2.1 INTRODUCTION

Indian Banking industry is facing severe problem of growing NPAs. The gross NPAs of public sector, private sector and co-operative sector banks were showing drastic growth. Government of India has been taking steps to reduce the mounting NPA levels. It has brought the banking sector reforms and enacted various laws to set up the special forum to tackle with the recovery disputes and help the banks and financial institutions to enforce its security interest. It has introduced various schemes to induce the defaulters to repay the dues.

This chapter deals with the recommendations of various committees, working groups for the development of banking sector in India. It also deals with the literature published in books, newspapers, magazines, e-papers on different websites with special reference to the growing NPAs and ‘The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) and the Security Interest (Enforcement) Rules, 2002’.

A brief survey of selected studies and their findings are written in the following paragraphs to serve as a background for the present study. The committees and working groups set up for banking sector reforms in India, terms of references and recommendations of Committees related to the present research study and reasons for enacting SARFAESI Act 2002 are taken into account.

2.2 REPORTS OF COMMITTEES AND WORKING GROUPS APPOINTED BY GOVERNMENT OF INDIA

The need for sound accounting standards in the banking came in to the existence when banking crises occurred in many countries. In many countries, accounting conventions for classifying non-performing assets are not tight enough to prevent banks from making bad loans good by lending more money to troublesome borrowers. It was very difficult to distinguish healthy banks from unhealthy banks because of absence of financial statements on the consolidated exposure of banks, by lack of uniform reporting system of banks within a country,
differences in accounting standards across the countries, the lack of serious penalties for submitting inaccurate and incorrect reports for supervisors etc. There was an urgent need to have a sound accounting standards in the financial sector.

2.2.1 Committee on International Financial Standards and Codes

An Advisory Group on International Accounting and Auditing under the chairmanship of Y.H. Malegam was constituted by the ‘Standing Committee on International Financial Standards and Codes’ to examine the availability of internationally accepted accounting standards in India. The Narsimham Committee I has also touched this area and recommended to implement the international accounting standards in Indian banking sector.

In India, according to the existing accounting system, banks were used to debit the interest to respective loan account and credited to its Profit and Loss account without taking in to account, whether the interest amount is actually received or not. This leads to show the fictitious profit scenario in banking sector. There was a need to improve the accounting standards with the tune of the international best practices which would help to attain the internationally harmonized public disclosure of bank performance. It would also help to strengthen foreign banks to do more business with Indian banks.¹

2.2.2 The BIFR and the SICA-1985

Government of India has been introducing new schemes and ideas to reduce the heaps of NPAs since long. As stated earlier in the introductory part of chapter I, the Government accepted the recommendations of the Tiwari Committee and enacted the Sick Industrial Companies SICA (Special Provisions) Act; 1985. The SICA empowers, the Board of Industrial and Financial Reconstruction (BIFR), to take appropriate measures for revival and rehabilitation of sick industrial companies and liquidation of non-viable companies. Unfortunately, the functioning of SICA has not been satisfactory and many deficiencies were noted in its functioning. Exorbitant delay in decision making was the major cause for its failure. While SICA has met with limited success, it has failed to reduce Industrial
sickness. The BIFR does not deal with cases of small scale sick units. The recovery measures of the bank have been affected adversely resulting into alarming increase in NPA accounts. The gross misuse of the Act, forced the successive governments to re-think the entire issue and remodel/ reframe/rationalize the existing enactment.

The year 1990 proved to be fatal year for the Indian financial system. The Government of India had to pledge tones of Gold in International Bank in order to fulfill the international transaction commitments. Since 1987 the symptoms were in existence in the form of indiscipline in repayment of debt given to borrowers. The frequent changes in Government policies like ban on import and export of some commodities, increase or decrease in taxes, Industrial sickness due to recession, wrong policy decision, mismanagement, diversification of funds and many other reasons affect on the repayment capacity of the borrower. One of the crucial problems faced by the public sector bank in management of their loan portfolio is low rate of recoveries.

This is evident from the writings of D.M.Mithani. "The total over dues of public sector banks was Rs. 9733 Corers in June 1987, which constituted nearly 17 % of their total outstanding advances. Of this over dues from the agricultural sector accounted for Rs. 2239 corers i.e. 23 % of the total, other priority sector accounted for Rs. 1627 corers i.e. 17 % of total. This means over dues accounted for 40 % of the total priority sector including agriculture. Small Scale Industries accounted for about Rs. 1937 Corers i.e. nearly 20 % of the total. The large and Medium sector industry had over dues of Rs. 2613 corers i.e. around 27 % of the total while the over dues of all sector amounted to Rs. 1316 Corers i.e. 13.5 % of the total."  

The Central Government headed by V.P. Narsimham Rao and finance Minister Manmohan Singh made policies which are in commensurate with international standards based on Basle recommendations. These recommendations were made applicable by Western Countries in the year 1980. But it took 10 years to introduce in India.

2.2.3  Narsimham Committee- I on Financial Sector Reform -1991

In 1991, Govt. of India accepted the principles of liberalization, privatization & globalization. Accordingly Govt. brought various changes in economic sector.
Govt. of India brought changes into foreign trade, foreign investment, industry and business in service sector. At the same time Govt. of India also brought development in credit sector. However with the speed of the progress some serious problems were arose defects and weakness in the working of banking business in our country. It was observed that these limitations become obstacles for India to face competitive economy. To overcome these defects and to give suggestions for having the Indian banking business more competitive, viable and efficient, Govt. of India appointed a high power committee in 1991, under the chairmanship of M. Narsimham, which examined all aspect relating to the structure, organization, functions & procedures of the financial system & submitted its reports in November 1991 to the RBI. This committee recommended vast changes in the financial system as per international norms to cater the needs of the sector & to strengthen the system.

The Important Terms of References of the Narsimham Committee are:  

1. To recommend measures for improving and modernizing the organizational systems, procedures and managerial policies.

2. To recommend measures for infusing greater competitive vitality in to the system, so as to enable the bank and FIs to respond more effectively to the emerging credit needs of the economy.

3. To examine the cost, composition and adequacy of the capital structure of various financial Institutions and to make recommendations in this regard.

4. To Review relative roles of different types of FIs in the financial system and to make recommendations for their balanced growth

5. To Review the existing supervisory arrangements relating to various entities in financial sector and to make recommendations for ensuring appropriate and effective supervision.

6. To Review existing legislative framework and to suggest necessary amendments for implementing the recommendations.

The committee observed that the capital ratios of Indian banks are generally low and some banks are undercapitalized. It submitted its report in November 1991. The Narsimham committee made recommendations on financial reforms.
Important Recommendations of the Committee

1. The capital adequacy standards recommended by Bank of International settlements, Basel (a minimum of 8% capital in relation to risk weighted assets) should be achieved by banks latest by March 1996.

2. Bank should adopt sound and uniform accounting practices with regard to:
   - Income recognition (i.e. rules regarding accounting treatment about income receivable but not actually received). All advances of a bank should be classified under the health code.
   - Provisioning against doubtful debts.
   - Valuation of investments.

3. Special Tribunal should be set up to speed up the process of recovery.

4. An asset Reconstruction Fund (ARF) should be established (with capital subscribed by the public sector banks and FIs), which could take over from banks and FIs a portion of the bad and doubtful debts at an appropriate discount and the ARF should be provided with special powers for recovery.

Thus it is observed from the above important recommendations that the Committee’s approach has been to consolidate the gains in the Indian financial sector by cementing the loopholes or weakness, by improving the quality of the loan portfolio of banks, providing the banks greater operational flexibility and autonomy which is necessary to nurture healthy competitive and vibrant financial sector.

In line with the international practices and as per the recommendations made by the Narsimham Committee I, Reserve bank of India accepted the recommendations in a phased manner and introduced the new accounting and prudential norms for Income Recognition, Asset Classification and Provisioning for the advances portfolio of the banks which is explained in detail in chapter III. Its object was to move towards greater consistency and transparency in the published accounts. Thus these norms are made applicable to nationalized banks and commercial banks in the year 1990, Urban Co-op Banks in the year 1992 and District Central Co-op banks in the year 1995. It is expected that the books of banks
will reflect their true financial position which is very necessary for effective monitoring and improving performance.\(^5\)

There were different opinions and comments on the subject of financial sector reforms in India. Major of these comments are illustrated below.

