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CHAPTER-II
THEORETICAL BACKGROUND OF THE SUBJECT

2.1 Introduction:
Non-Performing Assets (NPAs) do not earn interest income; repayment of loans to banks does not take place according to schedule which affects redeployment and recycling of funds, further affecting interest income. The Non-performing assets do not generate interest but at the same time banks have to make provision for such non-performing assets out of their current profit.

Huge amounts of NPAs are being faced by all type of banks and financial institution. Though these institution do observe the principal of lending viz. safety, profitability, liquidity, purpose, risk spread and security.

The growing proportion of the non –performing assets (NPAs) in the advances of the banks and financial institutions has engaged the attention of the government, bankers, economists and the general public. The NPAs have been described as a misuse of the public money which should be used with utmost care and a sense of responsibility. It has been recognized by all concerned that the growing NPAs can eventually destabilize and perhaps destroy the financial sector of the NPAs. An unstable and weak financial / banking sector can jeopardize the entire process of economic development because banks have been rightly called as the nerves of economic growth.

2.2 Concept of Non Performing Assets:
The concept of Non Performing Assets is not altogether unknown to India Banking. Earlier, banks had system of identifying accounts of sticky or causing concern such accounts were known as problem credits or bad and doubtful debt. In such accounts the repayment of interest /installments was either not easily forth coming as per schedule or recovery thereof could not fully be effected due to erosion of securities charged to them with continuous application of interest / other charges irrespective of recovery. In either case, banks were subject to losses on account of such credit portfolio. Partly, this was due to genuine business risks to which lending operations are subject to and partly due to the complacency and security oriented approach. Through experience banks found it prudent not to reckon such interest/other charges as
part of their income and pay tax on unrealized income. The banks therefore adopted the practice of ceasing to charge interest in such accounts of bad or doubtful nature and where the prospects of recovery were bleak.

2.3 Origin of NPA:

The Bank under study, since 1976, is following well laid down norms regarding treatment to identify bad and doubtful accounts. The bank directed the branches to cease charging interest on doubtful advances, on the basis of the criteria laid down, irrespective of whether the suits are filed for recovery of the dues or not. The criteria then adopted for the purpose were

- Non payment of the interest applied during the last four relevant periods i.e. month/quarters/half years / years as the case may be.
- Existence of a provision for bad and doubtful debts or a provision is proposed to be made.
- In the case of advances guaranteed by CGO / DICGC it advances, once the bad or doubtful character of an advance becomes apparent, as any subsequent interest whether debited or accounted for separately would not be eligible to be included in the “amount in default” and claimed from the corporation.
- It was also decided that ceasing to charge interest with effect from 1/1/1980 be made applicable to all suit filed accounts including where the decision to take legal action was waived, irrespective of the outstanding amounts.

The Reserve Bank of India introduced the Health Code System of classification of borrower accounts by banks in the year 1985, exactly after three years of implementation of the system by Bank under study. Based on this classification of advances it was decided by the Reserve Bank in the year 1989 and 1990 that banks should cease charging interest compulsorily in accounts under Health Codes 5 to 8 i.e. Recalled Suit filed, Decreed and Bad and doubtful and selectively taking into account the availability and reliability of security in accounts under Health Code 4 i.e. Sick Non viable /Sticky. Accordingly banks have been classifying their accounts as per Health Code System and ceasing to recognize income according to the scheme of things envisaged under the system.
The NPA concept introduced by the Reserve Bank in the year 1992 is the outcome of the Narsimham Committee recommendations on financial sector reforms. The Committee obtained the policy of income recognition should be objective and based on record of recovery, rather than any subjective consideration. The international practice is that an asset is treated as “Non-performing” when interest is overdue for at least two quarters. According to the committee, advances would be treated as non-performing assets, as on the balance sheet date.

- In respect of term loans, interest remains past due for a period of more than 180 days.
- In respect of overdraft and cash credit, account remains out of order for a period of more than 180 days.
- In respect of bills purchased and discounted, the bill remains overdue and unpaid for a period of more than 180 days.
- In respect of other accounts, any amount to be received remains past due for a period of more than 180 days.

An amount is considered post due when it remains outstanding 30 days beyond the due date.

