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CHAPTER-III
REVIEW OF LITERATURE

3.1 Introduction:

Review of literature is important part of the scientific research. It enables the researcher to understand different aspect of the study or the problems to be investigated. On this background a brief review of literature on Non-Performing Assets is taken in the following pages.

The concept of Non Performing Assets was introduced following introduction of Income Recognition and Asset Classification (IRAC norms), in the year 1993. In view of the importance of the matter in terms of the concept which was new, introduction in Indian banking industry for the first time, its impact on profitability and image of the banks, need to take urgent steps to switch over to international norms particularly to move to Basel II norms, various authorities/authors/researchers have contributed to the literature on the subject. In order to understand various aspect of the subject and to avoid the duplication the review is divided in different aspects of the subject and the authors are listed topic wise. Views, which are common, are given under each head. Specific views of the authors, which need a special mention, are given separately. The different aspects covered in the review of literature are as under:

- Background
- Concept
- RBI Guidelines
- Views on RBI Instructions
- Reasons for NPAs
- Impact of NPAs
- Prevention NPAs
- NPAs in rural credit
- Recovery measures
- Legal Aspects
- Compromise settlement
- Research/studies on NPAs
3.2 Background:

Y. V. Reddy (2009), in his article “Reforming India’s Financial Sector-Changing Dimensions and Emerging Issues” has described the background for financial sector reforms as under:

“India embarked on a strategy of economic reforms in the wake of a balance of payments crisis in 1991; a central plank of these was reforms in the financial sector and, with banks being the mainstay of financial intermediation, the banking sector. At the same time, reforms were also undertaken in various segments of financial markets to enable the banking sector to perform its intermediation role in an efficient manner. The thrust of these reforms was to promote a diversified, efficient and competitive financial system, with the ultimate objective of improving the allocative efficiency of resources through operational flexibility, improved financial viability and institutional strengthening. The reform measures in the financial sector can be envisaged as having progressed along the following lines”.

Y. V. Reddy (2009), further states in his another article “Global Financial Turbulence and the Financial Sector in India: A Practitioner’s Perspective” as under:

“The prudential norms relating to income recognition, asset classification and provisioning, introduced during 1992-93, are being continuously monitored and refined to bring them on par with international best practices. In keeping with this, several measures were initiated in 2005-06. The provisions for standard assets were revised progressively in stages in November 2005, May 2006 and January 2007, in view of the continued high credit growth in the real-estate sector, personal loans, credit card receivables, and loans and advances qualifying as capital market exposure and a higher default rate with regard to personal loans and credit receivables, which emerged as a matter of concern. The standard assets in the following categories of loans and advances attract a 2 per cent provisioning requirement: a) personal loans (including credit card receivables); b) loans and advances qualifying as capital market exposure; c) real-estate loans (excluding residential housing loans) and d) loans and advances to systematically important non-deposit accepting non-banking finance companies. In order to ensure continued and adequate availability of credit to the highly productive sectors of the economy, the provisioning
requirement for all other loans and advances, classified as standard assets, was kept unchanged, viz., a) direct advances to the agricultural and SME sectors at 0.25 per cent and b) all other loans and advances at 0.4 per cent.”

3.3 Concept:

Report of the Committee on the Financial System:
The Government of India had appointed a Committee in August 1991 on the financial system under the chairmanship of Shri M.Narasimham, the former Governor of Reserve Bank of India.

Dr. Suhas S. Sahasrabudhe (2003), in his article “Review of Important Aspects of NPAs of Banks in India in The Post Reform Period” has mentioned the terms of reference of the committee as under:

The terms of reference of the Committee included the following

i) Examination of the existing structure of the financial system and its various components and to make recommendations, to improve the efficiency and effectiveness of the system with particularly reference to the economy of operations, accountability and profitability of the commercial banks and financial institutions.

ii) Recommending measures for infusing greater competitive vitality into the system so as to enable the bank and financial institutions to respond more effectively to the emerging credit needs of the economy.

iii) Examination of the cost, composition and adequacy of the capital structure of various financial institutions and recommendations regarding review of relative roles of different types of financial institution in the financial system and to make recommendations for their balanced growth.

iv) Review of existing supervisory arrangements relating to various entities in financial sector and to make recommendations for ensuring appropriate and effective supervision.

v) Review of existing legislative framework and to suggest necessary amendments for implementing the recommendations.

The Committee submitted the summary of its Report on November 8, 1991 and its Main Report on November 16, 1991 to Government. The main recommendations of the committee were:
1. In regard to income recognition the committee recommends that in respect of banks and financial institutions which are following the accrual system of accounting, no income should be recognized in the accounts in respect of non-performing assets. An asset would be considered non-performing assets if interest on such assets remains past due for a period exceeding 180 days at the balance sheet date. The Committee further recommends that banks and financial institution be given a period of three years to move towards the above norms in a phased manner beginning with the current year.

2. For the purpose of provisioning, the committee recommends that using the health code classification which is already in vogue in banks and financial institutions the assets should be classified into four categories namely, Standard, Sub-standard, Doubtful & Loss Assets. In regard to Sub-standard Assets, a general provision should be created equal to 10 percent of the total outstanding under this category. In respect of Doubtful Debts, provision should be created to the extent of 100 percent of the security shortfall. In respect of the secured portion of some Doubtful Debts, further provision should be created, ranging from 20 percent to 50 percent, depending on the period for which such assets remain in the doubtful category loss assets should either be fully written off or provision be created to the extent of 100 percent. The committee is of the view that a period of 4 years should be given to the banks and financial institutions to conform to these provisioning requirements. The movements to wards these norms should be done in a phased manner beginning with the current year. However, it is necessary for banks and financial institutions to ensure that in respect of doubtful debts 100 percent of the security shortfall is fully provided for in the shortest possible time.

3. The Committee believes that the balance sheet of banks and financial institutions should be made transparent and full disclosures made in the balance sheets as recommended by the International Accounting standards Committee. This should be done in a phased manner commencing with the current year. The Reserve Bank, however may defer implementation of such parts of the standards as it consider appropriate during the transitional period until the norms regarding income recognition and provisioning are fully implemented.