The Committee’s major contribution was the introduction of prudential norms and imparting transparency and accountability in operations to restore the creditability of the institution. These prudential regulations produced a sea-change in the functioning of banks in the post –Narsimham Committee I period. Most of the public sector banks came to face the reality of the large Non-performing advances, which had not been identified till then. This affected profitability and net owned funds position of banks adversely. The banks were made to disclose the level of NPAs, depreciation of investments and accounting ratios relating to capital, income, operating profit, return on assets, business per employee etc. The reform process has attempted to bring about qualitative changes in the Indian banking system. This has led to creating the awareness of healthy banking almost at all levels of the banking establishments.\(^6\)

Jugale U.B. (2004) observed that “After the Financial sector Reforms, ability of a bank to absorb unexpected shocks and losses is solely dependent upon its capital base. Basle Capital Accord of 1988 played a positive role in strengthening the soundness and stability of banks and enhanced the competitive equality among international banks. On the one hand ongoing refinement in the capital adequacy norms had increased the capital requirements of Indian banks; there was increased pressure on the bottom lines of banks in view of the demand for setting aside profits for meeting the increased provisioning requirements.\(^7\)

Joshi P.N. (2002) pointed out the reforms introduced at the beginning of the nineties breathed fresh air in the banking sector. De-regulation and liberalization encouraged banks to go in for innovative measures, develop business, earn profit and benefit the shareholders. The reforms emphasized the ‘commercial character’ of the banking system and helped banks to stand on a firm footing. The reform process basically aims at strengthening the financial base of the banking system.\(^8\)
Munniappan G.P.(2003) former deputy Governor, RBI observed that “Committee on Financial Sector did not analyze and study the co-operative credit structure. The committee perhaps thought, it appears that Co-operative Banks are beyond their Preview. The Co-operative bankers also did not give any importance to the future of Co-operative Credit Structure when the committee was appointed. A total of 45 organizations have submitted their memoranda for the consideration of the committee. However it is heartening to observe that none of the co-operative banking institutions/bankers/individuals did ever submit any memoranda for the consideration of the committee.”

Initially, the co-op Banks thought that recommendations of CFS will not be made applicable to them. But they surprised, when the RBI extended the regulations for implementation to urban co-operative banks with necessary modifications. The RBI vide its circular UBD No. I&L 38/I.I-92/93 has issued detailed instructions regarding income recognition, asset classification, provisioning and other related matter to be introduced by UCBs. for the year 1992-93. The original circular has given some relief in the form of “past dues” so that banks could allow the borrower one month’s relief. Then after, RBI issued further circulars time to time to UCBs regarding classifying the NPA accounts. The RBI had already indicated that the DCC Banks and the State Co-op Banks are also asked to stick to the norms prescribed for commercial banks.

Munniappan pointed out that (2003) “In the contexts of NABARD was of the opinion that agricultural banking is fought with many risks, it would be more competitive and transparent. Its operations as to achieve viability and sustainability in the long run. NABARD felt that the applicability of the prudential norms to State Co-op Banks and District Central Co-op banks should be worked out separately keeping in view the basic differences in the structure, constitution, ownership pattern, mobilization of resources, method of disbursement of loan and deposit portfolio etc. between commercial banks and co-op banks”.

K. Elumalai observed that, NABARD has constituted a group containing seven members to make recommendations in this regard. The Group has made recommendations viz. the prudential norms applicable to commercial banks and
urban co-op banks may be made applicable simultaneously to State Co-op Banks and District Co-op Banks also. Those Banks which do not achieve the norms within the stipulated period mentioned above/maximum specified period of 10 years will have to go out of the system and the state Government as well as concerned co-operative banks are not in a position to bridge the gap in capital base so the RBI be requested to put aside funds out of its profit for creation of a Capital Adequacy Fund in NABARD. 11

As a result of adopting prudential norms in Indian banks, most of the banks started to show losses. During 1993-94 the balance sheets of public sector banks reflected red where as the SBI group showed profit which is reflected from the following paragraph.

K. Rani and M. Manickam (2006) pointed out that the balance sheets of the public sector banks have reflected their financial strength, revealing the true extent of the deterioration in their profitability. Apart from the SBI group, only 7 other public sector banks have declared profit. The net profit of the SBI group amounted to Rs. 280.03 crores the net loss of the public sector banks was to the tune of Rs. 3,648.91 crores. The bleeding of the balance sheets of public sector banks would continue and possibly all the banks may turn red in the balance sheet of 1993-94, as the balance 70 \% provision has to be compulsory made in addition to the provision for 1994.” 12

Thus the direct consequences of implementation of NPA norms were that except few banks, all banks started showing financial statement in “Red”. When financial reforms were introduced and the norms for capital adequacy were imposed on the banks during 1991-92, majority branches of public sector banks were went into loss. Banks and FIs have considerable difficulties in recovering loans and advances through Civil Courts and the existing procedure is not conducive as the ordinary system is burdened with public litigation which has led to locking up their funds in unproductive assets.

Urban Co-op Banks and DCC Banks were also trapped by NPA norms. The age-old system of showing “evergreen” balance sheets of most of all banks is
shrunked away. Nationalized and commercial banks were patronized by Central Government. The Urban banks and DCC banks did not get any kind of financial assistance due to their in-built financial structure. In spite of lapse of 20 years, still the banks in co-operative segment have not come out of NPA syndrome.

2.2.4 Debt Recovery Tribunal Act - 1993

The Govt. of India appointed the high level committee under the Chairmanship of Shri. Tiwari to examine all aspects in relating to the structure, organization, functions & procedure of financial systems. This committee made some observations & recommendations in the matter of difficulties faced by the banks & FIs, delays in legal processes for recovery of dues. Considering the inordinate delay in disposal of bank recovery cases in the civil courts and the ever growing NPAs in Banks, the curative measures are designed to maximize recoveries. 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. Government of India realized the need for a new legal machinery to speed up the disposal of bank recovery cases gave rise to enact the DRT Act. A draft Bill (No.59 of 1993) was introduced in the Lok Sabha of the parliament on 13.5.1993. The said bill has come into force with effect from 24th June 1993. According to the recommendation of the CFS and Tiwari Committee, Govt. has established special Debt Recovery Tribunals & Debt Recovery Appellate Tribunals for speedy recovery by passing ‘The recovery of debts due to banks and financial institutions Act (DRT Act) 1993.

Chatterjee Arun (1996) stated that the new legislation for recovery of debts and the rules drafted under it have several commendable features. The procedure reduces the need of detailed evidence and pleadings. There is no compulsive need to engage the services of the legal practitioner. The establishment of DRTs was a step in the right direction for speedy recovery mechanism, not enabling defaulters to raise pleas of counter-claims and set-off that used to be reasonably common place in ordinary civil courts. However, this Act did not really succeed in its end
goal that is to enable bank debt recovery; initially, the DRT Act 1993 was not free
from the criticism, as this legislation has been challenged on three grounds:13

- The qualification of the Presiding Officer of the DRT.
- The Act does not have any provision for admitting and adjudicating on the
defendant’s counter-claims and claims of set off and adjustment.
- The Act is unconstitutional as it erodes the independence of the judiciary and is
irrational, discriminatory, unreasonable, and arbitrary and is hit by Article 14
of the constitution.

M. Karunakar, Vasuki (2008) observed that “As at the end of June 1997, out
of a total number of 11,700 cases filed and transferred to DRTs involving Rs
8,866.67 crores, 1045 cases had been decided and comparatively a very small
amount of Rs 178.08 crores was recovered”14. It means banks could make recovery
through DRTs, only up to 8.93 % cases which involved only 2% quantum of
amount. This situation is unchanged in the year 2000. There are nearly 44,000 cases
pending in various DRTs involving amount around Rs. 38,000 crores.14

Finding out the lacunas in implementation of DRT which are elaborated in
subsequent chapter, the Central Government has amended DRT Act 1993 in
January 2000 for enhancing the effectiveness of DRTs. The provisions for
placement of more than one recovery officer, power to attach dependents property
before judgment, penal provision for disobedience of Tribunal’s order and
appointment of receiver with powers of realization, management, protection and
preservation of property are expected to provide necessary teeth to the DRTs and
speed up the recovery of NPAs in times to come. The efforts were futile to reduce
the NPAs of banks.