The Reserve Bank of India examined the above criteria of the Committee in regard to classification of advances as non-performing assets and credited to implement the same in a phased manner beginning with accounting year 1st April 1992.

The following was the basis for treating a credit facility as non-performing:

i) Term Loan
   If interest remains past due for a period of –
   a) 4 quarters, for the year ending 31-3-1993
   b) 3 quarters, for the year ending 31-3-1994
   c) 2 quarters, For the year ending 31-3-1995 and onwards

ii) Cash Credit and Overdrafts
   If the accounts remains out of order for the period indicated as above.

iii) Bills Purchased / Discounted
If the bill remains overdue & unpaid for the periods specified here in above.

iv) Other Accounts

If any amount to be received in respect of that facility remains past due for the periods specified.

It was also clarified that an account should be treated as out of order if the balance outstanding in the account remains in excess of the sanctioned limit / drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit / drawing power, but there are no credits continuously for six months as on the date of balance sheet, or credits during the same period, these accounts should also be treated as NPA. Such accounts should stagnant accounts with very little operations. Here drawing power in case of our Bank may be construed as drawing limit and no credits continuously for six months as on the date of balance sheet date would mean between 31st March and 30th September for the relative year i.e. as on 31st March 1994, the six months prior to that would mean between 31st March 1993 and 30 September 1993.

2.4 Reserve Bank of India Guidelines in 1992

2.4.1 Income Recognition:

Currently as per the instructions of the RBI income from advances is recognized on the basis of Health Code classification. Accordingly, income in respect of advances covered by Health Codes five to eight should not be recognized until it is realized. In respect of advances falling in Health Code four, banks have been advised to evolve a realistic system in the matter of income recognition taking into account the prospects of reliability of the security.

The committee has underlined the need for the policy of income recognition to be objective and based on the record of recovery. It has observed that internationally income from non-performing assets (NPA) is not recognized on accrual basis but is booked as income only when it is actually received.

An asset becomes Non-Performing when it ceases to generate income for a bank. The committee has defined NPA as advances where, as on the date of Balance Sheet a) in respect of term loans, interest remains past due for a period of more than 180 days, b) in respect of overdrafts and cash credit
accounts, they remain out of order for a period of more than 180 days, c) in respect of bill purchased and discounted, the bills remain overdue and unpaid for a period of more than 180 days and d) in respect of other accounts only amount to be received remains past due for a period of more than 180 days. According to the committee an amount is considered past due when it remains outstanding for 30 days beyond the due date.

We have examined the recommendations and it has been decided that an amount under any of the credit facilities mentioned above is to be treated as “past due” when it has not been paid on the due date. Further it has been decided that a “non-performing assets” (NPA) should be defined as a credit facility in respect of which interest has remained unpaid for a period of four quarters during the year ending 31 March 1993, three quarters during the year ending 31 March 1994 and two quarters during the year 31 March 1995 and onwards.

We advise that banks should not charge and take to income account interest on all non-performing assets. The basis for treating a credit facility as non-performing is given below.

2.4.2 Term Loans:

For the year ending 31 March 1993, a term loan will be treated as NPA if interest remains past due for a period of four quarters as on that date. For the year ending 31 March 1994 and 31March 1995 and onwards, a loan will be treated as NPA if interest remains past due for three quarters and two quarters respectively.

2.4.3 Cash Credit and Overdrafts:

A cash credit or overdraft account will be treated as NPA if the account remains out of order for a period of four quarters during the year ending 31March 1993, three quarters during the year ending 31 March 1994 and two quarters during the year ending 31 March 1995 and onwards. An account should be treated as ‘out of order’ if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for six months as on the date of Balance sheet or credit are not enough to cover the interest debited during the same period, these accounts should be treated as out of order.
2.4.4 Bills Purchased and Discounted:

The bills purchased / discounted accounted should be treated as NPA if the bill remains overdue and unpaid for a period of four quarters during the year ending 31 March 1993, three quarters during the year ending 31 March 1994 and two quarters during the year ending 31 March 1995 and onwards. However, overdue interest should not be charged and taken to income account in respect of overdue bill unless it is realized.