4. Banks at present experience considerable difficulties in recoveries of loans and enforcement of security charged to them. The delays that characterize our
legal system have resulted in the blocking of a significant portion of the funds of banks in unproductive assets, the value of which determinate with the passage of time. The Committee therefore considers that there is urgent need to work out a suitable mechanism through which the dues to the credit institutions could be realized without delays and strongly recommends that special Tribunals on the pattern recommended by the Tiwari Committee on the subject be set up to speed up the process of recovery. The introduction of legislation for this purpose is long overdue and should be preceded with immediately.

3.4. RBI Guidelines:

The Reserve Bank of India has issued guideline from time to time regarding classification and provisioning for NPA accounts. The important circulars are given below:

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3.5 Interpretation and Views on RBI Guidelines:

P.N.Joshi (2003), in his article “Non-Performing Assets - Causes, Extent and Remedies” has observed conceptual irregularities in the guidelines issued by the Central Bank as under:

The NPA position in Indian Banking is exaggerated, although called non-performing assets (NPAs) the ratio of non-performing credit is related to credit and not to assets. In fact, the internationally accepted norm is to relate the ratio to total assets. In our country loans form barely 52 per cent of the total --- credit-deposit ratio being around 54 per cent. The remaining 48 per cent of the
assets are held in CRR (5 per cent) and actual SLR (38 per cent) 5 per cent being other assets. 43 per cent of the assets (CRR+SLR) are the safest and risk free being funds with the RBI and in gilt-edged securities. If the ratio is related to total assets the net NPA ratio in the Indian Banking System falls sharply by more than 50 per cent from 5.5 per cent.

It is heartening to note that Dr. Bimal Jalan, Governor, Reserve Bank of India in his inaugural address at the Bank Economists’ Conference (in Bangalore December 1998), had observed, “In terms of percentage to total assets, gross and net non-performing assets have declined to 7 per cent and 3.3 per cent respectively by March 1998. I think, the present statistics are not unfavorable for the banking system as a whole.” Public Sector and Old Private Banks relate their NPA ratios to “Credit” as per RBI guidelines, while the New Private Sector Banks relate them to ingeniously invented concept viz. “Customer Credit” or “Credit like Instruments”, which include non-SLR investments. It is necessary to take a policy decision to relate NPAs to total assets and not to credit as at present. This will facilitate international comparisons.

NPAs are classified into (a) sub-standard, (b) doubtful and (c) loss assets. Loss assets are fully provided as per the guidelines of the RBI. There is hardly any need to show two different ratios of gross and net NPAs. Banks should be advised to disclose the total provisions held (outstanding) against the NPAs and not only provision made from the current year’s profit and loss account. This will give confidence to the shareholders about the magnitude of provisions held against problem accounts. It is also necessary for the banks to give disaggregated data of NPAs such as ‘sub-standard’, ‘doubtful’ and ‘loss assets’, which will throw more light on the quality of assets. For instance, two banks have the same NPA ratio of 10 per cent. The disaggregated data of Bank ‘A’ shows that the ‘sub-standard’ accounts for 2 per cent, ‘doubtful’ for 1 per cent and ‘loss asset’ for the remaining 7 per cent. In Bank ‘B’, the figures are 8 per cent, 1 per cent and 1 per cent respectively. Thus, though their NPA ratio is the same (10 per cent), clearly Bank ‘B’ is considerably better off than Bank ‘A’ because of its low ‘loss assets’ figure. The recently introduced disclosure, “Movement in NPAs” conveys precious little.
Dr. N. M. Bachhawat (2001) “Management of Non-Performing Assets in Commercial Bank” has stated as under:

The prudential norm of 90 days for classifying the A/cs as NPA is very much strict looking to the Indian conditions where whole of economy is still based on Agriculture and Agri is based on Monsoon and which is uncertain and erratic, instead of this Bank’s should recruit technical/ field officers for vigorous follow up and supervision of such accounts. RBI should reassess to bring fresh policy for recruitment of field staff for follow-up and supervision to control NPAs. NPA norms for agriculture advances should be relaxed to two years criteria and not two seasons i.e. one year, as in our country in most of the areas main crops are grown / cultivated once in a year, hence these norms are not fruitful to large sections of farmers who have availed the credit facility.

In case of relief measures for natural calamities provided to the affected farmers on his own request should be provided in such a manner that benefit of relief reaches to ground level in real sense and after replacement and reschedulement of the loan the same should immediately be considered as Standard Asset and such accounts should not be put under watch, period for which is one year for sub standard asset and two years for Bad & Doubtful assets. Banks is allowed to treat such rephrased / rescheduled NPA accounts as standard assets during same financial year.

3.6 Reasons for NPAs:
(A.T.PANNIRSELVAM COMMITTEE FINDINGS)

Any NPA Management policy has to identify the causes for the occurrence of NPAs. These causes may be attributed to either the borrower or the bank itself or may be due to factors beyond the control of both. Again these may be internal or external for either the borrower or the bank.

Causes attributable to borrowers:

Internal:
1. Wrong / Improper borrower identification.
2. Willful defaults.
3. Incompetent management.
5. Non-submission of requisite data or submission of wrong/inadequate data/information.
6. Time / Cost overruns due to delayed project implementation, etc.
7. Differences / disputes among Company promoters or controlling family members.
8. Technological obsolescence and low priority to technology upgradation.
9. Inadequate attention to R & D.
10. Poor Location choice.

External:
1. Poor stake / contribution of borrower.
2. Poor Inventory / Receivable management (W.C.dries up).
3. Delayed settlement of receivables of borrower by large Industrial houses, Govt. Depts., PSUs, etc.
4. Inability to compete in the market because of smaller size and new brand name.
5. Entry into business at an inappropriate time of business cycle.
6. Adverse exchange fluctuations.
7. Non-availability / Irregular supply of critical raw materials or other inputs.
8. Transport bottlenecks.

Causes attributable to Banks:

Internal:
1. Poor pre-sanction appraisal / unrealistic projections.
2. Poor assessment of commercial viability (due to lack of inadequate data / knowledge on market industry).
3. Delayed decision-making at operative level itself or due to multiplication of processing tiers (without real value addition).
4. Delayed disbursements.
5. Non-compliance of terms of sanction.
7. Inadequate supervision, absence of effective monitoring (post disbursement) & delays in detection of symptoms & initiation of remedial measures.
8. Over-stress on long relationships / family / group connections even at the cost of commercial viability of projects.
9. Ritualistic reviews (i.e. without proper or objective assessment of risks & requirements).
10. Non-availability of audited financial statements in time and too much reliance on provisional / un-audited data.
11. Lack of Networking / Information Systems amongst branches / Banks enabling borrowers to misuse Bank funds.

