CHAPTER - IV
NON – PERFORMING ASSETS
INTRODUCTION:

4.1.1. INTRODUCTION:
The term “NPA” stands for Non – Performing Assets. In banking sector Non – Performing Assets means an account of borrower and performance of said account is not satisfactory. It means the installment of loan amount and interest thereon is not remitted to the bank by account holder during the last three months or more. The Non Performing Asset has drawn the attention of banks, govt., public, borrowers and academician seen as a barometer of banking performance. The NPA management is gaining significance day by day. The NPA nowadays is considered as a major problem in banking and other financial institutions. It creates of fear and worry among the bankers and financing agencies, if its level goes up. “The level of NPA of a bank is considered to be the measure of its assets quality and in turn its performance and rating. Increasing NPAs not only affects the probability & liquidity of the banks but also forces the banks to maintain more liquid assets which increase in cost.”

The quantum of losses by NPAs is measured in Gross and Net NPAs. The NPAs are basically categorized into two types:

4.1.2. a) Gross NPA: Gross NPA is the total of all the loan assets that are classified as NPA as per RBI guidelines as on balance sheet date. The ratio of Gross NPA to Gross Advances indicates the quality of credit portfolio of the bank. The ratio can be used to determine main contributing factors for high NPA in the bank at different levels of loan sanctioning authorities. High ratio indicates low and poor quality of credit portfolio adopted by the bank. Gross NPA reflects the quality of loans made by the banks. It consists of all the non standard assets like sub-standard, doubtful and loss assets. It can be calculated with the help of following ratio:

\[
\text{Gross NPA Ratio} = \frac{\text{Gross NPA}}{\text{Gross Advances}}
\]
4.1.3. b) **Net NPA:** Net NPA is the sum of all the loan assets after subtracting provisions from gross NPAs and gross Advances. This indicates the degree of risk in the credit portfolio of the bank. The high ratio exhibits high risk. Net NPAs shows the actual burden of banks. Since the Balance sheet of Indian banks contains a huge amount of NPAs, the heavy and bulky provisions have to be made against NPAs by the banks because the process of recovery and writing off of loans is very time consuming. Because of that reasons the degree of difference between Gross and Net NPAs is always remains at a very high level. The Net NPAs can be calculated as follows:

\[
\text{Net NPA} = \text{Gross NPAs} - \text{Provisions \ or \ Gross Advances} - \text{Provisions}.
\]

The profit and profitability are considered as important parameters of performance in banking organisations. It is generally observed that the higher NPA level, the lower is the profitability of the banking institutions. Therefore, it is necessary to apply proper strategies by the banks in order to reduce NPAs.

The piling up of huge non-performing assets in banks has assumed greater importance. The Gross NPA reflect the quality of the loans given the banks whereas net NPA indicates the definite feasible burden of banks. The banks and financial institutions have to take the some corrective measures and initiative to reduce the quantum of NPAs in a stipulated time by framing a very sound strategic approach. The rising NPA is a matter of concern in the industry and academic circles because it is felt that NPAs impact reduces the profitability of banks, weaken its financial health and erode its solvency. For the recovery of NPAs a broad framework has to be evolved for the management of NPAs under which several options are provided for debt recovery and restructuring. Banking Institutions to designs and implement their own policies for recovery and write-off incorporating compromise and negotiated settlements.

Since the basic and primary aim of any Business organization is to make profit, therefore, any Asset created in the course of the conduct of business should generate income for the Business. The Banks deal mainly in money, by accepting Deposits (Liabilities) and out of such Deposits (Liabilities) Lend/Create Loans (Assets). If for any reason such recovery is no done then the very position of the Banks in repaying the Deposits (Liabilities) on the due dates would be in jeopardy. Banks with such Assets portfolio would become weak and naturally such weak banks will lose the faith and confidence of the investors.
There is a growing awareness to bring down Non-Performing Assets as these are having adverse impact on their profitability due to de-recognition of interests as well as requirement of heavy loan loss provision on such Assets. Therefore, it is necessary for Banks to manage their Assets in such a manner that they always remain healthy, generate sufficient income and capable of repayment on the due dates. Management of Performing / Non-Performing Assets in Banks is an ‘Arts and Science’. In the changing business scenarios management of Non-Performing Assets has nowadays become a crucial performance area for Banks. The Indian Banks are trying for the international standard in terms of efficiency, productivity, profitability, asset reorganization norms provisioning and capital adequacy to compete in competitive and global economy.

At present any borrowed account not serviced for either interest or principal for at least ‘Three Month’ be termed as Non-Performing Asset or NPAs. Reserve Bank of India has been implementing straight rules and regulations for assets classification of Non-Performing Assets from year to year.