The RBI statistical data reveals that “The performance of DRT has been far
from satisfactory. As on June 30th 2003 out of 57,915 cases involving Rs. 82,266
crores, filed by banks with DRT but only 22,163 cases involving Rs. 19,633 crores
have been adjudicated and the amount recovered so far stood at Rs. 5,787 crores.
In the year 2003-04, even though DRTs succeed in adjudicating 37 % of the filed
cases before it, banks could recover only 7 % of the total amount for which
recovery suits were filed in DRTs”.15
If we go through the above data, it is clear that the situation of recovery through DRTs was not satisfactory. Existing DRTs operating in India are overburdened with cases and their disposal is taking unduly long time.

2.2.5 Narsimham Committee II on Banking Sector Reform -1997

In order to accelerate the financial reformation the government and Reserve Bank of India felt that these measures are not in commensurate with present legal system. At the end of 1997, the Government of India felt necessary to review the implementation of financial system reforms and chart the reforms so that India’s banking system can become stronger and better equipped to compete effectively. Committee on banking Sector Reforms was constituted on December 26, 1997 under the chairmanship of the Shri. M. Narsimham.

Important Terms of Reference of the Committee were: 16

1. To review progress in reform in the banking sector over past six years from 1991.
2. To chart a programme of banking sector reforms, necessary to strengthen India’s banking system and make it internationally competitive, taking account of the vast changes in international financial markets and technological advances and experience of the other developing countries in adapting to such changes.
3. To make detailed recommendations in regard to banking policy-its institutional supervisory legislative and technological dimensions.

Important Recommendations of the Committee:

Report of Narsimham Committee II, submitted in April 1998, had the following important recommendations namely-

1. The advances guaranteed by the Govt, should either be treated as NPA or shown separately in the balance sheet to maintain the transparency.
2. Banks are advised to reduce their NPAs to below 5% by year 2000 and then after below 3% by the year 2002.
3. All loan assets constituting a higher proportion of NPAs and considered in the bad or loss and doubtful category should be transferred to a Asset
Reconstruction Company (ARC) which shall issue bonds representing the asset so transferred.

4. The banking industry should switch over to international practices with regard to recognized income by introducing 90 days norms.

5. Greater attention by the banks has to be given to asset liability management so as to avoid mismatches and mitigate liquidity and interest rate risk.

6. Laws should be amended to adapt with commercial practices in the financial sector.

As recommended by the Narsimham Committee II (CFS), Govt. of India felt necessity of a statute which gives the power of sale of the secured assets without intervention of the court and for reconstruction of assets. After the report of the Narsimham Committee II, the ministries of finance, setup an expert committee under the chairmanship of Shri.T.R.Andhyarjina, former Solicitor General of India, in Feb. 1999 to formulate specific proposals for giving effect to the suggestions made by the Narsimham Committee.

Narsimham Committee II and Andhyarujina Committee considered the need for changes in the legal system to address the issue of NPAs. These committees suggested a new legislation for securitization, and empowering banks and FIs to take possession of the securities and sell them without the intervention of the court and without allowing borrowers to take shelter under provisions of SICA/BIFR. Considering the totality of circumstances it was decided to have yet speedier legal method to recover dues without intervention of court.

The increasing accumulations of unrecovered & irrecoverable debts of the banks which resulted into problem of NPAs. The problem of NPAs affected on profitability and viability of banks. The efforts of banks to recover their dues have been mostly futile leading to the heap of NPAs. The gross NPAs of scheduled commercial banks increased from Rs.50, 815 crores at end-March 1998 to Rs. 70,904 crores at end-March 2002.17

To solve the problem of NPAs, there was a need to set up Asset Reconstruction Company which would take over the NPAs in the banking
sector and develop a market for securitized loans. Many scholars, bank experts, researchers reviewed the literature regarding the growing NPAs in Indian banks, poor recovery problems and measures to be taken by the concerned authorities are reflected in the following articles.

Mathur B.L. (2005) stated that, discipline is of utmost important & strict to the credit institutions. One of the most important problems in management of their loan portfolio management faced by the public sector bank is low rate of recoveries. In terms of quantum the NPA level of public sector banks is quite large. RBI’s study about 800 top NPA accounts in 17 banks, it has found that major accounts have become NPAs due to diversion of fund, internal business factors, changes in the environment like recession, infrastructural bottlenecks and changes in government policies & delay in release of sanctioned limits by banks. Due to the inadequate environment for enforcement of securities, the progress in recoveries has been slow. As per RBI study, the data of 33 banks (27 public sector and 6 private sector banks) show that, at the end of March, 1998, over 46 % of total quantum of NPA’s were in suit-filed accounts. The recoveries made out of such suit-filed accounts in March, 1998 were as low as 4.3 %. It was observed that over 14.37 crores suit-filed cases were pending for disposal It involved Rs.21, 825 crores. A significant portion of such suits were pending for more than a decade.¹⁸

Reddy Chandrayya (1990) expressed that the sponsoring agencies identify the prospective beneficiaries and ask the commercial banks to extend credit for the suggested productive activity. When the question of recovery arises, the sponsoring agencies do not extend any assistance. Recovery of loans from the borrower has proved to be a ticklish problem. The commercial banks in India do not have the necessary effective administrative mechanism at their command to supervise the proceedings of the recoveries and utilization of advances for the purpose for which they are meant.¹⁹

Lanjekar Jagdish (2001) observed that the Directors of selected banks have taken undue advantage of their position. They have taken huge loan from respective banks for themselves and for their relatives and denying repaying the
due amount. He generalized that the recovery procedure is complicated and took more than 6 to 7 years to recover the amount of loss asset from borrower or from guarantors. The NPAs of those banks are more than that of International standards.\textsuperscript{20}

Kulkarni Rohini (2006) has thrown light on public sector bank’s Loans and advances, growing NPAs, Precautions to be taken by bankers before granting different types of advances, classification of assets, Different debt recovery tribunals and courts. She has made an attempt to study the NPAs of public sector banks in Sangli district. She has suggested that there should be uniformity in the lending policies and procedures, policy of charging interest on loans and critical scrutiny of loan proposals should be made before granting loan.\textsuperscript{21}

Joseph (2000) emphasized on Credit risk, problem of NPAs & its recovery. He suggested that appointing Private Agencies to collect the dues is a good method to reduce the existing NPA level. 80% of the managers of banks in selected group suggested that second market for selling bad debts at discount rates should be developed. Persuasion & out of court settlements are most effective rather than legal recovery procedure.\textsuperscript{22}

Bidani S. N. (2002) has stated cause of slippage of Accounts to NPA category. He has given various suggestions to overcome the difficulties facing by the banks in recovery of due amount. Precautions to be taken by the banks before & after sanctioning the loans and advances, staff accountability, strong system of reporting are discussed in detail. It is suggested that the banks should be given freedom in the matter of taking decision for solving setting compromise cases without any fear of being questioned at a later date by the investigating Govt. agencies.\textsuperscript{23}

Nigamananda Biswas (2009) states that NPAs of all Banking Sector should be managed by accepting available machinery which gives sudden results. Banking sector of India needs to manage all the aforesaid challenges very effectively & efficiently for ensuring economic growth of the country.
SWOT analysis can be made & suitable strategies should be adopted. Fittest bank will survive otherwise they have to wind up their business.

B. Avudajamal and G. Vasanthi (2009) examined the NPA problems of UCB’s. Their study reveals that due to directed & pre-approved nature of loans sanctioned under sponsored programme, misuse of fund, absence of security, lack of effective supervision, inefficient measures taken by the banks for the recovery of advances, diversion of funds, corruption etc. Banks are also equally responsible for increasing their NPAs by neglecting to take proper care before and after sanctioning the loans.

