. (2002)[22] in “Non-Performing Assets” stated that the burden being immense, the reduction of NPAs of the Banking sector should be treated as a national priority to make the Banking system stronger, more resilient and geared to meet the challenges of globalization. The thrust of the policies of the Government, RBI and the Banks should be on how best to tackle existing NPAs, recovery of arrears, minimizing incidence of fresh NPAs, improving asset quality and preventing deterioration of assets. Changes in the legal system by introducing stringent foreclosure laws would be welcomed by entire financial sector.

Rajiv Ranjan and Sarat Chandra Dhal (2003)[23] in “Non-Performing Loans and Term of Credit of Public Sector Banks in India: Empirical Assessment, Reserve Bank of India” has attempted an empirical analysis of the non-performing loans of public sector banks in India and investigated the response of NPLs to terms of credit, bank size and macroeconomic condition. The empirical analysis suggested that term of credit variable have significant effect on the bank’s non-performing loans in the presence of bank size and macroeconomic shocks. The empirical analysis suggests that asset measure of size could yield meaningful results relating to borrowers loan response. The changes the cost of credit in term of expectation of higher interest rate induces increase in NPA. On the other hand, factors like horizon of maturity of credit, better credit culture and favorable macroeconomic and business conditions lead to lowering of NPAs. The empirical analysis suggests that positive deviation of an individual banks credit deposit ration, from that of industry’s average could have favorable effect on reducing NPAs. Appropriate credit culture and lending policy designed with relevant economic and financial factors constituting the term of credit will make a significant impact on banks non-performing loans.

Kiran Kumar, C.Munisekhar Reddy & K.C.Muktha(2004)[24] in “Causes of NPAs and Remedial Measures” observed that the recovery can be accelerated at a much faster pace through effective 1) Supervision 2) Follow-up Supervision of advances by bank officials includes

- Ensuring proper end use of funds and creation of assets out of loan / margin /subsidy within the anticipated period and compliance of all terms and conditions stipulated in the sanction letter.
• Timely and periodical inspection of the securities charged to the bank.

• Proper watch on the conduct of the borrower and operations in the account in various segments such as Ledger / Bill / Godowns.

• Proper maintenance of requisite records for limitation.

• Constant touch with persons trading with the borrower to obtain market report in regard to his trade dealings, solvency etc.

**Follow-up**

1. Issue of reminders / notices.

2. Personal contact with the borrowers at periodical intervals.

3. If both steps a) and b) do not give desired results, local pressure tactic, if possible, may be applied and guarantor if any may be pursued to get the amount deposited by the borrower.

4. In case of defaulter in rural areas, whose service area the borrower resides/operates the activity, with copies to the controlling officer of the addressee bank/society, Lead bank officer of the district, Bank’s own district coordinator.

**Mario Castelino (2005)[25]** in “Managing Non-Performing Assets” Stated that the NPAs of the corporate sector have come down drastically in the recent past, there is concern over issues of frauds in case of mortgage loans & increase in NPAs from the retail sector in the recent past. The impact of NPAs on the performance of banks largely depends on the management of assets and the priority given to recovery of NPAs. Secondly it is important to distinguish between NPAs, which are temporarily classified as such, due to the strict prudential norms stipulated by RBI, and the chronic NPAs where initiation of legal proceedings or enforcement of securities is ultimate means of recovery. Indian banking industry saddled with high NPAs. The reason diversions of funds and willful default have been found to be the major contributing factors for NPAs in public and private.
1.12 NPA MANAGEMENT

Effective NPA Management has become very vital in view of the multifarious impact NPAs have on profitability. No income accrues from NPAs. Provisioning eats into the profit made from other operations. Cost is involved in holding corresponding capital. Though no income is generated bank continues to incur cost on funds lent. The image of the bank also gets a beating. Effective NPA Management is a real challenge today and the entire staff members need to be sensitized to the urgency of task on hand.

Slippages

- Avoiding large-scale slippages.
- The credit appraisal system should be upgraded.
- Effective risk assessment mechanism at various levels.
- Annual review of the accounts should be taken up seriously.
- Credit monitoring has to be done effectively.
- Identification of watch category accounts is to be done in time.
- CARE (Critical amount recovery exercise) should be undertaken on an on-going basis.
- Rehabilitation/ Restructuring/ Rephrasing are to be undertaken wherever feasible before accounts slip into NPA category.
- In accounts where problems are of temporary nature Holding- on- Operation can be allowed to restore the health of the account.

Up gradation

All out efforts should be made to upgrade NPA accounts by recovering over dues. In accounts where it is not possible to affect recovery immediately, rephrasing/restructuring should be tried out so as to facilitate up gradation of the accounts at the earliest.
Recovery/Reduction

- Recovery/Reduction can be affected by using any of the following means:
- Follow up / Persuasion / Psychological pressure
- Compromise
- Recovery Camps
- Revenue Recovery
- Lok Adalat
- Civil Suit
- DRT
- SARFAESI ACT
- Write off
- Compromise settlements

1.13 RECOVERY MANAGEMENT IN RURAL CREDIT

The authors have carried out study titled “Recover Management in Rural Credit” and gave their findings in the occasional paper published by National Bank for Agriculture Rural Development. On various aspects of NPA management such as reasons for non-performing assets, recovery measures, legal remedies etc. As regards recovery management they say that the recovery and NPA management strategies adopted by the RFI s may be classified into two broad categories viz. 1. Preventive
2. Corrective strategies

1. Preventive Methods

The preventive methods include: More careful and responsible scrutiny and appraisal. This includes timely sanction, realism in fixing repayment schedule and adequacy of credit with efficient delivery. Evolving a broad loan recovery policy and implementing through the cadres with adequate accountability and empowerment. Regular and effective follow up with borrowers and timely action on sensing the likely default.

Title, value, etc. and additional security are to be investigated before the disbursement of loan. More detailed information about the borrowers is to be
obtained in terms of his / her family background such as i) size of the family ii) number of dependents in the family iii) earning members in the family iv) standard of living v) length of residency in the area, etc.

- Reviewing the advances in time and taking appropriate immediate action.
- Sending demand notices in time.
- Proper supervision of the borrower account through personal visits and calling for periodical returns to get incipient signals of default.
- Efficient MIS system on the borrowers and on the branches.
- Credit rating of clientele.
- Developing an early warning system for identifying potential weakness in the accounts.
- Strict observance of time schedules.
- Timely extension of period of limitation through debt acknowledgement, partial payment, renewal of documents etc.
- Timely replacement or rescheduling of loan in the event of natural calamities.

2. Corrective Methods

The corrective methods conventionally start with initiating legal action for recovery and followed by lodging insurance claims with DICGCI wherever possible and initiating coercive against the borrower and the surety. However, corrective methods, in recent years, have become more innovative and participatory.

i) Sharing the Threat Perception
ii) Staff Motivation
iii) Constitution of Special Recovery Cells and Related Measures
iv) Involvement of Government Agencies
v) Extraordinary Methods
vi) Corrective Management for NPA Management
Study the problems of NPAs-branch-wise, amount-wise ad age-wise Prepare a loan recovery policy and strategies exclusively for NPAs Create Special Recovery Cell at various levels Identify critical branches for intensive recovery Fix targets of recovery and draw time bound action plan

1.14 RECOVERY THROUGH LEGAL PROCESS

Experience has shown that legal support is critical to recovery management. The recovery of loans through crystallized collateral and other back shopping’s subject to a prolix process as the present legal system normally does not provide a fast and effective exit route.

Use of Collaterals and Collateral substitute

It is seen that the recovery process through legal system with or without collateral is equally costly and lengthy. The court fee is payable on the amount of default or on the amount to be recovered and not on the value of the security. Judiciary and Revenue machinery have been generally unable to help the RFIs in recovery. The sheet volume of cases weights them down even if the system has the intention. Except for the demonstrative effect, filing of summary or money suit for unsecured loans does not provide any tangible benefit for the RFIs. RFIs observe that pursuing such suits to a logical end is not prudent as it involves higher administrative and risk costs for them. The expenses made on the court lie in the books of accounts until affecting the sale makes their recovery. This is a drain on the RFI’s resources and is often without any return for the RFI during the period. The RFI’s feel that the cost of executing the collateral is quite high for RFI’s.

1. Revenue Recovery Acts:

An Expert Group headed by Shri R.K. Talwar in 1970 had recommended extension of similar facilities to commercial banks by appropriate State legislation (Talwar Committee, 1970). On the basis of the recommendations of the Talwar Committee, the State Governments (barring nine) had passed the Agricultural Credit Operations and Miscellaneous Provisions (Banks) Act. The act empowers designated officials of Revenue Department to issue an order having a force of decree of a civil court for payments of any sum due to a bank by sale of the property charged or
mortgaged in favour of the bank. This facilitates foreclosure of mortgage on land in bank’s favour and brings the property for sale. Under the act a nominal fee and not the entire salary of the government official, is charged to the bank.

The recovery officers under the Act have helped in recovering small loans of the banks. The banks, in States like Uttar Pradesh, Karnataka, have taken proactive steps to fund the cost (salary of recovery officers and other incidental expenses) by making a collective contribution for their establishment and / or allowing a recovery fee of 5% to 10% of the recovered amount towards their maintenance. But the above system has not worked uniformly well in all the states. The state governments had found it difficult to spare officials possessing zeal for this type of work, which is a prerequisite for a supporting machinery to work efficiently. Use of government official machinery helps in infusion of the threat perception amongst people, but the political interference becomes a part of it. Therefore, the lack of political will becomes a hindering factor in the process. It would perhaps be necessary to study the relative efficiency of the system across the country, so that improvements wherever possible, could be made.