The Non Performing Asset results in erosion of Banks Profitability, Stagnation in the economy and weakness of the Equity Investment. Banks are now required to recognize such loans faster and then classify them as problem Assets. Close to 16% of loans made by Indian Banks are NPAA’s – very high compared to say 5% in banking system in advanced countries.

Banks are not allowed to book any income from NPA or keep money aside in case they can’t collect from the borrower which impacts profitability adversely.

The banks Non-Performing Assets management has assumed the crucial importance and receiving focused attention on all levels. Many banking companies are adopting steps like enhancing retail loan portfolio, reducing Non Performing Assets and adopting latest technology to improve their performance.

The ability of a bank is largely determined by its recovery of loans, otherwise there will be stagnation in the credit flow. The delay and blocking of funds with borrowers hampers the process of credit recycling. The credit recycling is being considered as one of the major bottleneck in smooth functioning of banks and as a component of financial system of a nation. This has necessitated the bank and the government to keep a close watch on such advances that are getting converted into NPA. “The concept of Non-Performing
Assets came into existence with the recommendations of Narsimham Committee implemented by RBI in 1992. The most dominant area of improvement in the profitability of banks continues to be reduction of NPAs. No other problem in banking sector, especially UCBS, is as serious as the NPA problem. An asset becomes non-performing when it ceases to generate income for the bank.”

The Govt. through RBI has been vigilant and issued guidelines for the banks to improve the recovery from time to time. “The RBI has played a very important role in strengthening as well as preparing the Indian banks for the future. Through its guidelines, at different points of time, RBI has addressed the anomalies, if any, in the banking system. Also through its effective monetary management, it has put in place the right condition to improve the economic growth. The good performance of the Indian economy in the world surely would not have been possible without RBI’s effective monetary and the important contribution made by the Indian banks.”

The effective RBI guidelines enabled Indian Banks to keep NPAs under control and equipped them to compete at international level. “The Indian Banking industry may now compare itself reasonably well with the rest of Asia in some areas like growth, profitability and low rate of non-performing assets.”

4.2. DEFINITION OF NON – PERFORMING ASSET:

According to the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Ordinance, 2002, Non – Performing Assets (NPA) means “An Asset or Account of borrower, which has been classified by a Bank or Financial Institution as Sub- Standard, Doubtful or Loss Asset, in accordance with the directions and guidelines relating to the asset classifications issued by the Reserve Bank of India.”

According to Reserve Bank of India the Non – Performing Asset (NPA) referred to:-

A non performing asset (NPA) is a loan or advance where;

i) interest and/ or installment of principal remain overdue for a period of more than 90 days in respect of a term loan,

ii) the account remains ‘out of order’ in respect of an Overdraft/Cash Credit (OD/CC)
iii) the bill remain overdue for a period more than 90 days in the case of bills purchased and discounted.

iv) The installment of principal or interest thereon remains overdue for two crop seasons for short duration crops,

v) The installment of principal or interest thereon remains overdue for one crop season for long duration crops,

vi) The amount of liquidity facility remains outstanding for more than 90 days in respect of a securitization transaction undertaken in terms of guidelines on securitization dated February 1, 2006.

vii) In respect of derivatives transaction, the overdue receivables representing positive mark-to-market value of a derivative contract, if these remains unpaid for a period of 90 days from the specified due date for payment.6

There are several reasons for an account becoming Non Performing Assets, these include Sluggish Legal System, Funds borrowed for a particular purpose but not used for the said purpose, Project not completed in time. “The latest annual report published by Indian Banks’ Association reveals that the private banks of the country have successfully increased profitability by 41.9% from Rs.3,533 crore in 2005 to Rs.5,014 crore in 2006, as they have brought down the value of Non – Performing Assets (NPA) by 23.3% from Rs.4094cr to Rs.3141 crore.”7

4.3. Causes of NPA: There are two basic sets of factor that causes NPAs in the banks:

a) Internal Factors: The internal factors causing NPAs include – managerial ineffectiveness, deficiencies in mechanism, business failure, inappropriate technologies, poor appraisal system, improper SWOT analysis, product obsolescence, diversion of funds for unproductive purposes and absence of regular industry visits.

b) External Factors: The external factors causing NPAs include – improper and inefficient recovery drives and tribunals, natural calamities and accidents, industrial sickness, lack of demand, labour problem and changes in both government economic policies and technologies.
Apart from these two sets of factors, experts have given some other reasons that cause NPAs in the banking sector:

a) The slow, inefficient and lengthy legal system.
b) Diversion of funds.
c) Demand recession.
d) Depressed capital market.
e) Environment & pollution control measures.
f) Fear psychosis among banks for compromise settlement.
g) Improper & inadequate credit appraisal.
h) Poor post loan supervision & follow up.
i) Political compulsion & corruption etc.

