CHAPTER – IV

NPA RECOVERY MECHANISMS

This present chapter is devoted to throw light on the various legislations evolved by the Reserve Bank of India to recover NPAs. The guidelines in respect of Lok Adalats, Debt Recovery Tribunals, SARFAESI ACT, One-Time Settlement /Compromise Schemes, Corporate Debt Restructuring Mechanism, Asset Reconstruction Companies, and Sale/ Purchase of Non Performing Assets have been dealt in detail.

4.1 LOK ADALATS

Lok Adalats have proved an effective institution for settlement of dues in respect of smaller loans. Guidelines were issued to banks and financial institutions in 2001 indicating that:

(i) ceiling of amount for coverage under Lok Adalats would be Rs.5 lakh;

(ii) the scheme may include both suit-filed and non-suit filed accounts in the doubtful and loss category; and

(iii) the settlement formula must be flexible. Further, Debt Recovery Tribunals have been empowered to organize Lok Adalats to decide cases of NPAs of Rs.10 lakh and above. The public and private sector banks had recovered Rs. 78 crore by 31st March, 2002 through the forum of Lok Adalats.
The Reserve Bank has issued guidelines to commercial banks and FIs to enable them to make increasing use of Lok Adalats. They have been advised to participate in the Lok Adalats convened by various DRTs / Debt Recovery Appellate Tribunals (DRATs) for resolving cases involving Rs. 10 lakh and above to reduce the stock of NPAs. As on 30th June, 2003, the number of cases filed by banks in Lok Adalats stood at 272793 involving an amount of Rs.1193.3 crore and amount recovered in 87907 cases was Rs. 190.5 crore.

With the enactment of Legal Services Authority Act, 1987, Lok Adalats were conferred a judicial status and have since emerged as a convenient method for settlement of disputes between banks and small borrowers. The Reserve Bank has issued guidelines to commercial banks and FIs advising them to make increasing use of Lok Adalats. Government has recently revised the monetary ceiling of cases to be referred to Lok Adalats organised by Civil Courts from Rs.5 lakh to Rs.20 lakh.

The number of cases filed by commercial banks with Lok Adalats stood at 485046 involving an amount of Rs.2433 crore. The number of cases decided was 205032 involving an amount of Rs.974 crore, and the recoveries effected in 159316 cases stood at Rs.328 crore as on 31st March, 2004.

The Reserve Bank issued guidelines to commercial banks and financial institutions to enable them to make increasing use of the forum of Lok Adalats. In terms of the guidelines, banks could settle banking disputes involving an amount up to Rs.5 lakh through the forum of Lok Adalats.
Further, banks were advised to participate in the Lok Adalats convened by various DRTs/DRATs for resolving cases involving Rs.10 lakh and above to reduce the stock of NPAs. The Central Government, in consultation with the Reserve Bank, decided to increase the monetary ceiling of cases to be referred to the Lok Adalats organized by Civil Courts. Accordingly, on 3rd August, 2004, the Reserve Bank enhanced the monetary ceiling of cases to be referred to Lok Adalats organized by Civil Courts to Rs.20 lakh as against the earlier ceiling of Rs.5 lakh.

As on 30th June, 2005, Scheduled Commercial Banks had recovered an amount of Rs.113 crore out of the outstanding amount of Rs.801 crore through Lok Adalats.

As on 30th June, 2006, Scheduled Commercial Banks had recovered an amount of Rs.265 crore out of the outstanding amount of Rs.2144 crore through Lok Adalats.

As on 30th June, 2007, Scheduled Commercial Banks had recovered an amount of Rs.106 crore out of the outstanding amount of Rs.758 crore through Lok Adalats.

As on 30th June, 2008, Scheduled Commercial Banks had recovered an amount of Rs. 176 crore out of the outstanding amount of Rs.2142 crore through Lok Adalats.
As on 30th June, 2009, Scheduled Commercial Banks had recovered an amount of Rs. 96 crore out of the outstanding amount of Rs.4023 crore through Lok Adalats.

**TABLE 4.1**

NPAs Recovered by Scheduled Commercial Banks through LOK ADALATS

(Rs. in crore)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total amount outstanding</th>
<th>NPA Recovered</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004-05</td>
<td>801</td>
<td>113</td>
<td>14.1</td>
</tr>
<tr>
<td>2005-06</td>
<td>2144</td>
<td>265</td>
<td>12.4</td>
</tr>
<tr>
<td>2006-07</td>
<td>758</td>
<td>106</td>
<td>14.0</td>
</tr>
<tr>
<td>2007-08</td>
<td>2142</td>
<td>176</td>
<td>8.2</td>
</tr>
<tr>
<td>2008-09</td>
<td>4023</td>
<td>96</td>
<td>2.4</td>
</tr>
</tbody>
</table>


**4.2 DEBT RECOVERY TRIBUNALS**

Debt Recovery Tribunals (DRTs) aid the recovery of NPAs. To enhance the effectiveness of DRTs, the Central Government amended the Recovery of Debts due to Banks and Financial Institutions Act in January 2000. As on 31st March, 2002, there were 22 DRTs and 5 Debt Recovery Appellate Tribunals (DRATs). In respect
of public and private sector banks, the number of cases disposed by the DRTs increased from 8625 (involving recovery of Rs.1657 crore) as on 31st March, 2001 to 13520 (involving recovery of Rs.2864 crore) as on 31st March, 2002. RBI has suggested certain major amendments in the said Act to the Central Government.

