CHAPTER – VII

MEASURES TO MINIMISE NON-PERFORMING ASSETS

Strategy to Reduce the NPAs

From a RBI study conducted in 1999, which though confined to only big borrowal accounts, it was inferred that the factors, responsible for creation of NPAs, external to the bank are more predominant than those attributable to the bank. In such a case the role of the Government and the RBI assumes critical importance in ensuring a credit market climate wherein the legal system is more responsive and there is sufficient deterrence to willful defaulters and those who take recourse to litigation for just buying time. Once such environment is created the NPAs levels for different banks will depend to a large extent on their own policies, systems, and judgements and perhaps will gravitate to reasonably low levels reflecting the time credit market risks. From the regulator’s perspective, there are four steps to the management of NPAs, viz.,

- Assessment,
- Provisioning,
- Recovery, and
- Prevention of fresh NPAs.

The recent initiatives in management of NPAs relate in greater measure to the third and fourth aspect, viz., recovery and prevention aspect although norms relating to the first and second aspects have been progressively tightened to bring them at par with international best practices.

Measures to Control NPAs Menace:

It is proved beyond doubt that NPAs in bank ought to be kept at the lowest level. Two pronged approaches viz.,

1. Preventive management and
2. Curative management would be necessary for controlling NPAs.
Preventive Management:
Credit Assessment and Risk Management Mechanism:

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

Organisational Restructuring:

With regard to internal factors leading to NPAs the onus for containing the same rest with the bank themselves. These will necessities organizational restructuring improvement in the managerial efficiency, skill up gradation for proper assessment of credit worthiness and a change in the attitude of the banks towards legal action, which is traditionally viewed as a measure of the last resort.

Reduce Dependence on Interest:

The Indian banks are largely depending upon lending and investments. The banks in the developed countries do not depend upon this income whereas 86 percent of income of Indian banks are accounted from interest and the rest of the income is fee based. The banker can earn sufficient net margin by investing in safer securities though not at high rate of interest. It facilitates for limiting of high level of NPAs gradually. It is possible that average yield on loans and advances net default provisions and services costs do not exceed the average yield on safety securities because of the absence of risk and service cost.

Potential and Borderline NPAs under Check:
The potential and borderline accounts require quick diagnosis and remedial measures so that they do not step into NPAs categories. The auditors of the banking companies must monitor all outstanding accounts in respect of accounts enjoying credit limits beyond cut – off points, so that new sub-standard assets can be kept under check.

**Curative Management:**

The curative measures are designed to maximize recoveries so that banks funds locked up in NPAs are released for recycling. The Central government and RBI have taken steps for arresting incidence of fresh NPAs and creating legal and regulatory environment to facilitate the recovery of existing NPAs of banks. It follows

Once NPA has occurred, one must come out of it or it should be managed in most efficient manner. Legal ways and means are there to overcome and manage NPAs.

Under Curative Management recovery made through

I. Legal Measures and
II. Non-Legal Measures

**I. Legal Measures**

**Willful Default**

A. Lok Adalat and Debt Recovery Tribunal
B. Securitisation Act
C. Asset Reconstruction

**Lok Adalats:**

These are voluntary agencies created by the State Government to assist in matters of loan compromise. Lok Adalats meet at different places for the convenience of banks and borrowers on a given date where both the bankers and the borrowers should be present. After looking into the evidence and listening to both parties, the Lok Adalat works out an acceptable compromise. Thereafter, Lok Adalat issues a recovery certificate, which will enable the bank in obtaining decree from the concerned court. This arrangement shortens the period in obtaining decree from the concerned court, which would otherwise, normally, be awarded after a much longer period. In view of the unique advantage, the Government is thinking of strengthening them and raising the monetary limit set for referred cases. Along with this, efforts
should be made to give wide publicity to the scheme, besides educating both banks and borrowers on Lok Adalats. Lok Adalat has proved an effective institution for settlement of dues in respect of smaller loans and the following guideline were issued to banks and FIs.

- Ceiling of amount for coverage under Lok Adalats would be Rs. 10 lacs and above;
- The scheme may include both suit-filed and non-suit-filed accounts in the doubtful and loss category; and
- The settlement formula must be flexible.