2. **Debt Recovery Tribunals:**

Special Debt Recovery Tribunals (SDRTs) have been set up under the Recovery of Debts due to banks and Financial Institutions Act, 1993 for expeditious adjudication and recovery of debts. These court now adjudicate banks’ suits involving amount of Rs.10 lakh and above by transferring the cases pending with the civil courts. These loans are normally secured with collaterals. Only six such tribunals are operative now. The number of such tribunals is inadequate resulting in large number of cases pending before them. They are not yet equipped with proper infrastructure and flexibility to function smoothly.

Santosh A. Shah (2003)[26], in his study entitled “Non Performing Assets-Legal Remedies” while doing Critical Analysis of the recovery of Debts Due to Banks and Financial Institution Act, 1993 states:

1. After having seen the implementation of the Act up till now, it is general experience that the object of the Act of expeditious adjudication is fulfilled to
a large extent mainly due to the fact that the Tribunals under the Act have been accepting evidence by way of Affidavits and avoiding Examination in Chief and Cross Examination of the witnesses except under very special circumstances. It is our experience as I have mentioned before in this paper that the major time, which is taken for disposal of Civil Suits, is taken in trial, which consists of Examination in Chief and Cross Examination of the witnesses.

2. Again since the Tribunals are specially appointed and empowered to administer only these types of bank’s and financial institution’s legal proceeding, the Presiding Officer gets a good grip of the banking operations and also the law relating to banking which in turns enables him to dispose off the cases in a very expeditious manner.

3. There also seems to be, therefore, a development of specialized branch of law, lawyers, and law officers of various banks who are specializing in this work of the debt recovery tribunals.

4. All in all I see that at least the first object of the Act of expeditious adjudication has been fulfilled to a great extent debts recovered were Rs. 1864.30 Crores up to 30.09.2001. DRTs now cover almost all-important States in India.

5. However, the second object of the act of recovery having been started at least in this region only from last 5 years, its effectiveness needs to be still established. Moreover, recovery would need creation of proper infrastructure.

For recovery of small loans and to ensure quick justice on settlement of dues, Lok Adalats (People’s Courts) have been set up in some States. Retired high court judges and two other members head these courts. These small courts are founds to be of success in selected pockets. Efforts are continuing to popularize this arrangement. The judgment of these courts is found to lack the teeth of a civil court judgment for their enforceability. But these courts have provided good opportunity to narrow or bridge the differences between the banker and the defaulter by creating a favourable environment for a settlement and also in formalizing such settlements.
Critical analysis of the securitization and reconstruction of financial assets and enforcement of Security Interest Act, 2002

1. The Securitization Act has been enacted so as to tackle the growing NPAs in this country. The effect of the Act up till now has been encouraging as in most of the cases where notice for attachment and seizure of property has been sent under this Act, the parties are observed to have come for compromise with the Banks. The Act has created a new regime between the debtors and creditors. It is probably an outcome of what was thought by many as the position that many industries in the country took the financial sector for a ride up till now.

2. At the same time, however, care should also be taken to see to it that due to Acts of this nature which are termed by some as financial POTA, entrepreneurship in the country should not suffer. The Act is also termed by some as, ‘Shoot first – Act later’. The legislations up till now were debtor centric but now are turned to creditor centric.

3. The banks also have to learn to answer the usual criticism against them which is “When you do not need the funds, the banks have a lot of them and when you need them, they have none”.

4. Some critics have also pointed out that such an Act is an over reaction and the NPA norms do not take into account the agro based industries, oil industries, sugar industries which have seasonal product. The distinction is also be made between wilful V/s. bonafide defaulters. An Exit policy should be adopted for bonafide borrowers who due to reasons beyond their control have gone into default. As against that a strict policy and application of the Act needs to be stringently applied to wilful defaulters who many a time are found to be siphoning and misappropriating the funds of the Bank.

5. It must be borne in mind that one of the causes of NPAs is also non-prudent lending of money.
1.15 SIGNIFICANCE RESCHEDULING AND OTHERS


1. **Rephasement of the Loan:**

It is necessary to fix repayment schedule for term loan according to the income generating capacity of the unit. If repayment schedule is not fixed properly or a unit is not fixed properly or a unit is not able to generate expected profit, possibility may be explored in consultation with the borrowers for rephasement of loan installment. Rephasement of the loan installment should be done only when it is expected to get payment after the rephasement.

2. **Compromise Proposal:**

A compromise may be called where borrower agrees to pay a certain amount to the banker with some concession. A large number of compromise proposals are being approved by banks with a view to reduce their NPAs and recycling of funds instead of resorting to legal procedures.

Naidu and & A. Prasad (2004)[28] in their study entitled “Remedial Measures for Managing Non –Performing Assets in RRBs” stated-3. **Compromises with Borrowers:**

The bank should also enter into compromises through negotiations with the borrower to carry forward a clear picture of the latest position. It is a redundant to carry the non-recoverable loans on the bankbooks indefinitely. With proper justifications and convincing arguments, compromises could be entered into and implemented immediately. Rehabilitation package for potentially viable sick units will helps in the revival of the NPA into performing assets. A little help in this regard may go a long way resulting in constructive solution.

Krishna Reddy, Dr.A.V.Ramana, and K.Nandeeswaraiah (2004)[29] in their study entitled “Management of Non-Performing Assets in Banking Sector: Some Insights” observed-
4. **Compromise Proposal:**

   It is the mechanism for settling outstanding dues through compromise. Negotiation in this regard is to be handled skillfully on the basis of relative strengths of the borrower and the banker. Banks should make all endeavours to strike a Zero-loss deal on a deal with minimum sacrifice waiver. Such compromise must be related to

   - Waiver of penal interest
   - Reduction in interest rate
   - Write off the full or a part of the amount of interest debited to the account of the borrower.

   **Mohan & K. Rajesh (2004)[30]**, in their study entitled “Management of Non-Performing Assets in Institutional Agencies” stated that in the compromise settlement the points need to remembered are-

   - Maximum recovery with minimum cost.
   - Distinction needs to be made between willful defaulters and defaulters on account of conditions beyond their scope.
   - Where security is available, proper weight age needs to be given to location, marketability conditions, possession thereof.
   - Funds recycling to the maximum advantage instead of option for lengthy, expensive recovery process.
   - All compromise proposals should be reported to the next higher authority for scrutiny so as to prevent fraudulent activities.
   - Before presenting the compromise proposal before the Settlement
   - Advisory committee, the proposal needs to be examined by the top executive.
   - Adequate attention should be given and appropriate action initiated for upgrading substandard assets to standard assets.
Gupta (1994)[31] in their study entitled “Fast Track for Recovery of Bank Overdues” stated that the slow pace of recovery of bad and doubtful debts has been adversely affecting the viability of various banks and financial institutions. The prevailing system of recovery of bank dues through the machinery of civil courts is not only time consuming but also non-productive and expensive. Following recommendations of several high level committees including Narasimham panel on financial sector reforms and assurance of the Finance Minister on the floor of parliament to set up special tribunals to hear and decide the claim of banks, the bankers have been anxiously looking forward to the new set up of recovery. The new Act called “The Recovery of Debts Due to Banks and financial Institutions Act, 1993”.

Nayar (1994)[32], written in his article “Recovery of Bank Dues” has given the norms of decree-

- The decree in the hands of the creditor must be a decree for the payment money to Rs. 500 or more.
- The decree must have become final.
- The execution of the decree has served the debtor with an insolvency notice.
- The creditor must have served the debtor with an insolvency notice.
- The insolvency notice must be in respect of a decree for payment of any amount due to such creditor.
- The notice must require the debtor to pay the amount due under the decree.
- The debtor has failed to comply with the notice and the time specified in the notice has elapsed; and
- The notice must specify the time within which the debtor has to comply with notice by making payment.
- The notice has not been set aside by the District Court that is to say in case of debtor applying to the District Court under clause (b) of the provision this sub-section, his application has been rejected.
Rajendra Singh (2005)[33] in his article “Empowering Banks for Recovery of Non-performing Assets (NPAs)” stated that the SARFAESI Act 2002-Need of the hour is essentially about enforcement of the lender rights and improving recovery of NPAs. The financial sector is under severe stress due to its inability to enforce security interest and other rights, mainly due to slow legal system. The resulting increase in NPAs in the banking sector, the liquidity pressure on central and state financial and investment institutions and threat to the stability of the financial sector have forced the government to bring this legislation.

1.16 ISSUES BEFORE THE SECURITIZATION ACT

While the Act has been widely acclaimed by banks / FIs throughout the country as secured creditor(s) have unfettered liberty, the following issues deserve attention:

1. The issue of pricing of fixing a realizable value on the assets is a question not addressed in the act so far. World over, stressed assets are sold or transferred on a heavy discount, at times reaching a level of 75- 80 percent. In such a situation, banks will have to first be prepared to write off the difference between the sale / transfer price and the book value, secondly be prepared to face scrutiny of Agencies like CBI or CVC for sale / transfer of NPA at such a low price. Since the banks hold adequate provisions for the NPAs, write-off of the shortfall may not be included.

2. Issues with regard to stamp duty chargeable for transfer of assets from the originator to Asset Reconstruction Company (ARC) have not been addressed in the Act. The stamp duty is a state subject; it would require initiatives from the respective state government. As a matter of fact, these banking assets should be exempted from the levy of stamp duty.

3. Who will pay statutory dues like over due sales tax, excise duty, income tax, electricity charges and other local tax arrears after the management is taken over by the secured creditor? Legal position in this regard needs to be defined very clearly.
4. The appointment of a manager for the management of the acquired assets in consultation with the borrowers, whose assets have been seized by the banks, seems to be a utopian idea.

5. The Act provides for appeal and for appeal over appeal, resulting in lengthy judicial process, which may delay execution proceedings.

6. The Act provides for concurrence of secured creditors representing 75 percent in value of the amount outstanding where there are more than one secured creditors. This concurrence especially in case of going concerns may not come through.