2.4.5 Other Accounts:

Any other credit facility should be treated as NPA if any amount to be received in respect of that facility remains past due for a period of four quarters during the year ending 31 March 1993, three quarters during the year ending 31 March 1994 and two quarters during the year ending 31 March 1995 and onwards.

2.4.6 Asset Classification:

It has been decided that banks should classify their advances into four broad groups 1) standard assets 2) substandard assets 3) doubtful assets 4) loss assets by compressing the existing eighth health codes.

1. Standard assets

Standard asset is one which does not disclose any problems and which does not carry more than normal risk attached to the business. Such an asset is not a NPA.

2. Sub-standard assets

Sub-standard asset is one which has been classified as NPA for a period not exceeding two years.

3. Doubtful assets

A doubtful asset is one which has remained NPA for a period exceeding two years. In the case of term loans, those where installments of principal have remained overdue for a period exceeding two years should be treated as doubtful.
4. Loss assets
A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has been written off, wholly or partly.

2.4.7 Provisioning for Loans and Advances:
Taking into account the time lag between on an account becoming doubtful of recovery, its recognitions as such, the realization of the security and the erosion over time in the value of security charged to the banks, it has been decided that banks should make provision against sub-standard assets, doubtful assets and loss assets. Detailed instructions in this regard are furnished below.

1. Loss assets
The entire assets should be written off if the asset are permitted to remain in the books for any reason, 100% of the outstanding should be provided for.

2. Doubtful assets
a) 100% of the extent to which the advance is not covered by the realizable value of security to which the bank has a valid resource and the realizable value is estimated on a realistic basis.

b) Over and above item a) above depending upon the period for which the asset has remained doubtful, 20% -50% of the secured portion (i.e. estimated realizable value of the outstanding) on the following basis.

<table>
<thead>
<tr>
<th>Period for which the advance has been considered as doubtful</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to one year</td>
<td>20</td>
</tr>
<tr>
<td>One to three years</td>
<td>30</td>
</tr>
<tr>
<td>More than three years</td>
<td>50</td>
</tr>
</tbody>
</table>

3. Sub-standard assets
a general provision of 10% of total outstanding.

2.5. Present Guidelines
2.5.1 Non –Performing Assets:
Non-performing assets (NPA) is defined as a credit facility in respect of which interest and/or installment of principal has remained ‘past due’ for specified period of time. With a view to moving towards international best
practices and to ensure greater transparency the 90 days overdue norm for identification of NPAs has been adopted from the year ending March, 31, 2004.

2.5.2 Identification of Account as NPA:

RBI has laid down various criteria for classification of various types of advances as NPA which are as under.

2.5.3 Term Loan:

Interest and / or installment of principal remain overdue for a period of more than 90 days. One will have to determine the due date of interest and installment. If either interest or installment which is due as on 30th December would be overdue more than 90 days as on 31st March 2006 and the account become NPA.

2.5.4 Overdraft / Cash Credit:

If an account remains out of order, it would become NPA. For this purpose an account would be treated ‘out of order’ if

i) The outstanding balance remains continuously in excess of sanctioned limit / drawing power, for 90 days or more, or

ii) Even if the outstanding in the account is less than the sanctioned limit/ drawing power there are no credits in the account continuously for 90 days as on the date of balance sheet, or

iii) Credit in the account are not sufficient to cover interest debited during the same period

Thus, as on 31st March 2006, if any of the above criteria is satisfied the account would be classified as NPA.

2.5.5 Bills Purchased / Discounted:

If the bills purchased or discounted remains overdue for a period of more than 90 days from its due date.

2.5.6 Agricultural Advances: a loan granted for:

i) Short duration crops will be treated as NPA if the installment of principal or interest thereon remains overdue for two crop season.

ii) Long duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for one crop season.

For the purpose of these guidelines “long duration” crops would be crops with crop season longer than one year and crops, which are not “long duration” crops would be treated as “Short duration” crops.
Thus an auditor will have to verify the nature/ duration of crop circle and accordingly verify whether an agricultural account is NPA as on 31st March 2006.

2.5.7. Other Credit Facility:

In case of any other credit facility, if the amount to be received remains overdue for more than 90 days, then the account will be classified as NPA.

2.5.8 Income Recognition:

i) Income from NPA is not recognized on accrual basis but is booked as income only when it is actually received. Therefore for interest on any NPA should not be recognized unless realized.