External:
1. Changes in regulatory prescriptions causing change in norms for classification.
2. Long drawn legal processes for recovery of loan.
3. Delay in action for rehabilitation of accounts and finalisation of rehabilitation package either at the Bank level or at the BIFR level.
4. Non-compliance or delay in compliance of terms of rehabilitation package by borrower.
5. Lack of exchange of information / coordination between financial institutions & Bank.
6. Non-availability of powers for enforcing securities (possession & sale) unlike those enjoyed by SFCs.

Causes beyond both the Borrower and the Bank:
2. Depressed capital markets and consequent delay in arrangement of funds for the project.
3. Frequent adverse changes in the govt. policies, excise and customs duties, decategorisation of items reserved for SSI, price preferences, cash incentives, product reservation quota system, etc.
4. Changes in policies regarding pollution control including legal decisions as in case of aquaculture and few chemical industries, which virtually ruined them, resulting in huge NPA with banks.
5. Isolated or general law and order problem resulting in stoppage of industrial production and movement of goods.
6. Inadequacy of infrastructure, in particular power resulting in high cost of production and hence lesser marketability of products.
7. Political uncertainties.
8. Ineffective functioning of BIFR / DRT.
9. Outdated laws, labour unrest, Riots, Lockouts, Strikes, etc.
10. Cascading effect of debt Relief Schemes resulting in poor loan repayment environment.
11. Insensitivity of Govt. towards non-payment of dues by PSUs and procedural delays in invocation of govt. guarantees.
12. Slow disposal of recovery cases.
13. Poor selection of schemes and proponents under Govt. sponsored schemes by the different govt. agencies.
14. Delayed release / Non-payment of subsidies allocated by Central / State Govt. etc. which have been factored into the project cost at the time of appraisal.
15. Adverse Court Judgment.
16. Adverse market conditions.

Causes of NPAs under the Priority Sector:

1. Lack of experience / managerial expertise / technical competence.
2. Infrastructure constraints and non-availability of adequate and timely extension of support from the Govt. agencies and public bodies.
3. Slow disposal of recovery cases under the public Debt Recovery Act or non-enactment of the relevant Act in some of the states.
4. Adverse effect of general waiver of loans by the Govt. on the repayment culture, resulting in a large number of willful defaulters.
5. Unrealistically ambitious targets set under directed priority sector lending.
6. Non-settlement / Rejection of DICGC / ECGC claims by the corporation on flimsy grounds.
7. Delay in realization of supply bills by small units for supplies made to larger units.

Causes of NPA

P.N. Joshi (2003), in his article “Non-Performing Assets Causes, Extent and Remedies” observed that:

A number of factors have contributed to the high level of NPAs in banking particularly in the public sector banking system. They are enumerated below.
1. PSU banks and DFIs have been used as instrument of public policy. Landings under populist schemes like ‘loan melas’, directed lending to certain sectors like mini-steel, mini paper, mini-cement units, sugar and cotton spinning co-operative are examples. Most of these loans have joined the ranks of NPAs.
2. Projects financed in the pre-reforms era, with high earnings, low promote, stake with viability based on high tariffs and fiscal concessions have turned sick.
3. The largest to join the ranks of NPAs will be some of the large projects in the core sector financed after opening to private investments.
4. Three decades of government ownership have rendered banks organizationally weak. Faulty appraisals, absence of effective post sanction monitoring, lack of initiative to take timely action against willful defaulters, indecision on existing out of bad loans through OTS due to fear of investigation agencies like CBI.
5. All contributed in no small measures to the worsening situation on NPA front.
6. The mandatory referral to BIFR provides ideal sanctuary to willful defaulters.
7. Large corporate usually delayed payments to SSI and contributed indirectly to the NPA of SSI units.
8. If any installments or interest is not received from creditors at that time bank does not renewed within time in case of cash credit or overdrafts accounts.
9. NPA accounts information is not sent by branch officer to the head office. As a result NPA figures of the head office become smaller.
10. NPA categories are not considered from time to time.

Any NPA management policy has to identify the suitable strategy for recovery. These causes may be due to factors beyond the control of both Again these may be internal or external for either borrower or banks.

3.7 Impact of NPAs:
K.H.Vora (2007) in his study entitled “Management of Non-Performing Assets and Asset Reconstruction Company” observed the impact of NPAs.

The effect of NPA on the bank is as under-

- There is loss of interest income.
- The current profit is reduced, as banks have to make provision for NPA.
• Capital adequacy ratio is also affected as it is directly related to the quality of assets.
• It also affects the liquidity position of bank as also recycling of funds due to asset liability mismatch.
• Banks at times have to borrow at high cost to fulfill their commitment/obligations, which increases the cost of funds.
• The high level of non-performing assets also affects the image of the bank in the public. The credit rating of the bank also affected due to high NPA and consequently business prospects in the country & abroad.
• The NPA has effect on the moral of the staff and may shy away from doing credit business due to fear of NPA.
• The bank cannot remain competitive in the market due to various adverse effects on the balance sheet and profit.

3.8 Prevention of NPAs:
Monitoring and Follow Up Measures

With the Income Recognition and Asset Classification Norms becoming stricter, Branches are required to be more alert and proactive in monitoring the accounts. For this purpose, monthly interest application has become a useful tool to tackle potential delinquencies or defaults in standard accounts. To retain the asset quality, it is necessary for bank branches to:
• Recover the over dues or at least the critical amount through active follow up with borrowers.
• Put the accounts under holding on operations in case of temporary cash flow mismatches.
• Reschedule the repayment terms as per expected cash flows.
• Restructure the dues in keeping with the expected cash flows and gaps in cash flows, if any as per guidelines of the bank in their recovery policy.

Measures for follow up of NPAs / potential NPAs for recovery

The various means of monitoring / resolving NPAs available to the Banks are listed below:

A) Before the account becoming NPA
• Regular monitoring to maintain asset quality.
• Reminders to be sent where irregularities crop up.
• Periodic inspection of the unit and charged assets along with analysis of financial data.
• In the initial stages of sickness, rescheduling, restructuring, rehabilitation under Bank’s Restructuring Policy, CDR mechanism, BIFR approved rehabilitation etc. schemes shall be attempted to improve the health of the unit.