7. The appointment of a manager for the management of the acquired assets in consultation with the borrower, whose assets have been seized by the banks, seems to be practically impossible.

8. Section 13 (4) provides for management of secured assets only. Where a company has a number of assets, it is difficult to decide how feasible is the management of isolated assets and the Act is silent on this point.

9. In law, one cannot do indirectly what is prohibited directly. In case of sale of seized assets, the seller and the beneficiary will be the same. The sale of secured assets by banks at value enough to cover their dues would be adequately self-serving, but may appear to be unfair to the stakeholders.

10. In case of management control over the business of the defaulter(s) the secured creditor will have effective control over unsecured assets of the borrower as well, which contravenes the stipulated intent of the Act.

11. It will be difficult for banks to sell distressed assets, as there will be few takers for such assets. The corporate(s) may gang up to prevent sale of assets by banks. Auctions may turn to be farce.

12. The Act empowers the banks to takeover the management of defaulting companies; banks are not business tycoons or jacks off all trades who can run any business activity with guaranteed success. Banks are not even custodians or merchants of commodities.
13. The Act does not address the problem of lack of infrastructure and practical problems involved in sale of distressed assets.

14. In case of certain specific industries where an industrial licence, specific government approval or permission or special rights like mining lease etc. is issued in the name of the borrowing company, will such license/approval/permission be automatically transferred to the name of buyer/bank/concerned or not?

15. Will intangible assets like patents, goodwill, brands be deemed to be automatically transferred to the bankers/buyers and defaulter would not have any right, title or interest in such assets, once he has been divested of the secured assets charged to the bank.

16. Valuation of assets and bidding process can trigger legal cases. There can be lack of unanimity among lenders also, as all lenders holding atleast 75 percent stake in outstanding dues are required to agree to sell the assets of defaulters.

17. Borrowers might prefer objection on several issues before magistrates authorized to issue seizure order and can transform into potential enquiry into nature of secured assets, proper status, nature of liability etc.

18. Lenders are vulnerable to prosecution by compliance authorities on many issues, despite the indemnity given under the Act to persons exercising the rights of secured creditors.

19. The Act provides for creating a central registry to record the particulars of transactions related to SARFAESI Act and creation of security interest including electronic record of the same. It has not been clarified whether this registration would exempt ARCs and securitization companies from filling particulars with the state registry simultaneously.

20. The extent to which a secured creditor can proceed against a third party acquirer of secured assets from the borrower has not been adequately addressed in the Act. It may open a Pandora’s Box of legal proceedings with third parties for the secured creditor.
1.17 RESEARCH ON NPAS CLIMATE IN PUBLIC SECTOR BANKS

Shete (2002)[34], “Non-Performing Advances of Commercial Banks: An Overview” with regard to priority sector NPAs, found that the major factors like natural calamities, inadequate income generation, high transaction costs, inappropriate financial policies, poor working of the RFI, follow-up of prudential norms and provisioning of NPA. Needless to say that defaults in the FRIs adversely affects recycling of credit, squeeze up their resources and are closely linked with the banks’ heading towards a state of financial unsustainability.

Kulkarni (2006)[35], in his thesis entitled “A critical Study of Non Performing Assets of Public Sector Banks with Special Reference to Single District” concluded “Non -Performing assets are affecting viability and solvency of public sector as well private sector banks. Not only Banks in India are facing this problem but also all over the world the situation is common. Non –performing assets affect adversely the lending activities of banks. Nonrecovery of repayment installment and interest on loan create hindrances in credit dispensation process. Non recovery of loans also hurt the profitability of banks.” It is observed that in the case of public sector banks, marginal decline in NPAs ratio was mainly because of increase in the share of standard assets and decline in the doubtful assets and sub standard assets.

Parmar (1994)[36], in his article “Recovery: Finding of a Study of Two Districts in Gujarat” states that the guidelines given by the RBI have not adequately been followed by the banks. The study revealed that banks have not provided staff according to the business of the branch, and the job-role, function and responsibilities of the staff have not been clearly defined. The organizational strength remained weak and has not been strengthened to the extent necessary for better recovery performance. The study also revealed that a schematic approach in lending to clusters of borrowers of villages was not adopted to facilitate effective supervision. The approach of the Government agencies was just to sponsor the applications in bunch and that too without adequately examining the technical feasibility and economic viability of the loan proposals. Recovery performances of the branches were not constantly and closely reviewed by the controlling offices and separate recovery cells had not been set up as per the Guidelines of RBI.
Narayanan (2000)[37] NPA Reduction the New “Mantra” of Slippage Management. He says that any one short measure like “recovery camps” can at best be of supplementary nature. In a credit proposal is processed properly, sanctioned, disbursed in time and in adequate amount and monitored right from the beginning then the chances of this asset becoming NPA is relatively less than another which has been processed in haste, appraised mechanically, delayed in sanction and disbursed in adequate quantum. The NPA reduction techniques of “Slippage Management” along with proper credit appraisal and the occasional fire fighting of NPA will certainly help to check the incidence of NPA in the banking industry there by improving the banks’ profitability.

1.18 NPA NORMS

Though the issue of NPA was given more importance after the Narasimham Committee Report (1991) highlighted its impact on the financial health of the commercial banks and, subsequently, various asset classification norms were introduced, the concept of classifying bank assets based on its quality began during 1985-86. A critical analysis to monitor credit comprehensively and uniformly was introduced in 1985-86 by the RBI by way of the Health Code System in banks. This system, inter alia, provided information regarding the health of individual advances, the quality of the credit portfolio and the extent of advances causing concern in relation to total advances. It was considered that such information would be of immense use to banks for control purposes. The RBI advised all commercial banks (excluding foreign banks, most of which had similar coding system) on November 7, 1985, to introduce the Health Code System indicating the quality (or health) of individual advances under the following eight categories, with a health code assigned to each borrowal account (source: RBI):

1. Satisfactory - conduct is satisfactory; all terms and conditions are complied with; all accounts are in order and safety of the advance is not in doubt.

2. Irregular- the safety of the advance is not suspected, though there may be occasional irregularities, which may be considered as a short term phenomenon.
3. Sick, viable - advances to units that are sick but viable - under nursing and units for which nursing/revival programmes are taken up.

4. Sick: nonviable/sticky - the irregularities continue to persist and there are no immediate prospects of regularisation and the accounts could throw up some of the usual signs of incipient sickness.

5. Advances recalled - accounts where the repayment is highly doubtful and nursing is not considered worthwhile and where decision has been taken to recall the advance. Suit filed accounts - accounts where legal action or recovery proceedings have been initiated.

6. Decreed debts - where decrees (verdict) have been obtained.

7. Bad and Doubtful debts - where the recoverability of the bank's dues has become doubtful on account of short-fall in value of security, difficulty in enforcing and realising the securities or inability/unwillingness of the borrowers to repay the bank's dues partly or wholly. Under the above Health Code System, the RBI classified problem loans of each bank into three categories: (i) advances classified as bad and doubtful by the bank (Health Code No.8) (ii) advances where suits were filed/decrees obtained (Health Codes No.6 and 7) and (iii) those advances with major undesirable features (Health Codes No.4 and 5).

The Narasimham Committee (1991) felt that the classification of assets according to the health codes was not in accordance with international standards. It believed that a policy of income recognition should be objective and based on the record of recovery rather than on subjective considerations. In addition, before the Indian banks complied with the capital adequacy norms, their assets had to be revalued on a more realistic basis of their realisable value. Thus, the Narasimham Committee (1991) believed a system of income recognition and provisioning is fundamental to preserve the strength and stability of the banking system.

The international practice is that an asset is treated as non-performing when interest is due for at least two quarters. In respect of such non-performing assets, interest is not recognised on accrual basis but is booked as income only when it is actually received. The committee suggested that a similar practice be followed by
banks in financial institutions in India and recommended that interest on NPAs be booked as income on accrual basis. The NPA would be defined as advance, as on the balance sheet date in the following circumstances:

1. In respect of overdraft and cash credits, accounts remain out of order for a period of more than 180 days,

2. In respect of bills purchased and discounted, the bill remains overdue and unpaid for a period of more than 180 days,

3. In respect of other accounts, any account to be received remains past due for a period of more than 180 days.

4. As mentioned earlier, the grace period was reduced and from March 1995 onwards assets for which interest has unpaid for 90 days were considered as NPAs. Provisions need to be made for the

5. NPAs and total NPA (gross) minus the provisions is defined as net NPA.

6. Besides providing a detailed definition of NPA, the Narasimham Committee (1991) also suggested that for the purpose of provisioning, banks and financial institutions should classify their assets by compressing the health codes into four broad groups; (i) Standard (ii) Sub-standard, (iii) Doubtful and (iv) Loss. Broadly, sub-standard assets would exhibit problems and include assets classified as non-performing for a period not exceeding two years. Doubtful assets are those that remain as such for more than two years and include loans that are overdue for more than two years.

7. Loss assets are accounts where loss has been identified but amounts have not been written off.

According to international norms, commercial banks need to keep aside a portion of their income as a provision against bad loans. The amount of the provision depends on the type of NPAs and the time duration. Now Indian banks need to make provisions for all bad loans.
1.19 RECOVERY MECHANISM OF NPA

The Government of India felt that the usual recovery measures like issue of notices for enforcement of securities and recovery of dues was a time consuming process. Thus, in order to speed up the recovery of NPAs, the government constituted a committee under the chairmanship of late Shri Tiwari in 1981. The committee examined the ways and means of recovering NPAs and recommended, inter alia, the setting up of ‘Special Tribunals’ to expedite the recovery process. Later the Narasimham Committee (1991) endorsed this recommendation, and, suggested setting up of the Asset Reconstruction Fund (ARF). It was suggested that the Government of India, if necessary, should establish this fund by special legislation to take over the NPAs from banks and financial institutions at a discount and recover the dues owed by the primary borrowers.