**Debt Recovery Tribunals (DRT):**

The banks and the financial institutions can file a petition with DRTs. To hasten the recovery process, DRTs were established by Government of India vide the Recovery of Debts Due to Banks and Financial Institutions Act, 1993. Under the Act, two types of tribunals were set-up, i.e., Debt Recovery Tribunal (DRT) and Debt Recovery Appellate Tribunal (DRAT). These tribunals have been notified to entertain litigations where the amount of debt due to any bank or financial institutions or their consortium is not less than Rs. 10 lacs. In all such cases, a bank can file an application in the prescribed format accompanied by prescribed documents and ad-valor filing fee with the tribunal under whose jurisdiction:

- The defendant or any of the defendants at the time of making application, actually and voluntarily resides or carries on business or personally works for gain, or
- The cause of action or in part arises.

Upon filing of a petition, the tribunal:

- Shall issue summons requiring the defendants to show cause within 30 days of the service of summons as to why the relief prayed for, should not be granted.
- After giving an opportunity to the parties of being heard, may pass such orders as it thinks fit to meet the ends of justice and shall send a copy of every order passed to the applicant and the defendants.
- May make any interim order by way of injunction or stay against the defendant debarring him from transferring, alienating or otherwise
dealing or disposing of any property and assets belonging to him without prior permission of the tribunal.

- Shall issue a certificate under his signature on the basis of the order of the tribunal, to the Recovery Officer for recovery of the amount of debt specified in the certificate.
- The Recover Certificate is conclusive and parties cannot dispute or make objections. The Recovery Officer, thereafter, proceed to recover the amount by way of an attachment and sale of movable and immovable property. He appoint a Receiver for the management of movable / immovable properties of the defendants. The Recovery Officer is authorized to recover the amount of debt due by sale of the property in the manner laid down in the Income Tax Act. The Recovery Officer has been vested with the powers as exercised by the Income Tax Officer for the purpose of recovery of due amount.
- Any person aggrieved by orders of such tribunal may appeal to the appellate tribunal within 45 days from the date on which the copy of the order is received. No appeal, preferred by the debtors, shall be entertained, unless 75 per cent of the amount of the debt due form him as determined by the tribunal is deposited in Appellate Tribunal. An important power conferred on the tribunal is that of making an interim order against the defendant to debar him from transferring, alienating or otherwise dealing with or disposing of any property or asset belonging to him without prior permission of the tribunal.

The Government set-up a working group to review the existing provisions of the above Act and the rules framed there under in the light of suggestions received from various quarters such as banks, FIs, DRTs and individuals as also to examine the adequacy of the infrastructure available to DRTs. The poor recovery through DRTs can be attributed to various issues:

- Lack of infrastructure, manpower, etc.
- Lack of banking knowledge.
- Challenge to the verdicts of the appellate tribunals in the High Court.

Asset Reconstruction Company (ARC):
The Narasimham Committee on financial system (1991) has recommended for setting up of Asset Reconstruction Funds (ARF). The following concerns were expressed by the committee.

- It was felt that centralized all India fund will severely handicap in its recovery efforts by lack of widespread geographical reach which individual bank posses and.

- Given the large fiscal deficits, there will be a problem of financing the ARF. Subsequently, the Narasimham committee on banking sector reforms has recommended for transfer of sticky assets of banks to the ARC. Thereafter the Varma Committee on restructuring weak public sector banks has also viewed the separation of NPAs and its transfer thereafter to the ARF is an important element in a comprehensive restructuring strategy for weak banks. In recognition of the same ARC Bill was passed to regulate Securitization and Reconstruction of financial assets and enforcement of security interest. The ICICI BANK, State Bank of India and IDBI has promoted the country’s first Asset Reconstruction Company. The company is specialized in recovery and liquidation of assets. The NPAs can be assigned to ARC by banks at a discounted price. The objective of ARC is floating of bonds and making necessary steps for recovery of NPAs from the borrowers directly. This enables a one time clearing of balance sheet of banks by sticky loans.

**Corporate Debt Restructuring (CDR):**

The corporate debt restructuring is one of the methods suggested for the reduction of NPAs. Its objective is to ensure a timely and transparent mechanism for restructure of corporate debts of viable corporate entities affected by the contributing factors outside the purview of BIFR, DRT and other legal proceedings for the benefit of concerned.

The CDR has three tier structure viz.,

a. CDR standing forum

b. CDR empowered group and

c. CDR cell.
The Mechanism of the CDR:

It is a voluntary system based on debtors and creditors agreement. It will not apply to accounts involving one financial institution or one bank instead it covers multiple banking accounts, syndication, consortium accounts with outstanding exposure of Rs. 20 crores and above by banks and institutions.