However, interest on advances against term deposits, NSCs, IVPs and Life policies may be taken to income account on the due date, provide adequate margin is available in the account.

ii) Fees and commissions earned by the banks as a result of re-negotiations or rescheduling of outstanding debts should be recognized on an accrual basis over the period of time covered by the renegotiated or rescheduled extension of credit.

iii) If Government guaranteed advances become NPA, the interest on such advances should not be taken to income account unless the interest has been realized.

2.5.9 Assets Classification and Provision:

<table>
<thead>
<tr>
<th>Asset Category</th>
<th>Basic Consideration</th>
<th>Provision Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standard Assets</td>
<td>Standard Asset is one which does not disclose any problems and which does not carry more than normal risk attached to the business. Such asset should not be an NPA.</td>
<td>A general provision of a minimum of 0.40% for advances other than Bank’s direct advances to agricultural and SME sectors 0.25% for Bank’s direct advances to agricultural and SME sectors</td>
</tr>
<tr>
<td>Sub-standard Assets</td>
<td>With effect from 31-3-2005, the sub-standard asset is one which has remained as NPA for a period not exceeding 12 months.</td>
<td>A general provision of 10% on total outstanding should be made without making any allowance for DICGE / ECGC guarantee cover and securities available. The ‘unsecured exposures’ which are identified as substandard would attract additional provision of 10% i.e., a total 20 per cent of on the outstanding balance.</td>
</tr>
<tr>
<td>Doubtful Assets</td>
<td>With effect from 31 March 2005, an asset would be classified as doubtful if it remained sub-standard category for 12 months. Banks have been permitted to phase the consequent additional provisioning over a four year period commencing from the year ended 31 March 05 with a minimum 20 percent each year.</td>
<td>100 per cent of the extent to which the advance is not covered by the realizable value of the security. In regard to the secured portion depending upon the period for which the asset has remained doubtful. Up to 1 year 20% 1 to 3 year 30% Over 3 year 50% i) Outstanding stock of NPA as on March, 31, 2004. -60 % with effect from March 31, 2005. -75 % with effect from March 31, 2006.</td>
</tr>
</tbody>
</table>
2.6 Approaches to Management of NPAs

Managing credit assets entirely depends upon two basic approaches.

A. Profit maximization approach and
B. Risk management approach

2.6.1 A Profit Maximization Approach:

The principles of Income Recognition are linked with classification of assets and hence required to provide for bad debts. Due to imposition of provisioning norms, there is an immense pressure on profitability since the provisioning reduces the current income.

1. The opportunity cost of funds locked in bad loans.
2. The cross subsidization of interest rate on good loans high in order to cushion the drag on account of bad loan. This is comparatively sensitive in a competitive and risk based pricing scenario.

2.6.2 B Risk Management Approach:

The vast credit portfolio can be segregated into smaller groups such that priority attention can be focused on these, leading to initiation of result oriented steps. A credit manager while scanning the extent of
risk attached to an asset looks at the period of time for which the asset is NPA.

2.7. Willful Defaulters:

Commercial Banks are required to report instances of willful default to RBI periodically. RBI shall publish the same in their website.

As per RBI guidelines, willful default is defined as follows:

“A willful default would be deemed to have occurred if any of the following events is noted.”

The unit has defaulted in meeting its payment repayment obligations to the lender even when it has the capacity to honor the said obligations.

The unit has defaulted in meeting its payment or repayment obligations to the lender and has not utilized the finance was availed of but has diverted the funds for other purposes.

The unit has defaulted in meeting its payment or repayment obligations to the lender and has siphoned off the funds so that the funds have not been utilized for the specific purpose for which finance was availed of, nor are the funds available with the unit in the form of other assets.

Banks are required to initiate following measures against willful defaulters.

1) No additional facilities should be granted by banks /FIs.

2) Entrepreneurs / promoters of companies, where division funds, siphoning of funds misrepresentation, falsification of accounts and fraudulent transactions have been identified by banks/ FIs, should be debarred from institutional finance from banks/ FIs, Government owned NBFCs, investment institution, etc. for floating new ventures for a period of years from the date the name of willful defaulter is disseminated in the list of willful defaulters by RBI.

