CHAPTER FIVE

PROBLEMS IN MANAGEMENT OF NPAs

• Problems
• Remedies
• Efforts
Due to the banking sector reforms initiated in this country, banks are facing new challenges. The prominent challenges are related to four ‘C’ i.e., Credit (including NPAs), Customer, Computer and Capital Restructuring. In the changing scenario, the banks are under tremendous pressure to redefine their priorities for their survival and growth. There are many priorities but available resources and time are very limited. With the constraints of the means, the main goal of the banks to achieve sustained profit by adopting international standards of the banking practices can be achieved by proper prioritization of priorities. The top most priority for any bank is to manage its NPA at the international prescribed level of 5% on a gross basis and 2.5% on net basis or below. In this direction, the Reserve Bank of India has already taken following decisions for implementation by the banks:

- An asset will be treated as doubtful if it has remained in substandard category for 90 days from the year ending 31 March 2004.

- The Government guaranteed advances, which have turned sticky, are to classified as NPAs as per the existing prudential norms with effect from 1st April 2000.

- Banks should ensure a loan review mechanism for larger advances soon after its sanction and continuously monitor the weaknesses developing in the accounts for initiating corrective measures in time.

- Bank should take effective steps for reduction of NPAs and also put in place risk management systems and practices to prevent reemergence of fresh NPAs.

With the existing guidelines the position of NPAs in the Indian Banking System is now alarming. High level of NPAs has many ill effects on the banking industry and also it has devastating effects on the financial as well as economic condition of the country. Containing NPAs to the minimum level is a major challenge to the Bankers. The NPAs menace cannot be tackled by any quick-fix method. It is now necessary to manage the NPAs cancer in a more scientific and objective manner for survival in the long run.
PROBLEMS IN MANAGEMENT OF NPAs

The Public Sector Banks undertake lending to different sectors of the economy and have geographical spread through its branch network. Viability of any bank depends on the profit generating capacities of its operation. The most critical area in the improvement of the profitability of banks continues to be reduction of Non Performing Assets. Today the quality of loan assets is the most important factor for the basic viability of the banking system. The overdue advances of banks in India are mounting and in consequence the NPAs in their portfolio are on the rise, impinging on the bank's viability. Avoidance of loan losses is one of the pre-occupations of management of banks. While complete elimination of such losses is not possible, bank management aims to keep the losses at a low level. In fact, it is the level of NPAs, which to a great extent differentiate between a good and bad bank.

However, in an effort to manage the NPAs, banks are facing certain problems. The researcher observed certain problems of the banks in managing NPAs during discussion with the Branch managers/ Loan Officers/ Banking Consultants etc. These are:

- Non-availability of timely and sufficient information from branches regarding review of accounts under different categories. This leads to delay in identification of potential NPAs and executing timely remedial measure. Timely identification of NPAs may upgrade potential NPAs to standard assets.

- Banks do not get adequate time to analyze the data received from branches for NPA control. In banks, staff is overburdened, as due to VRS, staff opted Voluntary Retirement has not been replaced with new staff. Hence work distributed among the available staff resulted in excessive load of work among them. However, computerization of banking activities gave some relief to staff.

- Branches are not well equipped with adequate facilities to counter NPAs problem. Due to vast network of branches, computerization of banking activities is not available in all the
branches. Use of information and technology is of immense importance in NPAs management.

- Government interference in credit distribution system by way of directed lending pose a serious threat in management of NPAs. In management of NPAs appraisal of loan proposal is very important, but in case of Government sponsored schemes bank are bound to give loan to those sectors/borrowers with higher probability of NPAs at low interest rate. This has resulted in tax on profitability, and high graph of NPAs.

- It is observed that bank staff is not fully aware of guidelines issued by RBI regarding NPAs reduction techniques and recovery of loan aspects. All this require proper training which is much needed at different levels in bank branches.

- The biggest problem faced in management of NPAs is our faulty legal system. Judiciary process in India is very cumbersome and time consuming. It takes very long time to settle case and at times defaulters escape from the liability. Efforts are being initiated to improve the bottlenecks in the judiciary process.

- Proper appraisal of loan proposal, monitoring of warning signals and prompt follow-up is a key to control the NPAs at minimum level. But due to various reasons these basic elements do not exist at desirable level in bank branches.

- Willful defaulters also pose a serious threat in management of NPAs. However, efforts are being made to circulate the list of such willful defaulters so that other banks/ FIs may be restricted to extend loan to them.
REMEDIES FOR THE MANAGEMENT OF NPAs

'There is a salve for every sore'\textsuperscript{2}

A bank creates an asset by lending 50% to 90% of the project cost. The bank has major stake in an asset than the borrower, so it should be the responsibility of the bank to see and maintain the status of the asset. While creating an asset, the bank wants that the asset should be performing one from the beginning and remains so till its liquidation. But, sooner or later, it becomes or tends to become Non Performing Asset unless managed properly; due to various reasons. Then it becomes a problematic asset and needs intensive care.

In order to make more assets performing; to reduce quantum of NPAs, and to minimize the amount of provision requirements, the bank should make all efforts to arrest slippage of performing assets, upgrade NPAs and also to liquidate NPAs. However, before making any effort following aspects are of utmost importance:

UNDERSTANDING OF NPAs GAMUT

Understanding of NPA related aspect is of paramount importance. Banks should know about RBI guidelines regarding Prudential Norms on Income Recognition, Assets Classification and Provisioning pertaining to Advances. All these norms have been discussed in chapter four.

IDENTIFICATION OF NPAs.

As per RBI guidelines regarding Income Recognition, Assets Classification and Provisioning pertaining to Advances, bank should identify the NPAs regarding term loans, agriculture advances, cash credit and overdraft credit facilities, bills purchased and discounted and other credit facilities.