Based on the recommendations of the Tiwari and the Narasimham Committees, Debt Recovery Tribunals were established in various parts of the country. An Asset Reconstruction Company was also established. The various measures taken to reduce NPAs include rescheduling and restructuring of banks, corporate debt restructuring and recovery through Lok Adalats, Civil Courts, Debt Recovery Tribunals and compromise settlement. In addition, some legal reforms were introduced to speed up recovery.

1.20 SARFAESI ACT

The legal mechanism for recovery of default loans was so far cumbersome and time-consuming. Thus, it was felt that banks and financial institutions should be given the power to sell securities to recover dues. In this regard, the Government of India appointed a committee under the chairmanship of Shri T R Andhyarujina, senior Supreme Court advocate and former Solicitor General of India, in 1999 to look into these matters. The Committee submitted four reports. One of them is related to securitisation.

Based on the recommendations of the Andhyarujina Committee, The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002, was passed on December 17, 2002. The act
provides enforcement of the security factor without recourse to civil suits. This act was passed with the aim of enabling banks and financial institutions to realise long term assets, manage the problem of liquidity, reduce asset liability mismatches and improve recovery by taking possession of securities, selling them and reducing NPAs. The ordinance also allows banks and financial institutions to utilise the services of ARCs/SCs for speedy recovery of dues from defaulters and to reduce their NPAs. The ordinance contains provisions that would make it possible for ARCs/SCs to take possession directly of the secured assets and/or the management of the defaulting borrower companies without resorting to the time-consuming process of litigation and without allowing borrowers to take shelter under the provisions of SICA/BIFR. In addition to passing the SARFAESI Act, certain other legal reforms were also introduced to speed up the loan recovery process.

1.21 OTHER LEGAL REFORMS

One of the important factors responsible for the ever-increasing level of NPAs in the Indian banking industry is the weak legal system. According to an international rating agency called FITCHIBCA, “The Indian legal system is sympathetic towards the borrowers and works against the banks’ interest. Despite most of their loans being backed by security, banks are unable to enforce their claims on the collateral when the loans turn non-performing, and therefore, loan recoveries have been insignificant.” However, efforts have been made to rectify these problems through the judicial process as well as by enacting laws. In 1999, a standing committee under the aegis of Industrial Development Bank of India (IDBI) was constituted to initiate a co-ordinated approach to the recovery of large NPA accounts and for institutionalising an arrangement between banks and financial institutions for the systematic exchange of information in respect of large borrowers (including defaulters and NPAs). Moreover, as mentioned above, in 2002 the SARFAESI Act was passed and it empowered the creditors to foreclose non-performing loans and the underlying collateral without going through a lengthy judicial or tribunal process (Basu, 2005)[38]. All these efforts improved the recovery of NPAs by commercial banks, which in turn has helped in reducing the NPA level. The total worth of NPAs recovered through various channels was around Rs 4,039 crore during 2003-04, which increased many fold to Rs 20,578 crore during 2004-05.
1.22 NPAS IN PUBLIC SECTOR BANKS

The public sector banks have emerged strong across all key indicators as the global financial turmoil and slowing domestic economy put the banking sector on a test. The public banks have not only reduced the lending rates but have also managed to record higher average net profit and lower NPAs level than their private sector banks. The Public Sector Banks have shown very good performance over the private sector banks as far as the financial operations are concerned. The Public Sector Banks have also shown comparatively good result. However, the only problem of the Public Sector Banks these days are the increasing level of the non performing assets. The non performing assets of the Public Sector Banks have been increasing regularly year by year. If we glance on the numbers of non performing assets we may come to know that in the year 1995 the NPAs were Rs. 38385 crore and reached to Rs. 44042 crore in 2009 in Public sector banks and comparatively in the year 2001 the NPAs were Rs. 6410 crore and reached to Rs. 16887 crore in 2009 in Private sector banks. The only problem that hampers the possible financial performance of the Public and private Sector Banks are the increasing results of the non performing assets. The non performing assets impact drastically to the working of the banks. The efficiency of a bank is not always reflected only by the size of its balance sheet but by the level of return on its assets. NPAs do not generate interest income for the banks, but at the same time banks are required to make provisions for such NPAs from their current profits.

1.23 NON-PERFORMING ASSETS OF PUBLIC AND PRIVATE SECTOR BANKS

The quality of Indian banks” assets is likely to deteriorate over the next two years. This will be driven by the slowdown in the economy, and by the aging of loans made in recent years. The NPAs are considered as an important parameter to judge the performance and financial health of banks. The level of NPAs is one of the drivers of financial stability and growth of the banking sector. The Financial companies and institutions are nowadays facing a major problem of managing the Non Performing Assets (NPAs) as these assets are proving to become a major setback for the growth of the economy. NPAs in simple words may be defined as the
borrower does not pay principal and interest for a period of 180 days. However, it is taken into consideration now that default status would be given to a borrower if dues are not paid for 90 days. If any advance or credit facility granted by the bank to a borrower becomes non-performing, then the bank will have to treat all the advances/credit facilities granted to that borrower as non-performing without having any regard to the fact that there may still exists certain advances / credit facilities having performing status.

1.24 ASSET CLASSIFICATION CATEGORIES OF NPAS STANDARD ASSETS

Standard assets are the ones in which the bank is receiving interest as well as the principal amount of the loan regularly from the customer. Here it is also very important that in this case the arrears of interest and the principal amount of loan do not exceed 90 days at the end of financial year. If asset fails to be in category of standard asset that is amount due more than 90 days then it is NPA and NPAs are further need to classify in sub categories. 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 and the reliability of the dues: (1) Sub-standard Assets (2) Doubtful Assets (3) Loss Assets

(1) SUB-STANDARD ASSETS
With effect from 31 March 2005, a sub standard asset would be one, which has remained NPA for a period less than or equal to 12 month. The following features are exhibited by sub standard assets: 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.

(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 March 31, 2005, an asset would be classified as doubtful if it remained in the sub-standard category for 12 months.

(3) LOSS ASSETS
A loss asset is one which considered uncollectible and of such little value
that its continuance as a 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.

1.25 FACTORS FOR RISE IN NPAS

The banking sector has been facing the serious problems of the rising NPAs.
But the problem of NPAs is more in public sector banks when compared to private
sector banks and foreign banks. The NPAs in PSB are growing due to external as
well as internal factors.

External Factors

Ineffective Recovery: The Govt. has set of numbers of recovery tribunals,
which works for recovery of loans and advances. Due to their negligence and
ineffectiveness in their work the bank suffers the consequence of non-recover, their
by reducing their profitability and liquidity.

Wilful Defaults: There are borrowers who are able to payback loans but are
intentionally withdrawing it. These groups of people should be identified and proper
measures should be taken in order to get back the money extended to them as
advances and loans.

Natural Calamities: This is the measure factor, which is creating alarming
rise in NPAs of the PSBs. every now and then India is hit by major natural calamities
thus making the borrowers unable to pay back there loans. Thus the bank has to
make large amount of provisions in order to compensate those loans, hence end up
the fiscal with a reduced profit.

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.
Lack of Demand: Entrepreneurs in India could not foresee their product demand and starts production which ultimately piles up their product thus making them unable to pay back the money they borrow to operate these activities. The banks recover the amount by selling of their assets, which covers a minimum label. Thus the banks record the non recovered part as NPAs and has to make provision for it.

Change on government Policies: With every new govt. banking sector gets new policies for its operation. Thus it has to cope with the changing principles and policies for the regulation of the rising of NPAs.

Internal Factors

Defective Lending Process: There are three cardinal principles of bank lending that have been followed by the commercial banks since long. i. Principle of safety ii. Principle of liquidity iii. Principle of profitability.

Inappropriate Technology: Due to inappropriate technology and management information system, market driven decisions on real time basis cannot be taken. Proper MIS and financial accounting system is not implemented in the banks, which leads to poor credit collection, thus NPAs. All the branches of the bank should be computerized.

Improper SWOT Analysis: The improper strength, weakness, opportunity and threat analysis is another reason for rise in NPAs. While providing unsecured advances the banks depend more on the honesty, integrity, and financial soundness and credit worthiness of the borrower. - 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. They should use good credit appraisal to decrease the NPAs.

Managerial Deficiencies: The banker should always select the borrower very carefully and should take tangible assets as security to safe guard its interests. When accepting securities banks should consider the: 1. Marketability 2. Acceptability 3. Safety 4. Transferability.
The banker should follow the principle of diversification of risk based on the famous maxim “do not keep all the eggs in one basket”, it means that the banker should not grant advances to a few big farms only or to concentrate them in few industries or in a few cities. If a new big customer meets misfortune or certain traders or industries affected adversely, the overall position of the bank will not be affected.

**Absence of Regular Industrial Visit:** The irregularities in spot visit also increases the NPAs. Absence of regularly visit of bank officials to the customer point decreases the collection of interest and principals on the loan. The NPAs due to wilful defaulters can be collected by regular visits.

**Reloaning 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. The developing economy has been much affected due to high fiscal deficit, poor infrastructure facilities, sticky legal system, cutting of exposures to emerging Markets by Financial Institutions, etc. Under such a situation, it goes without saying that banks are no exception and are bound to face the heat of a global downturn. Bankers have realized that unless the level of NPAs is reduced drastically, they will find it difficult to survive.