The CDR system is applicable to standard and sub – standard accounts with potential cases of NPAs getting a priority. In addition to the steps taken by the RBI and Government of India for arresting the incidence of new NPAs and creating legal and regulatory environment to facilitate for the recovery of existing NPAs of banks, the following measures were initiated for reduction of NPAs.

Circulation of Information of Defaulters:

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

Recovery Action against Large NPAs:

The RBI has directed the PSBs to examine all cases of willful default of Rs. One crore and above and file criminal cases against willful defaulters. The board of directors are requested to review NPAs accounts of one crore and above with special reference to fix staff accountability in individually.

Credit Information Bureau (India) Ltd. (CIBIL)

In pursuance to the Central Government Budget proposals, 2000-’01, Credit Information Bureau (India) Ltd., (CIBIL) was set-up in January 2001 by SBI in collaboration with HDFC Ltd. CIBIL has been set-up with an authorised capital of Rs. 50 crore and a paid-up capital of Rs. 25 crore, with equity participation of 40
per cent each by SBI and HDFC and two Foreign Technology Partners Private Limited. The CIBIL was to be technology of error-free data at all times in the system. CIBIL’s technical partners have commenced the preliminary work relating to customisation of software on the basis of the information furnished by some banks.

Based on the recommendations of Iyer’s Working Group, banks and FIs have by submit the list of suit-filed accounts as on March 31, 2002 and quarterly updates thereof till December, 2002 and suit-filed accounts of willful defaulters of Rs. 25 lacs and above as at end-March, June, September and December 2002 to the RBI as well as to CIBIL for a period of one year till 31st March, 2003. Thereafter, the aforesaid information should be submitted to CIBIL only and not to the RBI.

Banks and notified FIs would, however, continue to submit the data relating to non-suit filed accounts of Rs. 1 crore and above, classified as doubtful and loss, as 31st March and 30th September and also quarterly list of willful defaulters (Rs. 25 lacs and above) where suits have not been filed only to RBI as hitherto. Thus, the statements of non-suit filed accounts need not be sent by banks / FIs to CIBIL. There are approximately 98 banks, 22 non-banking finance companies in India, as well as large number of co-operative banks and other regional credit grantors all of whom are potential users of CIBIL in the long-term. All sectors of the financial industry in India recognize the need for a credit bureau. RBI has issued instructions to banks / FIs to obtain the consent of all the borrowers for dissemination of credit information to enable CIBIL to compile and disseminate credit information. The RBI accords highest priority to the development of an efficient CIBIL and would be closely monitoring the progress in this regard.


Only recourse available with banks and financial institutions (FIs) to recover their non-performing assets, before the enactment of this Act, was by way of filing cases against the borrower in the DRTs or civil courts. Banks followed-up their cases hoping that the DRT / civil court rules in their favour delivering the locked-up dues to them. Unfortunately, the judicial process is often a lengthy one, with the result that the DRTs / courts have not been able to match the high expectations of the banking sector to recover their huge burden of NPA. All the 29 DRTs in the country
combined have been able to recover, in the 7 years of their existence, only about 10 per cent of the total dues. The SARFAESI Act empowers banks and financial institutions (FIs) to directly enforce the security interest, pledged to them at the time of sanctioning the loan without having to go through the judicial process. Further, the option of approaching the DRT always remain open to the banks / FIs, which they can exercise at any time. In addition, the pending cases will continue with the DRTs and will be disposed only after the bank informs the DRT that it has recovered the NPA on its own. In this way the banks / FIs have double recourse for recovering their NPAs.

The process of enforcement of the securities can be done either by the banks / FIs themselves, or through Securitisation Companies or Asset Reconstruction Companies, specialised agencies that will be created and registered under the provisions of this Act. The bank now has the right to directly sell the financial assets (that it is holding as security against defaulting loan accounts classified as NPA), to these newly formed companies. These companies will pay the bank’s dues usually in the form of bonds or debentures. After acquisition from the bank, it is up to the Securitisation Companies or Asset Reconstruction Company to recover the asset from the borrower and then either further sell-off/auction-off the assets; or in case of the asset being a business, try to revive it, i.e., reconstruct the asset.