PREVENTION OF NPAs

It has been observed that NPAs in absolute terms is increasing in Public Sector Banks. It indicates that the banks have not adopted effective preventive measures to arrest degradation of standard assets to NPAs.
category. Prevention of NPAs is the most effective NPAs management technique as 'prevention is better that cure'. Due to NPAs' fear many bankers are adopting the following measures for avoiding NPAs.

- Lower exposure to credit.
- Preference to credit against tangible securities.
- Over and undue caution in credit decisions.

The above measures cannot help to check the increase in NPAs; as because, extending credit to customers is the basic business of banks. Banks cannot escape from credit business and like any other business, there is also risk associated with credit business. There is nothing like zero risk lending. Banks should not feel shy of taking credit decisions; rather, due to liberalization, privatization and globalization, in the new millennium they are supposed to take critical credit decisions for their survival. Further, over cautious approach and obtaining tangible securities indiscriminately will not help the banks in arresting NPAs, as NPAs depends on the recoverability of interest/ installment but not on the securities. Therefore the banks are required to adopt effective remedial measures for arresting slippages of standard assets. The possible remedies for effective control over incidence and management of NPAs are:

- Effective credit risk management,
- Effective credit marketing,
- Management of potential NPAs,
- Upgradation of Fresh NPAs, and
- Liquidation of NPAs.

**EFFECTIVE CREDIT RISK MANAGEMENT**

Of all kinds of risks that banks are exposed to, credit risk poses a major threat to the survival of banks. Credit risk can be defined as the possible adverse impact on the bank arising out of loan default i.e. non-payment or delayed payment of principal and/ or interest. It is merely a chance or probability of default, which may vary from zero to 100 percent. It cannot be avoided, but can be minimized to a great extent by adopting proper credit risk management techniques.
Before lending, it is important to identify the determinants of risk involved with a particular credit. There are many risk factors associated with any credit, but important among them are the factors that may affect repayment of the proposed loan adversely. Following cardinal principles of lending should be kept in mind before giving loan:

**Safety**: It depends upon the credit worthiness of the borrower. Such credit worthiness is judged on the basis of age old 5 C's criteria of credit i.e. character, capacity, capital, collateral and condition.

**Liquidity**: It depends on the income generation capacity of the project/ asset. Preference should be given to those projects/ activities, which can generate sufficient income even in adverse situations.

**Security**: Security serves as a safety valve for an unexpected emergency. But, indiscriminate acceptances of any security will not help in any way. The bankers are facing a lot of problems in the disposal of the tangible securities, which include property and plant and machinery acquired from the borrowers. So, while accepting any security, the bank should follow the "MAST" principles of good security i.e. Marketability, Ascertainability of value, Stability of value and Transferability.

**Diversification of Risks**: Market recession, natural calamities and political interference may ruin even a prosperous business. To safeguard the loan assets against such unforeseen contingencies, banks should follow the principle of diversification of risks based on the famous adage" do not keep all the eggs in one basket". The advances should be spread over a reasonably wide area, distributed amongst a good number of customers belonging to different trades and industries.

**Proper Credit Management**: Quality of lending depends upon proper credit management, which involves the following aspects:

- Proper credit investigation,
• Scientific credit appraisal, which includes, project cost appraisal, technical feasibility, economic viability, managerial ability, marketability, financial viability and sensitivity analysis.
• Timely credit disbursement,
• Effective credit supervision/ surveillance,
• Proper credit documentation,
• Committee approach on credit dispensation,
• Effective loan review mechanism and portfolio management,
• Scientific credit risk pricing,
• Effective credit management information system, and
• Proactive credit policy,

It has been observed that loan accounts have become NPAs because of faulty repayment schedule stipulated by the banks. Repayment schedule should not be fixed up on the basis of any rule of thumb; rather it should be stipulated on case-to-case basis depending upon cash flows; the asset project life and borrower’s consumption requirement. In case of term loans, the installment should not be fixed always on flat rate basis, rather it should be either equated, graduated or flexible depending upon the stream of surplus available for repayment. It is also observed that some accounts, which have become NPAs due to the flat rate installment system, could have been avoided, had the banks adopted the equated installment system. Generally in case of consumer loan, car loan, education loan, housing loan, the banks are stipulating equated monthly installments. In early period of such loans there is high pressure on repayment due to low income in early years of service/ business. If there is slight increase in consumption of the borrowers, it may lead to default in repayment and ultimately the account may become NPA. This can be avoided by adopting graduated installment system, which is also commensurate with the gradual increase in income of borrowers over the loan periods.
EFFECTIVE CREDIT MARKETING

Traditional way of lending is one of the causes for creation of NPAs. Generally, while advancing to borrowers, most of the bankers think that they are obliging the borrowers with loan; rather they should be obliged to the good borrowers for giving a business opportunity. Because of this psychological factor some have developed procrastination in credit dispensation; make unnecessary and repeated queries; create procedural bottlenecks, and neglect in credit supervision.

After nationalization, the bankers are feeling the importance of the bank marketing. Some of the banks have started aggressive marketing of their deposit products; but credit marketing is still in infancy. A few banks have initiated credit marketing but it is restricted to traditional lending i.e. consumer finance, car finance, etc. It should be extended to agriculture finance, industrial finance, trade finance, etc. In traditional way of lending the borrowers approach the bankers, but in credit marketing the bankers are required to go to the market to locate the prospective borrowers and finance them for productive activities/ projects. In contrast to traditional finance, Credit Marketing in these areas is an acid test for bankers, as it involves:

- Moving closer to customers,
- Identifying their financial needs,
- Developing geographic as well as activity specific credit products,
- Tuning these products to meet the specific needs of the individual customers,
- Pricing these products at a competitive rate, and
- Servicing these products in better way in comparison to the competitors.

Banks are required to develop in-house expertise for the development and marketing of such credit products at a competitive price with a minimum risk.

MANAGEMENT OF POTENTIAL NPAs

Even after immunization; there is possibility of becoming an account NPAs. Generally, all of a sudden an account does not become NPA. Long before, it starts showing symptoms of NPAs. That is why it is important to diagnose the
potential NPAs at the earliest possible and take suitable preventive measures to check its slippage to NPAs.