4.4. CLASSIFICATION OF ASSETS:-

In line with RBI guidelines from time to time the loans given by Banks are classified as Performing and Non – Performing for the purpose of income recognition and provisioning. “The criteria for NPA recognition have become stricter over years. RBI reports that it is due to improvements in the payment and settlement system, recovery climate and upgradation of technology in the banking system, etc. these stricter guideline are increased”

The RBI has redefined the NPAs and has advised the banking sector to bifurcate their advances into four categories, viz: standard assets, sub-standard assets, doubtful assets and loss assets.

4.5. PERFORMING / STANDARD ASSET:

Loan assets in respect to which interest and principal are received regularly are called standard or performing assets. Standard assets also include loans where arrears or interest and / or principal do not exceed 180 days at the end of a financial year. No provision is required for such loans.
4.6.1. **NON – PERFORMING ASSETS:-**

According to Reserve Bank of India rules, any loan repayments, which are delayed beyond 90 days to be identified as a NPA’s.

4.6.2. **NPA’s are further classified into:**

2. Doubtful Assets.
3. Loss Assets.

4.6.3. **Sub – Standard Assets:**

The Sub – Standard Assets are those assets, which are Non – Performing for a period of not exceeding two years. Also, in cases where the loan repayment is rescheduled, RBI has asked banks to recognize the loans as sub – standard at least for one year.

In case of Sub – Standard Assets, the current net worth of the borrowers / guarantors or the current market value of the security charged is not enough to ensure the recovery of the dues to the banks in full. In other words, such assets will have well defined credit weakness in jeopardize the liquidation of debt and are characterized by the distinct possibility that the bank will sustain some loss, if deficiencies are not corrected.

An asset where the term of loan agreement regarding interest and principal have been renegotiated or rescheduled after commencement of production, should be classified as sub – standard and should remain in such category for a least Eighteen months of satisfactory performance under the re-negotiated or rescheduled terms. However, the period of Eighteen months may be reduced to one year (or four quarter) if the interest and installment of loans have been services regularly as per the terms of re-schedulement. In other words, the classification of an asset should not be upgraded merely as a result of rescheduling, unless there is a satisfactory compliance of this condition.

4.6.4. **Doubtful Asset:-**

Loans which have remained Non – Performing for a period exceeding two years and which are not considered as loan assets with effect from 31st March 2001, an asset required to be classified as doubtful, if it has remained in the sub-standard category for
Eighteen Months. As in the case of Sub – Standard Assets, rescheduling does not entitle the bank to upgrade the quality of an advance automatically.

A loan is classified as doubtful has all the weakness inherent as that classified as sub-standard, with the added characteristics that the weakness make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

A major portion in this category is related to ‘Sick’ companies referred to the Board for Industrial and Financial Reconstruction (BIRF) and awaiting finalization of rehabilitation packages.

With effect from 31st March 2005, an asset is being classified as doubtful, if it remained in the sub – standard category for 12 months. Banks are permitted to phase the consequent of additional provisioning over a four-year period commencing from the 31 March 2005, with a minimum of 20 percent.

4.6.5. Loss Assets:-

A Loss Asset is one where loss has been identified by the Bank or internal or external auditors or by the Co-operation department or by the Reserve Bank of India inspection but the amount has not been written off, wholly or partly. In other words, such an asset is considered un-collectible and of such little value that its continuance as a bankable assets is not warranted although there may be some salvage or recovery value.

4.7.1. A. GUIDELINES FOR THE CLASSIFICATION OF AN ASSETS

BASIC CONSIDERATION:-

i) Broadly speaking, classification of assets into above categories should be done taking into account the degree of well-defined credit weakness and extent of dependence on collateral security for realization of dues.

ii) In respect of accounts where there are potential threats to recovery of account of erosion in the value of security and existence of other factors such as frauds committed by borrowers, it will not be prudent for the banks to classify them first as sub – standard and then as doubtful after expiry of Eighteen months (Twelve months with effect from 31st March 2005) from the date the account
has became a NPA. Such accounts should be straight away classified as
doubtful asset or loss asset as appropriate, irrespective of the period for which it
has remained a NPA.

4.7.2. B. ADVANCES GRANTED UNDER REHABILITATION PACKAGES
APPROVED BY BIFER / TERM LENDING INSTITUTIONS:

i) Banks are not permitted to upgrade the classification of any advance in respect
of which the terms have been re-negotiated unless the package or re-negotiated
terms have worked satisfactorily for a period of One year. While the existing
credit facilities sanctioned to a unit under rehabilitation packages approved by
BIFR / Term Lending Institutions will continue to be classified as sub –
standard or doubtful as three case may be in respect of additional facilities
sanctioned under the rehabilitation packages the Income Recognition and Asset
Classification norms will become applicable after a period of One year from the
date of disbursement.

ii) A similar relaxation is made in respect of Small Scale Industry units which are
identified as sick by Banks themselves and where rehabilitation packages /
nursing programs have been drawn by the banks themselves or under
consortium arrangement.

