

**A STUDY ON NON-PERFORMING ASSETS AND ITS
IMPACT ON BANKS IN INDIA**

**A DISSERTATION TO BE SUBMITTED IN PARTIAL
FULFILMENT OF THE REQUIREMENT FOR THE
AWARD OF DEGREE OF MASTER OF LAWS**

SUBMITTED BY

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CERTIFICATE

This is to certify that the dissertation titled, “**A STUDY ON NON-PERFORMING ASSETS AND ITS IMPACT ON BANKS IN INDIA**” is the work done by Tuhina Misra under my guidance and supervision for the partial fulfilment of the requirement for the Degree of **Master of Laws** in School of Legal Studies Babu Banarasi Das University, Lucknow, Uttar Pradesh.

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LIST OF ABBREVIATIONS

1. **ARCs** - Asset Reconstruction Companies
2. **ARCIL**- Asset Reconstruction Company of India Ltd.
3. **ARF** - Asset Restructuring Fund
4. **BIFR** - Board for Industrial and Financial Reconstruction
5. **CAD** - Critical Amount Due
6. **CDR** - Corporate Debt Restructuring Mechanism
7. **CMIE**- Centre for Monitoring Indian Economy
8. **CRISIL** - Credit Rating Information Services of India Limited
9. **DFI**- Domestic Financial Institutions
10. **DRT** - Debt Recovery Tribunal
11. **IBC** - Insolvency and Bankruptcy Code
12. **IRP**- Insolvency Resolution Process
13. **KYC** - Know Your Customer
14. **NCLT** - National Company Law Tribunal
15. **NCLAT** - National Company Law Appellate Tribunal

16. **OTS** - One Time Settlement
17. **OPRs** - Operating Profit Ratio
18. **PSBs** - Public Sector Banks
19. **NPA** - Non-Performing Assets
20. **RBI** - Reserve Bank of India
21. **RDDBI** - Recovery of Debts Due to Banks and Financial Institutions
22. **ROA** - Return On Assets
23. **ROI** - Return on Investment
24. **SARFAESI** - The Securitization and Reconstruction of Financial Assets
And Enforcement of Securities Interest Act.
25. **SDR** - Strategic Debt Restructuring Mechanism
26. **SICA** - Sick Industries Companies Act.

LIST OF STATUTES

- ❖ The Banking Regulation Act, 1949.
- ❖ The Securitization and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (SARFAESI Act)
- ❖ The Revenue Recovery Act, 1980
- ❖ The Sick Industrial Companies Act (SICA), 1985.
- ❖ The Recovery of Debts Due to Banks and Financial Institutions Act, 1993
- ❖ Insolvency and Bankruptcy Code, 2016.

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CHAPTER 1

INTRODUCTION

1.1. INTRODUCTION

Non-performing Asset is a vital factor in the examination of financial performance of a bank. Non-Performing Assets means which amount is not received by the bank in return of loans disbursed. Non-Performing Assets affect not only the finance institution but the total financial system. Thus, this study has done on banks in India to evaluate the effect of Non-Performing Assets on the profitability of banks. Banks today are not judged only on the basis of number of branches and volume of deposits but also on the basis of standard of assets. NPAs negatively effect on the profitability, liquidity and solvency of the banks.

There are common causes responsible for NPAs in selected banks are like lack of supervision, political interference, willful defaulters, diverted use of funds, internal and external causes, fraudulent approach of borrowers, irresponsible attitude of officers and poor appraisal system. Thus, NPA is a threat to the existence of bank. Default on account of big borrowers is a problem in recovery for public sector banks. The quality of standard assets is important factor in determining NPA. The process of maintaining the quality of the assets starts from appraisal stage, sanctioning of loan, post disbursement activities, efficient use of legal norms, which strengthen the recovery process resulting in lower level of NPA. NPAs found at higher level are an indication of low profitability.