3) Initiate legal proceeding and foreclosure for recovery of dues expeditiously, wherever warranted, against the borrowers/ guarantors.

4) Initiate criminal proceeding against willful defaulters wherever necessary.

5) Banks/ FIs should adopt a proactive approach for a change of management of the willfully defaulting borrower unit, wherever possible.

6) Incorporate a convenient in the loan agreement with the borrowing companies stipulating that they should not induct a person who is a director on the Board of a company which has been identified as a willful defaulter
& that in case, such a person is found to be on the Board of the borrower company, it would take expeditious and effective steps for removal of the person from its Board.

7) If necessary criminal proceeding may also be initiated based on facts of each case.

   It is also necessary to ensure that the penal provision are used effectively and due caution. Towards this end, banks / FIs are advised to put in place a transparent mechanism, with the approval of their Board, for initiating criminal proceeding based on the facts of individual case.

2.8 Compromise Settlements:

   A compromise is a settlement of disputes reached by mutual consent. It is a negotiated settlement with sacrifice components on all the parties to the dispute. It is a non-legal remedy for reduction of NPAs of the Bank. Negotiated compromise settlement is made to maximize the compromise amounts. Each Bank has to devise their own Recovery policy facilitating compromise settlement of dues in NPA account. In additional to this compromise settlement can be under special one time settlement schemes of RBI OTS scheme for small and marginal farmers, RBI OTS 2005 for SME etc. are formulated by Government / RBI from time to time aimed at specific target groups.

2.9 Write Off:

   Write off is resorted to in the borrowal accounts when the Bank has exhausted all possible avenues of recovery and there are no more chances for affecting the recovery.

   Write off is of two kinds. Prudential write off and regular write off. The basic difference between prudential and regular write off is that in Prudential write off there is possibility of recovery at a distant future even after write off while in Regular write off there is no/little possibility of recovery.

   It is open to the Bank to resort to partial write of also. Partial write off would be in the accounts classified as doubtful assets, to the extent of provision held on the outstanding and not covered by any security.
2.10 Legal Measures

2.10.1 Debt Recovery Tribunal:

One of the problems faced by banks is the low rate of loan recoveries. This has a bearing on the accounting standards as well as on current operations of banks. It is in this context the ‘Recovery of Debts’ due to Banks and Financial Institutions Bill, 1993’ was passed in August 17, 1993 that facilities establishments of Debt Recovery Tribunals for expeditions adjudications and recovery of debt due to any bank or financial institutions. The provisions of this Act shall not apply where the amount of debt due to any bank or financial institution is less than Rs.10 lakh or such amount being not less than Rs. 1 lakh, as the Central Government may, by notification specify. These Tribunals will expeditiously deal with application made by bank / financial institution and endeavor to dispose of such applications. There is a provision to dispose off such applications within six months from the date of receipt of such applications. The provision to deposit 75 per cent of the amount of debt by the appellant with appellate tribunal would also discourage unnecessary delay in settlements of cases. These recovery tribunals will help clean up balance sheet, contributing to an improved recycling of funds and liquidity position of banks.

2.10.2 Corporate Debt Restructuring:

Corporate Debt Restructuring mechanism has been institutionalized in 2001 to provide a timely and transparent system for restructuring of the corporate debts of Rs.20 crore and above with the bank and financial institutions. The CDR process would also enable viable corporate entities to restructure their dues outside the existing legal framework and reduce the incidence of fresh NPAs.

The objective of the CDR mechanism has been to ensure timely and transparent restructuring of corporate debt outside the preview of the Board for Industrial and Financial Reconstruction (BIFR), DRT or other legal proceeding. The framework is intended to preserve viable corporate affected by certain internal / external factors and minimize losses to creditors / other through an orderly and coordinated restructuring programme.

RBI has issued revised guidelines in February 2003 with respect to the CDR mechanism. Corporate borrowers with borrowing from the banking
system of Rs. 20 crores 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 debtors creditors, agreement and inter creditor agreement. Restructuring helps in aligning repayment obligations for bankers with cash flow projections as reassessed at the time restructuring plan on the lines at the expected business plan along with project cash flows.