Potential NPAs is a loan asset which is going to be declared / classified as NPAs as on the coming balance sheet date i.e. on 31st March of the current financial year due to lack of recovery of Critical Due Amount (CDA). Hence, one of the most important aspects in managing NPAs is the need to curb the incidences of NPAs amongst new loans sanctioned at the earliest level. Potential NPAs can be prevented from becoming NPAs by the following ways:

- By recovering the critical due amount i.e. the amount of arrears to both interest and installment up to 31 August of the financial year before or as on 31 March of the financial year,
- By rescheduling the repayments where there is possibility of poor/ nil recovery due to genuine causes beyond the control of the borrower.

UPGRADATION OF NPAs

High volume of NPAs in banks has created a psychological barrier in the minds of bankers towards the recoverability due to a paradox in the NPAs concept. As per the NPAs concept, for a certain amount of default, the whole amount outstanding in the account including other credit facilities of the borrower becomes NPAs. It is surprising to note that default of 2% to 5% of the NPAs amount is responsible for creating 100% NPAs in some cases. Like prevention, upgradation of NPAs also is an equally important technique for reduction of NPAs. Upgradation of NPAs has more advantages in comparison to liquidation of NPAs, such as:

- For upgradation of NPAs, a smaller portion of NPAs is required to be recovered, whereas, as in case of liquidation the whole amount of NPAs is required to be recovered.
- The psychological pressure of recovery on borrower as well as bankers is less in case of upgradation of NPAs in comparison to liquidation of NPAs.
• By upgradation of NPAs, the asset becomes performing one, which if maintained, can generate income whereas by liquidation, source of income is blocked.

• Upgradation is less costly to liquidation of NPAs.

In certain cases accounts may become non-performing because of default in loan repayment, mainly due to circumstances beyond control of the borrowers like:

• Natural calamities such as flood, drought, earthquake, land slide, pest and disease, cyclone etc. that damages productive assets/crops/live stock etc.

• Unforeseen circumstances such as market recession, riots, political disturbances etc. which adversely affects price mechanism, forward and backward linkages etc.

Such NPAs accounts can be upgraded to standard category by Reschedulement of loan installments and / or rehabilitating fresh loaning to the affected borrowers on a case-by-case analysis.

LIQUIDATION OF NPAs

Liquidation of NPAs is the last resort for reduction of NPAs. Liquidation of fresh NPAs is not so easy as compared to their upgradation, because in case of liquidation of fresh NPAs, entire amount is to be recovered whereas a much lesser amount is to be recovered for its upgradation. But, in case of chronic NPAs, the critical amount for upgradation is more or less equal to the entire NPAs amount. Therefore, more emphasis should be given to liquidation of chronic NPAs in comparison to fresh NPAs. Liquidation of NPAs is not an easy task. Though full cash recovery is the best way for liquidating a NPA account, but it is very difficult to make cash recovery of the whole NPA amount.

For liquidating NPAs, banks are adopting various methods. They are:

CASH RECOVERY THROUGH THE BANK STAFF

As we know, lack of effective follows up / credit supervision is one of the main contributory factors for incidence of NPAs in the banks. The adage ‘out of
sight out of mind' holds true in case of the borrowers. When the banker fails to keep sight of the borrower, the borrower also loses sight of the banker; which results in non-payment of the loan.

The bankers should therefore visit personally to the borrowers premises not only for recovery of loan but also for guiding/ counseling the borrowers for smooth operation of the business and maintenance of good health of the loan assets in the interest of the bank as because the bank has major stake in the loan asset. To ensure recovery of loans the banks should act as good counselors to borrowers. On site supervision is the best technique to ensure better recovery of loans. Continuous and constructive visits to the borrowers are the prime requirement for ensuring cash recovery.

It has been observed that post sanction visit in its true sense is very much lacking in most of the banks due to various reasons such as lack of attitude, manpower shortage, lack of planning, etc. For recovery of high volumes of NPAs, the manager alone cannot do the job. It requires the committed involvement of all the staff of the branch. Staff involvement in NPAs recovery can be made possible by ensuring their participation in credit delivery, providing incentives as well as inculcating the team spirit. The banks may form task forces at various levels for recovery of NPAs. They should have clear planning and preparation for recovery of NPAs. The banks should also introduce some innovative incentive schemes for the borrowers for recovery of loans, such as assurance of further credit, some relaxation in interest, prizes, publication etc.

**RECOVERY THROUGH GOVERNMENT AGENCIES**

It has been observed that the higher proportion of NPAs in priority sector advances is a result of the directed and pre approved nature of loans sanctioned under sponsored programs; absence of any security, vitiation of the repayment culture consequent to loan waiver schemes; etc. For recovery of these loans the banks should utilize the services of the sponsored agencies. It is seen that where these agencies have helped sincerely, the recovery of such loans improved. Various forums like Block Level Banker's Committee, District Consultative Committee, District Level Review Committee,
State Level Banker's Committee etc., should be utilized effectively for creation of pressure on Govt. and sponsored agencies for recovery of these loans.

In terms of Gupta Committee recommendations the banks should take the help of Govt. agencies in those states where Agriculture Credit Operation Act is in vogue. The banks should conduct recovery camps with the help of the local elected bodies like Panchayats, Municipalities, and voluntary organizations (NGOs) for effective speedy recovery of NPAs. The banks in rural areas should utilize non-public business working days for recovery of NPAs. The banks may also introduce some innovative incentive schemes for Government agencies for recovery of the loans. Further, the Public Sector Banks should be allowed to analyze the viability of proposals before financing to directed / priority sector.