This study also highlights the policies followed by the banks to tackle the NPAs and suggests a multi-pronged strategy for speedy recovery of NPAs in banking sector. The present study is aimed at analyzing the impact of NPA's on Indian banks, analyze such existing measures to curb NPAs and the author provides his view for effective recovery. For the purpose of this study the author has made use of the Primary and Secondary sources for data collection. The main source of information has been RBI reports and websites and Journals.

Non-performing assets are one of the major concerns for banks in India. NPAs reflect the performance of banks. A high level of NPAs suggests high probability of a large number of credit

defaults that affect the profitability and net-worth of banks and also erodes the value of the asset. NPAs affect the liquidity and profitability, in addition to posing threat on quality of asset and survival of banks. The Indian banking sector has been facing serious problems of raising Non-Performing Assets (NPAs). The NPAs growth has a direct impact on profitability of banks. It involves the necessity of provisions, which reduces the overall profits and shareholders' value. The problem of NPAs is not only affecting the banks but also the whole economy. In fact, high level of NPAs in Indian banks is nothing but a reflection of the state of health of the industry and trade. It is necessary to trim down NPAs to improve the financial health in the banking system. The Indian banking sector is facing a serious problem of NPAs. An attempt is made in this paper that as to what is NPA and the factors contributing to NPAs, reasons for high NPAs and their impact on Indian banking operations, the trend and magnitude of NPAs in selected Indian banks.

The banking system in India comprises commercial and cooperative banks, of which the former accounts for more than 90 per cent of banking system's assets. Besides a few foreign and Indian private banks, the commercial banks comprise nationalized banks (majority equity holding is with the Government), the State Bank of India (SBI) (majority equity holding being with the Reserve Bank of India) and the associate banks of SBI (majority holding being with State Bank of India). These banks, along with regional rural banks, constitute the public sector (state owned) banking system in India.

The banking industry has undergone a sea change after the first phase of economic liberalization in 1991 and hence credit management. Asset quality was not prime concern in Indian banking sector till 1991, but was mainly focused on performance objectives such as opening wide networks/branches, development of rural areas, priority sector lending, higher employment generation, etc. While the primary function of banks is to lend funds as loans to various sectors such as agriculture, industry, personal loans, housing loans etc., but in recent times the banks have become very cautious in extending loans. The reason being mounting nonperforming assets (NPAs) and nowadays these are one of the major concerns for banks in India.

NPA (non-performing assets) is related to banking and finance term. When bank or finance company is unable to recover its lent money from borrower in 90 days than that amount which

have not been recovered will be treated as NPA. It represents bad loans, the borrowers of which failed to satisfy their repayment obligations.

With effect from March 31, 2004, a non-performing asset (NPA) shall be a loan or an advance where;

- Interest and/ or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan,
- The account remains 'out of order' for a period of more than 90 days, in respect of an Overdraft/Cash Credit (OD/CC),
- The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
- Interest and/or instalment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purposes, and w.e.f 30.09.2004 following further amendments were issued by the Apex Bank,
- A loan granted for short duration crops will be treated as NPA if the instalment of principal or interest thereon remains overdue for two crop seasons.
- A loan granted for long duration crops will be treated as NPA if the instalment of principal or interest thereon remains overdue for one crop season.
- Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.

If any advance or credit facilities granted by banks to a borrower become nonperforming, then the bank will have to treat all the advances/credit facilities granted to that borrower as non-performing without having any regard to the fact that there may still exist certain advances / credit facilities having performing status. As per the prudential norms suggested by the Reserve Bank of India (RBI), a bank cannot book interest on an NPA on accrual basis. In other words, such interests can be booked only when it has been actually received.

Narasimham Committee that mandated identification and reduction of NPAs to be treated as a national priority because NPA direct toward credit risk that bank faces and its efficiency in allocating resources. Profitability and earnings of banks are affected due to NPA numbers.