3.9 Recovery Measures-Legal measures:
• Recovery through courts
• Debt recovery tribunal
• Corporate debt restructuring
• National company law tribunal
• Asst reconstruction companies
• Lok Adalats
• RRC Act of state Government
• Recovery Action
• Innovations by banks
• Research/reports etc.

All these means have to be effectively pursued for resolution of NPAs.

H.V.Upadhyay (1994) in “Recovery through SEIZURE: Some Aspects” has stated that the legal actions involve high cost and long time. Even after settlement of the case, the decree has to be filed and executed periodically as per the term which is an unpleasant and difficult task. This process also slows down the speed of follow up and results in lethargic attitude by banker. The advocates also do not cooperate as much in execution of decree as they cooperate in filing of suits.

The rate of recovery after initiating legal actions has remained very low and, therefore, few banks in the state of Gujarat have adopted a procedure of seizure of the vehicles. These vehicles are trucks, matadors, autorickshaw and tractors.

The only advantage and biggest benefit is that the recovery of large overdues could be made very speedily at a very low cost. The procedure also has a demonstrative effect and the other borrowers in the village voluntarily come forward to repay their dues.
Rajiv Aggarwal (1991) in his study entitled “Designing Effective Credit Recovery Management and Control System” To ensure effective follow up and timely repayment, organizational set up and systems, the quality of existing credit portfolio, the organizational culture and the public image of banks need improvement. Credit recovery seminars would have to be organized with an aim of changing beliefs, attitudes and behavior of officers at various levels of management.

A. Govil (2000), in his article “Need for Revival of Loss Making Branches” says that Recovery management is useful in following strategies.

a) When we are associated with lending for government sponsored schemes, branches will have to insist on the government agencies to help in the enforcement of recovery. In each meeting, we will have to reinforce our point and invite their involvement in recovery.

b) ABC analysis of the overdue by categorizing the quantum of overdue where by more attention can be paid on such chronic accounts. Segregation of overdue where the quantum of expected recovery is high and the branch is willing.

c) The recovery drive should be planned well in advance.

Dr.J.B.Kulkarni (2003), in “Management of Non-Performing Assets” stated the non legal Recovery Measures include-

1. Reminders Visits
2. Personal contacts
3. Rehabilitation of sick units / replacement
4. Loan compromise
5. Recovery Camps

N.V. Darshan (2001), in “The Secret of Recovery” stated that the ‘Elusive’ recovery thus forms the core topic of this paper included-

i) Eliciting relevant / required information

ii) Maintain close rapport with the borrowers

iii) Database

iv) Ensuring end utilization.

Dr. K.C.Chakraborty (2005) in “Management of NPAs Trends and Challenges” has stated that the banks have to face several challenges in managing NPAs. Besides ensuring better scrutiny of the credit proposals before
sanction, banks need to watch closely and monitor the assets from the selection of borrowers. A continuous and consistent monitoring mechanism is a must for ensuring the best quality of the assets. Symptoms of any sickness should be addressed immediately and appropriate remedial action implemented. Despite the availability of various avenues of recovery in ultimate analysis it is the borrowers’ willingness to repay rather than his ability to repay. The mindset of the borrowers from the beginning should be tuned in such a way that he is willing to repay rather than turn into a willful defaulter.

K.Kannan (2001) “Creation of Performing Assets from NPA to PA” has highlighted the expertise required and the mismatch of assets & liabilities, restrained banks from steaming ahead. Hence there is a need to workout a ‘Loan Policy’ with risk limits as to rate, duration, security and follow up and refinance if needed by securitization of the assets. Special branches rather than all branches dealing with all products, catering to needs of specialized customers were felt necessary, help in generating special data about the customers and also helps centralized control on delinquency.

The strategy should be decided by each bank based its strength, area of operation, type of customer quality of staff. The policy should decide which are to be financed (Industry-big / small) Trade, Individuals (housing, car, other white goods) etc. how many customer maximum amount of loan with repayment and follow up mechanism necessary.

Dr. Kumar M.K., Reddy C.M. and Muktha K.C. (2004) in their article “Causes of NPAs and Remedial Measures” observed that the Bank’s bottom line improvement largely depends on reduction in NPA and preventing NPAs would also help to improve the profitability of Banks. However good the credit dispensation process may be total elimination of NPAs is not possible in banking business owing to externalities but their incidence can be minimized.

The following steps may be taken to reduce NPAs

1. Massive recovery campaigns are launched.
2. Infrastructure / adequate machinery are provided to branch to render a helping hand.
3. Branch managers are exhorted to exercise extraordinary care in the selection of fresh borrowers so that new borrowal accounts does not enter in NPA list.
4. Lot off understanding needed among bank staff and customers to address themselves to the problem of recovery.

5. Prompt control / follow up/ monitoring measures help to prove borrowal accounts becoming irregular.

Dr. P. Mohan Reddy and D. L. Narayana Reddy (2004), write in their paper “Non- Performing Assets in Regional Rural Banks: A Study of Rayalaseema Grameena Bank” tries to analyze the status and trend of non performing assets in Reyalseema Grameena Bank (RGB) through multi-dimensional classification of NPAs. It also examines the recovery strategy of the RGB and offers certain remedial measures for the effective reduction of NPAs in the Bank. A new credit insurance scheme for priority sector lending, substantially improved legal system, meticulous loan documentation, and gradual shift from bank based to market based system and sound credit management skills will enable the Bank to meet the challenges in business environment and kept its non performing assets low.

Sastry S.R. (1996) in “Recovery Management” stated that the Recoveries are an essential / integral part of operations of all financial institutions, without which these get into liquidity problems, as recycling of funds is adversely affected. Owing to adoption of mercantile system of accounting, which placed overemphasis on security, recovery did not get in the past its due recognitions and bankers were more complacent in view of the availability of enough security to cover the risk of default in repayment. It is only through constant recoveries (of interest / installment) that the proportion of performing assets in the total portfolio could be kept in high. This alone can ensure better balance sheet.