The Government set up a Working Group (Chairman: Shri S. N. Aggarwal) to review the existing provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and the rules framed there under in the light of the suggestions received from various quarters, such as, banks, financial institutions, DRTs and individuals as also to examine the adequacy of the infrastructure available to DRTs.

The Working Group suggested amendments to the Act and Rules framed there under. The Government has substantially amended the Debts Recovery Tribunal (Procedure) Rules, 2003 to facilitate better administration of the Act including plural remedies for banks. As on 30th June, 2003, out of 57915 cases (involving Rs.82266 crore) filed by banks to the DRTs, 22163 cases (involving Rs.19633 crore) have been adjudicated and the amount recovered so far stood at Rs. 5787 crore.

The Recovery of Debts Due to Banks and Financial Institutions Act was enacted in 1993 to provide for the establishment of tribunals for expeditious adjudication and recovery of debts due to banks and financial institutions and for matters connected therewith and incidental thereto. The amendments made in 2000 to the above Act and the Rules framed there under have strengthened the functioning of DRTs.
On the recommendations of the Reserve Bank, Government has since set up a working group headed by Additional Secretary (FS), Government of India to improve the functioning of DRTs.

As on 30th June, 2004, out of 63600 cases (involving Rs.91926 crore) filed with DRTs by the banks, 27956 cases (involving Rs.25358 crore) have been adjudicated by them. The amount recovered so far through the adjudicated cases is placed at Rs.7845 crore.

Debt Recovery Tribunals (DRTs) were set up under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 for expeditious adjudication and recovery of debts due to banks and financial institutions. On the recommendation of the Reserve Bank, the Government of India set up a Working Group in July 2004 to improve the functioning of DRTs.

The Working Group is expected to examine issues and recommend appropriate measures regarding:

a) the need to extend the provisions of the Recovery of Debts Due to Banks And Financial Institutions Act to cases for less than Rs.10 lakh;

b) redistribution of the jurisdiction of the various DRTs;

c) modification in the existing strength of the DRTs/Debt Recovery Appellate Tribunals (DRATs); and

d) legal and institutional provisions.
As on 30th June, 2005, Scheduled Commercial Banks had recovered an amount of Rs.3348 crore out of the outstanding amount of Rs.4130 crore through Debt Recovery Tribunals.

As on 30th June, 2006, Scheduled Commercial Banks had recovered an amount of Rs.3020 crore out of the outstanding amount of Rs.5819 crore through Debt Recovery Tribunals.

As on 30th June, 2007, Scheduled Commercial Banks had recovered an amount of Rs.3463 crore out of the outstanding amount of Rs.9156 crore through Debt Recovery Tribunals.

As on 30th June, 2008, Scheduled Commercial Banks had recovered an amount of Rs. 4735 crore out of the outstanding amount of Rs.6273 crore through Debt Recovery Tribunals.

As on 30th June, 2009, Scheduled Commercial Banks had recovered an amount of Rs.2688 crore out of the outstanding amount of Rs.14317 crore through Debt Recovery Tribunals.
### TABLE 4.2

NPAs Recovered by Scheduled Commercial Banks through DRTs

(Rs. in crore)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total amount outstanding</th>
<th>NPA Recovered</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004-05</td>
<td>4130</td>
<td>3348</td>
<td>81.1</td>
</tr>
<tr>
<td>2005-06</td>
<td>5819</td>
<td>3020</td>
<td>51.9</td>
</tr>
<tr>
<td>2006-07</td>
<td>9156</td>
<td>3463</td>
<td>37.8</td>
</tr>
<tr>
<td>2007-08</td>
<td>6273</td>
<td>4735</td>
<td>75.5</td>
</tr>
<tr>
<td>2008-09</td>
<td>14317</td>
<td>2688</td>
<td>18.8</td>
</tr>
</tbody>
</table>

**Source:** http://rbi.org.in/scripts/AnnualPublications.aspx?head=Trend+and+Progress+of+Banking+in+India

### 4.3 THE SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST (SARFAESI) ACT, 2002

The Ordinance provides certain benefits to the banks and financial institutions in the direction of realization of their loans and advances. In order to ensure strict compliance of the provisions of the Ordinance or any directions order issued there under, penalties have been prescribed for violation thereof.

The Rules have been notified by the Central Government to carry out the provisions relating to enforcement of securities by banks and financial institutions. In a writ petition filed against the Ordinance, the Supreme Court has stayed the operations of the Ordinance to a limited extent i.e., secured assets can be seized but cannot be sold or leased or assigned pending replacement of the Ordinance by the Bill.

The RBI has constituted two Working Groups for stipulating suitable norms for registration, prescribing prudential norms, recommending proper and transparent accounting and disclosure standards and framing appropriate guidelines for the conduct of asset reconstruction/ securitization.

The Government issued the SARFAESI Act, 2002 which, inter alia, provides, for enforcement of security interest for realization of dues without the intervention of courts or tribunals. The Government has also notified the Security Interest (Enforcement) Rules, 2002 to enable secured creditors to authorize their officials to enforce the securities and recover the dues from the borrowers. The Public Sector Banks and financial institutions have been advised to take action under the Act and report compliance to the Reserve Bank.
The Act provides for sale of financial assets by banks / financial institutions to Securitization Companies (SCs) / Reconstruction Companies (RCs). Guidelines have been issued to ensure that the process of asset reconstruction proceeds on sound lines.

