CHAPTER 7

MEASURES

TO CONTROL

NPA MENACE
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MEASURES TO CONTROL NPAS MENACE

7.1 It is proved beyond doubt that NPAs in bank ought to be kept at the lowest level. This would be possible only if two pronged approaches viz., A) Preventive management and B). Curative management is followed.

A) PREVENTIVE MANAGEMENT:

Credit Assessment and Risk Management

Mechanism: A lasting solution to the problem of NPAs can be achieved only with proper credit assessment and risk management mechanism. The documentation of credit policy and credit audit immediately after the sanction is necessary to upgrade the quality of credit appraisal in banks. In a situation of liquidity overhang the enthusiasm of the banking system is to increase lending with compromise on asset quality, raising concern about adverse selection and potential danger of addition to the NPAs stock. It is necessary that the banking system is equipped with Prudential norms to minimize if not completely avoid the problem of credit risk.

7.1.1) Credit appraisal Standards:

7.1.1. A) Qualitative:

At the outset, the proposition is examined from the angle of viability and also from the Bank's prudential levels of exposure to the borrower, Group and Industry. Thereafter, a view is taken about the past experience the bank has with the promoters, if there is a track record to go by. Where it is a new connection for the Bank but the entrepreneurs are already in business, opinion reports from existing bankers and published data if available are carefully perused. In case of a maiden venture, in addition to the drill mentioned above, an element of subjectivity is introduced as scant historical data would be available and weight age is given on impressions gained out of the serious dialogues with the promoter and his business contacts.
7.1.1. 8) Quantitative:
The basic quantitative parameters underpinning the Bank's credit appraisal for working capital are as follows:-

(i) Liquidity:
Current Ratio (CR) of 1.5 is generally considered as a benchmark level of liquidity. However, the approach has to be flexible. CR of 1.5 is only indicative and may not be deemed Mandatory. In cases where the CR is projected at a level lower than the benchmark or a slippage in the CR is proposed, it alone will not be a reason for rejection of the loan proposal or for sanction of the loan at a lower level. In such cases, the reasons for low CR or slippage should be carefully examined and in deserving cases the CR as projected may be accepted. In cases where projected CR is found acceptable, working capital finance as requested may be sanctioned. In specific cases where warranted, such sanction can be with a condition that the borrower should bring in additional long term funds to a specified extent by a given future date. Where it is felt that the projected CR is not acceptable but the borrower deserves assistance subject to certain conditions, suitable written commitment should be obtained from the borrower to the effect that he would be bringing in required amounts within a mutually agreed time frame.

(ii) Net Working Capital:
Although this is a corollary of current ratio, the movements in Net Working Capital are watched to ascertain whether there is a mismatch of long term sources vis-à-vis long term uses for purposes which may not be readily acceptable to the Bank so that corrective measures can be suggested.

(iii) Financial Soundness:
This will be dependent upon the owner's stake or the leverage. Here again the benchmark will be different for manufacturing, trading, hire-purchase and leasing concerns. For industrial ventures a Total Outside Liability/ Tangible Net Worth ratio of 3.0 is reasonable but deviations in selective cases for understandable reasons may be accepted by the sanctioning authority.

(iv) Turn-Over:
The trend in turn-over is carefully gone into both in terms of quantity and value as also market share wherever such data are available. What is more important is to establish a
steady output if not a rising trend in quantitative terms because sales realisation may be varying on account of price fluctuations.

(v) Profits:
While net profit is the ultimate yardstick, cash accruals, i.e., profit before depreciation and taxation conveys a more comparable picture in view of changes in rate of depreciation and taxation which may have taken place in the intervening years. However, for the sake of proper assessment, the non-operating income are excluded as these are usually one time or Extraordinary income. Companies incurring net losses consistently over 2 or more years will be given special attention, their accounts closely monitored, and if necessary, exit options explored.

(vi) Credit Rating:
Wherever the company has been rated by a Credit Rating Agency for any instrument such as CP/ FD, this will be taken into account while arriving at a final decision. However, as the credit rating involves additional expenditure, the banks do not normally insist on this and only use this tool if such an agency had already looked into the company finances.

(vii) Capital ‘Markets:
Where the Company's shares are listed on stock exchanges, the movement of the price of its share, the market value of shares vis-à-vis those of competitors in the same industry, response to public/ rights issues are also kept in view as these are reflective of the corporate image in the eyes of the investors' community.

(viii) Term Loan / Deferred payment guarantee:
(i) In case of term loans and deferred payment guarantees, the project report is obtained from the customer which may have been compiled either in-house or by a firm of Consultants/ merchant bankers. The technical feasibility and economic viability is vetted by the Bank and wherever it is felt necessary, the Credit Officer would seek the benefit of a second opinion either from the Bank’s Technical Consultancy cell or from the consultants of the Bank.
(ii) Promoter’s contribution of at least 20% in the total equity is what banks normally expect, but the promoter’s contribution may vary largely in mega projects. Therefore, there cannot be a definitive benchmark. The sanctioning authority will have the necessary discretion to permit deviations.
(iii) The other basic parameter would be the net debt service coverage ratio i.e. exclusive of
Interest payable, which should normally not go below 2. On a gross basis DSCR should not be below 1.75. These ratios are indicative and deviations may be permitted selectively by the sanctioning authority.

(iv) As regards margin on security, this will depend on Debt: Equity gearing for the project, which should preferably be near about 1.5:1 and should not in any case be above 2:1, i.e., Debt should not be more than 2 times the Equity contribution. Deviations from the norm may be permitted very selectively by the sanctioning authority in exceptional cases.

(v) Other parameters governing working capital facilities would also govern Term Credit Facilities to the extent applicable.