The CDR process is being stabilized certain revisions are envisaged with respect to the eligibility criteria (amount of borrowings) and time frame for restructuring. 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.

As of March 31, 2003, 60 cases worth Rs.44,369 crores had been referred to the CDR, of which 29 cases worth Rs. 29,167 corers have been approved for restructuring.

2.10.3 Credit Information Bureau:

Institutionalization of information sharing arrangement through the newly formed Credit Information Bureau of India Ltd., (CIBIL) is under way; RBI is considering the recommendations of the SRI year group to operationalise the scheme of information dissemination on defaults to the financial system. The main recommendation of the Group include dissemination of information relating to the suit filed accounts regardless of the amount claimed in the suit or amount of credit granted by a credit institution as also such irregular accounts where the borrower has give consent for disclosure. This would prevent those who take advantage of lack of system of information sharing amongst lending institution to borrow large amounts against same assets and property, which had in no small measures contributed to the incremental NPA of banks.

2.10.4 Corporate Governance:

A Consultative Group under the chairmanship of Dr. A Ganguly was set up by the Reserve Bank to review the supervisory role of Boards of banks and financial institutions and to obtain feedback. On the functioning of the Boards vis-a-vis compliance, transparency, disclosures, audit committees etc. and make recommendations for making the role of Board of Directors more
effective with a view to minimizing its recommendations shortly and may come out with guidelines for effective control and supervision by bank boards over credit management and NPA prevention measures.

NPA are better avoided at the initial stage of credit consideration by putting in place rigorous and appropriate credit appraisal mechanism credit and later run to supervisors / regulators for regulatory forbearance and owners or strategic partners to bail them out.

Secondly, the mindset of the borrowers needs to change so that a culture of proper utilization of credit facilities and timely repayment is developed. One of the main reasons for corporate entities should come forward to avoid this practice in the interest of strong and sound financial system.

Finally, extending credit involves lenders and borrowers and both should realize their role and responsibilities. They should appreciate the difficulties of each other and should endeavor to work towards contributing to a healthy financial system.

2.10.5 Lok Adalat:

For simpler, quicker and cost effective disposal of cases, banks are approaching the system Lok Adalats are organized under Legal Services Authority Act, 1987 by the state and or district and taluka Legal Services Committee. Branches should consult Local Legal Services Committee and IBA chapter, if necessary for organizing Lok Adalats.

Lok Adalat is a process of administering justice without resorting to courts. The process is voluntary and works on the principle that both the parties to the dispute are willing to sort out their dispute amicably. The functioning of Lok Adalat is entirely voluntary and conciliatory. The proceedings are relatively simple.

All cases / suits / disputes pending before a court or likely to be referred to court, can be referred to Lok Adalat. The award of Lok Adalat has the effect of a decree of a civil court and binding on the parties to the dispute. No appeal can be either of the parties.

The maximum claim amount that can be dealt by Lok Adalat is Rs. 20 lakh.
2.10.6 Decreed Accounts:

After the case is decided in favour of the bank, all necessary steps are taken within a month. Once the degree is obtained, immediate steps should be taken to execute the decree and the respective authority should ensure that the same is executed for recovery of decreed dues within a maximum period of one year. If the Bank is unable to execute for recovery of decreed dues within a maximum period of one year if the Bank is unable to execute decree due to non availability of details of assets, owned by the Judgment Debtor, the Bank shall apply to the Court for an order under order 21 Rule 41 of civil Procedure code/Sec.28 (4) (a) of DRT Act requiring the Judgment Debtor to disclose the particular of his assets.

Assignment of Decree

Bank can also consider assignment / sale of decrees. For the purpose of sale / assignment of decrees the value /amount of decree would be the amount decreed by the court together with the rate of interest awarded in the decree, However, the decree not be marked satisfied and handed over till the entire decretal dues after deduction is received.

At the time of appointing recovery agent, seizure agent or enforcement agents, on a case basis the Branch should enter into written agreement cum offer letter with the agents wherein the term of recovery and charges are clearly mentioned. A copy of the offer / agreement duly accepted by the agent shall be kept in record. This procedure shall help to avoid any disputes in future. It is of paramount interest that the individuals / firms used as Banks agent are of clean image and good reputation and does not violate any guidelines by RBI/Government.