These guidelines, inter alia, prescribe the financial assets which can be sold to SCs / RCs by banks / financial institutions, procedure for such sales, prudential norms for the sale transactions and related disclosures.

4.3.1 Final Guidelines and Directions for SCs / RCs by the Reserve Bank

The Reserve Bank issued the final guidelines and directions to Securitization Companies (SCs) and Reconstruction Companies (RCs) in April 2003. The guidelines have been finalised taking into account the feedback received from banks, financial institutions and others.

The regulations would facilitate the smooth formation and functioning of SCs / RCs. The guidelines and directions cover the aspects concerning asset reconstruction and securitization as also those relating to registration, owned funds, permissible business, and operational structure for giving effect to the business of securitization and asset reconstruction, deployment of surplus funds, internal control systems, prudential norms, and disclosure requirements for these companies.

In terms of the provisions of the SARFAESI Act, 2002, Securitization Companies are required to raise funds through the instrument of security receipts. The Reserve Bank has, however, clarified that the SCs / RCs can raise funds through the instrument of security receipts by the trust(s) set up by them. In addition to the
guidelines and directions, which are mandatory, the Reserve Bank has also issued
guidance notes of recommendatory nature covering aspects relating to acquisition of
assets, issue of security receipts, etc.

The Reserve Bank is in the process of framing a set of standard guidelines in
the matter of takeover of the management, sale or lease of whole or part of the
business of the borrower. The SCs / RCs have been advised not to proceed against
exercising the measures of takeover of management, sale or lease of the borrowers’
business as provided for in Section 9 of the SARFAESI Act, 2002, until guidelines in
this regard are notified by the Reserve Bank.

As regards enforcement of security interest, SCs / RCs may follow the
Security Interest (Enforcement) Rules, 2002 notified by the Government of India as
also the relevant provisions in the SARFAESI Act, 2002.

The enactment of the Securitization and Reconstruction of Financial Assets
and Enforcement of Security Interest (SARFAESI) Act has provided a significant
impetus to banks to ensure sustained recovery.

Banks and financial institutions have already initiated the process of recovery
under the SARFAESI Act. The Government has advised the Public Sector Banks and
financial institutions to take action under the SARFAESI Act and report the
compliance to the Reserve Bank.

Since the Act provides for sale of financial assets by banks / financial
institutions to Securitization Companies (SC) / Reconstruction Companies (RC)
created there under, a set of guidelines has been issued to banks and financial institutions so that the process of asset reconstruction proceeds on smooth and sound lines in a uniform manner.

These guidelines, inter alia, prescribe the financial assets which can be sold to SC / RC by banks / FIs, procedure for such sales (including valuation and pricing aspects), prudential norms for the sale transactions (viz., provisioning / valuation norms, capital adequacy norms and exposure norm) and related disclosures required to be made in the Notes on Accounts to their balance sheets.

The decline in NPAs has also been evidenced across bank groups, except in 2000-01. In line with this declining trend, NPAs declined sharply in 2002-03, reflecting, inter alia, the salutary impact of earlier measures towards NPA reduction and the enactment of the SARFAESI Act ensuring prompter recovery without intervention of court or tribunal.

The Supreme Court in its judgment dated April 8, 2004 in M/s. Mardia Chemicals has upheld the constitutional validity of the Act and its provisions except that a subsection 2 of Section 17 by the secured creditor, in case the borrower wants to appeal against the secured creditor’s notice under Section 13 (4) of the Act. It has declared Section 17 (2) as unconstitutional and violative of Article 14 of the Constitution of India. In the wake of this judgment, many banks have pointed out practical difficulties likely to arise in speeding up the recovery of NPAs.
Many thousands of notices sent by banks to defaulting borrowers under the Securitization Act asking them to pay up their dues were threatening to boomerang into a major headache for the banks and institutions themselves. The lending community, which had gone into an overdrive in serving recovery notices under the Act, was preparing for sending fresh follow-up communication to all defaulting borrowers who had sent replies raising objections to the notices.

The follow-up communication was to be sent to comply with a less-publicized portion of the recent Supreme Court judgment upholding the validity of the Securitization Act. The apex court had said that in each case where borrowers have raised objections to the notices, it would be compulsory for the lender to communicate in writing their reasons for not accepting the objections before initiating further recovery action\(^1\).

The suggestions of banks, Indian Bankers Association and other organizations in this regard are being examined to carry out necessary amendments in the Act. In the Union Budget 2004-05, the Government has proposed to amend the relevant provisions of the Act to appropriately address the Supreme Court’s concerns regarding a fair deal to borrowers while, at the same time, ensuring that the recovery process is not delayed or hampered.

\(^1\) [http://www.blonnet.com/2004/05/04/stories/2004050402550600.htm](http://www.blonnet.com/2004/05/04/stories/2004050402550600.htm)
4.3.2 NPAs recovered under SARFAESI Act

The Securitization Act allows lenders to take over the assets of defaulting companies and auction them to recover their dues. They can also choose to take over the management of companies. However, a 60-day period has to elapse from the time of sending the notices before such action can be initiated.