4.7.3. C. INTERNAL SYSTEM FOR CLASSIFICATION OF ASSETS AS NPA.

i) Banks should establish appropriate internal system to eliminate the tendency to
delay or postpone the identification of NPAs, especially in respect of high value
accounts. The Banks may fix a minimum cut-off point to decide what would
constitute a high value accounts depending upon their respective business
levels. The cut-off point should be valid for the entire accounting year.

ii) Responsibility and validation levels for ensuring proper asset classification may
be fixed by bank.

iii) The system should ensure that doubts in asset classification due to any reason
are settled through specified internal channels within One month from the date
on which the account would have been classified as NPA as per extant guidelines.

iv) RBI would continue to identify the divergences arising due to the non-compliance, for fixing accountability. Where there is willful non-compliance by the official responsible and is well documented, RBI would initiate deterrent action including imposition of monetary penalties.

4.8. Solving NPA Problem through Securitization Act

Handling of NPA is the greatest problem for the banking sector not only in India but all over the world. The problem is predominantly acute in India with NPAs according to thousands of Crores. The strengthening NPA cut off funds to potential borrowers thereby affecting the capital formation and limit the optimal use of one of the important factors of production and capital. The piling up of NPA levels is devastating, it reduces interest income, increases provisioning, erases in capital and the competitiveness of the bank.

The Government and the Banks are taking a lot of efforts to address the serious problems posed by the NPA. The Debt Recovery Tribunal (DRT) was set up to recover the bad loans. The banks now offers one time settlement scheme to settle the problems once and for all with the defaulting borrowers. Though the tribunal and the schemes were partly successful, they did not go to the extent of solving the problems. The Government also came up with the ultimate weapon, The Securitization Act. The Act empowered banks to change or takeover the management or even take possession on the secured assets of borrowers and sells or lease out such assets. For the first time, banks can take over immovable assets or the defaulting borrower without intervention of the court, claim future receivables, and supersede the Board of Directors.

When this act became enforceable, notices were sent to thousands of defaulting borrowers. Some of the borrowers who did not respond earlier started responding positively and the cash recoveries started becoming a reality.

“As banking sector reform represent the financial sector, they are necessary for faster economic growth to meet the emerging challenges. To improve the adverse situation in banking; banking sector reforms were introduced in 1991 and 1998 by the committee under the chairmanship of Mr. Narasimham"
4.9.1. PROVISIONING NORMS:

Norms for provisioning on Loans and Advances are as under;

1. In conformity with the prudential norms, provision should be made on the non-performing assets on the basis of classification of assets.

2. Taking into account the time lag between an account becoming doubtful or recovery, its recognition as such, the realization of the security and the erosion over time in the value of the security charged to the Bank, the Banks should make the provision against loss assets, doubtful assets and sub – standard assets as below:-

4.9.2. i) Loss Assets

   a. The entire assets should be written off after obtaining necessary approval from the competent authority and as per the provision of the co-operative societies Act/Rules. If the assets are permitted to remain in the books for any reasons, 100 percent of the outstanding should be provided for.

   b. In respect of an asset identified as a loss asset, full provision at 100 percent should be made if the expected salvage of the security is negligible.

4.9.3. ii) Doubtful Assets

   a. 100 percent of the extent to which the advantage is not covered by the realizable value of the security to which the bank has valid recourses should be made and the realizable value is estimated on a realistic basis.

   b. In regard to the secured portion, provision may be made on the following basis, at the rates ranging from 20 percent to 30 percent of the secured portion depending upon the period for which the asset has remain doubtful.

<table>
<thead>
<tr>
<th>Period</th>
<th>Amount of Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to One Year</td>
<td>20%</td>
</tr>
<tr>
<td>One to Three Year</td>
<td>30%</td>
</tr>
<tr>
<td>More than Three Year</td>
<td>100% of the outstanding irrespective of the security available</td>
</tr>
</tbody>
</table>

There has been a change in the norms in different periods according to the RBI guidelines. The following tables show the provision requirement for Tier I and Tier II banks.