The core banking business is of mobilizing the deposits and utilizing it for lending to industry. Lending business is generally encouraged because it has the effect of funds being transferred from the system to productive purposes which results into economic growth. The debtor take the funds from the bank in the form of credit and he have to pay back the principle amount with the interest to the creditor as a result the creditor (Bank)gets the profit in the form of interest and again this profit is reinvested leading to the growth of the economy. However lending also carries credit risk, which arises from the failure of borrower to fulfill its contractual obligations either during the course of a transaction or on a future obligation. Due to non performance of the fund the financial institutions become bankrupt and failed to provide investors with clearer and more complete information thereby introducing a degree of risk that many investors could neither anticipate nor welcome. The history of financial institutions also reveals the fact that the biggest banking failures were due to credit risk. As a result, banks nowadays are restricting their lending operations
to secured avenues only with adequate collateral security over which the company can overtake its right of authority.

What is needed is having adequate preventive measures in place namely, fixing pre-sanctioning appraisal responsibility and having an effective post-disbursement supervision. Banks concerned should continuously monitor loans to identify accounts that have potential to become non-performing. However, increasing NPAs have a direct impact on banks profitability, as legally banks are not allowed to book income on such accounts and at the same time banks are forced to make provision on such assets as per the Reserve Bank of India (RBI) guidelines. Also, with increasing deposits made by the public in the banking system, the banking industry cannot afford defaults by borrowers since NPAs affects the repayment capacity of banks.

The economic progress of a nation and development of banking is invariably interrelated. The Banking sector is an indispensable financial service sector supporting development plans through channelizing funds for productive purpose, intermediating flow of funds from surplus to deficit units and supporting financial and economic policies of government. The importance of bank’s stability in a developing economy is noteworthy as any distress affects the development plans (Rajaraman and Vasishtha, 2002)[39] thereby the economic progress (Thiagarajan, et al, 2011)[40]. The Indian Banking sector accounts a major portion of financial intermediation and acknowledged as main vehicle for monetary policy signals, credit channel and facilitator for payment systems.

The stability of banking hence is a pre-requisite for economic development and resilience against financial crisis. Like any other business, success of banking is assessed based on profit and quality of asset it possesses. Even though bank serves social objective through its priority sector lending, mass branch networks and employment generation, maintaining asset quality and profitability is critical for banks survival and growth. A major threat to banking sector is prevalence of Non-Performing Assets (NPAs). NPA represent bad loans, the borrowers of which failed to satisfy their repayment obligations. Michael et al (2006)[41] emphasized that NPA in loan portfolio affect operational efficiency which in turn affects profitability,
liquidity and solvency position of banks. Batra, S (2003)[42] noted that in addition to
the influence on profitability, liquidity and competitive functioning, NPA also affect
the psychology of bankers in respect of their disposition of funds towards credit
delivery and credit expansion. NPA generate a vicious effect on banking survival and
growth, and if not managed properly leads to banking failures. Many researches
including Chijoriga, MM (2000)[43] and Dash et al (2010)[44] showed the
relationship bank failures and higher NPA worldwide.

Banking in India originated in the last decade of the 18th century. Commercial
banks occupy a major part of the banking in India. They are the oldest form of
banking institution having large volume of operations over a vast area. They are
having very good net-work of branches even in rural and semi-urban areas. Now they
are not only engaged in their traditional business of the accepting and lending money
but have diversified their activities into new fields of operations like merchant
banking, leasing, housing finance, mutual funds and venture capital. They have
introduced a number of innovative schemes for mobilizing deposits. In addition to
the above they are providing valuable services to their customers, issuing drafts,
travellers cheques, gift cheques, accepting valuables for safe custody and modern
banking facilities.

Since the process of liberalization and reform of the financial sector were set
in motion in 1991, banking has undergone significant changes. The underlying
objective has been to make the system more competitive, efficient and profitable. A
strong banking sector is important for flourishing economy. The failure of the
banking sector may have an adverse impact on other sectors. Non-performing asset
(NPA) is one of the major concerns for banks in India. NPAs reflect the performance
of banks. A high level of NPAs suggests high probability of a large number of credit
defaults that affect the profitability and net-worth of banks and also erodes the value
of the asset. The NPA growth involves the necessity of provisions, which reduces the
overall profits and shareholders’ value.

1.26 VARIOUS COMMITTEE REPORTS – ON CREDIT

RBI and Govt. of India had appointed various committees and Study Groups
from time to time to study in depth different aspects on Banks Credit, Legal Reform
and Non-Performing Assets. All these subject matters are co-related and interconnected to this research study and hence it is necessary to know, in brief, about the purpose of appointment of such Committees, their terms of reference and some of the valuable recommendations made by them. Non-performing Assets have been plaguing the Indian financial sector since long but were not in the public domain till early nineties. By that time, significant amount of loan assets involving uncertainly with respect to ultimate collection piled up creating concerns with the opinion makers about health of Indian banking and financial sector. NPAs reflect natural waste of any economy. In advanced economies the financial markets are well developed and segmented; with various players operating in identified niches, catering to various users/risk segments. This constitutes an effective institutional mechanism for targeting risks to players with appetite for such risks. Commercial bank is conducted in a highly risk managed and mitigated ambience, unlike their Indian counterparts who are often required to take unmitigated risk as a part of business policy.

1. **Thakkar Committee on Employment Potential (1970)**

The then Union Finance Minister Shri Y.B. Chavan, while meeting the Chairman/ Custodians of the Public Sector Banks on 22nd July 1970 indicated that the committee might be constituted to review the special credit schemes of banks, with particular reference to their employment potential. The terms of reference were to identify the types of self employed persons who should be considered for special financing. To evolve guidelines in respect of security, rate of interest, period of repayments and other terms and conditions.

2. **Tandon Committee (1974)**

Till nationalization of the 14 major commercial banks in July 1969, the main contenders for banks credit were large and medium scale private industries and internal and external trade. Nationalisation of the major commercial banks, called for a new policy, both for deposit mobilization through accelerated branch expansion and for suitable disbursal of credit. Its terms of reference were to suggest guidelines for commercial banks to follow up and supervise credit from the point of view of ensuring proper endures of funds and keeps watch on the safety of the advances and
to suggest the type of operational data and other information that may be obtained by banks periodically from such borrowers by the Reserve Bank of India from the lending banks. To make suggestions for prescribing inventory norms for different industries both in the private and public sectors and indicate the broad criteria for deviating from these norms.

3. **Puri Committee on SSI (1975)**

Consequent to the discussions at the meeting of the Standing Committee on credit facilities of the Small Scale Industry (SSI) Board and the discussion that took place at the 33rd meeting of the Board in September, 1975, regarding credit problems faced by small scale industries, the Government of India appointed High Powered Committee under the Chairmanship of Shri I.C.Puri, the Development Commissioner (SSI), with the following terms of reference: To examine the possibility of introducing a measure of uniformity in the terms and conditions of finance and to suggest measures that should be taken by small scale units to facilitate the flow of institutional finance.

4. **N.K. Ambegaonkar Committee (1976)**

At the meeting of the regional consultative committee for the North Eastern Region, held at Gauhati on 5th July, 1976, it was decided that the RBI should appoint a small Working group to examine, inter-alia, the factors impeding the flow of bank credit in the Region and make recommendations for necessary changes in the procedures and practices of banks so as to bring about rapid and all round banking development in the region. The terms of reference were to identify the factors impeding the flow of bank credit in the North Eastern Region. To recommend, in the context of the socio-economic features of the region, suitable arrangements for expeditious disbursal of credit by commercial banks.

5. **Raj Committee on lending to priority sector (1976-77)**

The nationalisation of the 14 major scheduled commercial banks in July, brought in its wake a rapid growth in branch expansion, particularly in the rural areas, accompanied by considerable rise in the deposits and advances. RBI set up a Committee in June 1977 to study all aspects of the functioning of the Public Sector
of Banks under the Chairmanship of Shri James S. Raj. The terms of reference were to assess the impact of branch expansion that had taken place since 1969 and to examine whether any change in the tempo and direction of such expansion is called for and to inquire into the present pattern of branch expansion of public sector and to suggest the future course of action keeping in view the need for rural development and removal of regional imbalances.

6. **Chore Committee (1979)**

RBI appointed the Working Group to review the system of cash credit in all its aspect under the Chairmanship of Mr. K.B. Chore, Additional Chief Officer, Department of Banking Operations and Development, RBI. The terms of reference were to review the operation of the cash credit system in recent years particularly with reference to the gap between sanctioned credit limits and the extent of their utilization, to suggest modifications in the system with a view to making the system more amenable to rational management of fund by commercial banks.

7. **Dr. Hate Committee on resources of Co-op Banks (1981)**

RBI constituted on 22nd March, 1981, a Study Group called the “Study Group of Development of Resources by State and Central Co-operative Banks” under the Chairmanship of Dr. M.V. Hate, Executive Director, RBI to make an in-depth study of the problem of surplus resources and profitable investment of loanable internal resources faced by the State Co-operative Banks and Central Co-operative Banks. The terms of reference were to define and identify surplus resources with the State and Central Co-operative Banks and to identify the causes and examine the effects of this growing problem in relation to interest rate structure and the concessional refinance facilities available from the RBI.

8. **Dr. M.V. Hate Committee on Rural Credit (1983)**

An era of direct involvement of RBI in purveying agricultural credit may be said to have come to an end with the formation of the National Bank of Agricultural and Rural Development (NABARD) in July 1982. In line with the objective of national policies, the bank has also been insisting on the need for reserving a portion of credit for the weaker section. This committee briefly recount the technical and
managerial assistance the bank extended to agricultural credit and other related institutions both within the country and abroad.

9. **Dr.K.S.Krishnaswamy Committee (1985)**

At the meeting of the Finance Minister with the Chief Executive Officers of the Public Sector Banks held on 6th March, 1980. The terms of reference to identify the specific groups which are to be assisted under the 20 Point Programme. To identify the ways and means of rendering assistance to the beneficiaries. To look into the question of fixing subtargets (within the enhanced overall target of 40% for assistance to priority sectors) to the beneficiaries.