Since the commencement / enforcement of the SARFAESI Act till end-June 2003, Public Sector Banks have issued 33736 notices for an outstanding amount of Rs.12147 crore and have recovered Rs.499.20 crore from 9946 cases.

As on 30th June, 2004, 27 public sector banks had issued 61263 notices involving outstanding amount of Rs.19744 crore, and had recovered an amount of Rs.1748 crore from 24092 cases through SARFAESI Act.

As on 30th June, 2005, Scheduled Commercial Banks had recovered an amount of Rs.2391 crore out of the outstanding amount of Rs.13224 crore through SARFAESI Act.

As on 30th June, 2006, Scheduled Commercial Banks had recovered an amount of Rs.3363 crore out of the outstanding amount of Rs.8517 crore through SARFAESI Act.

As on 30th June, 2007, Scheduled Commercial Banks had recovered an amount of Rs.3749 crore out of the outstanding amount of Rs.9058 crore through SARFAESI Act.
As on 30th June, 2008, Scheduled Commercial Banks had recovered an amount of Rs. 4429 crore out of the outstanding amount of Rs.7263 crore through SARFAESI Act.

As on 30th June, 2009, Scheduled Commercial Banks had recovered an amount of Rs. 3982 crore out of the outstanding amount of Rs.12067 crore through SARFAESI Act.

**TABLE 4.3**

NPAs Recovered by Scheduled Commercial Banks through SARFAESI ACT

(Rs. in crore)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total amount outstanding</th>
<th>NPA Recovered</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002-03</td>
<td>12147*</td>
<td>499*</td>
<td>4.1</td>
</tr>
<tr>
<td>2003-04</td>
<td>19744*</td>
<td>1748*</td>
<td>8.9</td>
</tr>
<tr>
<td>2004-05</td>
<td>13224</td>
<td>2391</td>
<td>18.1</td>
</tr>
<tr>
<td>2005-06</td>
<td>8517</td>
<td>3363</td>
<td>39.5</td>
</tr>
<tr>
<td>2006-07</td>
<td>9058</td>
<td>3749</td>
<td>41.4</td>
</tr>
<tr>
<td>2007-08</td>
<td>7263</td>
<td>4429</td>
<td>61.0</td>
</tr>
<tr>
<td>2008-09</td>
<td>12067</td>
<td>3982</td>
<td>33.0</td>
</tr>
</tbody>
</table>


*in respect of Public Sector Banks*
However, the SARFAESI Act seems to be implemented more vigorously, if not selectively, only against the smallest of the small borrowers and against the Micro and Small Enterprises (MSEs) all over the country, leaving the big borrowers relatively untouched, if the spate of advertisements daily in the news dailies are anything to go by. More often than not, the assets of the MSEs are seized and sold at throwaway prices, enriching only the middlemen. Both the small borrower and the banks lose out on this score. A recent circular by the Reserve Bank of India has very sharply asked the banks not to dispose of their NPAs at less than their NPV (net present value).

4.4 ONE-TIME SETTLEMENT / COMPROMISE SCHEMES

The guidelines for compromise settlements of chronic NPAs up to Rs.5 crore were issued in July 2000. On a review and in consultation with the Government of India, it was decided to give one more opportunity to the borrowers to come forward for settlement of their outstanding dues.

The revised guidelines applicable to public sector banks will cover NPAs (below the prescribed ceiling) relating to all sectors including the small sector. The guidelines will not, however, cover cases of wilful default, fraud and malfeasance. The revised guidelines issued on 29th January 2003 for compromise settlement of dues relating to NPAs of public sector banks in all sectors are as follows:

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2 http://www.thehindubusinessline.com/2008/02/07/stories/2008020751110900.htm
• Guidelines are applicable for compromise settlement of chronic NPAs up to Rs. 10 crore.

• The guidelines will cover all NPAs in all sectors irrespective of the nature of business, which have become doubtful or loss assets as on 31st March 2000 with outstanding balance of Rs. 10 crore and below on the cutoff date.

• The guidelines will also cover NPAs classified as sub-standard assets as on 31st March 2000, which have subsequently become doubtful or loss assets.

• The guidelines will be applicable to cases in which the banks have initiated action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 and also cases pending before Courts / Debt Recovery Tribunals (DRTs) / Board for Industrial and Financial Reconstruction (BIFR), subject to consent decree being obtained from the Courts / DRTs / BIFR.

• The last date for receipt of applications from borrowers under the scheme was 30th September 2003 and their processing should be completed by 31st December 2003.

Guidelines for special One-Time Settlement Scheme for loans up to Rs.50000 to small and marginal farmers by Public Sector Banks which were issued in March 2002 were to be operational up to 31st December 2002. The Government and the Reserve Bank had received requests from banks for extending the time limit of the operation of the guidelines. In view of the above and keeping in view the drought /
flood situation in different parts of the country, it was decided, in consultation with the Government of India, to extend the operation of the guidelines, for a further period of 3 months, i.e., up to 31\textsuperscript{st} March 2003.

In May 2003, the time limit for processing of applications received under the revised guidelines for compromise settlement of chronic NPAs of public sector banks, up to Rs.10 crore was extended to 31\textsuperscript{st} December 2003. Based on the requests received for further extending the time limit for operation of the guidelines and in consultation with Government of India, the time limit for receiving applications was further extended up to 31\textsuperscript{st} July 2004.