Sharma R. (2002) in “Non -Performing Assets” stated that the burden being immense, the reduction of NPAs of the Banking sector should be treated as a national priority to make the Banking system stronger, more resilient and geared to meet the challenges of globalization. The thrust of the policies of the Government, RBI and the Banks should be on how best to tackle existing NPAs, recovery of arrears, minimizing incidence of fresh NPAs, improving asset quality and preventing deterioration of assets. Changes in the legal system
by introducing stringent foreclosure laws would be welcomed by entire financial sector.

Rajiv Ranjan and Sarat Chandra Dhal (2003) in “Non – Performing Loans and Term of Credit of Public Sector Banks in India: Empirical Assessment, Reserve Bank of India” has attempted an empirical analysis of the non-performing loans of public sector banks in India and investigated the response of NPLs to terms of credit, bank size and macroeconomic condition. The empirical analysis suggested that term of credit variable have significant effect on the bank’s non-performing loans in the presence of bank size and macroeconomic shocks. The empirical analysis suggests that asset measure of size could yield meaningful results relating to borrowers loan response. The changes the cost of credit in term of expectation of higher interest rate induces increase in NPA. On the other hand, factors like horizon of maturity of credit, better credit culture and favorable macroeconomic and business conditions lead to lowering of NPAs. The empirical analysis suggests that positive deviation of an individual banks credit deposit ration, from that of industry’s average could have favorable effect on reducing NPAs. Appropriate credit culture and lending policy designed with relevant economic and financial factors constituting the term of credit will make a significant impact on banks non performing loans.

Dr. M. Kiran Kumar, C.Munisekhar Reddy & K.C.Muktha(2004) in “Causes of NPAs and Remedial Measures” observed that the recovery can be accelerated at a much faster pace through effective 1) Supervision 2) Follow-up Supervision of advances by bank officials includes

- Ensuring proper end use of funds and creation of assets out of loan / margin /subsidy within the anticipated period and compliance of all terms and conditions stipulated in the sanction letter.
- Timely and periodical inspection of the securities charged to the bank.
- Proper watch on the conduct of the borrower and operations in the account in various segments such as Ledger / Bill / Godowns.
- Proper maintenance of requisite records for limitation.
- Constant touch with persons trading with the borrower to obtain market report in regard to his trade dealings, solvency etc.
Follow-up
1. Issue of reminders / notices.
2. Personal contact with the borrowers at periodical intervals.
3. If both steps a) and b) do not give desired results, local pressure tactic, if possible, may be applied and guarantor if any may be pursued to get the amount deposited by the borrower.
4. In case of defaulter in rural areas, whose service area the borrower resides/ operates the activity, with copies to the controlling officer of the addressee bank/society, Lead bank officer of the district, Bank’s own district co-ordinator.

Mario Castelino (2005) in “Managing Non-Performing Assets” Stated that the NPAs of the corporate sector have come down drastically in the recent past, there is concern over issues of frauds in case of mortgage loans & increase in NPAs from the retail sector in the recent past.

The impact of NPAs on the performance of banks largely depends on the management of assets and the priority given to recovery of NPAs. Secondly it is important to distinguish between NPAs, which are temporarily classified as such, due to the strict prudential norms stipulated by RBI, and the chronic NPAs where initiation of legal proceedings or enforcement of securities is ultimate means of recovery.

Indian banking industry saddled with high NPAs. The reason diversions of funds and willful default have been found to be the major contributing factors for NPAs in public and private.

3.10 NPA Management:
Effective NPA Management has become very vital in view of the multifarious impact NPAs have on profitability. No income accrues from NPAs. Provisioning eats into the profit made from other operations. Cost is involved in holding corresponding capital. Though no income is generated bank continues to incur cost on funds lent. The image of the bank also gets a beating. Effective NPA Management is a real challenge to day and the entire staff members need to be sensitized to the urgency of task on hand.
Slippages

- Avoiding large-scale slippages.
- The credit appraisal system should be upgraded.
- Effective risk assessment mechanism at various levels.
- Annual review of the accounts should be taken up seriously.
- Credit monitoring has to be done effectively.
- Identification of watch category accounts is to be done in time.
- CARE (Critical amount recovery exercise) should be undertaken on an on-going basis.
- Rehabilitation/ Restructuring/ Rephrasing are to be undertaken wherever feasible before accounts slip into NPA category.
- In accounts where problems are of temporary nature Holding- on-Operation can be allowed to restore the health of the account.

Upgradation

All out efforts should be made to upgrade NPA accounts by recovering over dues. In accounts where it is not possible to affect recovery immediately, rephrasing/restructuring should be tried out so as to facilitate up gradation of the accounts at the earliest.

Recovery/Reduction

Recovery/Reduction can be affected by using any of the following means:
- Follow up / Persuasion / Psychological pressure
- Compromise
- Recovery Camps
- Revenue Recovery
- Lok Adalat
- Civil Suit
- DRT
- SARFAESI ACT
- Write off
- Compromise settlements
3.11 Recovery Management in Rural Credit:

The authors have carried out study titled “Recover Management in Rural Credit” and gave their findings in the occasional paper published by National Bank for Agriculture Rural Development. On various aspects of NPA management such as reasons for non-performing assets, recovery measures, legal remedies etc. As regards recovery management they say that the recovery and NPA management strategies adopted by the RFIs may be classified into two broad categories viz. 1. Preventive 2. Corrective strategies

1. Preventive Methods

The preventive methods include-

- More careful and responsible scrutiny and appraisal. This includes timely sanction, realism in fixing repayment schedule and adequacy of credit with efficient delivery.
- Evolving a broad loan recovery policy and implementing through the cadres with adequate accountability and empowerment.
- Regular and effective follow up with borrowers and timely action on sensing the likely default.
- Title, value, etc. and additional security are to be investigated before the disbursement of loan.
- More detailed information about the borrowers is to be obtained in terms of his / her family background such as i) size of the family ii) number of dependents in the family iii) earning members in the family iv) standard of living v) length of residency in the area, etc.
- Reviewing the advances in time and taking appropriate immediate action.
- Sending demand notices in time.
- Proper supervision of the borrowal account through personal visits and calling for periodical returns to get incipient signals of default.
- Efficient MIS system on the borrowers and on the branches.
- Credit rating of clientele.
- Developing an early warning system for identifying potential weakness in the accounts.
- Strict observance of time schedules.
• Timely extension of period of limitation through debt acknowledgement, partial payment, renewal of documents etc.
• Timely replacement or rescheduling of loan in the event of natural calamities.