**RECOVERY THROUGH PRIVATE RECOVERY AGENTS**

It is seen that the banks have failed/ are not in a position to recover loans from some recalcitrant borrowers by themselves. Most of the foreign banks have been successful in recovering loans from such borrowers through the recovery agents. Some public sector banks are in the process of commissioning Private Recovery Agents to tackle the problem of NPAs. Under this scheme, banks engage Private Agents for recoveries on selective basis and formulate a transparent policy for empanelment of recovery agents, payment of commission, the norms to be followed by the agents, etc.

**RECOVERY THROUGH LEGAL BODIES**

When the other recovery measures become ineffective, the last resort available to the banks is to proceed through the legal/judicial process for recovery of the loans. To bring down the level of NPAs, it is absolutely necessary to initiate timely and appropriate legal action for realization of bank dues from the borrowers. Various judicial processes like Lok Adalats, DRTs, and SRFAESI Act etc. available for taking legal action are discussed in the next part of the chapter.
EFFORTS IN MANAGEMENT OF NPAs

Considering the ill effects of NPAs and possible danger to the financial system and the economy as a whole, the Government of India, RBI and various regulatory authorities have made various efforts to counter the problem of NPAs. These may include:

DEBT RECOVERY TRIBUNALS

DRTs were set up under Recovery of Debts Due to Banks and Financial Institutions Act 1993. Under the Act, two types of Tribunals were set up i.e. Debt Recovery Tribunal (DRT) and Debt Recovery Appellate Tribunal (DRAT). The DRTs are vested with competence to entertain cases referred to them, by the banks and FIs for recovery of debts due to the same. The order passed by a DRT is appealable to the Appellate Tribunal. But no appeal is entertained by the DRAT unless the applicant deposits 75% of the amount due from him as determined by it. However, the Appellate Tribunal may, waive or reduce the amount of such deposit.

Advances of Rs. 1 million and above can be settled through DRT process. The amendments made in 2000 to the above Act and the Rules framed there under have strengthened the functioning of DRTs. An important power conferred on the Tribunal is that of making an interim order (whether by way of injunction or stay) against the defendant to debar him from transferring, alienating or otherwise dealing with or disposing of any property and the assets belonging to him without prior permission of the Tribunal. This order can be passed even while the claim is pending.

It would be observed from the Table 5.1 that DRTs are emerging as an effective agency in recovery of NPAs. The number of cases referred to DRTs increased significantly from 11700 involving amount of Rs.8866.67 crore in the year 1997 to 67875 involving amount of Rs.105169 crore in the year 2005. Similarly constant increase is also observed in number of cases decided and the amount recovered. Number of cases decided which were 1045 with recovered amount of Rs.178.08 crore in the year 1997 rose to 32389 with recovery amount Rs. 10281 crore in the year 2005.
TABLE 5.1 PERFORMANCES OF DRTs

<table>
<thead>
<tr>
<th>Year</th>
<th>No. Of Cases Filed</th>
<th>Amount Involved</th>
<th>No of Cases Decided</th>
<th>Recovery Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>11700</td>
<td>8866.67</td>
<td>1045</td>
<td>178.08</td>
</tr>
<tr>
<td>2001</td>
<td>N.A.</td>
<td>N.A.</td>
<td>8625</td>
<td>1657.00</td>
</tr>
<tr>
<td>2002</td>
<td>N.A.</td>
<td>N.A.</td>
<td>13520</td>
<td>2664</td>
</tr>
<tr>
<td>2003</td>
<td>57915</td>
<td>82266</td>
<td>22163</td>
<td>5787</td>
</tr>
<tr>
<td>2004</td>
<td>63600</td>
<td>91926</td>
<td>27956</td>
<td>7845</td>
</tr>
<tr>
<td>2005</td>
<td>67875</td>
<td>105169</td>
<td>32389</td>
<td>10281</td>
</tr>
</tbody>
</table>

Source: RBI Trend and Progress Report (Various Issues)

Though DRTs are emerging as an effective agency in recovery of NPAs, it is observed that the defendants approach the High Court challenging the verdict of the Appellate Tribunal, leads to further delays in recovery. Validity of the Act is often challenged in the court, which hinders the progress of the DRTs.

LOK ADALATS

The institution of Lok Adalats constituted under the legal Service Authorities Act, 1987 helps in resolving disputes between the parties by conciliation, mediation, compromise or amicable settlement. These are voluntary agencies created by the State Government to assist in matters of loan compromise. Lok Adalats also provide banks with an avenue to recover their smaller NPAs. According to the earlier guidelines, banks could settle banking disputes involving amounts up to Rs.5 lakh through Lok Adalats. Later, the monetary ceiling of cases to be referred to Lok Adalats organized by civil courts was enhanced to Rs.20 lakh. Banks want to increase the limit to Rs 50 lakh. Furthermore, 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 Reserve Bank has issued guidelines to commercial banks and FIs advising them to make increasing use of Lok Adalats.

The popularity of Lok Adalats can be gauged from the fact that several people of particular localities/ various social organizations are approaching Lok
Adalats. Lok Adalats are generally presided over by two or three senior persons including retired senior civil servants, defense personnel and judicial officers. Lok Adalats meet at different places for the convenience of banks and borrowers. On the given date of the Lok Adalats meeting, both the bankers and borrowers should be present. After looking into the evidences and listening to both parties, the Lok Adalats work out an acceptable compromise. They are advised to reach to some settlement due to social pressure of senior bureaucrats or judicial officers or social workers. Thereafter, Lok Adalats issues a recovery certificate, which enables the bank in obtaining decree from the concerned court. Under the Legal Services Authorities Act, Lok Adalats has been given the status of a Civil Court and every award made by Lok Adalats is final and binding on all parties and no appeal lies to any court against its award 10.