4.4.1 One-Time Settlement Scheme for Small and Medium Enterprises Accounts

The one-time settlement scheme for recovery of NPAs below Rs.10 crore provides for a simplified, non-discretionary and non-discriminatory mechanism for one-time settlement of chronic NPAs in the Small and Medium Enterprises sector.

The scheme, however, does not cover cases of wilful default, fraud and malfeasance. The scheme covers all NPAs in the Small and Medium Enterprises sector, which have become doubtful or loss as on 31\textsuperscript{st} March 2004 with outstanding balance of Rs.10 crore and below on the date on which the account was classified as doubtful.

The scheme also covers NPAs classified as sub-standard as on 31\textsuperscript{st} March 2004, which have subsequently become doubtful or loss where the outstanding
balance was Rs.10 crore or below on the date on which the account was classified as doubtful.

The scheme covers cases in respect of which banks have initiated action under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 and also cases pending before courts/Debt Recovery Tribunals (DRTs)/Board for Industrial and Financial Reconstruction (BIFR), subject to consent decree being obtained from the courts/DRTs/BIFR.

The last date for receipt of applications from borrowers was 31\textsuperscript{st} March 2006. The processing under the revised guidelines was required to be completed by 30\textsuperscript{th} June 2006.

As on 30\textsuperscript{th} June, 2006, Scheduled Commercial Banks had recovered an amount of Rs.608 crore out of the outstanding amount of Rs.772 crore through one time settlement scheme.

**4.5 CORPORATE DEBT RESTRUCTURING (CDR) MECHANISM**

A scheme of Corporate Debt Restructuring (CDR) was developed in India based on international experience and detailed guidelines on the same were issued for implementation by banks and financial institutions in 2001.

The objective of the framework has been to ensure timely and transparent mechanism for restructuring the corporate debts of viable entities, outside the purview of BIFR, DRTs and other legal proceedings.
Consequent upon the Union Budget announcements, 2002-2003, a High Level Group (Chairman: Shri Vepa Kamesam) was constituted in order to revamp the earlier CDR scheme. Based on the recommendations made by the High Level Group and in consultation with the Government, a revised scheme of CDR was finalised and forwarded to banks in February 2003.

The progress made under CDR mechanism up to 30th June 2003 is as under:

**Table 4.4**

**Progress under CDR Scheme**

(Amount in Rs. crore)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>No.of cases</th>
<th>Amount involved</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cases referred to CDR forum</td>
<td>71</td>
<td>53,736</td>
</tr>
<tr>
<td>Final schemes approved</td>
<td>41</td>
<td>38,638</td>
</tr>
<tr>
<td>Rejected</td>
<td>18</td>
<td>7,252</td>
</tr>
<tr>
<td>Pending</td>
<td>12</td>
<td>7,846</td>
</tr>
</tbody>
</table>

The salient features of the revised CDR scheme issued in February 2003 are as follows:

- It will cover multiple banking accounts / syndication / consortium accounts with outstanding exposure of Rs.20 crore and above.

- It will be a voluntary system based on Debtor-Creditor Agreement (DCA) and Inter-Creditor Agreement (ICA).
• CDR will have a three-tier structure consisting of: (a) CDR Standing Forum and its Core Group (the policy-making body), (b) CDR Empowered Group (the functional group deciding on the restructuring of cases referred to the CDR mechanism), and (c) the CDR Cell (the secretariat to the CDR system).

• The revised guidelines provide exit options for lenders who do not wish to commit additional financing or wish to sell their existing stake.

• ‘Stand-still’ agreement binding for 90 days or 180 days by debtors and creditors respectively, under which both sides commit themselves not to take recourse to any legal action during the ‘stand-still’ period.

The Scheme of Corporate Debt Restructuring (CDR) started in 2001 with a view to put in place a mechanism for timely and transparent restructuring of corporate debts of viable entities facing problems, outside the purview of BIFR, DRT and other legal proceedings, was further fine-tuned in February 2003 based on the recommendations made by a Working Group under Shri Vepa Kamesam.

A recent review of the operation of the Scheme revealed that nearly one-third of the units assisted under the Scheme improved their financial position. However, issues relating to proper identification and successful implementation of packages along with other operational aspects need to be addressed from a systemic point of view.
Accordingly, a Special Group has been constituted to review the performance of the CDR mechanism and suggest measures to make it more effective. The Group was expected to submit its Report by December 2004.

The number of cases and value of assets restructured under the CDR mechanism stood at 94 and Rs.64017 crore, respectively, as on 30th June 2004. The major beneficiaries were iron and steel, refinery, fertilizers and telecommunication industries, accounting for more than two-third share of value of assets restructured.

A Special Group (Chairperson: Smt. S. Gopinath) was appointed to undertake a further review of the corporate debt restructuring (CDR) mechanism and suggest certain changes/improvements in the existing scheme for enhancing its scope and to make it more efficient.