Reddy Ranga (2004) highlighted on institutional credit and problem of high overdue. The total volume of institutional credit for 1996-99 is Rs.28,817 crores of which 58 % is provided by co-operatives, 37% by commercial banks & 5% by the regional rural banks. Both the co-operatives & commercial banks accumulated overdue of about 40% and Regional Rural Banks had 50% overdue. The low rate of recovery has made the recycling of credit weak and the lending ineffective. He suggested that the recovery machinery needs considerable strengthening by effective enactment and adoption implementation of recovery acts and the State Level Monitoring Cell for every State needs to be created.

Bhattacharya K. M. (2006) has observed that banks are controlled with various kinds of risks such as credit risk, market risk, liquidity risk, interest rate risk, foreign exchange risk, commodity price risk & equity price risk, solvency risk & operational risk. If credit granting process is defective, banks definitely face the problem of recovery. Banks experience asset quality problems due to absence of effective credit review mechanism. Its purpose is to provide appropriate checks & to provide an independent judgment of asset quality, uninfluenced by the relationship with the borrower. Failure in post sanction monitoring and follow up in borrowed accounts is the one of the major cause for credit problems.
2.3 GOVERNMENT’S EFFORTS TO DEAL WITH NPAs

There was increasing importance and need for quick and trouble-free solutions for dealing with the NPA problem. With the change in times and operational environment for banks in the light of liberalization, globalization and deregulation, there has been a pressure on the banks to speed up the recovery of NPAs and fast resolution of the funds blocked therein. Under these conditions, banks started to think about the alternative ways to recover the dues for achieving the desired results.

This part thus highlights options like Corporate Debt Restructuring and its related issues and concepts, as also non legal strategies like compromise settlements, rehabilitation, and the related issues. Thus in addition to mandatory, statutory implementation banks was informed by central, State Government and RBI to persuade the borrowers for repaying their overdue amount. The banks were given number of remedial measures such as settlement through the compromise, through Lokadalat, One Time Settlement Scheme, Restructuring of advances and many others. The intention of giving concessions in dues is to unbundle the locked amount of advances, which is affecting recycling of funds, lowering down of profitability.

Finance minister in the Union Budget for 1999-2000 announced an important measure for speedy recovery by setting up of “Settlement Advisory Committee” by the public sector banks, to avoid the lengthy litigation process. The RBI issued a circular DBOD.BP.BC.57/21.01.040/99 dated May 27, 1999 and set out the guidelines for constitution of Settlement Advisory Committees (SACs) for compromise settlements of chronic NPAs of small sector.

2.3.1 Compromise Settlement

A compromise is a negotiated settlement in which the borrower agrees to pay a certain amount to the bank after getting certain concessions. A large number of proposals can be considered by the bank with a view to reducing the NPAs and recycling the funds instead of resorting to expensive recovery proceedings spread over a long period. Banks should recover their dues to the
maximum extent possible at minimum expenses. While entering into the compromise proposals Banks were given guidelines regarding making distinction between willful and genuine defaulters, assessment of borrowers and guarantee’s creditability and repayability etc. But the RBI revealed that compromise settlement scheme is not proved good to reduce NPAs.

The RBI issued the revised guidelines for recovery of dues relating to NPAs of public sector banks in all sectors. The new guidelines covered cases of willful default, fraud and malfeasance. As per the new guidelines, the banks were guided to identify cases of willful default, fraud and malfeasance and initiate prompt action against them. These guidelines were for the settlement of the NPA amount up to 5.00 crores and for above 5.00 crores.28

Taori K.J. (2004) stated that; “Compromise is necessary a negotiated settlement. A few aspects which the bank may keep in view are: Realizable value of the security charged, other assets attached and net means of borrowers/guarantors-this should form the basis for negotiating the compromise. The properties should be valued by reliable approved Valuar. It is suggested to have ‘SWOT ANALYSIS’ of the compromise proposal done on the basis of Asset quality, Age of account, marketability of Assets or collaterals and legal position of the bank.. Compromise settlement would be an effective tool for tackling and reducing NPAs.” 29

Sarda D.P. (1996) suggested that each bank should have a ‘Loan Recovery Policy’ which gives details of the strategies to be adopted for recovery of dues, period-wise targeted level of reduction in NPAs, norms for entering into compromise proposals ,decision levels, reporting to higher authorities and monitoring of write–off cases. He suggested that repayment schedule for a term loan should be fixed according to income generating capacity of the unit. Rephasement of loan installments should be done only when it is expected to get payment after the Rephasement. Compromise with borrowers: with the proper scrutiny, instead of resorting to expensive recovery proceedings, banks should try to recover their dues to the maximum extent at minimum expenses. 30
The Government of India introduced One Time Settlement Scheme in 1999. In pursuance of this Scheme, mainly covering small borrowers, the public Sector banks had recovered a total sum of Rs. 2,192 crores pertaining to 5.23 lakhs accounts as on 30.6.2001. The bank is free to frame their own policies both for recovery and for writing off. The RBI issued guidelines for implementation to Banks and FIs and suggested to keep in view the experience of implementation of RBI guidelines issued to public sector banks vide circular DBOD.No.BP.BC.11/21.01.040/99-00 dated July 27, 2000 on one-time settlement.

Lok Adalat become popular among the people, due to its prompt, speedy, inexpensive and involving both the parties in a transparent manner. There is no court fees involved when fresh disputes are referred to Lok Adalat. If no settlement is arrived at, the parties can continue with court proceedings. Its decrees have legal status and are binding on the parties. It has, therefore, been decided that with a view to making increasing use of the forum of Lok Adalats to settle banking disputes involving smaller amounts.

2.3.2 Corporate Debt Restructuring:

For the big NPA amounts, Corporate Debt Reconstructing Scheme (CDR) was announced in the year 2001 to reduce 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. It is applicable only to multi banking accounts having an outstanding exposure of Rs. 20 crores and above with banks and FIs. The Mechanism of the CDR 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.
2.3.3 Credit Information Bureau:

Some borrowers borrow large amount of loan against the same security with a view to deceive the banks and FIs due to the lack of system of information sharing amongst leading institutions. So that there was a need of a strong Information System to exchange the information among the financial institutions about the borrowers. There was a need of institutionalization of information sharing arrangement. SBI, HDFC and two foreign technology partners set up Credit Information Bureau of India Limited (CIBIL) in January 2001 to prevent the tendency of borrowing large amount against same assets and property. The purpose of establishing the CIBIL was to restrain the borrowers from borrowing the loans from different banks against the same security by exchanging the information amongst the different lending institutions.

2.3.4 Filing Criminal Cases against the Willful Defaulters

The RBI has directed the all Public Sector Banks to examine all cases of willful default of Rs. One crores and above and file criminal cases against willful defaulters. The board of directors is requested to review NPA accounts of one crore and above, with special reference to fix staff accountability in individually. 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 crores and above) against whom banks and financial institutions in recovery of funds have filed suits. 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 this entities.

Unfortunately all the above efforts of the Government of India and RBI could not brought solution to reduce the NPAs. Banks offer huge amount in the form of loans to the needy people in the society and when the accounts become NPAs, they have to spend their most of the time and money to recover the dues.
Bimal Jalan- Governor, RBI in his inaugural address at the Bank Economist Conference in Bangalore had observed that, “Once the borrower evades payment of interest & repayment of installments, banker was left with no alternative except going to courts. As in every stage of litigation bank cases also took years or decades. If by any chance, in some cases lower court gave the decision, appeals to higher courts are common. During this period, the borrower used to sale a part of valuable security, divert useful machinery to other units etc. The law requires that the officer, who was in the bank at the time of sanction of loans, should verify the signature of the borrowers. After 5 or 6 years of filing the legal suits, the case would come up for hearing when that manager or officer would have been transferred to some remote branch. After getting the summons to remain present in the court on the day of hearing the officer/ manager has to travel to the place. It was found on an average, every day nearly 200 to 300 bank officers are traveling to attend court cases. To cover long distances, they would travel by AC luxurious coach or aero plane merely to verify only the signature.  

Sarkar A.N. (2003) observed that though most of the public sector banks have started classifying their assets, as per the NPA norms, prescribed by RBI since 1992-93, there was a progressive build-up of NPAs as a result of compounded effect of old NPAs. This needed further tightening-up of NPA norms by RBI, both for Commercial and Co-operative Banks from 1995-96. As a result of this intervention, though NPA position of public sector banks improved in terms of % asset over the years between 1993 - 2000. The absolute figure of gross as well as the Net NPAs kept increasing steadily after 1996. 