(ix) Lending to Non-Banking Financial Companies (NBFCs):
RBI have been issuing guidelines from time to time regarding lending by banks to NBFCs in order to ensure their healthy and orderly functioning and growth. In the context of mandatory registration with RBI, prescribed for all NBFCs under provisions of the RBI Act, in May 1999, RBI removed the ceiling on bank credit linked to Net Owned Funds (NOF), in respect of all NBFCs which are statutorily registered with RBI and are engaged in the principal business of Equipment Leasing (EL), Hire Purchase (HP) and Loan and Investment companies. As regards bank finance to the NBFCs which do not require to be registered with RBI, banks have been permitted to take their credit decisions on the basis of purpose of credit, nature and quality of underlying assets, repayment capacity of borrowers, as also risk perception, etc. In respect of Residuary Non-Banking Companies (RNBCs) registered with RBI, bank finance would continue to be restricted to the extent of their NOF. RBI have also advised that bank finance should not be extended to NBFCs for certain activities like investments in shares and debentures, advances to subsidiaries / group companies, investments in inter-corporate loans/deposits, etc..

The Bank's approach to financing NBFCs has been formulated within the RBI guidelines issued from time to time. Given the special features of NBFCs, as different from manufacturing units, a separate Credit Risk Assessment (CRA) model has been put in place for assessment of NBFCs. Half-yearly reviews of CRA rating have been made obligatory for units rated as risky (may be B3 ).
x) Financing of infrastructure projects:
In view of the national importance attached to infrastructure development, its criticality to Economic development of the country, the potential for large volume business and the special skills required for credit appraisal / assessment, some banks set up separate Project Finance Business Units for financing infrastructure projects. **Infrastructure would include sectors such as power, roads, highways, bridges, ports, airports, rail system, water supply, irrigation, sanitation and sewerage system, telecommunication, housing, industrial park or any other public facility of a similar nature as may be notified by CBDT in the Gazette from time to time.** Financing of infrastructure projects is characterised by large capital costs, long gestation period and high leverage ratios. Banks can sanction term loans to infrastructure projects within the overall ceiling of the prudential exposure norms. Further, subject to certain safeguards, banks are also permitted to exceed the single borrower / group exposure norm to the extent of 10%, provided the additional exposure is for the purpose of financing infrastructure projects.

xi) Lease Finance:
The exposures under lease finance are generally subject to compliance with the following Standards:

xi. (i) Normally exposure will be for full payment financial leases to be granted on the basis of Recovery of cost of asset during a single lease term.

xi. (ii) Aggregate outstanding lease exposure to a single unit not to exceed 50% of the lessee’s net worth or Rs.200 cr. in case of a Public Sector Undertaking (Rs.100 cr. in case of Private Sector company), whichever is less.

xi (iii) Banks normally limit its exposure to no more than 25% of the outlay proposed in single project on plant, machinery and other equipments.

xi (iv) Greenfield projects are accepted by the Banks only after sufficient afterthought for its exposure.

xi (v) Bank will endeavour to diversify its lease portfolio over a range of industries and a variety of equipment to avoid concentration of exposures.

xi (vi) Bank selectively participate in leasing syndications with certain reputed organisations like IDBI, ILFS etc., particularly in high value leases.
Aggregate outstanding leases normally don’t exceed 10% of the Bank’s total advances.

(xii) Letters of Credit, Guarantees and bills discounting:
Banks normally open Letters of Credit (LCs), issue guarantees/acceptances and discount bills under LCs only in respect of genuine commercial and trade transactions of borrower constituents who have been sanctioned regular credit facilities by the Bank. The prescription would not, however, prohibit the Bank from accepting such bankable business from non-borrower constituents such as Govt. / Research / Defence / Educational organizations etc. and other statutory organisations etc. who have no borrowing arrangements with any FI/bank. Bank would not open LCs and purchase/discard negotiate bills bearing the “without recourse” clause. Bank would not ordinarily discount bills drawn by front finance companies set up by large industrial groups on other group companies. While discounting bills of services sector, Bank would ensure that actual services are rendered and accommodation bills are not discounted.

Fair Practices Code (FPC) for lenders
The Banks continuously attempt to introduce transparent and fair practices, as envisaged by RBI, in respect of acknowledging loan applications, their quick processing, appraisal and sanction, stipulation of terms and conditions, post disbursement supervision, changes in terms and conditions, recovery efforts etc.

7.2) Early Recognition of the Problem:
Invariably, by the time banks start their efforts to get involved in a revival process, it’s too late to retrieve the situation - both in terms of rehabilitation of the project and recovery of bank’s dues. Identification of weakness in the very beginning, (that is when the account starts showing first signs of weakness regardless of the fact that it may not have become NPA) is imperative. Assessment of the potential of revival may be done on the basis of a techno-economic viability study. Restructuring should be attempted where, after an objective assessment of the promoter’s intention, banks are convinced of a turnaround within a scheduled timeframe. In respect of totally unviable units as decided by the bank, it is better to facilitate winding up/selling of the unit earlier, so as to recover whatever is possible through legal means before the security position becomes worse.
7.3) Identifying Borrowers with Genuine Intent:

Identifying borrowers with genuine intent from those who are non-serious with no commitment or stake in revival is a challenge confronting bankers. Here the role of frontline officials at the branch level is paramount as they are the ones who have intelligent inputs with regard to promoters’ sincerity, and capability to achieve turnaround. Based on this objective assessment, banks should decide as quickly as possible whether it would be worthwhile to commit additional finance. In this regard banks may consider having “Special Investigation” of all financial transaction or business transaction, books of account in order to ascertain real factors that contributed to sickness of the borrower. Banks may have penal of technical experts with proven expertise and track record of preparing techno-economic study of the project of the borrowers. Borrowers having genuine problems due to temporary mismatch in fund flow or sudden requirement of additional fund may be entertained at branch level, and for this purpose a special limit to such type of cases should be decided. This will obviate the need to route the additional funding through the controlling offices in deserving cases, and help avert many accounts slipping into NPA category.

7.4) Timeliness and adequacy of response:

Longer the delay in response, grater the injury to the account and the asset. Time is a crucial element in any restructuring or rehabilitation activity. The response decided on the basis of techno-economic study and promoter’s commitment, has to be adequate in terms of extend of additional funding and relaxations etc. under the restructuring exercise. The package of assistance may be flexible and bank may look at the exit option.