Earlier the role of Lok Adalats was confined to road accidents, matrimonial cases, and compoundable criminal and land acquisition cases until it was broadened to include debt recovery cases and listed cases. After Debt Recovery Tribunals were empowered to organise Lok Adalats to decide on cases of NPAs, cases referred to Lok Adalats and amount of recoveries of NPAs increased considerably. Number of cases filed with Lok Adalats in the year 2003 which were 272793 involving amount of Rs.1193.3 crore increased to 465046 in the year 2004 involving amount of Rs.2433 crore 11. Table 5.2 shows clearly that amount of recoveries made through Lok Adalats has increased from 40.38 crore in 2001 rose to 328 crore in the year 2004. It proves the effectiveness of Lok Adalats in settlement of NPAs of banks.

<table>
<thead>
<tr>
<th>YEAR</th>
<th>AMOUNT RECOVERED</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>40.38</td>
</tr>
<tr>
<td>2002</td>
<td>78.00</td>
</tr>
<tr>
<td>2003</td>
<td>190.50</td>
</tr>
<tr>
<td>2004</td>
<td>328.00</td>
</tr>
</tbody>
</table>

In general, it is observed that banks do not get full advantage of Lok Adalats. It is difficult to collect the concerned borrowers willing to go in for compromise
on the day when the Lok Adalats meets. Still in many states, the Legal Services Authorities Act has not been notified and Legal Services Authorities / Committees have not been constituted. In such States, Lok Adalats cannot be organized. Efforts should be made to give wide publicity to the scheme, besides educating both banks and borrowers about Lok Adalats.

The banks should take following steps for effective settlement of a case through Lok Adalats:

- The bank should prepare a detailed list of suitable cases including both pending suits filed as well as fresh cases covering all the branches located in the area for taking up with the Lok Adalat.
- The bank, in association with other banks where cases are not enough; may approach the legal services cell attached to the District Court or High Court for organizing Lok Adalats exclusively to deal with the bank cases.
- The bank may initiate pre reconciliation with the borrowers in advance for easy settlement in the Lok Adalat
- The bank may make necessary publicity for the proposed Lok Adalat to ensure maximum participation of the borrowers.
- The bank should keep ready all the necessary documents and the paper works for putting to the Lok Adalat on the fixed day for quick settlements.

BOARD FOR INDUSTRIAL AND FINANCIAL RECONSTRUCTION (BIFR)

In the wake of sickness in the country's industrial climate prevailing in the eighties, the Government of India set up in 1981, a Committee of Experts under the Chairmanship of Shri T.Tiwari to examine the matter and recommend suitable remedies therefore. Based on the recommendations of the Committee, the Government of India enacted a special legislation namely, the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986) commonly known as the SICA.
The main objective of SICA is to determine sickness and expedite the revival of potentially viable units or closure of unviable units (Sick Industrial Company). It was expected that by revival, idle investments in sick units will become productive and by closure, the locked up investments in unviable units would get released for productive use elsewhere.

All the companies, which come under the preview to SICA, need to be referred to BIFR. BIFR was set up in January 1987 for determining the preventive, ameliorative, remedial and other measures which were required to be taken in respect of sick industrial companies and for expeditious enforcement of the measures determined. The Board is empowered to decide the course of action according to requirement of the case like (i) allowing the company time on its own, (ii) deciding on the winding up of the company, (iii) deciding reconstruction, revival or rehabilitation of the sick company, (iv) deciding amalgamation of sick company, (v) deciding the sale or lease of a part or whole undertaking etc. The decision of the BIFR has binding on all concerned.

However, the working of BIFR has been subject to much debate. The available data reveal that as on 31st March 2001, out of total 3435 cases, which were registered with the board only 2160, cases were disposed off by the board. The disposed cases included over 700 such companies, which were simply dismissed as non-maintainable by the board. That effectively means that the board took decision on only 1460 companies. Thus as on March 31st 2001, the board was yet to take a decision on 1275 companies. The performance till year 2004 also indicates that out of total 5147 cases registered with board only 436 cases were reviewed, 259 cases were under revival, 1377 cases are dismissed and the board recommended winding up in 1302 cases.

SICA applies to companies both in public and private sectors owning industrial undertakings: -

- Pertaining to industries specified in the First Schedule to the Industries (Development and Regulation) Act, 1951, (IDR Act) except the industries relating to ships and other vessels drawn by power and;
• Not being "small scale industrial undertakings or ancillary industrial undertakings" as defined in Section 3(j) of the IDR Act.
• The criteria to determine sickness in an industrial company are (i) the accumulated losses of the company to be equal to or more than its net worth i.e. its paid up capital plus its free reserves (ii) the company should have completed five years after incorporation under the Companies Act, 1956 (iii) it should have 50 or more workers on any day of the 12 months preceding the end of the financial year with reference to which sickness is claimed. (iv) it should have a factory license 14.

SETTLEMENT OF CLAIMS WITH DEPOSIT INSURANCE $ CREDIT GUARANTEE CORPORATION (DICGC) / EXPORT CREDIT & GUARANTEE CORPORATION LTD. (ECGC)

The concept of insuring deposits kept with banks received attention for the first time in the year 1948 after the banking crises in Bengal. After the crash of the Palai Central Bank Ltd., and the Laxmi Bank Ltd. in 1960. The Deposit Insurance Corporation (DIC) Bill was introduced in the Parliament on August 21, 1961. After it was passed by the Parliament, the Bill got the assent of the President on December 7, 1961 and the Deposit Insurance Act, 1961 came into force on January 1, 1962. The Deposit Insurance Scheme was initially extended to functioning commercial banks only. This included the State Bank of India and its subsidiaries, other commercial banks and the branches of the foreign banks operating in India.

Further, the Government of India, in consultation with the Reserve Bank of India, introduced a Credit Guarantee Scheme in July 1960. The Reserve Bank of India was entrusted with the administration of the Scheme, as an agent of the Central Government, under Section 17 (11 A)(a) of the Reserve Bank of India Act, 1934 and was designated as the Credit Guarantee Organization (CGO) for guaranteeing the advances granted by banks and other Credit Institutions to small scale industries. The Reserve Bank of India operated the scheme up to March 31, 1981.
The Reserve Bank of India also promoted a public limited company on January 14, 1971, named the Credit Guarantee Corporation of India Ltd. (CGCI). The main thrust of the Credit Guarantee Schemes, introduced by the Credit Guarantee Corporation of India Ltd., was aimed at encouraging the commercial banks to cater to the credit needs of the hitherto neglected sectors, particularly the weaker sections of the society engaged in non-industrial activities, by providing guarantee cover to the loans and advances granted by the credit institutions to small and needy borrowers covered under the priority sector.