**Tier I.**

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Period for which the advance has remained in ‘doubtful’ category</th>
<th>Provision requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>01.</td>
<td>Up to one year</td>
<td>20 per cent</td>
</tr>
<tr>
<td>02.</td>
<td>One to three years</td>
<td>30 per cent</td>
</tr>
<tr>
<td>03.</td>
<td>(i) More than three years (D - III)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Outstanding stock of NPAs as on March 31, 2010.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(ii) Advances classified as ‘doubtful for more than three years’ on or after April 1, 2010.</td>
<td></td>
</tr>
</tbody>
</table>

**Tier II**

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Period for which the advance has remained in ‘doubtful’ category</th>
<th>Provision requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>01.</td>
<td>Up to one year</td>
<td>20 per cent</td>
</tr>
<tr>
<td>02.</td>
<td>One to three years</td>
<td>30 per cent</td>
</tr>
<tr>
<td>03.</td>
<td>More than three years (D - III)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(i) Outstanding stock of NPAs as on March 31, 2007.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(ii) Advances classified as ‘doubtful for more than three years’ on or after April 1, 2007.</td>
<td></td>
</tr>
</tbody>
</table>

(Source: RBI Master Circular – UBD, PCB, MC. No. 3 / 09.14.000 / 201-11 dated July 1, 2010.)

**4.9.4. iii) Sub – Standard Assets**

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

b. “10% of secured exposure and 20% of unsecured exposure need to be provided in respect of Sub – Standard Assets with effect from 31.03.2005.” 10
4.9.5. vi) Standard Assets

<table>
<thead>
<tr>
<th>Assets</th>
<th>Percentage of Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture and SME sectors</td>
<td>0.25%</td>
</tr>
<tr>
<td>Housing loans above Rs. 20 lacs</td>
<td>1.0%</td>
</tr>
<tr>
<td>*Personal loans (including Credit Card Loans)</td>
<td>2.0%</td>
</tr>
<tr>
<td>*Loans qualifying as capital market exposure</td>
<td></td>
</tr>
<tr>
<td>* Commercial real state</td>
<td></td>
</tr>
<tr>
<td>All other advances</td>
<td>0.40%</td>
</tr>
</tbody>
</table>

**Source:** (S. Murali and K. R. Subbakrishna, Bank Credit Management, Himalaya Publication House, First Edition, 2008 P. 45.)

From the year 31.02.2002 the banks should make a general provision for minimum of 0.25 percent on standard assets.

a. The provision towards Standard Assets need not be netted from gross advances but shown separately as “Contingent Provision Against Assets” under “Other funds and Reserves” in the Balance Sheet.

b. In case banks are already maintaining excess provision than what is required / prescribed by statutory Auditor / RBI Inspection for impaired credit under Bad and Doubtful Debt Reserve, additional provision required for Standard Assets may be segregated from Bad and Doubtful Debt Reserve and the same may be parked under the head of “Contingent Provision against Standard Assets” with the approval of their Board of Director. Shortfall if any, on this account made good in the normal course.

The standard asset provisioning requirements for all UCBs are summarized as under:

<table>
<thead>
<tr>
<th>Category of Standard Asset</th>
<th>Rate of Provisioning</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct advance to Agriculture and SME sectors</td>
<td>0.25% 0.25%</td>
</tr>
<tr>
<td>Commercial Real Estate (CRE) sector</td>
<td>1.00 % 1.00 %</td>
</tr>
<tr>
<td>All other loans and advances not included in (a) and (b) above</td>
<td>0.40% 0.25%</td>
</tr>
</tbody>
</table>

(Source: RBI Master Circular – UBD, PCB, MC. No. 3 / 09.14.000 / 201-11 dated July 1, 2010.)


There is no objection if the banks create bad and doubtful debts reserve beyond the specified limits on their own.
4.10 RECOVERY FROM ADVANCES
A Bank has to see that money advanced by the bank is also recovered in time. The bank has to keep a close watch on the borrower and to take adequate follow – up measures, for ensuring that recovery of advances is smooth and timely. The liquidity and profitability of the bank depends to a great extent on the recovery of advances in time. Following are the precautions to be taken by a bank to ensure better recovery and the procedure to be followed for recovery of advances.

4.11.1. PRECAUTIONS FOR BETTER RECOVERY
Precautions for better recovery are:
1. Precautions at the Appraisal Stage and
2. Precautions after the Disbursement of Advance.