There were different causes for non recovery of Bank Dues. Civil Courts and Co-op courts proved insufficient to dispose the recovery cases speedily. DRTs, Lok Adalats, One time settlement etc was also not proved efficient machinery for reducing the piles of NPAs. Along with the time consuming and expensive procedure of recovery, there were some lacunas in the present laws related to recovery.
Sec. 69 of the Transfer of Property Act permitted a mortgagee (Bank) to take possession of mortgaged property and sell them without intervention of court. But this right can be enjoyed only in case of English Mortgage, where the mortgager binds him to pay the mortgage money on a certain day and transfer the mortgaged property, to the mortgagee. The Bank could take possession of mortgaged property which was situated in specific towns like Kolkata, Chennai or Bombay, but in other cases possession of property could be taken only through the court which is famous for time consuming and lengthy process. Another lacuna was that, there was no provision either in the contract act or in the law relating to hypothecation, about the enforcement of security interest with regard to hypothecated asset which is an important security created in favor of secured creditor. This background compelled the government to set up the expert committee on banking sector reform.\(^{38}\)

The ongoing debate over enactment of new law, allowing banks to bypass the then present loan overdue recovery system, the various methods adopted by Government and RBI, to reduce the overdue percentage, many articles appeared in news papers, periodicals, journals symposiums threw light upon the poor system of recovery, leading to erosion in capital base and achieving international accounting standards based on bank accord. It was proper on the part of Government of India to place before the parliament a bill called SARFAESI Act.

### 2.4 IMPACT OF SARFAESI ACT 2002

To overcome the critical situation of increasing NPAs, Government of India decided to act on suggestions of expert committees. The ministry of Finance set up an expert committee under the chairmanship of T.R. Andhyarjunia. Considering the totality of circumstances, the committee recommended enactment of new law for the purpose of enforcement of securities by banks and securitization of financial assets. As per the recommendations of expert committees regarding the setting up of ARCs, an Ordinance with the title “Securitization and Reconstruction of Financial Assets
and Enforcement of Security Interest Act, 2002” was promulgated. The Bill was presented before the Lok Sabha on 21st November 2002 and before the Rajya Sabha on 25th November 2002. The Bill was passed by both the houses of parliament which has received the assent of the President on 17th December, 2002. It came on the statute book with its long meaningful name. The detailed provisions under the SARFAESI Act related to enforcement of security interest have elaborated in chapter IV.

The Government of India has enacted this special featured law with a view to help the secured creditors to enforce their secured credit without intervention of court and reduce the piles of NPAs accumulated in Indian banks. Many positive and negative incidents regarding the newly enacted law have been occurring. The following literature will take us to understand the views of different writers:

The Sec.17 (2) of the Act provides for deposit of 75 % of the claimed amount before entertaining an appeal by the DRT. The SARFAESI Act was put to test in the case of Mardia Chemicals Vs. Union of India. In this case, the Supreme Court observed that, the word ‘appeal’ in section 17 is not the appeal but it is the initial action raising grievance against the action taken by the parties to the contract which is an application. Supreme Court upheld the validity of the provisions of the SARFAESI Act. Thus condition of pre-deposit of 75 % of the claim amount was proved unreasonable, arbitrary and violative of constitutional right. The Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Ordinance, 2004 was promulgated on the 11th November, 2004. The stipulation of Predeposition of 75 % of the claim amount was removed. The secured creditor started to send the notices under the Act.

Venugopal Dharmalingam (2004) wrote that, “The judgment of the Supreme Court in the Mardia Chemicals case upholding the SARFAESI Act, 2002, seems to have received more brickbats than bouquets from bankers and analysts. The ruling has put the clock back to the pre-SARFAESI days. The main contention of the defaulters was that the SAIFAESI Act was one-sided and had vested the banks and the FIs with arbitrary powers in dealing with
defaulters. The Act did not take into account lender's liability and provide safeguards against irresponsible action by the lenders.”

Geetesh Arun (2003) expressed his views as Bank debt recovery took a turn in the right direction after the SARFAESI Act, which denied the borrowers an opportunity to challenge debt recovery in judicial forums. This Act did simplify the process of foreclosure, but at the same time, does not intend to penalize borrowers, but more importantly seeks to ensure that dues are realized. As far as the question of innocent/genuine and non-willful default is concerned, this can always be determined in the course of prosecutions. Banks and FIs should not sell off the assets at the earliest possible opportunity, but should ensure that they obtain the best price for this. SARFAESI Act is seen as a means for disciplining habitual defaulters.

Raralikar Ashutosh (2003) stated that the SARFAESI Act really fruitful. Public sector banks have managed to recover Rs. 440 crores from 7556 sticky accounts. This amount is recovered between 21st June 2002 and 31st March, 2003. Within 9 months after enactment of this Act, PSBs could succeed in reducing the NPA amount. The Gross NPAs of the 19 nationalized banks have declined from Rs.36,763 crores to Rs.35,646 crores i.e. Rs.1117 crores between March, 31, 2002 to March 31, 2003. Thus the SARFAESI Act was passed in Nov. 2002 the recovery of NPA’s has been encouraging because of the increased morale of the banks. He concluded that, the new Act is really a boon to the banks for reducing their NPAs.

Singh Jogindar & Yadav Omkar (2010) stated that the enactment of SARFAESI Act 2002 has helped in recovering the bad loans of banks. Its impact is yet to be at the ground level. However, SARFAESI Act is having loopholes. They have suggested that the Govt. and RBI should come together and find ways to strengthen the process of recovery & work towards an environment so that willful defaulters cannot hide under stakes of legal documents.

Chandrasekhar C.P. (2004) stated that despite of wide powers given under SARFAESI Act, Indian Banks showed little movement towards reducing
the volume of NPA’s in the banking system. NPA in Indian Bank rose from Rs.37, 500 crores at the end of 1991-92 to Rs.1 10,000 crores at the end of 2001-02. At the end of F.Y.2002, the accumulated NPA’s of 27 PSB totaled to Rs.56000 crores. He further added that 40 % of the total defaulters are the big borrowers who with 11,000 individual accounts accounted for Rs.40, 000 crores of the total Bad Debts. Among Public Sector banks, too high value defaults involving 1,741 accounts exceeding 5 crores amounted to Rs.22, 866 crores or 40% of the total. An Assessment conducted by All India Bank Officer's Association in Dec. 2002 - indicated that less than Rs.5000 crores of bad debts had been recovered during the preceding 8 years. This record of poor recovery is observed in a period when NPA burden of bank was receiving considerable attention.\footnote{44}

The Market Bureau of Financial Express stated that the SARFAESI Act 2002 helped the public sector banks & financial institutions to reduce their NPAs by recovering Rs.931.16 crores as on Dec. 31 2002. ICICI bank has accounted for a whopping 90 % (i.e. 837 crores) of the total amount recovered under the securitization act. Till Dec. 2002, PCBs and FIs had sent 16,165 notices under the Act to various NPA account holders. NPA a/c holders, involving NPA amount Rs.13750.84 crores are approaching banks & FIs for settlement of their accounts. Thus SARFAESI Act led to significant decrease in NPA’s.\footnote{45}

The economist with Indian Overseas Bank, Chennai stated that, the true success of recovery measures, particularly the SARFAESI Act has brought the repayment/recovery culture in the banks. Defaulters who lost touch with the banks for several years are rushing back anxious for a compromise settlement. Long pending and complicated cases, which may take years if taken to court, are resolved at the OTS meeting. There is no disputing the fact that various debt recovery measures including the SARFAESI Act have had a salutary effect on the huge NPA burden of the Banks.\footnote{46}

Kukkudi Jagannath and Deene Shivkumar (2006) stated that securitization of debt is a popular route for raising resources by banks and FIs
in India. There is a vast scope for commercial banks to go for securitization instead of blocking of assets. Stamp duty is one of the major hindrances to the development of securitization in India. Securitization of debts continues to reduce the opportunity cost of capital and act as a flexible mechanism to transfer the capital from less efficient to more efficient activities.\(^{47}\)

S. Bridget Leena (2004) writes that banks have found the mechanism of Debts Recovery Tribunal and the SARFAESI Act, more helpful. The Debt Recovery Tribunals have been established to determine those disputed between the Bank and the Borrower, but even in spite of several observations by the Supreme Court of India, they are totally biased and sparingly give support to the Borrower.\(^{48}\)

Even though the SARFAESI Act is a weapon in the hands of secured creditor to enforce its secured interest and reduce the heaps of NPAs, it has another part which is criticized on various parts. The criticism is that it is being misused by the Banks and Financial Institutions.