With a view to integrating the functions of deposit insurance and credit guarantee, the above two organizations (DIC & CGCI) were merged and the present Deposit Insurance and Credit Guarantee Corporation (DICGC) came into existence on July 15, 1978. Consequently, the title of Deposit Insurance Act, 1961 was changed to 'The Deposit Insurance and Credit Guarantee Corporation Act, 1961'.

The Government of India set up the Export Risks Insurance Corporation (ERIC) in July 1957 in order to provide export credit insurance support to Indian exporters. It was transformed into Export Credit & Guarantee Corporation Limited (ECGC) in 1964. To bring the Indian identity into sharper focus, the Corporation's name was once again changed to the present Export Credit Guarantee Corporation of India Limited in 1983. ECGC is a company wholly owned by the Government of India. It functions under the administrative control of the Ministry of Commerce and is managed by a Board of Directors representing Government, Banking, Insurance, Trade, Industry, etc.

If Deposit Insurance and Credit Guarantee Corporation (DICGC)/ Export Credit Guarantee Corporation (ECGC) claims are available, banks / branches should submit the claim proposals in all eligible NPAs accounts with necessary details as per the claim settlement guidelines. Proper follow-up with DICGC/ECGC is necessary for early settlement of claims and reducing the NPA.
COMPROMISE SETTLEMENT SCHEME

Compromise is one of the 'NPA Management' techniques being adopted by the banks. Of late, banks have been increasingly resorting to compromise settlements. A compromise can be defined as a negotiated settlement in which the borrower agrees to pay a certain amount to the bank after getting certain concessions and which will ensure to recover the bank's dues to the maximum extent possible at a minimum sacrifice.

Advantages of compromise are:

- It reduces non-performing assets of the banks,
- The bank can recycle the fund received as compromise amount,
- The bank can save the manpower, time and expenses involved in the legal process,
- Generally any method other than compromise takes longer time. With the passage of time there is deterioration in the quality of asset/security and forced sale of security, in case of need, affects the market value; which may not fetch even the present compromise amount in future.
- Sometimes the bank may not win the case in the legal proceedings due to defective documents/procedures, and
- It is less irksome method to NPA reduction.

In every compromise case the Benefit Sacrifice Analysis (BSA) should be done to ascertain whether the compromise is financially beneficial to the bank or not, beside the advantages of NPA reduction. It is expected that the bank can recycle the amount received as compromise amount; which has also the time value of money. In a very conservative approach, even if, the bank does not recycle the compromise amount, still the bank can save of cost of funds plus the operating/servicing cost on the loan assets, which is to be maintained over a period to time for recovery through an expensive and time consuming legal process. Anyhow, whatever may be the benefit in a compromise case, the bank incurs financial loss; which is equal to the sacrifice amount i.e. the total loan outstanding as on the date of compromise minus the compromise amount. The benefit-sacrifice ratio can be defined as the ratio of the present value of the total benefits to be received and the
present value of the total sacrifices to be made by the bank. In mathematical
terms, the Benefit-Sacrifice Ratio (BSR) can be expressed as:

$$BSR = \frac{100+D}{P \cdot (100+RT)+100L}$$

Where:

- **C** - Total compromise amount
- **P** - Principal loan outstanding including notional interest/the suit file amount as on the date of Compromise.
- **L** - Expected total legal expenses
- **F** - Cost of funds of the bank (in percentage)
- **S** - Credit Operating cost/ Servicing cost /Establishment cost as percentage of working funds (in percentage)
- **R** - Rate of interest charged in the account (in %)
- **d** - Discount factor at R% on T' th Year
- **D** - Aggregate discount factor at F% for T year

In any compromise where BSR is more than one, that compromise is beneficial to the bank. If it is less than one, it is not beneficial.

There can be several forms of compromise settlement e.g. One Time Settlement Scheme (OTS) and Negotiated Settlement Schemes.

**ONE TIME SETTLEMENT SCHEMES (OTS)**

RBI has issued guidelines under the one time settlement scheme. It covers all NPAs in all sectors, which have become doubtful or loss assets as on 31st March 2000 are thereafter. All cases in which the banks have initiated action under the SRFAESI Act and also cases pending before Courts/DRTs/BIFR, subject to consent decree being obtained from the Courts/DRTs/BIFR are covered. However, cases of willful default, fraud and malfeasance are not covered.

As per the OTS scheme, for NPAs up to Rs.10 crore, the minimum amount under the scheme recovered should be 100% of the outstanding balance in the account. For NPAs above Rs. 10 crore the CMDs of the respective banks should personally supervise the settlement of NPAs on a case-to-case basis.
Board of Directors may evolve policy guidelines regarding one time settlement of NPAs as a part of their loan recovery policy.

As on March 31, 2003 under the OTS scheme for NPAs up to Rs. 10 crore a total of 52,669 applications amounting to Rs. 519 crore were received. Of these recoveries affected were for 30,888 cases amounting to Rs. 168 crore. OTS under banks own scheme the corresponding recoveries were for 1.62 lakh accounts amounting to Rs. 1,583 crore.

NEGOTIATED SETTLEMENT SCHEMES
The RBI / Government have been encouraging banks to design and implement policies for negotiated settlements, particularly for old and unresolved NPAs. The broad framework for such settlements was put in place in July 1995. Specific guidelines were issued in May 1999 to public sector banks for one-time settlements of NPAs of small-scale sector. This scheme was valid until September 2000 and enabled banks to recover Rs.6.7 billion from various accounts. Revised guidelines were issued in July 2000 for recovery of NPAs of Rs.50 million and less. These guidelines were effective until June 2001 and helped banks recover Rs.26 billion.