In pursuance of the recommendations made by the Special Group, major modifications were proposed in the draft guidelines issued on 6th May 2005 in the existing CDR scheme. These included:

i) extension of scheme to corporate entities where banks and institutions have an outstanding exposure of Rs.10 crore or more from the earlier exposure of Rs.20 crore and above;

ii) requirement of support of 60 per cent of creditors by number in addition to the support of 75 per cent of creditors by value with a view to making the decision-making process more equitable;
iii) linking the restoration of asset classification prevailing on the date of reference to CDR Cell for implementation of package within three months from the date of approval of the package;

iv) restricting the regulatory concession in asset classification and provisioning requirement to the first restructuring where the package also has to meet certain norms relating to turnaround period and minimum sacrifice and funds infusion by promoters;

v) convergence in the methodology for computation of economic sacrifice among banks and FIs;

vi) regulatory treatment of non-SLR instruments acquired while funding interest or in lieu of outstanding principal and valuation of such instruments;

vii) limiting the Reserve Bank’s role to providing broad guidelines for the CDR system;

viii) enhancing balance sheet disclosures;

ix) pro-rata sharing of additional finance requirement;

x) including one-time settlement (OTS) as part of the CDR scheme to make the exit option more flexible; and

xi) discretion to the core group in dealing with wilful defaulters in certain cases.

Corporates sometimes find themselves in financial difficulty, despite their best efforts and intentions, because of factors beyond their control and also due to certain
internal reasons. With a view to enabling corporate to tide over temporary financial
difficulties as well as for the safety of the money lent by the banks and financial
institutions, timely support through restructuring in genuine cases at times is
considered necessary.

4.6 CORPORATE DEBT RESTRUCTURING MECHANISM (CDRM)

Companies sometimes are found to be in financial troubles for factors beyond
their control and also due to certain internal reasons. For the revival of such
businesses, as well as, for the security of the funds lent by the banks and financial
institutions, timely support through restructuring in genuine cases was required. With
this view, a CDR system was established with the objective to ensure timely and
transparent restructuring of corporate debts of viable entities facing problems, which
are outside the purview of BIFR, DRT and other legal proceedings. In particular, the
system aimed at preserving viable corporate/businesses that are impacted by certain
internal and external factors, thus minimizing the losses to the creditors and other
stakeholders.³

Based on the cross-country experience, the Corporate Debt Restructuring
Mechanism was modified, and detailed guidelines were issued in August 2001 for
implementation by banks. Subsequently, guidelines on CDRM were revised in
February 2003.

³ http://www.dnb.co.in/Arcil2008/SARFAESI.asp
A Special Group was constituted in September 2004 (Chairperson: Smt. S. Gopinath) to undertake a review of the scheme on CDRM. The Group suggested certain changes/ improvements in the existing scheme for enhancing its scope and making it more efficient. Based on the recommendations by the Special Group and the feedback received, draft guidelines were prepared and issued to all commercial banks/financial institutions (excluding RRBs) in November 2005.

4.6.1 CDRM - Revised Guidelines

The salient features of the revised guidelines on CDRM are as indicated below:

- To extend the scheme to entities with outstanding exposure of Rs.10 crore or more.
- To require the support of 60 per cent of creditors by number in addition to the support of 75 per cent of creditors by value with a view to ensuring the decision making more equitable.
- To give discretion to the core group in dealing with willful defaulters in certain cases other than cases involving frauds or diversion of funds with malafide intentions.
- To link the restoration of asset classification prevailing on the date of reference to the CDR Cell to implementation of the CDR package within four months from the date of approval of the package.
• To restrict the regulatory concession in asset classification and provisioning to the first restructuring where the package also has to meet norms relating to turnaround period, minimum sacrifice and funds infusion by promoters.

• To converge the methodology for computation of economic sacrifice among banks and financial institutions.

• To limit the Reserve Bank’s role to providing broad guidelines for CDRM.

• To enhance the disclosures in the balance sheet for providing greater transparency.

• To share on a pro-rata basis an additional finance requirement by both term lenders and working capital lenders.

• To allow OTS as a part of the CDRM to make the exit option more flexible.

• To modify the regulatory treatment of non-SLR instruments acquired while funding interest or in lieu of outstanding principal and valuation of such instruments.

In order to review and align the existing guidelines on restructuring of advances (other than under CDR mechanism and SME debt restructuring mechanism) on the lines of provisions under the revised CDR mechanism, a Working Group comprising members from commercial banks, Indian Banks’ Association (IBA) and the Reserve Bank was constituted.
The Working Group suggested adoption of the regulatory framework prescribed under CDR mechanism to other categories of advances (those extended to non-CDR/non-SME borrowers) with suitable modifications. On the basis of the recommendations made by the Working Group and the feedback received, the draft prudential guidelines on restructuring/rescheduling were issued in June 2007.

**4.7 ASSET RECONSTRUCTION COMPANIES (ARCS)**

To solve the problem of bad loans, several institutions have initiated steps towards establishment of ARCs, which takeover nonperforming loans of banks and financial institutions at a discounted rate, and manage and dispose such assets.

The Reserve Bank has granted certificate of registration to three ARCs till 2003 out of which Asset Reconstruction Company India Ltd. (ARCIL) has already started its operations. Till 2003, ARCIL has acquired NPAs worth Rs.9631 crore from banks and financial institutions at a price of Rs.2089 crore.

In order that ARCs have a sound capital base and a stake in the management of the NPAs acquired, the requirement of owned funds for commencement of business has been stipulated as not less than 15 per cent of the assets acquired or Rs.100 crore, whichever is less.