4.11.2. (1). PRECAUTION AT THE APPRAISAL STAGE:
In case following precautions are taken at the time of appraisal of the application for advance, the chances of recovery of the advance will definitely improve.

i) Proper Selection of the borrower: The banks should be careful in selecting the borrower. They should have a clear appraisal about the three C’s – Character, Capacity and Capital, of the borrower before advancing money to him.

ii) Viable Project: The Project should be physically, economically and technically viable. It should generate enough surpluses to repay loan.

iii) Proper Assessment: The banks should have proper assessment of both the fixed and working capital requirements of the borrower. It should ensure that the borrower would have sufficient funds to run his business. Over – Finance and Under – Finance, both are dangerous. In case of Over – Financing the possibility of mis-utilization of funds increases while in case of Under – Financing the project between unviable and due to shortage its survival becomes difficult.

iv) Consumption Needs: In case of small borrowers the banker should see that some provision is also made out of the incremental income to meet their
consumption requirements and the repayment amount should be fixed accordingly.

v) No-Dues Certificates: In order to avoid double financing the borrower should be asked to bring ‘no dues certificate’ from other financial institutions, if he has business dealing with them.

vi) Provision for Repayment: In order to ensure that the bank get back the funds from the borrower for better utilization, it should inculcate a sense of repayment in the borrower. In case of working capital advances, the limits are renewed every year and no repayment is insisted. This results in sanctioning of the credit limits in those cases also where the borrowers do not genuinely require funds for their business operations. The borrower avails of the credit limit and diverts the funds to the other areas.

vii) Proper Repayment Schedule: The repayment schedule should be fixed keeping in view the time periods during which cash will available with the borrower. This is necessary because fixation of unrealistic repayment schedule will result in inconvenience to the borrower and finally he will default in repayment.

4.11.3 (2.) PRECAUTION AFTER DISBURSEMENT OF LOAN:

In case the bank is satisfied with the appraisal of the loan application, the bank sanctions and disburses the advances to the borrower. In order to ensure that the recovery of loan is satisfactory, the banker should take steps for effective supervision and follow-up. The bank must, in particular, check the end use of the borrowed funds and also keep an eye on the conduct of the borrower’s account. In case the borrower is making unauthorized use of funds, the banker should give appropriate notice to the borrower asking him to stop such practice. The banker may recall the advance if necessary.

4.12.1. RECOVERY PROCEDURE:

In case the banker is facing difficulties in getting repayment of advance, it may take the following steps:
4.12.2. (1) Exerting Moral Pressure:
The bank should send the officers who visit the borrower’s place of business and find out the causes of non-payment of the bank’s dues. The banker may also request some influential parties of the area to exert pressure on the borrower to clear the Banks’ dues.

4.12.3. (2) Notice Recalling Advance:
In case the persuasion fails, the bank send a notice by Registered. A. D to the borrower stating clearly that since the borrower has failed to clear his account in spite of repeated reminders he is finally asked to pay the dues within 30 days of the receipt of Registered Notice, failing which the banker will dispose of the borrower’s security/securities lying with the banker and take legal action for recovery of the advance.

4.12.4. (3) Filing of the Suit:
In case the notice does not have any effect on the borrower, the banker may have to file a suit against the borrower in a court of law. The following points are relevant in this connection:
   a. The suit should be filed only as remedy of the last resort. This is because filing of suit is not only burdensome but also a time consuming and costly exercise.
   b. Before filing the suit the bank should exercise any right of set off available to it and also dispose off security, if any. This will reduce the amount of claim for which the suit is being filed in the court. Consequently the cost in terms of courts lawyer fees will also get reduced.
   c. In case of recovery of agricultural advances, the recovery proceedings have to be initiated under the Agricultural Recovery Act.
   d. In case of default in payment of advances guaranteed by Deposit Insurance and Credit Guarantee Corporation (DICGC) the following steps may be taken;
      i. After the expiry of 30 days from the days of recall notice, the amount outstanding in the loan account should be transferred to “Protested Advances Account”. The nomenclature of the account may differ from bank to bank.
ii. Any interest now due on the account should be debited to the Protested Advances Account and credited to Interest Suspense Account.

iii. The borrower should not be able to withdraw any money against such loans.

iv. The claim should be failed with DICGC giving the necessary details. The “DICGC Claim Account” should be debited and credit should be given to Protested Advance Account with the amount of claim filed. The amount received from the DICGC will be credited to DICGC Account.

v. Any recovery from the borrower should be credited to the Protested Advance Account. The share of DICGC in such a recovery should be remitted to it by giving a debit to Protested Advance Account.

e. In case the borrower offers a proposal to ‘scale down the dues’, the banker should study its implication. For instance if the borrower offers to pay 75% of his dues proved he is given a complete discharge, the banker should see whether it will be beneficial for it to accept the proposal vis a vis. filing the suit for the amount due in a court of law. The banker should opt for filing a suit only when it feels that such a course will be beneficial.

f. In case of hypothecation of stock in trade, vehicles etc., the banker should apply to the court for issue of order – “Attachment Before Judgment” (ABJ). The effect of this order is that the bank will be in a position to have the possession of the security even before the financial judgment of the court. This is necessary because the court’s final judgment may take a long time and in the meanwhile the security hypothecated may be removed or sold away by the borrower.

g. In case of adverse judgment by the court, the bank should file an appeal to the Higher Court within the stipulated time. Normally the limit is 30 days from the Day of Judgment. However, the time taken by the court in giving a certified copy of judgment is excluded from this limit. In order to save the time it will be appropriate for the bank to ask its lawyer to apply for the certified copy of the court’s judgment on the Day of Judgment itself.
h. The banker from the date of filing of a suit should maintain a separate file for each default account. The file should contain the copy of the every paper filed in the court viz. plain, written statement of the defendant, copy of the judgment, appeal etc.