7.5) Focus on Cash flows:

While financing, at the time of restructuring the banks may not be guided by the conventional fund flow analysis only, which could yield a potentially misleading picture. Appraisal for fresh credit requirements may be done by analyzing funds flow in conjunction with the Cash Flow rather than only on the basis of Funds Flow.

In some default cases, where the unit is still working, the bank should make sure that it captures the cash flows (there is a tendency on part of the borrowers to switch bankers
once they default, for fear of getting their cash flows forfeited), and ensure that such cash flows are used for working capital purposes. Toward this end, there should be regular flow of information among consortium members. A bank, which is not part of the consortium, may not be allowed to offer credit facilities to such defaulting clients. Current account facilities may also be denied at non-consortium banks to such clients and violation may attract penal action. The Credit Information Bureau of India Ltd. (CIBIL) may be very useful for meaningful information exchange on defaulting borrowers once the setup becomes fully operational.

7.6) **Management Effectiveness:**

The general perception among borrower is that it is lack of finance that leads to sickness and NPAs. But this may not be the case all the time. Management effectiveness in tackling adverse business conditions is a very important aspect that affects borrowing unit’s fortunes. A bank may commit additional finance to an ailing unit only after basic viability of the enterprise also in the context of quality of management is examined and confirmed. Where the default is due to deeper malady, viability study or investigative audit should be done – it will be useful to have consultant appointed as early as possible to examine this aspect. A proper techno-economic viability study must thus become the basis on which any future action can be considered.

7.7) **Multiple Financing:**

During the exercise for assessment of viability and restructuring, a **Pragmatic and unified approach** by all the lending banks/ FIs as also sharing of all relevant information on the borrower would go a long way toward overall success of rehabilitation exercise, given the probability of success/failure.

Broadly, the objectives of post-sanction follow up, supervision and monitoring are as under:

(a) **Follow up function:**
   - To ensure the **end**-use of funds
   - To relate the out standings to the assets level on a continuous basis
o To correlate the activity level to the projections made at the time of the sanction / renewal of the credit facilities
o To detect deviation from terms of sanction.
o To make periodic assessment of the health of the advances by noting some of the key indicators of performance like profitability, activity level, and management of the unit and ensure that the assets created are effectively utilized for productive purposes and are well maintained.
o To ensure recovery of the instalments of the principal in case of term loans as per the scheduled repayment programme and all interest.
o To identify early warning signals, if any, and initiate remedial measures thereby averting the incidence of incipient sickness.
o To ensure compliance with all internal and external reporting requirements covering the credit area.

(b) Supervision function:
o To ensure that effective follow up of advances is in place and asset quality of good order is maintained.
o To look for early warning signals, identify ‘incipient sickness’ and initiate proactive remedial measures.

(c) Monitoring function:
o To ensure that effective supervision is maintained on loans / advances and appropriate responses are initiated wherever early warning signals are seen.
o To monitor on an ongoing basis the asset portfolio by tracking changes from time to time.
o Chalking out and arranging for carrying out specific actions to ensure high percentage of ‘Standard Assets’.
o Detailed operative guidelines on the following aspects of effective credit monitoring are in
o place:
o Post-sanction responsibilities of different functionaries
o Reporting for control
o Security documents, Statement of stocks and book debts
o Computation of drawing power (DP) on eligible current assets and maintaining of DP register
o Verification of assets
o Inspection by branch functionaries – frequency, reporting, register etc.
o Stock Audit
o Follow up based on information systems
o Follow up during project implementation stage
o Follow up post-commercial production
o Monitoring and control
o Detection and prevention of diversion of working capital finance
o Monitoring of large withdrawals
o Allocation of limit
o Handling of NPA accounts etc.

B) CURATIVE MEASURES TO TACKLE NPAS:

7.8 Credit Risks of NPAs: The most of the public sector banks are incapable of visualizing the risk they are going to face in the emerging global economic scenario. The risk management machinery adopted requires a comprehensive overhaul of the system by the banks in this changing condition. The second consultative document on the New Basle capital accord on banking supervision has given a stress on the risk management aspect of the banks by introducing a more risk sensitive standardized approach towards capital adequacy. In spite of the stringent recommendations and RBIs apprehensions of the adequate preparedness of the banking sector in adopting instructions, it is quite clear about the willingness of the banks to vigorously pursue effective credit risk management mechanism by visualizing the magnitude of credit risk management to curtail the growth of mounting NPAs. The concept of recovering debts through Debt Recovery Tribunals has become a grand failure. The concept of establishing Asset Reconstruction Company (ARC) has greatly benefited the banks in containing the NPAs at a manageable level. The ARC is to take over the bad debts of the public sector banks. These banks have the option of either liquidating the assets of defaulting companies overwriting off these bad debts altogether. The viable solution available to the public sector banks is to go for a better credit risk management scheme, which may be considered as difficult preposition. However a clear understanding of the
concept of risk, availability of instruments to curtail risk and the strategies required to be 
applied for implementing a risk management system are considered to be the call of the 
hour. The risk is inherent and absolutely unavoidable in banking sector. The risk is 
considered to be potential loss of an asset and portfolio is likely to suffer due to various 
reasons. It is around for centuries and thought to be the dominant financial risk today. The 
risk can be defined as the risk of erosion of value due to simple default and non-payment 
of the debt by the borrower. The degree of risk is reflected in the borrower’s credit rating, 
the premium it pays for funds and market price of the debts. In such a situation the 
financial institutions may increase their net market exposure sometimes at the expense of 
increasing the credit risk to certain parties. The credit derivatives allow financial institutions 
to change their exposure to a range of credit related risks. There are various structures that 
allow the transference of credit risk from one party to another. In some cases the bank can 
buy protection in the form of default puts to transfer the credit risk to an insurance 
company or other financial investors. Moreover the bank may swap one credit for another 
credit of equal rating to reduce its exposure to one party. The credit risk management has 
two basic objectives
1) It manages the asset portfolio in a manner which ensures that the banks have adequate 
capital to hedge their risks and
2) It matches the return to the risk. It comprises of two basic steps viz.