2.10.7 SARFAESI Act 2002:

Securitization and Reconstruction of financial Asset and Enforcement of Security tool in the hands of the dues there by reducing NPAs

The Act has three segments –

a) Securitization and Asset Reconstruction Companies
b) Central Registry
c) Enforcement of Security Interest
Criteria

Before enforcing security interest, branches should ensure that the borrowal accounts comply with the following criteria-
The contractual dues in the account should be more than Rs. 1.00 lakh.
The default must have occurred i.e. the account should have become NPA as per RBI norms.
The security charged to the Bank must be specific, clear and available to the Bank and therefore, enforceable if the borrower fails to pay in response to the notice.
The security documents in the advance account should be in full force on the date of serving the 60 days notice. As an abundant caution, it should be ensured that they will be in force even at the time the action that will follow for enforcement of security i.e. at least up to one year from the date of serving the notice.
The security documents should be duly filled in and no column should be kept blank.
Either the Bank must be the sole banker to the borrower i.e., 100% lending is done by the bank or in case of joint lending, at least lenders representing 75% of the contractual amount due and outstanding agree to take action.
In case of multiple banking, if the security is exclusively charged, the bank can proceed as through it is the sole banker. Even in BIFR referred cases and also suit filed cases action can be taken.

Exemptions

The following are exempted from the purview of the Act-
1. Accounts where the contractual dues are less than Rs.1.00 lakh.
2. When the security interest is created on agricultural land. However, other agricultural related assets like tractor implements etc. can be enforced, if charged as security to Bank’s advance.
3. Where the contractual remaining unpaid is less than 20% of the principal i.e., total amount disbursed and interest.
4. Assets under pledge, lien / assets financed under lease or hire purchase are not covered.
Issue of Notices

Service of proper notice is a pre-requisite for enforcement of security interest. Hence it should be ensured that proper notices are served on the borrowers / guarantors who created the security interest, under section 13(2) of the Act.

Enforcement Action:

If full payment is made during the notice period, no further action is called for. If part payment is made, the Bank retains the right to claim the balance amount. If the borrower/ guarantor fails to meet their liability in full within 60 days from the date of notice then the authorized officer may by himself or through approved enforcement agency take one or more of the following measures u/s 13 (4) of the Act.

- Take possession of the secured assets.
- Take over the management of the secured assets.
- Appoint a person to manage the assets so taken over.
- Bank can also sell or / lease out the business and take over the management of the company also.

In case of the borrower refuses peaceful handing over of the assets, Bank can also file on application before the relevant Chief Metropolitan Magistrate / District Magistrate Court for taking possession of the assets. The possession should not be taken as a matter of routine. A due diligence should be conducted in respect of secured assets to be taken into possession covering nature and value of such assets, probability of finding a buyer in the shortest period (it will be better if a buyer is identified before undertaking the exercise), expenses to be incurred in connection with safekeeping / storage, appointment of security guards, estimated realizable value of the assets in case of sale, etc.

Where recovery is not forthcoming, the Bank may explore the avenue of engaging the service of recovery agents/ seizure agents/ enforcement agents. These include government agencies NGOs, advocates, reputed firms and individuals with proven track record. Recovery agents, enforcement agents and seizure agents should be distinguished by the nature of assignments entrusted to them. The same person’s can be recovery agents,
enforcement agents as well as seizure agents. Combined assignments can also be given to them.

Board for Industrial and Financial Reconstruction (BIFR)

Board for Industrial and Financial Reconstruction is a body constituted under sick Industries companies (Special Provision) Act (SICA) 1985. It is a quasi judicial body with powers to initiate legal steps against erring promoters who fail to abide by the steps regulations of SICA. It has the powers to summon and record evidence and over ride some of the provisions of companies Act.

Reference

All the sick Industrial companies which are-

a) Engaged in manufacturing / processing activity, employing 50 workers or more.

b) Registered for 5 years or over.

c) Whose net worth has completely been eroded as at the end of any financial year required to make reference to BIFR, within 60 days from the date of adoption of annual accounts/ audited balance sheet at the Annual General Body of the concerned company or where the Board of directors have come to the conclusion that the company has become sick Industrial company.