ENACTMENT OF SRFAESI ACT
The "The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act" (SRFAESI) provides the formal legal basis and regulatory framework for setting up Asset Reconstruction Companies (ARCs) in India. In addition to asset reconstruction and ARCs the Act deals with the following largely aspects, viz.:

- Securitisation and Securitisation Companies
- Enforcement of Security Interest
- Creation of a central registry in which all Securitisation and asset reconstruction transactions as well as any creation of security interest has to be filed.

The Reserve Bank of India (RBI), the designated regulatory authority for ARCs has issued directions/guidance notes, application form and guidelines.
to Banks in April 2003 for regulating functioning of the proposed ARCs. These directions/guidance notes cover various aspects relating to registration, operations and funding of ARCs and resolution of NPAs by ARCs, consideration for the same and valuation of instruments issued by ARCs. The RBI has also issued guidelines to banks and financial institutions on issues relating to transfer of assets to ARCs. Additionally, the Central Government has issued the security enforcement rules ("Enforcement Rules"), which lays down the procedure to be followed by secured creditors while enforcing its security interest pursuant to the Act.  

In April 2004, a Supreme Court ruling on the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2003 struck down the provisions requiring the borrower to pre-deposit 75 per cent of the liability in case the borrower wants to appeal against the order of attachment of the assets. Accordingly The SARFAESI Act was amended in 2004 in order to dissuade the borrower from delaying the repayment of dues and to facilitate the speedy recovery of debt of secured creditors.  

The Act permits the secured creditors (if 75% of the secured creditors agree) to enforce their security interest in relation to the underlying security without reference to the court after giving a 60-day notice to the defaulting borrower upon classification of the corresponding financial assistance as a non-performing asset. The Act permits the secured creditors to take any of the following measures:  

• Take over possession of the secured assets of the borrower including right to transfer by way of lease, assignment or sale;  
• Take over the management of the secured assets including the right to transfer by way of lease, assignment or sale;  
• Appoint any person as a manager of the secured asset (such person could be the ARC if they do not accept any pecuniary liability); and  
• Recover receivable of the borrower in respect of any secured asset, which has been transferred.
After taking over possession of the secured asset, the secured creditors are required to obtain valuation of the assets. These secured assets may be sold by using any of the following routes to obtain maximum value.

- By obtaining quotations from persons dealing in such assets or otherwise interested in buying the assets.
- By inviting tenders from the public.
- By holding public auction, or
- By private treaty

Lenders who have seized collateral in some cases and if it has not yet been possible for them to recover value from most such seizures due to certain legal hurdles, are now clearly in a much better bargaining position vis-a-vis defaulting borrowers than they were before the enactment of SRFAESI Act. When the legal hurdles are removed, the bargaining power of lenders is likely to improve further and one would expect to see a large number of NPAs being resolved in quick time, either through security enforcement or through settlements.

As on June 30, 2004, 27 public sector banks had issued 61,263 notices involving outstanding amount of Rs.19,744 crore, and had recovered an amount of Rs.1,748 crore from 24,092 cases. By end-March 2005, public sector banks had issued 83,984 notices involving an outstanding amount of Rs.26,291 crore. An amount of Rs.3,337 crore was recovered in respect of 41,697 cases. Furthermore, an amount of Rs.2,193 crore was received through 21,311 compromise proposals.

ASSET RECONSTRUCTION COMPANIES

Under the SRFAESI Act, ARCs can be set up under the Companies Act, 1956. The Act designates any person holding not less than 10% of the paid up equity capital of the ARC as a sponsor and prohibits any sponsor from holding a controlling interest in being the holding company of or being in control of the ARC. The SRFAESI Act and SRFAESI Rules / Guidelines require ARCs to have a minimum net-owned fund of not less than Rs. 20,000,000. Further, the Directions require that an ARC should maintain on an ongoing basis, a minimum capital adequacy ratio of 15% of its risk-weighted assets.
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. ARCs have been granted a maximum realization time frame of five years from the date of acquisition of the assets. The Act stipulates several measures that can be undertaken by ARC for asset reconstruction. These include:

- Enforcement of security interest,
- Taking over or changing management of the business of borrower,
- The sale or lease of the business of the borrower,
- Settlement of the borrower's dues, and
- Restructuring or rescheduling of debt.

ARCs are also permitted to act as a manager of collateral assets taken over by the lenders under security enforcement rights available to them or as a recovery agent for any bank or financial institution and to receive a fee for the discharge of these functions. They can also be appointed to act as a receiver, if appointed by any Court or DRT.

To solve the problem of bad loans, several institutions have initiated steps towards establishment of ARCs, which takeover non-performing loans of banks and FIs at a discounted rate, and manage and dispose such assets. The Reserve Bank has granted Certificate of Registration (CoR) to three ARCs so far out of which ARCIL has already started its operations. So far ARCIL has acquired NPAs worth Rs.9,631 crore from banks and FIs at a price of Rs.2,089 crore.

CORPORATE DEBT RESTRUCTURING (CDR)
The RBI has instituted the Corporate Debt Restructuring (CDR) mechanism for resolution of NPAs of viable entities facing financial difficulties. The CDR mechanism instituted in India is broadly along the lines of similar systems in the UK, Thailand, Korea and Malaysia. The objective of the CDR mechanism has been to ensure timely and transparent restructuring of corporate debt
outside the purview of the Board for Industrial and Financial Reconstruction (BIFR), DRTs or other legal proceedings. The framework is intended to preserve viable corporate affected by certain internal/external factors and minimize losses to creditors/other stakeholders through an orderly and coordinated restructuring programs.