Lavi Mohan R. (2003) stated that, the initial implementation of this Act to reduce the non-performing assets in the country was stopped by Mardia Chemicals, in which Supreme Court had passed a temporary order permitting banks to take over the assets hypothecated but not dispose them. The less litigious-minded among the defaulters' list have ensured that some repayment has been made to creditors who contemplate action under the SARFAESI Act. Hence, it all boils down to the willingness of the borrower to pay up. That’s why certain chambers of commerce have suggested that the Act should only be made applicable to willful defaulters. Hon. Supreme Court would do well to nip this embarrassing situation in the bud by pronouncing its verdict in the Mardia case at the earliest.\(^{49}\)

Kacker Shikhar & Desai Vyapak (2009) stated that the ‘doctrine of priority of state debts’ is a settled principle under common law, as per which the government (‘State’) has first charge over the priority of debts. The Bombay High Court observed that, the State has first priority of claims over the dues of a secured creditor (s). Though, the Supreme Court has recognized the
fact that the DRT Act and SARFAESI Act have been created for benefit of a
banks, it has been clarified that these two Central legislations do not per se
create first charge in favor of the banks, FIs and other secured creditors. Thus,
it is clear that the State Government would have priority of claim.  

Dravid G.K. (2002) has critically stated that there are hurdles built in
the act and the rules, which will make the task of security enforcement, very
tough. There is a possibility that the creditors will become scared of following
the strict scheme under the rules. They will again go to civil courts and DRTs
which offer a safe road of recovery. The entire sequence of repossession,
running the unit, liquidates the dues & transfer back to borrower is very
difficult task. A District Magistrate or a Chief Metropolitan Magistrate may not
have the machinery or the required mindset to do the needful under this Act.
But it is true that after the passage of time, the Act will be accepted &
assimilated in the statute.  

The Economic Survey during the year 2004-05 witnessed the decline
in NPAs of Public and Private sector banks; due to the implementation of
SARFAESI Act. According to the economic survey in 2004-05 it was observed
that, there was a significant decline in NPAs of scheduled Commercial Banks
in 2003-04. The gross NPAs of SCBs declined from 4.0 % of total assets in
2002-03 to 3.3 % in 2003-04. In terms of Rupees, the gross NPA's declined
from Rs.68,717 crore in 2002-03 to Rs. 64,787 crores in 2003-04, net NPA’s
decided from Rs. 32,670 crores to Rs 24,617 crores in the same period. The
decline in NPAs in 2003-04 was witnessed across all bank groups. The decline
in net NPA’s as a proportion of total assets was quite significant in the case of
new private sector banks, followed by PSBs.

Patil J. F.(2004) stated that the NPA's of Public Sector banks are
decreasing. Compared with advanced countries, Net NPA / Net Advances Ratio
in India in 2000-2001 were almost more than three times larger. It is observed
that the genesis of increasing incidence of NPA's is the outcome of directed
lending or convenient priority sector lending for meeting high levels of SLR.
The other major cause of increasing NPAs was the faulty accounting practice
of counting of interest as income merely on accrual basis. He has suggested developing effective credit appraisal mechanism. A rigorous scheme of efforts should be introduced to strengthen culture of proper utilization & timely repayment to reduce the problem of NPAs.\textsuperscript{53}

Puri Ashwin (2005) criticized the SARFAESI ordinance. He stated that the ordinance is seen as biased towards creditors, it is open to abuse by creditors, and it may not solve the problem of NPA. It has not made any distinction between willful defaulters & genuine ones. Banks has to prepare the list of willful defaulters and genuine defaulters. Genuine defaulters should be given soft corner and finance should be made so that they can overcome the critical situation and run the business smoothly.\textsuperscript{54}

N.Narsimham (2005) stated that “Thousands of notices u/s 13(2) are being served on small units because statistically the number must look impressive but their amounts are very small. In doing so banks are ignoring the basic cost benefit management approach which says that the bigger the amount outstanding the greater the priority for recovering it. He compared the securitization ordinance with the \textit{sledge hammer} to deal with small NPA accounts. He suggested that, banks should honestly classify NPA's among large industrial borrowers & small borrowers whose figure would negligible and implement the SARFAESI Act accordingly.\textsuperscript{55}

Sharma G.V. (2005) expressed that the ordinance has created balance of convenience in favor of lender banks for realization of outstanding dues in NPA accounts without intervention of court & it put an end to recovery litigation. The ordinance gives shape to the Indian experiment with other countries, where such measures gave positive results. The banks can now clean their books of bad assets by selling them to ARCs at a discounted price or taking over the assets of a defaulters & selling them to recover the bad debts without any delay. The bank that has determination to take the lead to implement SARFAESI Act, will always be benefited.\textsuperscript{56}

Vackayil Joseph (2005) said that small & medium enterprises have always had a host of problems that they have had to deal with SARPAESI Act,
bank notices and newspaper advertisements for sale of immovable property mortgaged to a bank. The large number of NPA cases & small amount of recovery reveals that fact, most of cases were against the small borrowers & banks have not yet touch the bigger one. The SARFAESI Act has been useful in managing NPA’s whether implemented against big or small borrowers. 57

Venkatesh Mahua stated that only 10 states provide stamp duty concessions on transfer of NPAs to Assets Reconstruction Company or other third party. Alok Dhir, a partner of Dhir & Dhir Associates told that there should be uniform legal conditions between different states to make recoveries of bad assets faster. He concluded that different state Laws relating to sales tax and stamp duty have made it difficult for banks & financial institutions to go ahead with recoveries of bad assets through SARFAESI Act. 58

Purohit S. N. criticized the Act on ground that it has been used against the small borrowers and letting big borrowers untouched. In India, the experience with this Act shows that it has been effective only against small defaulters. The amount ultimately realized is often as low as 15%. Therefore, a one-sided approach as adopted by this Act. In the absence of restructuring of inefficient industries and removal of government interference, this problem of NPAs shall only worsen. However, one of the biggest shortcomings of this Act is that it enables only the expeditious recovery of small debt. It is funnily stated that, “Default for Rs. 40000, then you are in trouble, borrow Rs. 40 crores and default, then the bank is in trouble” 59

Sanghvi Hitesh criticised this Act as it is not beneficial for the foreign lenders. Certain provisions of SARFAESI Act seem to be a deterrent to foreign lenders providing finance to Indian borrowers, which in turn affects genuine Indian companies also from raising low-cost international finance. The SARFAESI Act partly allows for the enforcement of security by some secured creditors without the intervention of courts. But offshore lenders (except those specifically notified by the Central Government in this respect) would not be a secured creditor for the purposes of the SARFAESI Act. The remedy under SARFAESI Act would not be available to a foreign lender in an event of
default by the borrower. Foreign lenders are therefore unable to take advantage of the relevant provisions of the SARFAESI Act that allow for enforcement of security without recourse to court. This places foreign lenders at a disadvantage against Indian banks. They are further left with no option but to enforce their Indian security by filing a suit in the relevant court.⁶⁰

Kothari Vinod focused on the presumption of the SARFAESI Act 2002. This Act presumes that the debt between the borrower and the Bank is undisputed. The Act again and again talks only about liquidation of the debt by enforcement of security interest and not about the adjudication. The Act doesn’t deal with any dispute between the borrower and the creditor. The dispute regarding the debt cannot be resolved under this law. The scheme of appeals under Sec. 17 is only for the grievances about the measures taken by the bank under Sec. 13(4) i.e. taking possession of secured property from the borrower. If there is a dispute about the amount of the debt or interest charged on it, there is no remedy for borrower in DRT. Borrower can approach the DRT only after the banker’s action of taking possession of secured property.⁶¹

Chaturvedi R.G. (2005) stated that the provisions in Sec.3 describes for compulsory registration of the companies to carry on business of securitization or reconstruction of Assets. Individual or group of individuals to carry on such business is totally omitted field outside the scope of Act. As per the right guaranteed under Article 19(1) (g) of the Constitution, any citizen can engage himself in business. The Act nowhere provides that no person other than a company registered under section 3 of the Act can engage himself in the business of securitization but it provides for compulsory registration under the Companies Act 1956. In simple words he wants to state that a person or a partnership firm or Joint Hindu Family can engage himself or itself in the business of securitization even though it is not a company.⁶²

Dalal Sucheta observed that the SARFAESI Act is enacted to reduce the piles of NPAs but in practice it seems that banks are implementing this weapon for small borrowers and neglecting the big and industrial borrowers because of whom the Indian Banking has challenged. The SARFAESI Act
seems to be implemented more vigorously and only against the smallest of the small borrowers and against the Micro and Small Enterprises (MSEs) all over the country, leaving the big defaulters relatively untouched.  