10. **Dr. P.D. Ojha Committee (1988)**

Governor, RBI suggested to the Chief Executives of Public Sector Banks at a meeting held on 17th October, 1987 that a field study would be carried out with their personal participation in different districts all over the country and the findings would be discussed in a Seminar. The terms of reference were to examine and recommend the necessary procedures for effective co-ordination between the three institutional agencies viz. Commercial Banks, Regional Rural Banks and Cooperative under the new area approach.

11. **Kapur Committee on Credit Delivery System for SSI (1997)**

A Committee was set up by the RBI in December 1997 (under the Chairmanship of Shri S.L. Kapur) to suggest measures for improving the Credit Delivery System for SSIs. The recommendations of the Committee were special treatment to smaller among small industries and removal of procedural difficulties to facilitate SSI advances.

12. **Gupta Committee on Agricultural Sector (1998)**

The one-man Committee under the Chairmanship of Shri R.V. Gupta, which examined the problems faced by the borrowers in agricultural sector, had made several recommendations for ameliorating the problems in the flow of agricultural credit. “The recommendations relating to several procedural modifications on agricultural credit have been advised to banks for implementation.
1.27 VARIOUS COMMITTEE REPORTS ON NPAs

1. **Narsimhan Committee – Reform I (1991)** The development of the financial sector is a major achievement and it has contributed significantly to the increase in our savings rate, especially of the household sector. The terms of reference were to examine the existing structure of the financial system and its various components and to make recommendations for improving the efficiency and effectiveness of the system with particular reference to the economy of operations, accountability and profitability of the commercial banks and financial institutions.

2. **Khan Committee on Financial Reforms (1997)** RBI had constituted a 7 member Working Group on 15th Dec. 1997 under the Chairmanship of Shri S.H. Khan, Chairman and Managing Director of IDBI, keeping in view the need for evolving an efficient and competitive financial system. The terms of reference were to review the Role, Structure and Operations of DFIs and Commercial Banks in the emerging operating environment and suggest changes and to examine whether DFIs could be given increased access to short term funds and the regulatory framework needed for the purpose.

3. **Tarapore Committee on Capital A/c Convertibility (1997)** The Union Finance Minister, Shri P. Chidambaram, in his Budget Speech for 1997-98 had indicated that the regulations governing foreign exchange transactions need to be modernized and replaced by a new law consistent with the objective of progressively liberalizing capital account transactions. Committee on Capital Account Convertibility under the Chairmanship of Shri S.S. Tarapore was appointed. The terms of reference were to review the international experience in relation to Capital Account Convertibility and to indicate the preconditions for introduction of full Capital Account Convertibility and to specify the consequences and time frame in which such measures are to be taken.
4. **Pannir Selvam Committee on NPA (1998)** Banking Division constituted a 3 Member Committee under the chairmanship of Shri A.T. Pannir Selvam, Chairman, IBA and Chairman & Managing Director, Union Bank of India. The terms of reference assigned to the above Committee were Causes of NPAs, factors for slump in recovery of loans; measures to be taken for effective recovery of bank dues and reduction of NPAs and banks anks wise study on factors responsible for the NPAs and banks specific suggestions for recovery.

5. **Narsimhan Committee – Reform II (1998):** Reform of the Indian banking sector is now under way following the recommendations of the Committee on Financial System (CFS), which reported in 1991. The second generation of reform could be conveniently looked at in terms of 3 broad interrelated issues and actions that need to be taken to strengthen the foundation of the banking system and structural changes in the system suggested capital adequacy, asset quality, prudential norms, systems and methods in banks.

6. **RBI Panel on DRT’s (1998)** The RBI had set up Working Group in the month of March 1998 to review the functioning of Debt Recovery Tribunals under the Chairmanship of Shri N.V. Deshpandey. The objectives of the panel were to look into various issues and problems confronting the functioning of DRTs in expeditious recovery of banks dues and to examine the existing statutory provisions and suggest necessary amendments to the Recovery of Debts due to Banks and Financial Institutions Act, 1993 and Rules framed there under with a view to improving efficacy of legal machinery,

7. **Special Report on NPA by RBI (July 1999)** In order to study some aspects and issues relating to NPAs in Commercial Banks, RBI has prepared a report in the Department of Banking Supervision. Shri A.Q.Siddiqui, Chief General Manager, was in charge of this project whereas, Shri A.S. Rao and R.M. Thakkar, both Deputy General Managers, assisted this project. This study has been carried out using the RBI inspection reports on Banks, information / data obtained from public sector banks and 6 private sectors banks and those
collected from the files on borrowable accounts maintained in banks for assessing comparative position on NPAs and their recoveries in banks. The causes for sickness /weak performance and consequently the account turning NPA in respect of Public sector banks and private sector banks.

1.28 LEGAL FRAME WORK AND NOTIFICATION

Globalization has resulted into the rapid transformation of the financial system all over the world. As a result capital market, money market and debt market are getting widened deepened. The growth of financial market has increased the need for innovative instruments for raising funds. There is increasing from investors, for high quality, low risk securities. Today the toughest problem faced by the entire banking industry in India is the NPAs, i.e. the loans, where the principal and interest cannot be recovered, thus the assets stop earning any income.

The unbearable level of NPAs has led to lower interest income and loan loss provisioning requirements which have destroyed the profitability of the banks to great extent. Besides the recycling of funds is restricted, thus leading to serious asset liability mismatches. The supply of credit to potential borrowers have been blocked which is having a harmful effect on the capital formation and hampering the economic activity of the country. So the NPA problem is an issue of public debate and of national priority.

India’s legal system has traditionally been friendly towards borrowers and famously slow and inefficient. In 1993, Debt Recovery Tribunal (DRTs) was set up precisely to avert the said problem, to give bank faster access to justice. In 2002, a major step in empowering banks in their loan recovery effort came in the form of the NPA Ordinance, later turned into the Securitization and Reconstruction of Financial Assets and Enforcement of security Interest (SARFAESI) Act. The Act paves the way for the establishment of Assets Reconstruction Companies (ARCs) that can take the NPAs off the balance sheets of banks and recover them.

Purpose of the Act

Securitization, the process of converting illiquid loans into tradable securities, has emerged as an important tool for financing worldwide. Securitization has gained
increased acceptance in India over the years. Securitization emerged as an important tool for fund raising by Indian Banks and non banking financial institutions. Success of securitization depends upon proper implementation of the Act. Priority sector lending requirement of Indian bank was the key driver behind the retail securitization transaction during 2009. A majority of the retail loan pools securitised in 2009 were backed by priority sector loan originated by NBFCs. Transactions through direct assignment route dominated the market in 2009, as this route facilitates the transfer of priority sector loans directly to the acquirer’s loan book instead of investment book and thereby fulfilling priority sector lending requirement. Unlike the developed countries where Mortgage Backed Securities (MBS) are more prevalent, it is the Asset Backed Securities (ABS) which has been the main driver of securitization market in India, contributing more than 50% of total issuance. In India, underlying assets which have been securitized mainly include commercial vehicle loans, car loans, construction loans, farm equipment loans, three-wheeler loans, consumer durable loans, personal loans, corporate loans, and residential mortgage loans. India’s securitisation issuance includes ABS, MBS, single loan Collateralized Loan Obligation (CLO) and Direct Assignment of loans. Act empowers bank and financial institutions (FIs) to seize the assets charged to them without intervention of the courts and sell them off to realize their loans, which have become NPAs. But the option approaching the DRT, in case the banks or financial institutions do not recover the dues by themselves will always remain open.

**Highlights of the Act / Features of the Act**

1. In case the borrower of an NPA account fails to pay the dues of the bank within 60 days from the date of the notice sent by the bank, the bank can exercise any of the following rights under sub-section 13(4) to recover his secured debt.
   a. Take possession of the secured assets of the borrower and transfer the same by way of lease, assignment or sale for releasing the dues without intervention of the DRT/Court
   b. Take over the management of the borrower’s concern.
c. Appoint a manager or Court Receiver to manage the secured assets

d. Send notice to a third person who has acquired the assets from the borrower without the consent of the bank

2. In case NPA account is a consortium account or under multiple finance the right to enforce securities can be exercised by the banks/Financial institutions, only when secured creditors representing not less than three fourth in value on the amount outstanding are agreeable as laid down in sub-section 13(9).

3. After acquiring the possession of the assets charged to the bank and selling the same and appropriation of scale proceeds towards the dues of the bank, then the bank can approach DRT for recovering the balance amount, if any, from the borrower/ guarantor as laid down in sub-section 13(10).

4. If the bank feels that there can be resistance for acquiring the assets charged to the bank from the borrower, in such a case the bank can approach the concerned Chief Metropolitan Magistrate or the District Magistrate by filing a written request for taking possession of the said assets.(section 14)

5. After issuance of 60 days notice by the bank to the borrower, the borrower shall not deal with the assets which are charged to the bank. However, dealing in the said assets in the ordinary course of business of the borrower is permitted.

6. The provisions of the Act are not applicable to the following transaction:

a. Any security interest created for payment of financial assets not exceeding Rs. 1 lakh

b. Any security interest created over agricultural lands.

c. Any case in which the amount due is less than 20% of the principal amount and interest therein.

d. Pledge of movable assets within the meaning of section 172 of the Indian Contract Act, 1872.
e. Any conditional sale, hire purchase or lease, or any other contract, in which no security interest has been created.

f. Security created in any aircraft under Aircraft Act, 1934.

g. Security created in a vessel under Merchant Shipping Act,

h. Any rights of unpaid seller under Section 47 of the Sale of Goods Act, 1930.

i. Any property exempted from attachment under Section 60 of CPC.