4.13. RECOVERY IN CASE OF INSOLVENCY OF BORROWER:
In case of insolvency of the borrower, the property of the insolvent is taken over by the official assignee or the official receiver. The creditors of the insolvent have to submit adequate proof of their debts to the court issuing the order to adjudication declaring the borrower as insolvent.

The banker will also have to submit a proof of debt due by the defaulting borrower (insolvent) to the concerned court. The official assignee or the receiver will, from time to time, make payment to the various creditors of insolvent (including banker) depending upon the property realized and the priority of claims as per the insolvency laws. The banker at his level should stop operations in the account of insolvent as soon as he comes to know that the borrower or his partner or his guarantor has become insolvent. This is necessary to save the bank from additional loss on account of continued operations in the account.

4.14. GOVERNMENT AND RECOVERY MEASURES:
There are some effective machinery for speedy recovery of the debts of banks and other financial institution. It is a fact that, the recoveries or debts by the institution are normally due to leisurely disposal of cases, cumbersome procedure, pending cases and lack of special attention. In order to remove these difficulties, the Government has taken the following measures:-

4.15.1. ENACTMENT OF RECOVERY OF DEBTS DUE TO BANKS AND FINANCIAL INSTITUTION ACT, 1993:
DRTs are a common used acronym for Debt Recovery Tribunals. These have been set-up under an Act of parliament. This is done specifically with a view to help banks recover their dues. The Act was amended in January 2000 to tackle some problem with old Act.
One of the main factors responsible for mounting Non-Performing Asset (NPAs) in the financial sector has been the inability of Banks to recover their dues from borrowers when all options failed. The bank used to file a suit in a civil court. Generally that led to banks having a huge portfolio of accounts where cases were pending in civil courts.

4.15.2. APPEAL TO DEBT RECOVER TRIBUNAL (DRT):
Any person may file an appeal to Debts Recovery Tribunal, within 45 days from date on which action of taking possession of asset, takeover of management of business of borrower, appointing person to manage secured asset etc. is taken by the creditor. When a borrower files an appeal, the appeal cannot be entertained unless; the borrower deposits 75% of the amount claimed in the notice by secured creditor. The DRT can waive or reduce the amount required to be deposited. The amount is not required to be deposited at the time of filing appeal, but appeal will not be heard till the amount is deposited. The borrower while filing the appeal should also file an application requesting the Debt Recovery Tribunal to admit the appeal without deposit of any amount. It the DRT orders partial deposit of the amount and the same is not deposited, appeal can be dismissed.

The 75% deposit is only required if the appeal is filed by the borrower. If some other aggrieved person (e.g. guarantor, shareholder) files it the deposit is not required.

4.15.3. DEBT RECOVERY APPEAL TRIBUNAL:
If a person is aggrieved by the order of the DRT, it can file an appeal to the Appellate Tribunal within 30 days from date of receipt of the DRT order.

If the DRT or Appellate Tribunal holds that possession of assets by the secured creditors was wrongful and directs the secured creditor to return asset to concerned borrower, the borrower shall be entitled to compensation and costs as may be determined by DRT or Appellate Tribunal.

The Tribunal can also direct return of asset, if the secured creditor had already sold or transferred the asset to a third party.

Assets so that by the time final verdict came, there was nothing left of the security that have been pledged to the bank.
In a bid to tackle this problem, the committee on the financial sector (better known as the Narasimham Committee) suggested the setting up of special tribunals that would do away the civil court route. DRTs, it was felt, would do away with the costly, time consuming civil court procedure that stymied recovery procedure since they follow a summary procedure that expedites disposal of suit filed by the Banks/Financial Institutions.

Following the passage of the Act in August 1993, Debt Recovery Tribunals were set-up at Calcutta, Delhi, Bangalore, Jaipur and Ahmadabad along with an Appellate Tribunal at Mumbai.

However, DRTs soon ran into rough weather. The constitutional validity of the Act itself was questioned. It was only in March 1993, that the Supreme Court modified its earlier order – staying the operation of the Delhi High Court order quashing the constitution of DRT or Delhi to allow the setting up the three more Debt Recovery Tribunals in Chennai, Guwahati and Patna. Subsequently many more DRTs and ADRTs have been set-up.