This Act may be quite useful for the banks / FIs. The banks / FIs have initiated the process of recovery of their dues under this Act soon after the commencement of the same, which shows their anxiety to recover their NPAs. The Act has recognized the urgency of framing legislation empowering the banks / FIs whose hands had been tied until now, to unlock their NPAs on their own. There are hopes that this empowerment will go a long way in bringing back into circulation the massive amount of locked up funds in the form of NPAs. It also opens up a completely new area of private enterprise in the form of the Securitisation Companies or Asset Reconstruction Companies. The act will lead to the reconstruction of hitherto decaying financial assets, a large number of which are sick industrial units, which will give a great boost to the overall health of the economy. In spite of many good objects and merits, the Act has some areas of concern, which need to be addressed by the government.
Loan Compromise

Once an NPA / sick unit is evaluated and found that it cannot be revived, it becomes incumbent on the branch to initiate recovery proceedings. Here, the branch should bear in mind that money has got time value and hence, should pick such means that result in quick repayment. It has to, therefore, exercise the option of either going to a court praying for decree or negotiate with the customer for a compromised settlement. Successful outcome of a negotiation for a compromised settlement depends much on the abilities of the negotiator in exploiting the key elements. In any dispute, parties become emotionally involved and are more likely to get angry. Partisan factors operating consciously or unconsciously at the borrower’s level are likely to distort his judgment. A negotiation banker too is prone to this syndrome. In the organisational context, the negotiator is often forced to avoid taking responsibility under the plea of getting the necessary approval from the higher-ups. Such passing the buck is likely to protract the negotiations besides dampening the spirit of the borrower. Such prolonged negotiations may result in disillusionment of the borrower and that may send wrong signals across the system. It is, therefore, always preferable to get the boundaries for negotiations defined in consultation with the competent authorities and keep the dialog, positively, rolling on, till an acceptable proposition emerges, which is unique by itself for each loan account. This has to be reached, keeping in mind the following:

- The realisable value of assets charged in the account;
- Likely time taken for enforcement of securities through court’s intervention;
- Enforceability of securities;
- Scope for disposing the assets;
- Deterioration in the inventory value due to prolonged litigation;
- The social status of the borrowers / guarantors;
- Their concern for self-esteem;
- Whether default is a resultant phenomena of external or internal factors; and
- Whether the borrowers are having other sources of income besides the unit financed.
Appointment of Professional Agencies for Recovery

Recently, IBA has worked out certain guidelines for banks on matters concerning the appointment of outside professional agencies whose services can be utilised to ascertain the whereabouts of the borrower and enforcement of securities. There is some hesitancy on the part of public sector banks in engaging them for recovery purpose due to unpleasant experience in certain cases. However, during the post-VRS scenario, it is suggested to seek such out-sourcing, after examining the credentials of the professionals and keeping a constant vigil on their practices.

II. Non-Legal Measures

Reminder System

The cheapest mode of recovery is by sending reminders to the borrowers before the loan instalment falls due. Generally, response to this arrangement particularly from honest borrowers is encouraging. However, efforts need to be strengthened in banks in sending reminders on timely basis.

Visit to Borrower’s Business Premise/Residence

This is a more dependable measure of recovery. Visits need to be properly planned and involvement of staff at all levels in the bank branch is called for. Costs involved in recovery need to be kept to the minimum. Frequent visits are called for, in case of hard-core borrowers. Over the years, it is observed that the number and quality of visits are going down. Consequently, the recovery process is affected.

Recovery Camps

In respect of agricultural advances, recovery camps should be organized during the harvest season. To ensure maximum advantage, recovery camps need to be properly planned. It is also essential to take the help of outsiders, particularly, revenue officers in the state Government, local panchayat officials, etc. It also calls for professional approach to give a wide publicity of the recovery camps to be organized in the local area, mobilize as many farmers as possible and motivate the staff to get involved in the recovery drive.
Rephrasing Unpaid Loan Instalments

In respect of small advances, bankers need to be sympathetic in respect of sincere and hardworking borrowers. If such borrowers fail to play loan instalments due to natural calamities or for some other convincing reasons, unpaid loan instalments may be rephrased / rescheduled. Bankers’ efforts need to be strengthened.

Rehabilitation of Sick Units

Once an account slips into the non-performing zone, the bank, through the branch concerned, should make an attempt to identify the reasons for such sickness and the scope for its rehabilitation. In addition, if a unit is identifies as non-viable, it becomes all the more urgent for the branch to recover the dues and thereby reduce the NPAs. One such possibility is recovering the dues through compromise. Effective credit monitoring, as per the laid down procedures, gives enough clues to identify the sickness of a unit as it is surfacing. However, the misery is that there is always a wide gap between expectations and reality. Yet, becoming an NPA. The branch has to necessarily be alert to pick up sickness signals at the very initial stage and launch corrective measures so as to arrest fresh accretions to the NPAs. Now, the moot question is how to identify incipient sickness.