If we through the light on the recent newspapers and breaking news during 4 May to 15 May about MSCB, it is clear that RBI has directed in its order dated 4th May 2011 to appoint an administrator on the bank. Even though the issues are on discussion, the NABARD observed that MSC bank has violated NABARD and RBI norms in determining cash credit limits. It has released pre-seasonal and short term loans for co-operative sugar factories. The result was that recipient factories failed to repay loans. Its NPAs stood at Rs. 2,039.95 crores at the end of March 2011 but the MSCB did not invoke the SARFAESI Act to recover the amount on all eligible accounts to recover the amount. It took possession of 27 co-operative Sugar Factories with dues of Rs. 1,450.85 crores under SARFAESI Act but did not auction them. Public notices were issued for the sale of acquired units but there was no follow-up. The Official of the NABARD said that many secured properties possessed under SARFAESI are sold below the reserved price.

After considering the positive and negative views on the SARFAESI and after finding out the loopholes in SARFAESI Act, such as priority of Government dues, decisions of DRTs in some cases which hurdles the banks to take possession of secured property from the defaulters, some writers are suggesting making the law stronger by bringing some amendments.

Umarji M.R. (2010) stated that, there are loopholes in the Act that need to be removed. One issue is the priority of claims of government (arrears of tax) provided in certain taxation laws that defeats the recovery efforts of banks. There have been cases where entire amount recovered by a bank was directed to be deposited in government treasury. Lawyer’s profession (business) is to delaying the hearing, taking the dates and seeking the adjournments which both the borrower as well as secured creditor suffers. Defaulters are always in a mood to file the litigation to delay and postpone the process initiated by the bankers against them. He suggested some measures to
overcome the loopholes in the Act 2002. It is necessary to amend the law to bring it in conformity with the provisions of the Civil Procedure Code that requires the court to pass orders in terms of the settlement whenever the suit is settled out of court.  

Alexander F. M observed the situation and finds out the problems before secured creditors to take possession or management of the secured property under SARFAESI Act. Defaulters often misuse the provisions of often file playful litigation before the debt recovery tribunal (DRT) to delay the process initiated by the bank against them. The problem is compounded by the Tribunal not being able to take these matters on a priority basis. Although there is a time frame for disposal of disputes under SARFAESI Act, it is usually overstepped. The lawyers play a significant part in delaying the hearings of such applications by seeking unnecessary adjournments. The Tribunals should be strictly directed to adhere to timeframes. He suggested that notice period for a delinquent borrower can be shortened to 15 or 30 days since the account has become a non performing asset and the borrower is aware of this. The seven days provided for banks to respond to the borrower’s reply is too short and should be suitably enhanced.

Further, when the possession of the secured asset is to be taken in areas other than cities where there are Chief Metropolitan Magistrates, the secured creditor has to approach the District Magistrate, who is also the District Collector. However, the district collector is invariably unavailable to attend to these matters due to his pre-occupation with other duties, leading to inordinate delays. It would be appropriate to substitute the District Magistrate with the Chief Judicial Magistrate to speed up the proceedings. The proposal to amend the SARFAESI Act wherein the district administration is to be involved in taking of possession of secured asset could result in time over-runs. Therefore, the Chief Metropolitan Magistrate should continue with the stipulation that orders to be issued within a fixed timeframe. However, banks and FIs are ill-equipped to take over the management of business of the borrower due to lack of expertise in business management.
2.5 CROSS COUNTRY EXPERIENCE TO SOLVE THE NPA PROBLEMS

2.5.1 Debt Recovery Procedure: 68

**United Kingdom**

Debt recovery in U.K. is fairly institutionalized and there is a credit service Association. An Association of Debt Recovery agent acts as a self regulatory organization and aims at professionalization the business of debt recovery. Debt collection is divided into number of sections viz. consumer debt collection, car debt collection, international debt collection, legal debt collection and stressing missing debtors. There is no minimum requirement of educational qualifications only basic literacy, numeracy and computing skills are necessary to become recovery agents. The recovery agents are given training on job and through training via seminars and courses. Recovery gents in U.K. need not obtain any certificate but they should obtain a consumer credit license from office of Fair Trading government department.

**Australia**

For Debt Recovery in Australia, consumer commission, an independent statutory authority set up to enforce the Trade Practices Act. This authority is concerned with upholding of the consumer rights. It is responsible for overseeing that these rights of the consumer about are upheld. It aims to educate consumers about their rights with respect to debt collection and also making them aware them about the debt collection practices to be followed by the debt collection agencies. The commission lays down rules for conduct such as the number of phone calls that can be made to a customer per week, the hours of personal contact. It also encourages responsibilities borrowing by educating debtors about their obligations to honor their debts and timely repayment. The commission also encourages debtors to seek counseling from the community financial counseling centers that have been set up by the Australian Federal or State Governments in various states and territories free of cost.
United States of America

Fair practices in debt recovery are covered in USA under the Fair Debt Collection Practices Act (FDCPA). The Federal Trade Commission is the main body responsible for overseeing the enforcement of the Act with respect to banks. There is two agencies that are responsible for overseeing the enactment of the ct. The office of the Comptroller of Currency which enforces compliances with respect to national banks and the federal reserve Board. The FDCPA prohibits abusive /deceptive and improper collection practices. The Act balances the rights of the debt collector to recover legitimate debts with the rights of the consumer not to be harassed, deceived or be invaded in their privacy. The procedure for debt recovery is well laid down. The debt collector have to send a written notice to consumers that includes details such as the amount of debt owed, the name of the creator to whom the debt is owed and a statement that if within 30 days of receiving the notice the consumer disputes the debt in writing the collector will obtain verification of the debt and mail it to the consumer. Debt collectors are prohibited from calling the consumers place of work, if the collector know that an employer disallows such calls. Third party contact i.e. friends, relatives, neighbors etc for debt collection is permitted only to seek information on the location of the debtor. Various agencies have been entrusted with the task of enforcement of compliance under FDCPA in USA. The office of the controller of currency and the Federal Reserve board are the enforcement agencies for compliance with FDCPA with respect to banks. FRB conducts the examination, interviews of bank personnel who are engaged in the debt collection activities of bank.

2.5.2 Procedure to Solve the NPA Problems

Problem of NPAs are not only in India but they are disturbing many of the economies of countries. While talking about the cross country experience to overcome the problem of NPAs, these countries have tried to solve the NPA problems very systematically. They have adopted several strategies to restructure the banking systems to overcome the critical situation. Many
governments have used the ARC’s (Assets Reconstruction Companies) route to solve the NPL (Non-Performing Loans) problem of their banks. In some countries, ARCs are government owned and private capital can also be introduced in the process. Bank restructuring process adopted in many countries seek to achieve some important goals: preventing bank runs, avoiding a credit crunch, improving the efficiency of the financial intermediation process and attracting new equity into the banking industry. There was a growing tendency to define loans more than three months overdue as substandard. There are several restructuring methods, viz., and Govt. capital injection, establishment of Asset management corporations, domestic bank mergers and foreign bank takeovers.

**Brazil**

Brazil introduced a deposit insurance scheme encompassing all financial institutions subject to liquidation or intervention. This was meant to protect the interest of small depositor’s. The creation of DIS with insufficient resources or legal powers to deal with the problems can be disastrous. Deposit protection agencies in Kenya and Philippines were not provided with sufficient resources to deal with the level of bank problems.