7.9 Identification and Ascertainment of Credit Default Risk:
In order to assess the credit default risk the concerned bank has to check the following 
five C’s from the borrower.

- Cash flows reflecting the earning capacity of the borrower.
- Collateral - the tangible assets of the borrowers who intends to mortgage.
- Character – the management capabilities of the concerned party.
- Conditions - the loan covenants to safeguard the lenders interest and
- Capital - referring to the buffer to absorb earnings shocks.

Utilization of credit default protection measures and instruments: Once the credit default is 
ascertained and quantified, credit default protection measures and instruments like credit 
default swaps, credit default options and credit linked notes can be utilized.
7.9.a Credit Default Swap: It is a bilateral financial contract in which buyer pays a periodic fee expressed in fixed basis points on the notional amount in return for a floating payment contingent on the default of a third party reference credit. The floating payment is designated to mirror the loss incurred by creditors of the reference credit in the event of its default. The credit event varies from bank to bank and from transaction to transaction. The credit events are predefined in the agreement, which includes 1. Bankruptcy 2. Insolvency 3. Rating, and downgrading below agreed threshold 4. Failure to adjust for new payment obligation and 5. Debt Rescheduling. The credit event triggers the obligation of the seller of default protection to the purchaser of the same. The investors who need to protect themselves against default but do not want to sell them at risk security for accounting, tax and regulatory reasons can buy a credit default swap.

7.9.b Credit Limited Notes (CLN): These are known as credit swaps in which buyer makes periodic payments of a fixed percentage of the reference asset to the seller over the life of the swap. Then the seller promises a payment in the case of credit default for the reasons viz., bankruptcy, delinquency and credit rating downgrade. The payments may be either a pre-determined amount and also decrease in the market value of the reference obligation that may cause the credit event. The seller calls the structure away from the investor and delivers the defaulting notes against them on the happening of credit event. The CLN are like bonds in character and are acceptable to certain banks. They are not allowed to involve in credit default swap.

7.10 Corporate Debt Restructuring (CDR): The corporate debt restructuring is one of the methods suggested for the reduction of NPAs. Its objective is to ensure a timely and transparent mechanism for restructure of corporate debts of viable corporate entities affected by the contributing factors outside the purview of BIFR, DRT and other legal proceedings for the benefit of concerned. The CDR has three tier structure viz., a. CDR standing forum b. CDR empowered group and c. CDR cell.

7.10.1 The Mechanism of the CDR: It is a voluntary system based on debtors and creditors agreement. It will not apply to accounts involving one financial institution or one bank instead it covers multiple banking accounts, syndication, consortium accounts with outstanding exposure of Rs. 20 crores and above by banks and institutions. The CDR system is applicable to standard and sub-standard accounts with potential cases of NPAs getting a priority. In addition to the steps taken by the RBI and Government of India for arresting the
incidence of new NPAs and creating legal and regulatory environment to facilitate for the recovery of existing NPAs of banks, the following measures were initiated for reduction of NPAs. It was institutionalised in 2001 to provide a timely and transparent system for restructuring of the corporate debt of Rs. 20 crore and above with the banks and FIs on a voluntary basis and outside the legal framework. Under this system, banks may greatly benefit in terms of restructuring of large standard accounts (potential NPAs) and viable sub-standard accounts with consortium/multiple banking arrangements. In a forum of lenders, the priority of each lender will be different. While one set of lenders may be willing to wait for a longer time to recover its dues, another lender may have a much shorter timeframe in mind. So it is possible that the letter categories of lenders may be willing to exit, even at a cost – by a discounted settlement of the exposure. Therefore, any plan for restructuring/rehabilitation may take this aspect into account.

7.11 Capital Adequacy Ratio of Public Sector Banks: The capital adequacy ratio reveals the health of a bank. The public sector banks are required to attain the stipulated nine percent capital adequacy ratios. The capital adequacy ratio is defined as the ratio between the total banks capital and its risk-weighted assets. As a part of the financial sector reforms the RBI has introduced the capital adequacy norms in April 1992 to encourage banks to be more risk sensitivity against both on and off balance sheet exposures. Under the prevailing system, except the government generated loans the most of the advances carry 100 percent risk weightages. According to the norms all claims on banks are assigned a risk weightage of 20 percent. With regard to off balance sheet items guarantees issued by the banks against the counter guarantee of other banks and discounting of documentary bills accepted by other banks are to the treated as claims on banks and carry a risk weight of 20 percent. But the commercial banks strived and achieved a 9 percent capital adequacy ratio to mitigate credit risk.

Table 7.1: NPAs in Scheduled Commercial Banks

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross non-performing assets</th>
<th>%</th>
<th>Net non-performing assets</th>
<th>%</th>
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<td>1992-93</td>
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<td>23.18</td>
<td>Nil</td>
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<tr>
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<td>41041</td>
<td>24.78</td>
<td>19691</td>
<td>14.46</td>
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<tr>
<td>Year</td>
<td>Gross non-performing assets</td>
<td>%</td>
<td>Net non-performing assets</td>
<td>%</td>
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<td>---------</td>
<td>-----------------------------</td>
<td>------</td>
<td>---------------------------</td>
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<td>68973</td>
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</table>

(Data compiled from RBI reports on trends and progress of banks)

**Table 7.2: RECOVERY OF NPAS**

<table>
<thead>
<tr>
<th>Year</th>
<th>% of Recovery</th>
</tr>
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<tbody>
<tr>
<td>02-03</td>
<td>33.74%</td>
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<tr>
<td>03-04</td>
<td>45.25%</td>
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<tr>
<td>04-05</td>
<td>45.37%</td>
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<tr>
<td>05-06</td>
<td>56.14%</td>
</tr>
<tr>
<td>Year</td>
<td>NPAs (%)</td>
</tr>
<tr>
<td>------</td>
<td>----------</td>
</tr>
<tr>
<td>06-07</td>
<td>53.82%</td>
</tr>
<tr>
<td>07-08</td>
<td>50.08%</td>
</tr>
<tr>
<td>08-09</td>
<td>36.72%</td>
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</table>