**4.7.1 Regulatory Environment for ARCs in India**

In India, the enactment of SARFAESI Act, 2002 enabled lending agencies (banks and financial institutions) to foreclose and sell underlying assets without court intervention.
The existing framework envisages non-Government supported multiple ARCs/securitization companies, which may be set up by the lenders, NPA investors or corporate. The SARFAESI Act permits an ARC to commence operations with a minimum net-owned funds of Rs. two crore.

Directions require an ARC to maintain a capital adequacy ratio of 15 per cent of its risk-weighted assets. However, financial assets held in trusts shall not be subject to capital adequacy requirements.

An ARC may issue bonds and debentures for meeting its funding needs but cannot mobilize deposits. ARCs can acquire financial assets by way of simple agreement from the banks/financial institutions subject to some terms and conditions or by an issuance of bonds and debentures to the originating banks/financial institutions.

All the rights of the lender vest in the ARC after acquiring the assets and become party to all the contracts/deeds/agreement etc. ARCs are also allowed to function as a manager of collateral assets taken over by the lenders under security enforcement rights available to them as a recovery agent for any bank/institution. Since the date of acquisitions of assets, ARCs are given a resolution time frame of maximum five years.

As per the Act, to discharge its function of asset reconstruction, an ARC can undertake

i. enforcement of security interest,
ii. takeover or change the management of the borrower,

iii. undertake sale or lease of the borrowers’ business and

iv. enter into settlements and reschedule the debt.

However, as per the SARFAESI, for enforcement of security interest, at least 75 per cent of the secured creditors need to agree to exercise this right.

For speedier resolution of NPAs, financial assets due from a single debtor to various banks/ financial institutions may be considered for acquisition. Similarly, financial assets having linkages to the same collateral may be considered for acquisition to ensure relatively faster and easy realization.

As per the guidelines, the valuation process should be uniform for assets of same profile and a standard valuation method should be adopted to ensure that the valuation of the financial assets is done in a scientific and objective manner. Valuation may be done internally and or by engaging an independent agency, depending upon the value of the assets involved.

The acquired assets may be sold by inviting quotations from persons dealing in such assets, by inviting tenders from the public, by holding public auctions or by private treaty. While there is no restriction on ARCs to acquire assets which are considered to be unrevivable, as per the guidelines to banks, ARCs will normally not takeover such assets and will act as an agent for recovery on a fee basis for these assets.
Three ARCs, viz., Asset Reconstruction Company (India) Ltd. (ARCIL), Asset Care Enterprise (ACE) Ltd. and ASERC (India) Ltd. have been registered. ACE Ltd. and ASERC Ltd. are yet to start their operations.

ARCIL has bought assets worth Rs.9631 crore from the banks and financial institutions at a price of 2089 crore. IDBI has transferred 11 cases with aggregate principal outstanding of Rs.239 crore to ARCIL.

Up to 31st March 2004, IFCI’s Board of Directors had approved the offer made by ARCIL to acquire 4 NPA accounts with an aggregate net outstanding of Rs.173 crore at a discounted value of Rs.83 crore.

As on 31st March 2004, ARCIL had given further proposals for acquiring 16 more NPAs (principal amount outstanding in IFCI’s portfolio of Rs.334 crore, for which offers received amounted to Rs.146 crore) which were under consideration. IIBI and SIDBI have also been exploring the option of selling their NPAs to ARCs.

One of the important issues in respect of ARCs in India is that of difference in stamp duty rates on the assignment of financial assets across the States which, in turn, impacts the transaction costs.

Another issue is the appropriate number of securitization companies/AMCs required in the present environment since too many companies can lead to the problems relating to debt aggregation and impede the process of asset reconstruction.
To prevent entry of non-serious players and orderly functioning of ARCs, the registration process needs to emphasize upon ARCs promoted by reputed parties with adequate financial backing.

The functioning of ARCs also depends on the willingness of lender banks and financial institutions to transfer NPAs to the ARCs. In the case of India, security enforcement seems to be a key resolution strategy for securitization companies and ARCs because majority of the NPAs belong to doubtful and bad debts category. Therefore, to dispose of these assets and improve recovery levels, market trading of such acquired assets is essential.

In order to ensure a sound capital base and a stake in the management of the NPAs acquired, the requirement of owned fund for commencement of business has been stipulated as not less than 15 per cent of the assets acquired or Rs.100 crore, whichever is less.

A Report by Asian Development Bank (February 2004) had suggested further policy changes required for the proper functioning of ARCs. The major recommendations were -

i. amending SARFAESI Act to enable a single party to control an ARC, subject to safeguards to be regulated by the Reserve Bank against ‘warehousing’ of NPAs,

ii. allowing single party including foreign entities to subscribe to entire 100 per cent of security receipts of a scheme,
iii. ensuring and clarifying that asset managers are permitted to undertake all activities for asset reconstruction under SARFAESI Act.

The setting up of the Asset Reconstruction Corporation of India (ARCIL) has provided a major boost to banks’ efforts to recover their NPAs. During 2004-05, several banks and certain financial institutions sold their NPAs to the ARCIL to the extent of Rs.15,343 crore.

During 2005-06, with a view to facilitating resolution of NPAs of the Indian banking system by SCs/RCs and to enhance the possibility of banks realizing better value for their NPAs through the expertise and resources of foreign institutions with international experience in management of stressed assets, the Government of India permitted FDI up to 49 per cent in the equity capital of SCs/RCs registered with the Reserve Bank. So far, none of the SCs/RCs registered with the Reserve Bank has any FDI participation in equity.