It is perhaps more easy to identify a sick unit by negation. It is gut feeling of the traditional bankers that a healthy unit usually depicts a balance sheet where:

- Current assets are sufficient to meet current liabilities (Current liabilities / Current assets = 0.75)
- Outside liabilities are not more than three times of net worth (Outside liabilities / Net worth = 3)
- Internal cash generation is at least equal to one-fifth of the long-term liabilities (Long-term liabilities / Internal cash generation = 5)
- Profits after tax is at least equal 10 per cent of net worth (Net worth / Profit after tax = 10)
- A part of profit is retained in business (Share capital / Net worth = 1).

On any given date, the branch can work out these ratios by calling a fresh balance sheet and identify a unit as healthy or otherwise. Any unit scoring more than 20 must, therefore, either be already sick or showing symptoms of sickness. Higher
the score, the more intense is the sickness. Identification of causes for sickness is as important as identification of sickness, for that alone helps the branch in measuring its potential for revival and drafting a suitable rehabilitation package. A unit may become sick owing to various hindrances / threats that are either intrinsic or extrinsic in nature. A few such universally identified causes are listed hereunder:

**Internal**

**Congential**

(i) Management: inexperienced promoters’ faulty planning and over run-time and cost, locational error;

(ii) Marketing: faulty survey;

(iii) Financial : lack of capital, and inadequate costing; and

(iv) Production: obsolete technology.

**Otherwise**

(i) Management: dishonest, dissension, and poor industrial relations;

(ii) Marketing: dependence on few buyers, poor distribution network, keen competition, and long deliveries at fixed prices;

(iii) Production: low machinery breakdown, capacity under utilization, high wastages, high labour cost, poor quality control, and product obsolescence;

(iv) Financial: faulty pricing, unplanned expansion, diversion of funds, poor realization of book debts, costly outside borrowings and inability to identify loss/profit contributing products.

**External**

**Marketing**

(i) Glut;

(ii) Demand recession: domestic and global;

(iii) Change in: fashion, and taste;

(iv) Financial: non-availability of finance, credit squeeze, delayed decision by bank government action, additionally duty, withdrawal of subsidy, government inaction, dumping of overseas products, and price support;
(v) Production: non-availability of raw materials, power, fuel, water and natural calamities.

Having identified the sickness and diagnosed its causes, the bank must choose the right course of action from the available alternatives, viz. nursing the unit if potentially viable after implementing a relief package for not more than 5 years for SSI and for non-SSI, and if unviable, amalgamate / merge with another healthy unit, compromise, or recall. Sick units both from the SSI and non-SSI sectors should be identified on timely basis keeping in mind the official definitions. If the project found viable in terms of Debt Service Coverage Ratio (DSCR), rehabilitation package has to be prepared keeping in mind the broad parameters suggested by the RBI. The package should be implemented at the earliest by the bank and the borrower. Close monitoring of the progress of implementation is called for as generally the success rate in revival of sickness is discouraging. Further, in the process of financial sector reforms, banks and FIs are hesitant to rehabilitate due to make provision for sick SSI units during the first year of implementation. New guidelines on rehabilitation should essentially create a sense of urgency on the part of both banks and borrowers. Efforts on the part of the Government in announcing terms of concessions, reliefs, etc. should be made on timely basis. Understanding between banks and SFCs should be strengthened. Above all, stem action against willful defaulters is called for.

Other Measures

It is suggested to review the existing system of staff incentives for recovery from hardcore NPAs and derecognized interest. Incentives may be offered to lawyers who can manage to get a decree in a record time. Close monitoring of suit-filed cases is also called for. Finally, in respect of small advances, loan write-off may be considered, if the chances of recovery are remote.

Measures against Banks

It is not that all the measures have been taken against borrowers only, the Government has also initiated steps to supervise the working of the banks, and wherever, the bank, FIs etc. were at fault, they have been penalized. For this Board of Financial Supervision is entrusted with the supervision of commercial banks, select all Indian Financial Institutions (IFIs), non-banking financial companies (NBFC), the Clearing Corporation of India and Primary Dealers (CCIPDs). The focus of the