Source: Deccan Chronicle 27 November 2007 and RBI reports

C) PROCEDURES FOR NPA IDENTIFICATION AND RESOLUTION IN INDIA:

7.12. Internal Checks and Control

Since high level of NPAs dampens the performance of the banks identification of potential problem accounts and their close monitoring assumes importance. Though most banks have Early Warning Systems (EWS) for identification of potential NPAs, the actual processes followed, however, differ from bank to bank. The EWS enable a bank to identify the borrower accounts which show signs of credit deterioration and initiate remedial action. Many banks have evolved and adopted an elaborate EWS, which allows them to identify potential distress signals and plan their options beforehand, accordingly. The early warning signals, indicative of potential problems in the accounts, viz. persistent irregularity in accounts, delays in servicing of interest, frequent devolvement of L/Cs, units' financial problems, market related problems, etc. are captured by the system. In addition, some of these banks are reviewing their exposure to borrower accounts every quarter based on published data which also serves as an important additional warning system. These early warning signals used by banks are generally independent of risk rating systems and asset classification norms prescribed by RBI. The major components/processes of a EWS followed by banks in India as brought out by a study conducted by Reserve Bank of India at the instance of the Board of Financial Supervision are as follows:

1) Designating Relationship Manager/ Credit Officer for monitoring accounts

2) Preparation of 'know your client' profile

3) Credit rating system

4) Identification of watch-list/special mentions category accounts.

5) Monitoring of early warning signals
1) Relationship Manager/Credit Officer

The Relationship Manager/Credit Officer is an official who is expected to have complete knowledge of borrower, his business, his future plans, etc. The Relationship Manager has to keep in constant touch with the borrower and report all developments impacting borrowable account. As a part of this contact he is also expected to conduct scrutiny and activity inspections. In the credit monitoring process, the responsibility of monitoring a corporate account is vested with Relationship Manager/Credit Officer.

2) Know your client' profile (KYC)

Most banks in India have a system of preparing 'know your client' (KYC) profile/credit report. As a part of 'KYC' system, visits are made to clients and their places of business/units. The frequency of such visits depends on the nature and needs of relationship.

3) Credit Rating System

The credit rating system is essentially one point indicator of an individual credit exposure and is used to identify measure and monitor the credit risk of individual proposal. At the whole bank level, credit rating system enables tracking the health of banks entire credit portfolio. Most banks in India have put in place the system of internal credit rating. While most of the banks have developed their own models, a few banks have adopted credit rating models designed by rating agencies. Credit rating models take into account various types of risks viz. financial, industry and management, etc. associated with a borrowable unit. The exercise is generally done at the time of sanction of new borrowable account and at the time of review renewal of existing credit facilities.

4) Watch-list/Special Mention Category

The grading of the bank's risk assets is an important internal control tool. It serves the need of the Management to identify and monitor potential risks of a loan asset. The purpose of identification of potential NPAs is to ensure that appropriate preventive / corrective steps could be initiated by the bank to protect against the loan asset becoming non-performing. Most of the banks have a system to put certain borrowable accounts under watch list or
special mention category if performing advances operating under adverse business or economic conditions are exhibiting certain distress signals. These accounts generally exhibit weaknesses which are correctable but warrant banks’ closer attention.

7.13 Management/Resolution of NPAs

A reduction in the total gross and net NPAs in the Indian financial system indicates a significant improvement in management of NPAs. This is also on account of various resolution mechanisms introduced in the recent past which include the SARFAESI Act, one time settlement schemes, setting up of the CDR mechanism, strengthening of DRTs. From the data available of Public Sector Banks as on March 31, 2003, there were 1,522 numbers of NPAs as on March 31, 2003 which had gross value greater than Rs. 50 million in all the public sector banks in India. The total gross value of these NPAs amounted to Rs. 215 billion. The total number of resolution approaches (including cases where action is to be initiated) is greater than the number of NPAs, indicating some double counting. As can be seen, suit filed and BIFR are the two most common approaches to resolution of NPAs in public sector banks. Rehabilitation has been considered/ adopted in only about 13% of the cases. Settlement has been considered only in 9% of the cases. It is likely to have been adopted in even fewer cases. Data available on resolution strategies adopted by public sector banks suggest that Compromise settlement schemes with borrowers are found to be more effective than legal measures. Many banks have come out with their own restructuring schemes for settlement of NPA accounts. 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 incorporated credit Information Bureau (India) Limited (CIBIL) in January 2001. Pending the enactment of CIB Regulation Bill, the RBI constituted a working group to examine the role of CIBs. As per the recommendations of the working group, Banks and FIs are now required to submit the list of suit-filed cases of Rs. 10 million and above and suit filed cases of wilful defaulters of Rs. 2.5 million and above to RBI as well as CIBIL. CIBIL shares this information with commercial banks and FIs so as to help them minimize adverse selection at appraisal stage.
7.14 Wilful Defaulters

RBI has issued revised guidelines in respect of detection of wilful default and diversion and siphoning of funds. As per these guidelines a wilful default occurs when a borrower defaults in meeting its obligations to the lender when it has capacity to honour the obligations or when funds have been utilized for purposes other than those for which finance was granted. The list of wilful defaulters is required to be submitted to SEBI and RBI to prevent their access to capital markets. Sharing of information of this nature helps banks in their due diligence exercise and helps in avoiding financing unscrupulous elements. RBI has advised lenders to initiate legal measures including criminal actions, wherever required, and undertake a proactive approach in change in management, where appropriate.

7.15 Legal and Regulatory Regime

7.15.1 Debt Recovery Tribunals (DRT): In order to expedite speedy disposal of high value claims of banks Debt Recovery Tribunals were setup. The Central Government has amended the recovery of debts due to banks and financial institutions Act in January 2000 for enhancing the effectiveness of DRTs. The provisions for placement of more than one recovery officer, power to attach dependents property before judgment, penal provision for disobedience of Tribunals order and appointment of receiver with powers of realization, management, protection and preservation of property are expected to provide necessary teeth to the DRTs and speed up the recovery of NPAs in times to come.