**China**

In China, bank restructuring process included not only the restructuring of commercial banks, but also non-bank financial institutions. From 1995 to 1998, more than 2000 Urban credit Co-operatives were merged into 88 city commercial banks on the basis of assessing assets and capital, writing off some bad debts, estimating net worth of equity and encouraging new shareholders. During 1997 and 1998 one insolvent bank and three trust and investment companies have been closed down in China. The asset management cop any responsible for dealing with NPLs of state bank was established in April 1999.

**Korea**

In Korea, the Government is helping the viable banks to recapitalize and dispose of Non-Performing loans by injecting public funds on the condition that they make efforts on their own to rehabilitate by mergers, injection of
foreign capital and improve the management. To resolve the large amount of NPLs held by financial institutions, the government set-up the Non-performing Asset Management Fund in CAMEO in Nov. 1997.

**Mexico**

In Mexico, banks and government shared the cost of restructurings. Only few banks remained with shareholders who had acquired them at the beginning of 1990s.

**Saudi Arabia**

In Saudi Arabia, to strengthen the banking system a number of steps were undertaken such as tax holidays, tax deductibility of provisions for doubtful accounts, withholding tax on inter-bank transactions, creation of banking disputes committee, strengthening of technological infrastructure, corporate governance and exchange of information on large borrowers and on delinquent loans.

Thus all these countries have set-up agencies to manage bad assets and introduced schemes to inject public money as capital into banks. Asset management Corporations have been established in all these economies. Malaysia established a public company, ‘Danaharta’ owned by the Ministry of Finance in June 1998 whose objectives are to acquire, manage, finance and dispose of assets and liabilities of FIs to allow them to focus on the core business of lending. In Indonesia, the Indonesia Bank Restructuring Agency (IBRA). In Sept. 1998 the authorities in Indonesia announced the four state owned banks would be merged into the new bank “Mandiri” by transferring their bad-debts to IBRA.

**2.6 ASSET RECONSTRUCTION COMPANIES IN INDIA**

In India, the Narsimham Committee on financial system (1991) has recommended for setting up of Asset Reconstruction Company. The Narsimham committee on banking sector reforms has recommended for transfer or 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 Asset Reconstruction Fund is an important element in a comprehensive restructuring strategy for weak banks.

After taking into account the various articles supporting and criticizing the effectiveness of SARFAESI Act 2002, the remaining or lateral part of this Act which contains the setting up of Asset Reconstruction Company (ARCs) and provision of transferring the NPAs of secured creditors to them has been taken into account. The Asset Reconstruction Company is specialized in recovery and liquidation of assets. The NPAs can be assigned to ARC by banks at a discounted price. The objective of ARC is floating of bonds and making necessary steps for recovery of NPAs from the borrowers directly. This enables a onetime clearing of balance sheet of banks by sticky loans.

Features of Reconstruction Company & Securitization Company:
1. Their main purpose is reconstruction of assets – mix both the good and bad assets in such manner as to make them saleable.
2. They act as an agent for the bank/FI for the purpose of recovering their dues from the borrowers.
3. They act as the receiver of properties of any bank/FI
4. They act as the manager of the borrowers’ assets taken over by the banks/FIs.
5. They also carry on such other incidental or ancillary business with prior approval of the Reserve Bank of India.

Several countries across the globe have used ARCs for managing their NPAs. In some countries, ARCs are government-owned and funded, although private capital can also be introduced in the process. But the ARCs in India are not supported through Government funding and nor structured like a central disposition agency, since NPA problem is not solved systematically. ARCs in India shall be governed by the provisions of SARFAESI Act 2002 and must be registered with RBI before conducting the business and shall operate within the preview of RBI guidelines. RBI requires all ARCs to have minimum owned funds of Rs. 2 crores and maintain a Capital Adequacy Ratio (CAR) of at least 15% at all times. Provisioning norms for ARCs are stricter than the banks. The
ICICI Bank, State Bank of India and IDBI has promoted the country’s first Asset Reconstruction Company. Several players have applied to RBI for registration to commence the business.\textsuperscript{70}

K. Shreenivasan stated that, “The SARFAESI Act, 2002 appears to be losing its momentum. After nearly two years of its existence, neither a securitization company nor a reconstruction company has come up. There were high hopes that they would relieve banks and financial institutions of all deadwoods and turn it to account. Meanwhile, banks and financial institutions were expected to make full use of Sections 13 to 19 providing for the enforcement of `security interest' and take-over of the management of their secured debts/business and affect as much recovery of their secured dues as possible”.\textsuperscript{71}

Kakkar Rajendra threw light some issues before the ARCs like valuation of financial assets, legal and regulatory measures, funding of the transaction and some other operational matters. ARCs are required to pay ‘fair market value’ for the loan being acquired. Even having various international valuation techniques, determining fair market value is a complex task. Higher uncertainties, subjectiveness and lack of information are major constraints. Stamp Duty on Transfer of Asset is a major hurdle for acquisition of Assets by ARCs. In order to give momentum to the quick and efficient working of ARCs, it should be provided adequate regulatory support from the Government which is available in other countries. The market for NPAs is not developed because domestic players’ have limited resources and foreign investors are interested only if high returns are available.\textsuperscript{72}

Sharma G.V. and Kavery V.S. (2006) observed some issues regarding the setting up of ARCs in India observed some issues regarding the formation of Asset Reconstruction Companies (Arcs), the central issues like whether there would be one centralized ARC or several ARCs, the nature of funding for the same and the prices at which lenders would transfer loan assets to ARCs, are yet to be resolved. The SARFAESI Act only provides for legal framework for setting up of an ARC, functioning and regulatory mechanism. The
effectiveness of ARCs would depend on conducive environment for implementation. ARCs have to be strong not only in seizure of assets but also in respect of post-seizure actions such as maintenance, sale of assets etc.\textsuperscript{73}

Chintala Medha observed that asset Reconstruction of India Ltd. dominates the asset reconstruction scene in the country. The business of ARC seems to be in the boom, as the net NPAs in the domestic banking industry rose from Rs.20, 280 crores in 2006-07 to 24,742 crores in 2007-08. There is an opportunity to ARC to hunt and work for bad loans. A couple of months ago Kotak Mahindra, had received a license from the RBI. The Indian Financial Markets are attracting more players towards the market for bad loans. ARCIL, International Asset Reconstruction Company, Pegasus, Dhir & Dhir Kotak Mahindra, ARC, UTI promoted ASREC, IFCI promoted ACE, ADA Group promoted Reliance ARC & Pridhvi Asset Reconstruction & Securitization Company are the 10 ARCs approved by the RBI. It is boom time for ARCs. In November, 2006, the NPA of banks stood at over Rs.65, 000 crores. Along with 10 ARCs many private players are investing huge amounts in the Assets recovery business.\textsuperscript{74}

2.7 CONCLUSION

The overdue advances of banks in India were mounting and in consequence the NPAs in their portfolio are on the rise affecting badly on the banks viability. The lending institution’s task of recovering their loans has been more difficult by the steps taken by the government in the name of reviving sick units through the enactment of SICA and the setting up of the Board for Industrial and Financial Reconstruction (BIFR) in1985. The Reserve Bank and Government of India have initiated several institutional measures to contain the levels of NPAs. Notable among these include Lok Adalats, Asset Reconstruction Companies (ARCs) and Corporate Debt Restructuring (CDR) mechanism. The establishment of DRTs was a step in the right direction, since they considerably expedited this process of recovery by their speedy recovery mechanism. However, this Act did not really succeed in reaching its end goal
that is to enable bank to recover its debt. Therefore, the shortcomings of this Act resulted with the increasing proportion of NPAs demanded for reorientation of the system. By taking into account the recommendations of Narsimham Committee and Andhyarujina Committee, in 2002, the SARFAESI Act was enacted by the Indian government to solve the problem of recovery of NPAs. The Act provides a procedure through which the Bank or Financial Institution itself will adjudicate the debt. The Act provides ample power to ARCs for resolving the problems of NPAs. The provision of the Act is elaborated in separate foregoing chapter.

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