7. This Act has permitted to float assets reconstructions companies which will purchase the NPA accounts from the bank at a discounted price. They will also take over the assets charged by the bank for the particular account for necessary recovery action through reconstruction of the assets or otherwise.

8. Section 17, any person including the borrower may approach DRT by filing an appeal before the DRT within 45 days from the date on which steps have been taken by the bank. But such an appeal shall not be entertained by the DRT unless a specified amount of the outstanding dues of the bank is deposited in the DRT. The right to appeal before DRAT (Debt Recovery Appellate Tribunal) within 30 days is given under Section 18 to any person aggrieved by the order of DRT. The ousts the jurisdiction of the Civil Courts and declares that no injunction shall be granted in respect of any exercise of rights conferred by this ACT.

After the publication of this Act, several borrowers had filed writ petitions in the Supreme Court of India, challenging the validity of the Act. In the landmark case of Mardia Chemical Ltd. & Others vs. Union of India & Others (2004) 120.Comp.Case 373 (SC), the Supreme Court has upheld the validity of the Act. Some salient features of the judgement are:

- The Court directed that the banks should evolve appropriate internal mechanism to thoroughly resolve the contentions raised by the borrower. The bank should apply its mind to the objections and communicate its reasons to the borrower. This shall be an act of fairness on the part of the bank.
The court held that banks and financial institution have been provided with guidelines by the RBI laying down the terms, conditions and circumstances in which the debt is to be classified as non-performing assets. Hence, there is no arbitrary illusory. It is also unreasonable and violation of Article 14 of the constitution.

Section 34 of the Act lays down that Civil Courts have no jurisdiction to entertain any suit in respect of any matter which DRT or DRAT (Debts Recovery Appellate Tribunal) is empowered to deal with. The court has upheld the validity of these provisions.

Accordingly, the Supreme Court upheld the whole of the Act excluding Section 17 (2).

The SARFAESI Act and the action of creditors have been challenged in the courts almost immediately. In a decision in Mardia Chemicals Vs ICICI case, the Supreme Court upheld the Act in 2004, tilting the balance for the banks. Meanwhile the RBI has been encouraging the banks to use the provisions of the SARFAESI Act. Ever since the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests (SARFAESI) Act came into play, banks and financial institutions have had a mixed experience. The initial brouhaha over this devise to plug the burgeoning non-performing assets (NPAs) in the country was stonewalled by Mardia Chemicals, whose legal acumen persuaded the Supreme Court to pass a temporary order permitting banks to take over the assets hypothecated but not dispose them. This halfway house still continues. A decision was expected on September 15, but Mardia Chemicals is proving to be very tenacious litigant.

The intent of the Act is to provide a remedy to the secured creditors to minimise their NPAs. It is nobody's case that any bank or financial institution would take over a cement plant, a boutique or a hotel and actually run it. It would be handed over to an asset reconstructing company (ARC) at the earliest opportunity which, in turn, would ensure that the bank or financial institution obtains its pound of flesh from the asset. The ultimate aim of the secured creditor would be to ensure that some money hits the account of the borrower.
The less litigious-minded among the defaulters' list have ensured that some repayment has been made to creditors who contemplate action under the SARFAESI Act. Hence, it all boils down to the willingness of the borrower to pay up. This is precisely the reason why certain chambers of commerce have suggested that the Act should only be made applicable to wilful defaulters. Although a thin line of difference exists between a wilful and a non-wilful defaulter, it remains a fact that a non-wilful defaulter would prefer to dispose of an asset that is bleeding him all over than hang on to the asset by taking protection from any available court in the land.

With a view to help the Banking sector to overcome the mounting 'non performing assets', Banks have been vested with enormous powers in the matter of enforcing their security interest under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. The Civil Procedure Code 1908 was enacted for enforcing substantive civil rights and it was ruling the field for several decades. It was realized later that litigation through the Civil Procedure Code was virtually defeating the process of rendering justice in view of abnormal delays and technicalities in following the Code. Added to that enormous increase in litigation caused serious concern and therefore measures were initiated to have procedures which could render justice without delay. Banks and financial institutions are the custodians of public money and there was a need to rotate the money for the public good. Non-Performing Assets (NPA) is a loss to the economy. When the SARFAESI Act was enacted in 2002, the NPA stood at Rs. 1.10 lakh Crores and were threatening the balance of economy.

In this background the Government of India had appointed the Narasimham Committee for studying and recommending the ways and means for quick recovery of the public money locked up in NPAs. In furtherance of the recommendations of the Narasimham Committee, the Recovery of Debts by Banks and Financial Institutions Act 1993 was enacted with much hope that the said Act would enable quick recovery of NPAs by Banks and Financial Institutions. However the Act (DRT Act) failed to yield the desired result. In Transcore, the Supreme Court itself has taken note of the failure of the DRT Act by observing Further in cases where the debt is secured by pledge of shares or immovable properties, with the passage of time and delay in the DRT proceedings, the value of the pledged assets or mortgaged
properties invariably falls. On account of inflation, value of the assets in the hands of the bank/FL invariably depletes which, in turn, leads to asset liability mismatch. These contingencies are not taken care of by the DRT Act and, therefore, Parliament had to enact the NPA Act, 2002."

Enactment of SARFAESI Act

In the above background the policy makers and legislators realized the need for further measures for the quick recovery of NPAs, and to empower Banks and Financial Institutions to recover the NPAs without intervention of judicial process. In that process guidance was found from Section 69A of Transfer of Property Act and State Finance Corporation Acts, where there is provision for the sale of secured assets without the intervention of Courts. In that process Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (SARFAESI) was enacted. The SARFAESI Ordinance 2002 was promulgated on the 21st June 2002 to regulate securitization and reconstruction of financial assets and enforcement of security interest and for matters connected therewith or incidental thereto. The provisions of the Ordinance would enable banks and financial institutions to realize long-term assets, manage problem of liquidity, asset liability mismatches and improve recovery by exercising powers to take possession of securities, sell them and reduce nonperforming assets by adopting measures for recovery or reconstruction." SARFAESI Act Section 13 empowers the Banks/Financial Institutions inter alia to take possession and effect sale of the secured assets. After the enactment of the SARFAESI Act, like any other new legislation it was subjected to judicial scrutiny and interpretation to settle down the legal position. Two most important cases in that process are Mardia Chemicals Ltd v. Union of India (2004 (4) CTC 759; 2004 (4) SCC 311) and Transcore v. Union of India & Anr7 2006 (5) CTC 753; AIR 2007 SC 712) wherein the Supreme Court had settled the legal position substantially with regard to the SARFAESI Act and made the rigor of SARFAESI Act for the recovery of NPAs effective in letter and spirit. SARFAESI Act is simply a procedural enactment like CPC and it seldom deals with substantive rights on the properties. In effect SARFAESI Act, explicitly or by implication overrides all other earlier procedural laws for the recovery of NPAs. To be more specific Banks and Financial Institutions
In Transcore case the Supreme Court has held in: “In our view, Section 17(4) shows that the secured creditor is free to take recourse to any of the measures under Section 13(4) notwithstanding anything contained in any other law for the time being in force, When the Supreme Court compared State Revenue law with the SARFAESI Act it sent wrong signals as if the SARFAESI Act overrides even the substantive laws. The Bench analysed the Rules empowering the Recovery Officer to put the auction purchaser in possession of the properties. (Rule 40). The Bench also considered the rules which permitted the Recovery Officer to put back in possession any person who other than the defaulter claiming in good faith to be in possession of the property on his own account or on account of some person other than the defaulter. (Rules 44 to 47)

Secondly they drew an analogy with the provisions of CPC and held that the Rules framed under the ITCP Rules largely correspond to the relevant Rules occurring under Order 21 of the Code of Civil Procedure relating to the execution of a decree. They held that Rule 39 of the ITCP Rules corresponds to Order 21 Rule 95 C.P.C. which deals with delivery of possession in occupancy of judgment debtor and Rule 40 of the ITCP Rules corresponds to Order 21 Rule 96 C.P.C. They were of the view that Rule 40 of the ITCP Rules dealing with the case where the property is in occupation of the tenant or other person entitled to occupy the same in his own right contemplates only symbolical possession to the auction purchaser and the tenants (who are strangers to the decree) cannot be evicted by the Recovery Officer by issuing an order directing them to vacate the properties forfeiting their rights under the relevant provisions of the Rent Control Law.

Limitations of the Act

1. The legislation empowers one party to the dispute, i.e. the creditor to take action without due judicial process against the other party. The bank and FIs in their eagerness to recover NPAs may violate the fundamental rights of the borrowers. The borrowers can approach the DRTs in case of grievances, but it amounts to post corrective measure as the Act allows the banks and securitisation companies to initiate action.
2. In case of enforcement of their claims by banks/FIs under this Act, they do not examine the validity of the charge nor are they empowered to do so. Therefore, in the rarest case of defective charge also the recovery shall take place.

3. The main object of the Act is fast recovery of debts. But the Act provides for appeal over appeal, which is lengthy judicial process and leads to delay in execution proceedings.

4. It will be difficult for banks to sell distressed assets as there are few takers for such assets.

5. The Act empowers the banks to take over the management of defaulting companies. Banks are not skilled enough to run any business activity with guaranteed success.

6. In case of enforcement of claims in consortium advances the creditors can enforce only on the consent of the other creditors having minimum 75% share in the loan whereas enforcement of claim though DRT/Civil Court can be initiated by a single creditor by adding other creditors as respondents in the case.

7. In case of sale of seized assets, the seller and the beneficiary will be the same. The sale of secured assets by banks at a value enough to cover their dues would be adequately self serving, but it may appear to be unfair to the stakeholders.

8. The Act provides to take help from the district administrative machinery for enforcement of security interest is an impractical stipulation. As our district administrative machinery is even unable to provide assistance even to the DRTs for the recovery work.