RBI has issued revised guidelines in February 2003 with respect to the CDR mechanism. Corporate borrowers with borrowings from the banking system of Rs.20 crore and above under multiple banking arrangement are eligible under the CDR mechanism. Accounts falling under standard, sub-standard or doubtful categories can be considered for restructuring. CDR is a non-statutory mechanism based on debtor-creditor agreement and inter-creditor agreement. Restructuring helps in aligning repayment obligations for bankers with the cash flow projections as re-assessed at the time of restructuring. Therefore, it is critical to prepare a restructuring plan on the lines of the expected business plan along with projected cash flows.

In CDR process certain revisions are envisaged with respect to the eligibility criteria (amount of borrowings) and time frame for restructuring. Foreign banks are not members of the CDR forum, but it is expected that they would be signing the agreement shortly. The first ARC to be operational in India – Assets Reconstruction Company of India Ltd. (ARCIL) is a member of the CDR forum. Lenders in India prefer to resort to CDR mechanism to avoid unnecessary delays in multiple lender arrangements and to increase transparency in the process. While, in the RBI guidelines it has been recommended to involve independent consultants, banks are so far resorting to their internal teams for recommending restructuring programs.

By March 31, 2003, 60 cases worth Rs. 44,369 crore had been referred to CDR, of which 29 cases worth Rs. 29,167 crore have been approved for restructuring. As much as Rs 7,438 crore of corporate debt is yet to be recast under the Corporate Debt Restructuring (CDR) mechanism as of June 2003, causing strain on the financial health of both lenders and borrowers.
CREDIT INFORMATION BUREAU (CIB)

Credit Information Bureau (India) Limited (CIBIL) was incorporated in January 2001 by State Bank of India, HDFC Limited, M/s Dun and Bradstreet Information Services (India) Pvt. Ltd. and M/s Trans Union to serve as a mechanism for exchange of information between banks and FIs for curbing the growth of NPAs. The scheme aims at collecting from / disseminating to them details about borrowers with outstanding aggregating Rs.1 crore and above which are classified by them as 'doubtful' or 'loss' assets or where suits have been filed by them. Whereas information on non-suit filed accounts (i.e., doubtful and loss accounts) is disseminated on half-yearly basis, viz., as on March 31 and September 30 (on floppy diskettes for their confidential use), the information on suit-filed accounts is published as on March 31 every year and is updated on quarterly basis.

The information on suit-filed accounts is now published in a compact diskette (CD) form and is also available on the Reserve Bank website. The defaulters list (non – suit filed accounts) has been disseminated as on September 30, 2002; the defaulters list (suit filed accounts) as on March 31, 2002 has been published in CD form and is also placed on the Bank's website. Its quarterly updates up to December 31, 2002, have also been placed on the website.

Following the recommendations of Working Group on Willful Defaulters (Chairman: Shri S.S. Kohli), with a view to making the scheme of willful defaulters effective, the banks and FIs were advised on May 30, 2002, a revised definition of 'willful default', including diversion and siphoning of funds by borrowers and penal measures to be initiated against willful defaulters by them. In another step in this direction, the Reserve Bank set up a Working Group in response to observations made in the JPC Report regarding diversion of funds by borrowers with malafide intention and recommendation of criminal action against them in case of wrong certification on end-use of funds. The Group submitted its report in April 2003 and their recommendations are under consideration of the Reserve Bank. As a transparency measure, the banks / FIs were advised on July 29, 2003 to put in place a high-level grievances redressal
mechanism for giving a hearing to representing borrowers that they have been wrongly classified as willful defaulters.

CERTIFICATE CASES

In States where the Agricultural Credit Operations and Miscellaneous Provisions (Banks) Act has been passed, the bank loans should be secured through the mechanism of the declaration prescribed there under. The scope to the certificate proceedings varies from State to State. It may cover all agricultural loans, Govt. sponsored schemes, etc.

The following benefits are available in filing of Certificate Cases:

- No cumbersome court procedures are involved,
- No legal expenses except court fees are involved, as there is no need to engage advocates for this purpose,
- If followed properly, the decision is very quick,
- There is good impact on the borrowers because of involvement of Executive Officers of the State,
- There is no wastage of manpower in attending the courts, and
- Decree is as good as that of the Civil Court.

WRITE-OFF

Write-off is the last resort of NPAs management techniques. The bad debts which are unrecoverable have to be written off from the bank’s balance sheet. Write-off is a process by which a loan asset, preferably loss asset/bad debt, is liquidated from the balance sheet of the bank by debiting / transferring from the bank profit and loss account. For reduction of NPAs, it is an easy process for the branches but painful to the banks. Write off is required for the reasons like:

- A bad loan, which cannot be recovered, increases the NPAs level of the bank,
- Maintenance of these dead-weight assets is very expensive,
- In the long run, the servicing / maintenance cost will be more than the loan amount, and
- It makes the bank’s balance sheet clean.
Write off is an internal mechanism of the banks to clean up the unproductive assets from the balance sheet, but it, in no other way prevents the banks to recover the dues from the borrowers. Due to various reasons the banks have written off some accounts, where, some recovery can be obtained. Further the recovery drive should continue in the written off cases as to create a healthy repayment environment in the banks. Therefore, the banks should employ some innovative techniques like engagement of private recovery agents, award of incentives to branch staff for recovery in these cases. Any recovery in the written off accounts will increase directly the profitability of the banks.

Due to introduction of effective recovery techniques as mentioned above, banks succeeded in significant recovery of NPAs. As it would be observed from the Table 5.3 Public Sector Banks recovered Rs. 12,581 crore in the year 2002 which invariably increased to Rs.14,059 crore in year 2003 and Rs.18,730 in the year 2004. Volume of NPAs can be reduced more and the recoveries may be increased by adopting effective appraisal and monitoring system and by improving legal framework.
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<td><strong>12,581</strong></td>
<td><strong>14,059</strong></td>
<td><strong>18,730</strong></td>
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*Including write-offs
Source: Parliament Questions www.cir, rbi.org.in

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