DRTs were set up under the 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 shall be entertained by the DRAT unless the applicant deposits 75% of the amount due from him as determined by it. However, the Affiliate Tribunal may, for reasons to be received in writing, waive or reduce the amount of such deposit. Advances of Rs. 1 million and above can be settled through DRT process. 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 within prior permission of the Tribunal. This order can be passed even while the claim is pending. DRTs are criticized in respect of recovery made considering the size of NPAs in the Country. In general, it is observed that the defendants approach the High Country challenging the verdict of the Appellate Tribunal which leads to further delays in recovery. Validity of the Act is often challenged in the court which hinders the progress of the DRTs. Lastly, many needs to be done for making the DRTs stronger in terms of infrastructure.

**DRT cases of Chhattisgarh are currently operational at Jabalpur. (M.P). Efforts are on to establish a DRT at Raipur. A letter was issued by the Committee of State bankers to the department of financial Services and the matter is with the Finance ministry of C.G. They would be writing a letter strongly to the appropriate authorities in the Ministry of finance, Government of India recommending an establishment at DRT at C.G. It is expected that there would be a DRT at C.G by the end of 2012.**

**7.15.2 Lok Adalats:** The Lok Adalats institutions help banks to settle disputes involving accounts in doubtful and loss categories. These are proved to be an effective institution for settlement of dues in respect of smaller loans. The Lok Adalats and Debt Recovery Tribunals have been empowered to organize Lok Adalats to decide for NPAs of Rs. 10 lakhs and above. The institution of Lok Adalats constituted under the Legal Services Authorities Act, 1987 helps in resolving disputes between the parties by conciliation, mediation, compromise or amicable settlement. It is known for effecting mediation and counselling between the parties and to reduce burden on the court, especially for small loans. Cases involving suit claims up to Rs. 1 million can be brought before the Lok Adalats and every award of the Lok Adalats shall be deemed to be a decree of a Civil Court and no appeal can lie to any court against the award made by the Lok Adalats. Several people of particular localities various social organizations are approaching Lok Adalats which are generally presided over by two or three senior persons including retired senior civil servants, defense personnel and judicial officers. They take up cases which are suitable for settlement of debt for certain consideration. Parties are heard and they explain their legal position. They are advised to reach to some settlement due to social pressure of senior bureaucrats or judicial officers or social workers. If the compromise is arrived at, the parties to the litigation sign a statement in presence of Lok adalats which is expected to be filed in court to obtain a consent decree. Normally, if such settlement contains a clause that if the compromise is not adhered to by
the parties, the suits pending in the court will proceed in accordance with the law and parties will have a right to get the decree from the court. In general, it is observed that banks do not get the full advantage of the Lok adalats. It is difficult to collect the concerned borrowers willing to go in for compromise on the day when the Lok adalat meets. In any case, we should continue our efforts to seek the help of the Lok adalat

Table 7.3- Recovery through various channels.

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<td>96</td>
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<td>4.130</td>
<td>3.348</td>
<td>9.797</td>
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</tr>
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The figure reveals that as far as recovery is concerned, The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002, acted as a powerful weapon for bankers to recover loans by auctioning the bad assets of the borrower in three months’ time. In comparison, the Debt Recovery Tribunal (DRT) and Lok Adalats take years to recover these loans. According to Reserve Bank of India data, there has been a steady fall in the amount of bad loans recovered under SARFAESI Act, as a per cent of the total amount of bad loans involved under this channel — a trend seen between 2008-09 and 2009-10. Of course, prior to 2010, DRTs were very effective in recoveries. As a look at DRT figures and SARFAESI recovery shows that DRT had better recovery Percent.

This can be attributed to the absence of any structured market for selling the distressed assets which are securitized under the SARFAESI Act. Moreover, selling sticky assets is a problem due to differences between the seller and the buyer in the valuation of such loans. Apart from this any dis satisfied borrower against whom the Securitization Act has been initiated can take recourse to court of law and file a suit against the lender thereby making the lender to fall in what is termed as ‘legal trap’. On the other hand recovery through the
DRTs is much speedier. Though there is a provision of filing a suit against the lender as under the Securitisation Act, but here the borrower filing the suit has to deposit 25% of the amount involved for further processing and hearing of the case. This provision ensures that only the genuine cases are taken up by the DRTs.

7.16 Enactment of SARFAESI Act

7.16.1 The "The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act" (SARFAESI) provides the formal legal basis and regulatory framework for setting up Asset Reconstruction Companies (ARCs) in India.

7.16.2 Asset Reconstruction Company (ARC): The Narasimham Committee on financial system (1991) has recommended for setting up of Asset Reconstruction Funds (ARF). The following concerns were expressed by the committee. It was felt that centralized all India fund will severely handicap in its recovery efforts by lack of widespread geographical reach which individual bank posses and given the large fiscal deficits, there will be a problem of financing the ARF. Subsequently, the Narasimham committee on banking sector reforms has recommended for transfer of sticky assets of banks to the ARC. Thereafter the Varma committee on restructuring weak public sector banks has also viewed the separation of NPAs and its transfer thereafter to the ARF is an important element in a comprehensive restructuring strategy for weak banks. In recognition of the same ARC Bill was passed to regulate Securitization and Reconstruction of financial assets and enforcement of security interest. The ICICI BANK, State Bank of India and IDBI have promoted the country’s first Asset Reconstruction Company. The company is specialized in recovery and liquidation of assets. The NPAs can be assigned to ARC by banks at a discounted price. The objective of ARC is floating of bonds and making necessary steps for recovery of NPAs from the borrowers directly. This enables a onetime clearing of balance sheet of banks by sticky loans. In addition to asset reconstruction and ARCs, the Act deals with the following largely aspects:

1) Securitization and Securitization Companies

2) Enforcement of Security Interest

3) Creation of a central registry in which all securitization and asset reconstruction transactions as well as any creation of security interests has to be filed.
7.16.3 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 and these Directions/ Guidance Notes cover various aspects relating to registration, operations and funding of ARCS and resolution of NPAs by ARCS. The RBI has also issued guidelines to banks and financial institutions on issues relating to transfer of assets to ARCS, consideration for the same and valuation of instruments issued by the ARCS. Additionally, the Central Government has issued the security enforcement rules ("Enforcement Rules"), which lays down the procedure to be followed by a secured creditor while enforcing its security interest pursuant to the Act. 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 receivables of the borrower in respect of any secured asset which has been transferred. After taking over possession of the secured assets, 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 auctions; or

By private treaty.
7.16.4 Lenders have seized collateral in some cases and while it has not yet been possible to recover value from most such seizures due to certain legal hurdles, lenders are now clearly in a much better bargaining position vis-a-vis defaulting borrowers than they were before the enactment of SARFAESI 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. Under the SARFAESI 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 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. 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 ARCs for asset reconstruction. These include:

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

7.16.5 RCS 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. The curative measures are designed to maximize recoveries so that banks funds locked up in NPAs are released for recycling.
7.17 Guidelines on sale of financial assets to Securitization Company (SC)/Reconstruction Company (RC) (created under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002) and related issues

7.17.1 Scope

These guidelines would be applicable to sale of financial assets by banks/ FIs, for asset reconstruction/ securitisation under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

7.17.2 Structure

The guidelines to be followed by banks/ FIs while selling their financial assets to SC/RC under the Act ibid and investing in bonds/ debentures/ security receipts offered by the SC/RC are given below. The prudential guidelines have been grouped under the following headings:

i) Financial assets which can be sold.

ii) Procedure for sale of banks’/ FIs’ financial assets to SC/ RC, including valuation and pricing aspects.

iii) Prudential norms, in the following areas, for banks/ FIs for sale of their financial assets to SC/ RC and for investing in bonds/ debentures/ security receipts and any other securities offered by the SC/RC as compensation consequent upon sale of financial assets:

a) Provisioning / Valuation norms

b) Capital adequacy norms

c) Exposure norms

iv) Disclosure requirements
7.17.3 **Financial assets which can be sold:**

A financial asset may be sold to the SC/RC by any bank/ FI where the asset is:

i) A NPA, including a non-performing bond/ debenture, and

ii) A Standard Asset where:

(a) the asset is under consortium/ multiple banking arrangements,

(b) at least 75% by value of the asset is classified as non-performing asset in the books of other banks/FIs, and

(c) at least 75% (by value) of the banks / FIs who are under the consortium / multiple banking arrangements agree to the sale of the asset to SC/RC.

**7.17.4. Procedure for sale of banks’/ FIs’ financial assets to SC/ RC, including valuation and pricing aspects**

(a) The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) allows acquisition of financial assets by SC/RC from any bank/ FI on such terms and conditions as may be agreed upon between them. This provides for sale of the financial assets on ‘without recourse’ basis, i.e., with the entire credit risk associated with the financial assets being transferred to SC/ RC, as well as on ‘with recourse’ basis, i.e., subject to unrealized part of the asset reverting to the seller bank/ FI. Banks/ FIs are, however, directed to ensure that the effect of the sale of the financial assets should be such that the asset is taken off the books of the bank/ FI and after the sale there should not be any known liability devolving on the banks/ FIs.

(b) Banks/ FIs, which propose to sell to SC/RC their financial assets should ensure that the sale is conducted in a prudent manner in accordance with a policy approved by the Board. The Board shall lay down policies and guidelines covering, *inter alia*,

i. Financial assets to be sold;

ii. Norms and procedure for sale of such financial assets;
iii. Valuation procedure to be followed to ensure that the realisable value of financial assets is reasonably estimated;

iv. Delegation of powers of various functionaries for taking decision on the sale of the financial assets; etc.

(c) Banks/ FIs should ensure that subsequent to sale of the financial assets to SC/RC, they do not assume any operational, legal or any other type of risks relating to the financial assets sold.

(d) (i) Each bank / FI will make its own assessment of the value offered by the SC / RC for the financial asset and decide whether to accept or reject the offer.

(ii) In the case of consortium / multiple banking arrangements, if 75% (by value) of the banks / FIs decide to accept the offer, the remaining banks / FIs will be obligated to accept the offer.

(iii) Under no circumstances can a transfer to the SC/ RC be made at a contingent price whereby in the event of shortfall in the realization by the SC/RC, the banks/ FIs would have to bear a part of the shortfall.

(e) Banks/ FIs may receive cash or bonds or debentures as sale consideration for the financial assets sold to SC/RC.

(f) Bonds/ debentures received by banks/ FIs as sale consideration towards sale of financial assets to SC/RC will be classified as investments in the books of banks/ FIs.

(g) Banks may also invest in security receipts, Pass-through certificates (PTC), or other bonds/ debentures issued by SC/RC. These securities will also be classified as investments in the books of banks/ FIs.

(h) In cases of specific financial assets, where it is considered necessary, banks/ FIs may enter into agreement with SC/RC to share, in an agreed proportion, any surplus realised by SC/RC on the eventual realisation of the concerned asset. In such cases the terms of sale should provide for a report from the SC/RC to the bank/ FI on the value realised from the
asset. No credit for the expected profit will be taken by banks/ FIs until the profit materializes on actual sale.

7.17.5 Prudential norms for banks/ FIs for the sale transactions:

(A) Provisioning/ valuation norms

(a)(i) When a bank / FI sells its financial assets to SC/ RC, on transfer the same will be removed from its books.

(ii) If the sale to SC/ RC is at a price below the net book value (NBV)(i.e., book value less provisions held), the shortfall should be debited to the profit and loss account of that year.

(iii) If the sale is for a value higher than the NBV, the excess provision will not be reversed but will be utilized to meet the shortfall/ loss on account of sale of other financial assets to SC/RC.