2. Corrective Methods

   The corrective methods conventionally start with initiating legal action for recovery and followed by lodging insurance claims with DICGCI wherever possible and initiating coercive against the borrower and the surety. However, corrective methods, in recent years, have become more innovative and participatory.

   i) Sharing the Threat Perception
   ii) Staff Motivation
   iii) Constitution of Special Recovery Cells and Related Measures
   iv) Involvement of Government Agencies
   v) Extraordinary Methods
   vi) Corrective Management for NPA Management

The following diagram shows the corrective management of NPAs.

Study the problems of NPAs-branch-wise, amount-wise ad age –wise
Prepare a loan recovery policy and strategies exclusively for NPAs
Create Special Recovery Cell at various levels
Identify critical branches for intensive recovery
Fix targets of recovery and draw time bound action plan

3.12 Recovery through Legal Process:

   Experience has shown that legal support is critical to recovery management. The recovery of loans through crystallized collateral and other back shopping’s subject to a prolix process as the present legal system normally does not provide a fast and effective exit route.

   Use of Collaterals and Collateral substitute

   It is seen that the recovery process through legal system with or without collateral is equally costly and lengthy. The court fee is payable on the amount of default or on the amount to be recovered and not on the value of the security. Judiciary and Revenue machinery have been generally unable to help the RFIs in recovery. The sheet volume of cases weights them down even if the system
has the intention. Except for the demonstrative effect, filing of summary or money suit for unsecured loans does not provide any tangible benefit for the RFIs. RFIs observe that pursuing such suits to a logical end is not prudent as it involves higher administrative and risk costs for them.

The expenses made on the court lie in the books of accounts until affecting the sale makes their recovery. This is a drain on the RFI’s resources and is often without any return for the RFI during the period. The RFI’s feel that the cost of executing the collateral is quite high for RFI’s.

1. **Revenue Recovery Acts:**

   An Expert Group headed by Shri R.K. Talwar in 1970 had recommended extension of similar facilities to commercial banks by appropriate State legislation (Talwar Committee, 1970). On the basis of the recommendations of the Talwar Committee, the State Governments (barring nine) had passed the Agricultural Credit Operations and Miscellaneous Provisions (Banks) Act. The act empowers designated officials of Revenue Department to issue an order having a force of decree of a civil court for payments of any sum due to a bank by sale of the property charged or mortgaged in favour of the bank. This facilitates foreclosure of mortgage on land in bank’s favour and brings the property for sale. Under the act a nominal fee and not the entire salary of the government official, is charged to the bank.

   The recovery officers under the Act have helped in recovering small loans of the banks. The banks, in States like Uttar Pradesh, Karnataka, have taken proactive steps to fund the cost (salary of recovery officers and other incidental expenses) by making a collective contribution for their establishment and / or allowing a recovery fee of 5% to 10% of the recovered amount towards their maintenance. But the above system has not worked uniformly well in all the states. The state governments had found it difficult to spare officials possessing zeal for this type of work, which is a prerequisite for a supporting machinery to work efficiently. Use of government official machinery helps in infusion of the threat perception amongst people, but the political interference becomes a part of it. Therefore, the lack of political will becomes a hindering factor in the process. It would perhaps be necessary to study the relative efficiency of the system across the country, so that improvements wherever possible, could be made.
2. Debt Recovery Tribunals:

Special Debt Recovery Tribunals (SDRTs) have been set up under the Recovery of Debts due to banks and Financial Institutions Act, 1993 for expeditious adjudication and recovery of debts. These court now adjudicate banks’ suits involving amount of Rs.10 lakh and above by transferring the cases pending with the civil courts. These loans are normally secured with collaterals. Only six such tribunals are operative now. The number of such tribunals is inadequate resulting in large number of cases pending before them. They are not yet equipped with proper infrastructure and flexibility to function smoothly.

Adv. (Dr.) Santosh A. Shah (2003), in his study entitled “Non Performing Assets-Legal Remedies” while doing Critical Analysis of the recovery of Debts Due to Banks and Financial Institution Act, 1993 states:

1. After having seen the implementation of the Act up till now, it is general experience that the object of the Act of expeditious adjudication is fulfilled to a large extent mainly due to the fact that the Tribunals under the Act have been accepting evidence by way of Affidavits and avoiding Examination in Chief and Cross Examination of the witnesses except under very special circumstances. It is our experience as I have mentioned before in this paper that the major time, which is taken for disposal of Civil Suits, is taken in trial, which consists of Examination in Chief and Cross Examination of the witnesses.

2. Again since the Tribunals are specially appointed and empowered to administer only these types of bank’s and financial institution’s legal proceeding, the Presiding Officer gets a good grip of the banking operations and also the law relating to banking which in turns enables him to dispose off the cases in a very expeditious manner.

3. There also seems to be, therefore, a development of specialized branch of law, lawyers, and law officers of various banks who are specializing in this work of the debt recovery tribunals.

4. All in all I see that at least the first object of the Act of expeditious adjudication has been fulfilled to a great extent debts recovered were Rs. 1864.30 Crores up to 30.09.2001. DRTs now cover almost all-important States in India.
5. However, the second object of the act of recovery having been started at least in this region only from last 5 years, its effectiveness needs to be still established. Moreover, recovery would need creation of proper infrastructure.

For recovery of small loans and to ensure quick justice on settlement of dues, Lok Adalats (People’s Courts) have been set up in some States. Retired high court judges and two other members head these courts. These small courts are founds to be of success in selected pockets. Efforts are continuing to popularize this arrangement. The judgment of these courts is found to lack the teeth of a civil court judgment for their enforceability. But these courts have provided good opportunity to narrow or bridge the differences between the banker and the defaulter by creating a favourable environment for a settlement and also in formalizing such settlements.

Critical analysis of the securitization and reconstruction of financial assets and enforcement of Security Interest Act, 2002

1. The Securitization Act has been enacted so as to tackle the growing NPAs in this country. The effect of the Act up till now has been encouraging as in most of the cases where notice for attachment and seizure of property has been sent under this Act, the parties are observed to have come for compromise with the Banks. The Act has created a new regime between the debtors and creditors. It is probably an outcome of what was thought by many as the position that many industries in the country took the financial sector for a ride up till now.