9. Valuation of assets and binding process can trigger legal cases. There may be lack of unanimity among lenders, as all lenders holding at least 75% stake in outstanding dues are required to agree to sell the assets of defaulters.
10. The appointment of a manager for the management of acquired assets, in consultation with the borrower, whose assets have been seized by the banks, is a utopian idea.

**SARFAESI (Amendment) Ordinance- 2004**

In the light of the Supreme Court judgment in the Mardia Chemicals Vs ICICI Bank Ltd, the Government promulgated the Ordinance to amend certain sections of the Act, which has been passed by the Parliament in December, 2004.

**Highlights of the changes are as under:**

a. Amendment in Section 13: On receipt of the notice if the borrower makes any representation or raises any objection, the secured creditor shall consider such representation or objection and shall communicate within one week of receipt of such representation to the borrower.

b. Amendment in Section 17: The borrower may make an application to the DRT if the secured creditors have not accepted his representation or objection. Any application made by the borrower shall be dealt with by DRT, as expeditiously as possible and to be disposed of within 60 days from the date of such application. If the application is not disposed of by DRT within the period of 4 months, any party to the applicant may make an application to the DRAT for directing the DRT for expeditious disposal of the application.

c. Amendment in Section 18: No appeal shall be entertained by DART unless the borrower has deposited with it 50% of the amount of debt due from him, as claimed by the secured creditor or determined by the DRT, whichever is less. DRAT may reduce the amount upto 25% of the debt.

1. The Act is term as comprehensive and extraordinary piece of legislation. The only way to put a stop to NPA problem is to attack the problems which are in built in the system like lack of infrastructure, liberal terms of financing, holding the managers personally responsible for any laziness and negligence on their part.
2. As Justice B.P. Banerjee puts in: “The Act does not provide a magic wand to remove the sickness in the industry, it can, at the best, be looked upon a transient phase in the culture of financing”

3. The Act gives sweeping powers to banks and FIs to seize the assets charged to them and realize their loans without any intervention of the Court. It is a tool and not a weapon in the hands of the banks to shoot the defaulters”.

Taking over the defaulters personal assets where the wilful defaulters has siphoned out the assets under the banks charge needs to be taken in the long run if the Act fails to deliver the required result. Since the NPA is an integral part of the operational risk the government provided a legal frame work through which banks can transfer the NPAs to a separate entity called Special purpose Vehicles (SPV) which is private owned Asset Management Companies (AMC).

4. The major originators/issuers of securitisation transactions have been more private Banks, NBFC and Housing Finance Companies (HFCs). Major investors in securitisation transaction have been public and private sector banks, mutual funds and insurance companies. The single loan CLO transaction involved a bank giving a loan to a corporate the receivables were then securitized immediately using a Private Trust Company (PTC) structure and formation of a trust. Securitization can serve as an important capital adequacy management tool for such banks. Banks can free up capital by securitizing their illiquid loan assets.

5. In earlier years, securitization was used as a tool to book profit upfront at the time of transaction as all the risks and rewards were transferred to the investors. However, in February 2006, the RBI released guidelines on securitization, which required amortization of profit over the tenure of the transaction, thereby removing the upfront profit booking incentive. The guidelines also required the originator to split the transaction credit enhancements to be reduced from capital funds.
6. Indian banks are expected to benefit immensely from the judicious use of the securitization tool to free capital, generate liquidity and manage assets and liabilities.

The origination of NPAs in Indian banking landscape can be broadly classified into two stages:

Pre-liberalization era:

In the context of accretion to NPAs in the banking system, contributory factors during this period were mainly the following:

- Down swings in agricultural sectors triggered by monsoon vagaries bringing about all round economic and demand recession
- Industrial licensing: The scale of economy in relation to international standards was compromised leading to high capital cost per unit of production. This was often said to be off-set by lower labour cost, but in reality labour productivity coupled with application of robotics outweighed the benefit from labour cost in the Indian context.
- Sector wise reservation: Reservation for major sectors for investment by (GOI) in the public sector structure in post independence days became necessity due to various reasons including non-availability of private capital.
- Controlled interest rate: In the controlled interest rate regime, banks were not in a position to price the risk premium. This led to cross subsidization across the risk profile of the loan assets. Although additional collaterals were taken risky loan assets, in the absence of favourable legal system, the banks were not in a position to realize value from these collaterals.
- Tariff protection: In the absence of long-term tariff policy, it was difficult for the banking system to establish viability of the project with any degree of certainty during the loan payback period.
- Role of Development Financial Institutions (DFIs): The DFIs played a predominant role in the growth financing during the pre-liberalization era. This model became unsustainable as they started facing the difficulty in raising funds.
In a way the DFIs in India played the role of Venture Capital (VC) funding without capturing the possible upside the model. The success of DFIs can therefore be compared only with VC funding.

Post- liberalization era:

India’s macroeconomic policies were conservative until early eighties. Accompanied by some liberalization in the form of de-licensing of select industries permitted change in the product mix within the overall capacity and creeping relaxation of imports, during mid eighties, the Indian economy registered the average growth rate of 5.3 percent per annum (sixth five fear plan), much higher than the average growth of 3.5 percent per annum during the previous three decades. With the commencement of reform of the economy in 1991, banks were to follow the Basel Accord. Consequently RBI issued first set of comprehensive guidelines for Income Recognition and Asset Classification (IRAC) in April 1992. The central bank, with a cautious move, adopted time based provisioning method; and averted a near situation by not imposing write-off the entire loan asset impairment amount based on present value of realizable cash flow upon recognition of NPA. The banking system in India places significant importance on tracking net NPA as percentage of gross assets. Net NPA percentage is important for regulatory purpose; it does not capture the shareholders perspective. The focus should be on recovery of gross NPA including fully written off accounts in present value terms using cost of carrying NPA as the discounting factor at minimum value if not the opportunity cost.

1.29 OPERATIONAL EFFICIENCY OF BANKS AND NPAS OCCURRENCE IN BANKS

Rangarajan (1997)[45], Training Centre of the Nepal Rashtra Bank Katmandu on 18th May 1997 addressed in his speech in respect of “direct lending, there is a prescription that 40% of the net bank credit should go to priority sector such as agriculture, small scale industries, small business man and programmes for poverty alleviation without affecting the viability and profitability of the bank. Speaker emphasized on operational efficiency and allocation efficiency. Operational efficiency relates to the transaction cost and allocation cost deals with the mobilized funds among competing demand. Governors speech covered aspects such as Global
experience, reforms undertaken in India, Philosophy, strategy, policy frame work, improvement in financial health, and institutional strengthening in India.

**Bimal Jalan(2001)[46]**, Governor RBI, in s speech titled “Banking and Finance in the New Millennium” delivered at 22nd Bank Economists Conference, New Delhi, 15th February, 2001 cited “As regards internal factors leading NPAs, the onus rest with the banks themselves. This calls for organisational restructuring improvement in managerial efficiency, skill up gradation for proper assessment of creditworthiness and a change in the attitude of the banks towards legal action which is traditionally viewed as a last resort. Highlight of the speech was setting up of independent Settlement Advisory Committees headed by retired judge of the High Court to scrutinise and recommend compromise proposals and appointment of Lok Adalat, Debt recovery Tribunal, and circulation of Information on defaulters, Asset Reconstruction Company to negotiate with banks and financial institution for acquiring distressed assets and develop markets for such assets.”

**Muniappan(2002)[47]**, Deputy Governor, RBI at CII Banking Summit 2002 at Mumbai on April, 2002 “It is not any more Lenders problem alone equally that of borrowers to” was cited in context of SARFAESI Act being brought into force Mr. Muniappan, in his article, “The NPA Overhang: Magnitude, Solutions, and Legal Reforms” concludes at the end of the articles “I am of the opinion that NPAs are avoided at the initial stage of credit consideration by putting in its place rigorous to appropriate credit appraisal mechanism and mindset of the borrower needs to change regarding credit utilization and repayment modes”. Deputy Governor concluded in his summit “NPAs are avoided at the initial stages of credit consideration by putting in place rigorous and appropriate credit appraisal mechanism. Finally both lenders and borrowers should realize their role and responsibilities. They should contribute to healthy financial system.

**Report of the Fourth International Conference on Ethiopian Economy (2006)[48]**, Banks play a very important role in economic development of every nation. Banks are the main stimulus of the economic progress of a country. The study deals with the NPAs in commercial banks of Ethiopia. Essentially deals with the provision for doubtful debts are one among the most important cause for reducing the
profitability of the bank. And also highlights NPA is a double-edged weapon, which affects bank profitability due to interest income not being recognized on NPA accounts and loan loss previously to be created from profit earned.

Leeladhar (2007)[49], Basel II: Implementation Challenges in Banks in association with the Federal Reserve Bank New York, organised by NIIBM on Jan 15th & 16th, 2007, Mumbai brought an insight for the need and implementation of Basel. He also emphasised globally stress testing is becoming an integral part of banks’ risk management system. For achieving an effective Basel II implementation in the Indian banking system and to reap the full benefits of the migration to the revised framework, it is essential for banks to ensure meaningful implementation of the various important elements and concluded his speech saying board and senior management involvement is critical.

1.30 SIGNIFICANCE OF THE STUDY

Providing loans for economic activities is the social responsibility of banking. Credit dispensation activity is considered to be major part of funding apart from raising resources through fresh deposits, borrowings and recycling of funds received back from borrowers. Lending is generally encouraged because it has the effect of funds being transferred from the system to productive purposes, which results into economic growth. However lending involves credit risk, which arises from default by the borrowers. The process of credit cycle is affected by non-recovery of loans along with interest. Thus, loan losses and requirement of provisioning for loss affect the banks profitability on a large scale. Though complete elimination of such losses is not possible, but banks can always aim to keep the losses at a low level.