Unfortunately, as a consequence of the numerous lacunae in the Act and the huge backlog of past cases where suits have been filed, DRTs failed to make a significant dent. For instances, the Tribunals did not have powers to attachment before judgment for appointment of receivers or for ordering presentation of the property.

The amendment (January 2000) to the DRT Act addresses many of the lacunae in the original Act, it empowers DRT to attach the property on the borrower filing a complaint of default. It also empowers the presiding officer to execute the decree of the official receiver based on the certificate issued by the DRT. Transfer to cases from the DRT to another DRT has also made easier.

The Supreme Court has ruled that the DRT Act will take precedence over the Companies Act in the recovery of debt, putting to rest all doubts on that matter.

Now the DRT Act supersedes all Acts other than the Sick Industrial Companies Act (SICA). This means that the companies declaring themselves sick under SICA can still stall recovery procedure. Once the fact of their sickness has prima facie been accepted by the Board for Industrial and Financial Reconstruction (BIRF), there is nothing a DRT can do till such time as the case is disposed of by the BIRF.
4.16. RIGHTS OF FINANCIAL CORPORATION IN CASE OF DEFAULT:

1. Where any industrial concern, which is under a liability of the Financial Corporation under an agreement, makes any default in repayment of any loan or advance or any installment thereof or in meeting its obligation in relation to any guarantee given by the Corporation or otherwise fails to comply with the terms of its agreement with the Financial Corporation, the Financial Corporation shall have the right to take over the management or possession or both industrial concern as the right to transfer by way of lease to sale and realize the property pledged, mortgage, hypothecated or assigned to the Financial Corporation.

2. Any transfer of property made by the Financial Corporation, in exercise of its powers under sub-section (1), shall vest in the transferee all the rights in or to the property transferred as if the transfer has been made by the owner of the property.

3. The Financial Corporation shall have the same rights and powers with respect to goods manufactured or produced wholly or partly from goods forming part of the security held by it as it had with respect to the original goods.

4. Where any action has been taken against an industrial concern under the provision of sub-section (1), all costs, charges and expenses which in the opinion of the Financial Corporation have been properly incurred by it as incidental thereto shall be recoverable from the industrial concern and the money which is received by it shall, in the absence of any contract to the contrary, be held by it in trust, to be applied firstly, in payment of such costs, charges and expenses and secondly, in discharge of the debt due to the Financial Corporation, and the residue of the money so received shall be paid to the person entitled thereto.

5. Where the Financial Corporation has taken any action against an industrial concern under the provisions of sub-section (1), the Financial Corporation shall be deemed to be the owner of such concern, for the purpose of suits by or against the concern, and shall sue and be sued in the name of the concern.

4.17. TIME LIMIT FOR TAKING ACTION AFTER NOTICE IS SERVED:

The secured creditor can take action any time after the expiry of 60 days notice. There is no time limit. However, action must be taken within reasonable time. The notice
cannot be said to be perpetually valid. If the creditors do any act, which is contrary to the intention of notice (e.g. reschedules loans or gives further time for repayment), it can be said that the notice has abated and no action can be taken against such notice.

4.18. SALIENT FEATURES OF SECURITISATION ACT.
1. The secured creditor, may require the borrower by notice in writing to discharge his liabilities in full within 60 days from the date of the notice, failing which the secured creditor can exercise all or any of the following rights.
   a. Take possession of secured assets of the borrower assets of the borrower including right to transfer by way of lease, assignment or sale for realizing the secured assets.
   b. Takeover the management of the secured assets of the borrower including right to transfer by way of lease, assignment or sale for realizing the secured assets.
   c. Appoint any person as manager to manage the secured assets, the possession of which has been over by the secured creditor.
2. In case of financial assets has been jointly financial by more than one secured creditors under consortium or multiple banking arrangement, no secured creditors will be entitled to any or all the above said rights conferred on him U/Sec. 13(4) of the Act, unless it is agreed upon by the secured creditors representing not less than \(\frac{3}{4}\) in value of the amount outstanding as on record date and such actions will be binding on all secured creditors.
3. Where dues of the secured creditor are not fully satisfied with the sale proceeds of the secured assets, the secured creditors can file an application with the debt recovery tribunal having jurisdiction or a competent court of the law for recovery of the balance amount from the borrowers.
4. Secured creditors can proceed against the guarantors or sell the pledge without first taking any of the measures specified in clause ‘a’ to ‘d’ of the Sub-section 13(4) in relation to the secured assets under the act.
5. Once notice is predatory to repulsion is received, the borrower cannot alienate the secured assets in question.
6. Banks can package and sell loans via securitization. Loan can be traded among banks, like bonds and shares.