(iv) When banks/ FIs invest in the security receipts/ pass-through certificates issued by SC/RC in respect of the financial assets sold by them to the SC/RC, the sale shall be recognised in books of the banks / FIs at the lower of:

- the redemption value of the security receipts/ pass-through certificates, and
- the BV of the financial asset.

The above investment should be carried in the books of the bank / FI at the price as determined above until its sale or realization, and on such sale or realization, the loss or gain must be dealt with in the same manner as at (ii) and (iii) above.

(b) The securities (bonds and debentures) offered by SC / RC should satisfy the following conditions:
(i) The securities must not have a term in excess of six years.

(ii) The securities must carry a rate of interest which is not lower than 1.5% above the Bank Rate in force at the time of issue.

(iii) The securities must be secured by an appropriate charge on the assets transferred.

(iv) The securities must provide for part or full prepayment in the event the SC / RC sells the asset securing the security before the maturity date of the security.

(v) The commitment of the SC / RC to redeem the securities must be unconditional and not linked to the realization of the assets.

(vi) Whenever the security is transferred to any other party, notice of transfer should be issued to the SC/ RC.

(c) Investment in debentures/ bonds/ security receipts issued by SC/ RC

All instruments received by banks/FIs from SC/RC as sale consideration for financial assets sold to them and also other instruments issued by SC/ RC in which banks/ FIs invest will be in the nature of non SLR securities. Accordingly, the valuation, classification and other norms applicable to investment in non-SLR instruments prescribed by RBI from time to time would be applicable to bank’s/ FI’s investment in debentures/ bonds/ security receipts issued by SC/ RC. However, if any of the above instruments issued by SC/RC is limited to the actual realisation of the financial assets assigned to the instruments in the concerned scheme the bank/ FI shall reckon the Net Asset Value (NAV), obtained from SC/RC from time to time, for valuation of such investments.

(B) Capital Adequacy

For the purpose of capital adequacy, banks/ FIs should assign risk weights as under to the investments in debentures/ bonds/ security receipts/ PTCs issued by SC/ RC and held by banks/ FIs as investment:

i) Risk weight for credit risk: 100%.
ii) Risk weight for market risk: 2.5%

Applicable risk weight = (i) + (ii)

(C) Exposure Norms

Banks’/ FIs’ investments in debentures/bonds/security receipts issued by a SC/RC will constitute exposure on the SC/RC. As only a few SC/RC are being set up now, banks’/ FIs’ exposure on SC/RC through their investments in debentures/bonds/security receipts issued by the SC/RC may go beyond their prudential exposure ceiling. In view of the extraordinary nature of event, banks/ FIs will be allowed, in the initial years, to exceed prudential exposure ceiling on a case-to-case basis.

7.17.6. Disclosure Requirements

Banks/ FIs, which sell their financial assets to an SC/RC, shall be required to make the following disclosures in the Notes on Accounts to their Balance sheets:

Details of financial assets sold during the year to SC/RC for Asset Reconstruction

a) No. of accounts

b) Aggregate value (net of provisions) of accounts sold to SC/RC

c) Aggregate consideration

d) Additional consideration realized in respect of accounts transferred in earlier years

e) Aggregate gain / loss over net book value.

7.17.7. Related Issues

(a) SC/RC will also take over financial assets which cannot be revived and which, therefore, will have to be disposed of on a realisation basis. Normally the SC/RC will not take over these assets but act as an agent for recovery for which it will charge a fee.
(b) Where the assets fall in the above category, the assets will not be removed from the books of the bank/ FI but realisations as and when received will be credited to the asset account. Provisioning for the asset will continue to be made by the bank / FI in the normal course.

The Central government and RBI have taken steps for arresting incidence of fresh NPAs and creating legal and regulatory environment to facilitate the recovery of existing NPAs of banks. They are:

7.18 Circulation of Information of Defaulters: The RBI has put in place a system for periodical circulation of details of willful defaulters of banks and financial institutions. The RBI also publishes a list of borrowers (with outstanding aggregate rupees one crore and above) against whom banks and financial institutions in recovery of funds have filed suits as on 31st March every year. It will serve as a caution list while considering a request for new or additional credit limits from defaulting borrowing units and also from the directors, proprietors and partners of these entities.

7.19 Recovery Action against Large NPAs: The RBI has directed the PSBs to examine all cases of willful Default of Rs. One crore and above and file criminal cases against willful defaulters. The board of directors review NPAs accounts of one crore and above. It is observed from the above table that the gross NPAs of the banks is gradually declining from Rs. 68717 crores in 2002 - 03 to Rs. 50552 crores in 2006 – 07 whereas the net recovery of NPAs is increasing from Rs. 23183 crores in 2002 - 03 to Rs. 27176 crores in 2006 – 07. It shows that the banks have taken strenuous efforts to contain the NPAs. Moreover the percentage of recovery to gross NPAs is also in the increasing trend.

7.20 Credit Information Bureau: The institutionalization of information sharing arrangement is now possible through the newly formed Credit Information Bureau of India Limited (CIBIL) It was set up in January 2001 by SBI, HDFC, and two foreign technology partners. This will prevent those who take advantage of lack of system of information sharing amongst leading institutions to borrow large amount against same assets and property, which has in no measures contributed to the incremental of NPAs of banks.

Conclusion: It is needless to mention, that a lasting solution to the problem of NPAs can be achieved only with proper credit assessment and risk management mechanism. In a situation of liquidity overhang, the enthusiasm of the banking system to increase lending
may compromise on asset quality, raising concern about their adverse selection and potential danger of addition to the stock of NPAs. It is necessary that the banking system is to be equipped with prudential norms to minimize if not completely to avoid the problem of NPAs. The onus for containing the factors leading to NPAs rests with banks themselves. This will necessitates organizational restructuring, improvement in the managerial efficiency and skill up gradation for proper assessment of credit worthiness It is better to avoid NPAs at the nascent stage of credit consideration by putting in place of rigorous and appropriate credit appraisal mechanisms to avoid gloomy NPAS.