2. At the same time, however, care should also be taken to see to it that due to Acts of this nature which are termed by some as financial POTA, entrepreneurship in the country should not suffer. The Act is also termed by some as, ‘Shoot first – Act later’. The legislations up till now were debtor centric but now are turned to creditor centric.

3. The banks also have to learn to answer the usual criticism against them which is “When you do not need the funds, the banks have a lot of them and when you need them, they have none”.

4. Some critics have also pointed out that such an Act is an over reaction and the NPA norms do not take into account the agro based industries, oil
industries, sugar industries which have seasonal product. The distinction is also be made between wilful V/s. bonafide defaulters. An Exit policy should be adopted for bonafide borrowers who due to reasons beyond their control have gone into default. As against that a strict policy and application of the Act needs to be stringently applied to willful defaulters who many a time are found to be siphoning and misappropriating the funds of the Bank.

5. It must be borne in mind that one of the causes of NPAs is also non-prudent lending of money.

**3.13. Significance Rescheduling and Other:**


**3.13.1 Rephasement of the Loan:**

It is necessary to fix repayment schedule for term loan according to the income generating capacity of the unit. If repayment schedule is not fixed properly or a unit is not fixed properly or a unit is not able to generate expected profit, possibility may be explored in consultation with the borrowers for rephasement of loan installment. Rephasement of the loan installment should be done only when it is expected to get payment after the rephasement.

**3.13.2 Compromise Proposal:**

A compromise may be called where borrower agrees to pay a certain amount to the banker with some concession. A large number of compromise proposals are being approved by banks with a view to reduce their NPAs and recycling of funds instead of resorting to legal procedures.

M.C. Naidu and & A. Prasad (2004) in their study entitled “Remedial Measures for Managing Non –Performing Assets in RRBs” stated-

**3.13.3 Compromises with Borrowers:**

The bank should also enter into compromises through negotiations with the borrower to carry forward a clear picture of the latest position. It is a redundant to carry the non-recoverable loans on the bankbooks indefinitely. With proper justifications and convincing arguments, compromises could be entered into and implemented immediately.

Rehabilitation package for potentially viable sick units will helps in the revival of the NPA into performing assets. A little help in this regard may go a long way resulting in constructive solution.
Dr. B. Krishna Reddy, Dr. A. V. Ramana, and K. Nandeeswaraiah (2004) in their study entitled “Management of Non-Performing Assets in Banking Sector: Some Insights” observed:

### 3.14 Compromise Proposal:

It is the mechanism for settling outstanding dues through compromise. Negotiation in this regard is to be handled skillfully on the basis of relative strengths of the borrower and the banker. Banks should make all endeavours to strike a Zero-loss deal on a deal with minimum sacrifice waiver. Such compromise must be related to:

- Waiver of penal interest
- Reduction in interest rate
- Write off the full or a part of the amount of interest debited to the account of the borrower.

Prof. B. Mohan & K. Rajesh (2004), in their study entitled “Management of Non-Performing Assets in Institutional Agencies” stated that in the compromise settlement the points need to remembered are:

- Maximum recovery with minimum cost.
- Distinction needs to be made between willful defaulters and defaulters on account of conditions beyond their scope.
- Where security is available, proper weightage needs to be given to location, marketability conditions, possession thereof.
- Funds recycling to the maximum advantage instead of option for lengthy, expensive recovery process.
- All compromise proposals should be reported to the next higher authority for scrutiny so as to prevent fraudulent activities.
- Before presenting the compromise proposal before the Settlement Advisory committee, the proposal needs to be examined by the top executive.
- Adequate attention should be given and appropriate action initiated for upgrading substandard assets to standard assets.

V.K. Gupta (1994) in their study entitled “Fast Track for Recovery of Bank Overdues” stated that the slow pace of recovery of bad and doubtful debts has been adversely affecting the viability of various banks and financial
institutions. The prevailing system of recovery of bank dues through the machinery of civil courts is not only time consuming but also non-productive and expensive. Following recommendations of several high level committees including Narasimham panel on financial sector reforms and assurance of the Finance Minister on the floor of parliament to set up special tribunals to hear and decide the claim of banks, the bankers have been anxiously looking forward to the new set up of recovery. The new Act called “The Recovery of Debts Due to Banks and financial Institutions Act, 1993”.

S. D. Nayar (1994), written in his article “Recovery of Bank Dues” has given the norms of decree-

- The decree in the hands of the creditor must be a decree for the payment money to Rs. 500 or more.
- The decree must have become final.
- The execution of the decree has served the debtor with an insolvency notice.
- The creditor must have served the debtor with an insolvency notice.
- The insolvency notice must be in respect of a decree for payment of any amount due to such creditor.
- The notice must require the debtor to pay the amount due under the decree.
- The debtor has failed to comply with the notice and the time specified in the notice has elapsed; and.
- The notice must specify the time within which the debtor has to comply with notice by making payment.
- The notice has not been set aside by the District Court that is to say in case of debtor applying to the District Court under clause (b) of the provision this sub-section, his application has been rejected.

Rajendra Singh (2005) in his article “Empowering Banks for Recovery of Non-performing Assets (NPAs)” stated that the SARFAESI Act 2002-Need of the hour is essentially about enforcement of the lender rights and improving recovery of NPAs. The financial sector is under severe stress due to its inability to enforce security interest and other rights, mainly due to slow legal system.
The resulting increase in NPAs in the banking sector, the liquidity pressure on central and state financial and investment institutions and threat to the stability of the financial sector have forced the government to bring this legislation.

Issues before the Securitization Act

While the Act has been widely acclaimed by banks / Fls throughout the country as secured creditor(s) have unfettered liberty, the following issues deserve attention:

1. The issue of pricing of fixing a realizable value on the assets is a question not addressed in the act so far. World over, stressed assets are sold or transferred on a heavy discount, at times reaching a level of 75-80 percent. In such a situation, banks will have to first be prepared to write off the difference between the sale / transfer price and the book value, secondly be prepared to face scrutiny of Agencies like CBI or CVC for sale / transfer of NPA at such a low price.

Since the banks hold adequate provisions for the NPAs, write-off of the shortfall may not be included.

2. Issues with regard to stamp duty chargeable for transfer of assets from the originator to Asset Reconstruction Company (ARC) have not been addressed in the Act. The stamp duty is a state subject; it would require initiatives from the respective state government. As a matter of fact, these banking assets should be exempted from the levy of stamp duty.