Effect of Reference

The immediate effect of the reference is that-

a) No legal action/ recovery action can be instituted against the borrower company and the guarantors.

b) All pending cases against the borrower/ guarantors are suspended during the pendency of reference.

c) The limitation is suspended for the period for which the reference is pending with BIFR.

However, legal proceedings can be instituted / continued after obtaining the permission of BIFR.

Ineligible cases: Shipping companies, Industrial units registered as SSIs and service units like Hotels, etc. are not eligible for reference.

AAIFR
If any of the parties is aggrieved by any of the order of BIFR, such affected party may prefer any appeal within 45 days from the date of order to Appellate Authority for Industrial and Financial Reconstruction (AAIFR).

2.10.8 Bid Policy:

Many a times in spite of Bank successfully obtaining an auction order from court / DRT, the actual implementation and achieving the benefits there by are eluding mainly due to the following reasons

i) Many a times due to influence exerted by the defendants, no bid offers are received by the court / DRTs leading to postponement of the scheduled auction more than once.

ii) Recent instances reveal that in the absence of bidders to the suit properties, Court / DRTs have indicated to the Bank that such execution petitions would be disposed off as ungratified. This would mean that our resource for recovery is affected adversely.

iii) The defendants from a cartel of prospective buyers with intention to ensure that the properties fetch much lower price than their market value and thus succeed in scuttling Bank’s interest.

In all cases where bid / auction orders have been issued by the court / DRTs etc. and no bid offer is received till the time of auction / bid, Bank may participative in the bid for purchase of the suit properly subject to getting of approval at the appropriate level.

2.10.9 Revenue Recovery Act:

The Talwar Committee had recommended a simplified procedure for recovery of commercial banks’ dues financed under state Government sponsored schemes. These recommendations have been accepted by most of the major states. However, results in terms of recovery have not been encouraging.

2.10.10 Asset Reconstruction Company:

The Securitization and Reconstruction of financial Assets and Enforcement of Security Act 2002 provides sale of financial assets by financial institutions to Securitization Company / Reconstruction Company. The salient features of these guidelines, regarding sale of assets to Asset Reconstruction Company decided by Reserve Bank of India are as under.

1) A financial asset may be sold to ARC by bank / FI where the asset is
a) NPA including Non performing bond / debenture.

b) A standard asset where asset is under consortium / multiple banking arrangement and 75% (by value) is classified as NPA and 75% (by value) of the sale to ARC.

2) The sale of the assets as above should be “without recourse” basis, which means that are being transferred to ARC with the entire credit risk associated with assets.

3) Banks / FIs which propose to sale assets to ARC are required to ensure that the sale is conducted in a prudent manner and as per policy approved by their board. The policy / guideline of the board should cover the type of financial assets to be sold, norms and procedure for sale, valuation procedure and delegation of power to various functionaries.

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

5) In no circumstances, transfer of assets can be made at a contingent price whereby in the event of shortfall in the realization by ARC the seller has to bear the shortfall.

6) Securities issued by ARC will carry the following risk weightage from capital Adequacy point of view.
   a. Risk weight for credit Risk 100% and
   b. Risk weight for Market Risk 2.5%
   c. Application risk weight (a) + (b)

7) Banks / FIs investment in security as above will be treated as exposure to ARC since only two ARCs are functioning at present, banks will be allowed to exceed prudential norm.

8) The banks / FIs which sell the assets to ARC will be required to make following disclosures in the Notes of Accounts to their Balance Sheet.
   a. No of accounts
   b. Aggregate value (Net of provision) sold to ARC
   c. Aggregate consideration.
   d. Additional consideration received, if any, in respect of accounts transferred earlier years.
   e. Aggregate gain / loss over Net Book Value
There are two Asset Reconstruction Companies in India at present. They are:

1. ARCIL (Asset Reconstruction Co. of India Ltd.) promoted by ICICI Bank, SBI, Punjab National Bank, IDBI and others.

2. ASREC (Asset Reconstruction Company (India) Ltd.) where main sponsors are UTI, Bank Of India, Allahabad Bank Standard Chartered Bank, Indian Bank etc. As per data available, up to February 2006, ARC had taken over 375 accounts from banks / FIs with outstanding dues of 18000 crores and with security Receipts Value at above 4300 crores.

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