During 2005-06, ARCIL acquired 559 cases of NPAs from 31 banks/financial institutions with total dues amounting to Rs.21126 crore. The portfolio of assets acquired by ARCIL was diversified across major industry segments, which were generally performing well in the stock market. About 78 per cent of assets under management were fully/partially operational.

The Reserve Bank has issued certificate of registration to six securitization companies/reconstruction companies till the end of June 2007, of which three have commenced their operations. At end-June 2007, the book value of total amount of
assets acquired by SCs/RCs registered with the Reserve Bank stood at Rs.28544 crore. The security receipts subscribed to by banks amounted to Rs.6894 crore. The security receipts redeemed amounted to Rs.660 crore.

The Reserve Bank has issued certificate of registration to eleven securitization companies/reconstruction companies till the end of June 2008, of which six have commenced their operations. At end-June 2008, the book value of total amount of assets acquired by SCs/RCs registered with the Reserve Bank was at Rs.41414 crore, showing an increase of 45.1 per cent during the year (July 2007 to June 2008). While security receipts subscribed to by banks/financial institutions amounted to Rs.8319 crore, security receipts redeemed amounted to Rs.1299 crore.

The Reserve Bank has issued Certificate of Registration to 12 Securitization Companies/Reconstruction Companies till the end of June 2009, of which 11 have commenced their operations. As at end-June 2009, the book value of total amount of assets acquired by SCs/RCs registered with the Reserve Bank was Rs.51542 crore, showing an increase of 24.5 per cent during the year (July 2008 to June 2009). While security receipts subscribed to by banks/financial institutions amounted to Rs.9570 crore, security receipts redeemed amounted to Rs.2792 crore.

Public sector banks prefer to pursue recoveries of Non-Performing Assets and retain transfer to Asset Reconstruction Companies (ARCs) as the last option. One of the major factors in the way of Non-Performing Asset transfers to ARCs such as Asset Reconstruction Company of India Ltd is the high level of discounting to face value. Another factor preventing bankers from passing Non-Performing Assets to
ARCs is the fact that they would have to make large provisioning in the balance sheets, if the assets are liquidated at very high discounts\(^4\).

### 4.8 GUIDELINES ON SALE/PURCHASE OF NON-PERFORMING ASSETS

With a view to providing an additional option and developing a healthy secondary market for NPAs, guidelines on sale/purchase of nonperforming assets were issued in July 2005 where securitisation companies and reconstruction companies are not involved.

The draft guidelines cover the following broad areas:

- i) procedure for purchase/sale of non-performing financial assets by banks, including valuation and pricing aspects; and
- ii) prudential norms relating to asset classification, provisioning, accounting of recoveries, capital adequacy and exposure norms and disclosure requirements.

The guidelines include several specific provisions:

- i) a nonperforming asset in the books of a bank shall be eligible for sale to other banks only if it has remained a non-performing asset for at least two years in the books of the selling bank and such selling should be only on a cash basis;
- ii) a nonperforming financial asset should be held by the purchasing bank in its books at least for a period of 15 months before it is sold to other banks;

iii) a bank may purchase/sell non-performing financial assets from/to other banks only on a ‘without recourse’ basis;

iv) banks should ensure that subsequent to sale of the non-performing financial assets to other banks, they do not have any involvement with reference to assets sold and do not assume operational, legal or any other type of risks relating to the financial assets sold;

v) a non-performing financial asset may be classified as ‘standard’ in the books of the purchasing bank for a period of 90 days from the date of purchase. Thereafter, the asset classification status of the account shall be determined by the record of recovery in the books of the purchasing bank with reference to cash flows estimated while purchasing the asset. The asset shall attract provisioning requirement appropriate to its asset classification status in the books of the purchasing bank;

vi) any recovery in respect of a nonperforming asset purchased from other banks should first be adjusted against its acquisition cost. Recoveries in excess of the acquisition cost can be recognised as profit;

vii) the asset classification status of an existing exposure to the same obligor in the books of the purchasing bank will continue to be governed by the record of recovery of that exposure and hence may be different;

viii) for the purpose of capital adequacy, banks should assign 100 per cent risk weights to the non-performing financial assets purchased from other banks;
ix) in the case the nonperforming asset purchased is an investment, then it would attract capital charge for market risks also; and

x) the purchasing bank should ensure compliance with the prudential credit exposure ceilings (both single and group) after reckoning the exposures to the obligors arising on account of the purchase.

These guidelines were partially modified in May 2007, whereby it was stipulated that at least 10 per cent of the estimated cash flows should be realized in the first year and at least 5 per cent in each half year thereafter, subject to full recovery within three years.

However, it was brought to the Reserve Bank’s notice that in some cases, NPAs were sold for much less than the value of available securities and no justification was given for sale below the economic value.

Accordingly, in October 2007, the Reserve Bank issued guidelines in terms of which banks should work out the net present value (NPV) of the estimated cash flow associated with the realizable value of the available securities net of the cost of realization, while selling NPAs. The sale price should generally not be lower than the NPV arrived at in the manner described above.

The same principle should be used in the case of compromise settlements also. As the payment of the compromise amount may be in instalments, the NPV of the settlement amount should be calculated and this amount should generally not be less than the NPV of securities.