3. Who will pay statutory dues like over due sales tax, excise duty, income tax, electricity charges and other local tax arrears after the management is taken over by the secured creditor? Legal position in this regard needs to be defined very clearly.

4. The appointment of a manager for the management of the acquired assets in consultation with the borrowers, whose assets have been seized by the banks, seems to be a utopian idea.

5. The Act provides for appeal and for appeal over appeal, resulting in lengthy judicial process, which may delay execution proceedings.

6. The Act provides for concurrence of secured creditors representing 75 percent in value of the amount outstanding where there are more than...
one secured creditors. This concurrence especially in case of going concerns may not come through.

7. The appointment of a manager for the management of the acquired assets in consultation with the borrower, whose assets have been seized by the banks, seems to be practically impossible.

8. Section 13 (4) provides for management of secured assets only. Where a company has a number of assets, it is difficult to decide how feasible is the management of isolated assets and the Act is silent on this point.

9. In law, one cannot do indirectly what is prohibited directly. In case of sale of seized assets, the seller and the beneficiary will be the same. The sale of secured assets by banks at value enough to cover their dues would be adequately self-serving, but may appear to be unfair to the stakeholders.

10. In case of management control over the business of the defaulter(s) the secured creditor will have effective control over unsecured assets of the borrower as well, which contravenes the stipulated intent of the Act.

11. It will be difficult for banks to sell distressed assets, as there will be few takers for such assets. The corporate(s) may gang up to prevent sale of assets by banks. Auctions may turn to be farce.

12. The Act empowers the banks to takeover the management of defaulting companies; banks are not business tycoons or jacks off all trades who can run any business activity with guaranteed success. Banks are not even custodians or merchants of commodities.

13. The Act does not address the problem of lack of infrastructure and practical problems involved in sale of distressed assets.

14. In case of certain specific industries where an industrial licence, specific government approval or permission or special rights like mining lease etc. is issued in the name of the borrowing company, will such license/approval/permission be automatically transferred to the name of buyer/bank/concerned or not?

15. Will intangible assets like patents, goodwill, brands be deemed to be automatically transferred to the bankers/buyers and defaulter would not have any right, title or interest in such assets, once he has been divested of the secured assets charged to the bank.
16. Valuation of assets and bidding process can trigger legal cases. There can be lack of unanimity among lenders also, as all lenders holding at least 75 percent stake in outstanding dues are required to agree to sell the assets of defaulters.

17. Borrowers might prefer objection on several issues before magistrates authorized to issue seizure order and can transform into potential enquiry into nature of secured assets, proper status, nature of liability etc.

18. Lenders are vulnerable to prosecution by compliance authorities on many issues, despite the indemnity given under the Act to persons exercising the rights of secured creditors.

19. The Act provides for creating a central registry to record the particulars of transactions related to SARFAESI Act and creation of security interest including electronic record of the same. It has not been clarified whether this registration would exempt ARCs and securitization companies from filling particulars with the state registry simultaneously.

20. The extent to which a secured creditor can proceed against a third party acquirer of secured assets from the borrower has not been adequately addressed in the Act. It may open a Pandora’s Box of legal proceedings with third parties for the secured creditor.

3.15 Research:

Dr. N. B. Shete (2002), “Non-Performing Advances of Commercial Banks: An Overview” with regard to priority sector NPAs, found that the major factors like natural calamities, inadequate income generation, high transaction costs, inappropriate financial policies, poor working of the RFI, follow-up of prudential norms and provisioning of NPA. Needless to say that defaults in the FRIs adversely affect the recycling of credit, squeeze up their resources and are closely linked with the banks’ heading towards a state of financial unsustainability.

R.M. Kulkarni (2006), in his thesis entitled “A Critical Study of Non-Performing Assets of Public Sector Banks with Special Reference to Single District” concluded “Non-Performing assets are affecting viability and solvency of public sector as well private sector banks. Not only Banks in India are facing this problem but also all over the world the situation is common. Non
performing assets affect adversely the lending activities of banks. Non-recovery of repayment installment and interest on loan create hindrances in credit dispensation process. Non recovery of loans also hurt the profitability of banks.”

It is observed that in the case of public sector banks, marginal decline in NPAs ratio was mainly because of increase in the share of standard assets and decline in the doubtful assets and sub standard assets.

T. Parmar (1994), in his article “Recovery: Finding of a Study of Two Districts in Gujarat” states that the guidelines given by the RBI have not adequately been followed by the banks. The study revealed that banks have not provided staff according to the business of the branch, and the job-role, function and responsibilities of the staff have not been clearly defined. The organizational strength remained weak and has not been strengthened to the extent necessary for better recovery performance. The study also revealed that a schematic approach in lending to clusters of borrowers of villages was not adopted to facilitate effective supervision. The approach of the Government agencies was just to sponsor the applications in bunch and that too without adequately examining the technical feasibility and economic viability of the loan proposals. Recovery performances of the branches were not constantly and closely reviewed by the controlling offices and separate recovery cells had not been set up as per the Guidelines of RBI.

V. Narayanan (2000) NPA Reduction the New “Mantra” of Slippage Management. He says that any one short measure like “recovery camps” can at best be of supplementary nature. In a credit proposal is processed properly, sanctioned, disbursed in time and in adequate amount and monitored right from the beginning then the chances of this asset becoming NPA is relatively less than another which has been processed in haste, appraised mechanically, delayed in sanction and disbursed in adequate quantum.

The NPA reduction techniques of “Slippage Management” along with proper credit appraisal and the occasional fire fighting of NPA will certainly help to check the incidence of NPA in the banking industry there by improving the banks’ profitability.
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26. DBOD.No.BP.BC.9/21.04.048/97
27. DBOD.No.BP.BC.163/21.04.048/ 96
28. DBOD.No.BP.BC.65/21.04.048/96
29. DBOD.No.BP.BC.26/21.04.048/96
30. DBOD.No.BP.BC.25/21.04.048/96
31. DBOD.No.BP.BC.36/21.04.048/95
32. DBOD.No.BP.BC.134/21.04.048/94
33. DBOD.No.BP.BC.58/21.04.048/94
34. DBOD.No.BP.BC.50/21.04.048/94
35. DBOD.No.BP.BC.8/21.04.043/94
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