If we glance on the numbers of non-performing assets, we may come to know that in the year 1995 the NPAs were Rs. 38385 crore and reached to 71047 crores in 2011 in Public sector banks and comparatively in the year 2001 the NPAs were Rs. 6410 crore and reached to Rs. 17972 crores in 2011 in Private sector banks.

Factors for rise in NPAs:

The banking sector has been facing the serious problems of the rising NPAs. But the problem of NPAs is more in public sector banks when compared to private sector banks and foreign banks. The NPAs are growing due to external as well as internal factors.

- External factors

a. Ineffective recovery - The Govt. has set up numbers of recovery tribunals, which works for recovery of loans and advances. Due to their negligence and ineffectiveness in their work the bank suffers the consequence of non-recover, thereby reducing their profitability and liquidity.

b. Willful defaults - There are borrowers who are able to pay back loans but are intentionally withdrawing it. These groups of people should be identified and proper measures should be taken in order to get back the money extended to them as advances and loans.

c. Natural calamities - This is the major factor, which is creating alarming rise in NPAs of the PSBs. Every now and then India is hit by major natural calamities Thus, making the borrowers unable to pay back their loans. Thus, the bank has to make large amount of provisions in order to compensate those loans, hence end up the fiscal with a reduced profit.

d. Industrial sickness - Improper project handling, ineffective management, lack of adequate resources, lack of advance technology, day to day changing govt. Policies give birth to industrial sickness. Hence the banks that finance those industries ultimately end up with a low recovery of their loans reducing their profit and liquidity.

e. Lack of demand - Entrepreneurs in India could not foresee their product demand and starts production which ultimately piles up their product Thus, making them unable to pay back the money they borrow to operate these activities. The banks recover the amount by selling of their assets, which covers a minimum label. Thus, the banks record the non-recovered part as NPAs and has to make provision for it.

f. Change on govt. Policies - With every new govt. banking sector gets new policies for its operation. Thus, it has to cope with the changing principles and policies for the regulation of the rising of NPAs.

g. Directed loans system - Under this commercial bank are required to supply 40% percentage of their credit to priority sectors. Most significant sources of NPAs are directed loans supplied to the —micro sector are problematic of recoveries especially when some of its units become sick or weak.

- Internal factors

a. Defective lending process - There are three cardinal principles of bank lending that have been followed by the commercial banks since long. i. Principle of safety ii. Principle of liquidity iii. Principle of profitability.

b. Inappropriate technology - Due to inappropriate technology and management information system, market driven decisions on real time basis can't be taken. Proper MIS and financial accounting system is not implemented in the banks, which leads to poor credit collection, Thus, NPAs. All the branches of the bank should be computerized.

c. Improper swot analysis - The improper strength, weakness, opportunity and threat analysis is another reason for rise in NPAs. While providing unsecured advances the banks depend more on the honesty, integrity, and financial soundness and credit worthiness of the borrower.

d. Poor credit appraisal system - Poor credit appraisal is another factor for the rise in NPAs. Due to poor credit appraisal the bank gives advances to those who are not able to repay it back. They should use good credit appraisal to decrease the NPAs.

e. Managerial deficiencies -The banker should always select the borrower very carefully and should take tangible assets as security to safe guard its interests. When accepting securities banks should consider the: 1. Marketability 2. Acceptability 3. Safety 4. Transferability

The banker should follow the principle of diversification of risk based on the famous maxim do not keep all the eggs in one basket, it means that the banker should not grant advances to a few big farms only or to concentrate them in few industries or in a few cities. If a new big customer meets misfortune or certain traders or industries affected adversely, the overall position of the bank will not be affected.

f. Absence of regular industrial visit - The irregularities in spot visit also increases the NPAs. Absence of regularly visit of bank officials to the customer point decreases the collection of interest and principals on the loan. The NPAs due to willful defaulters can be collected by regular visits.

g. Faulty credit management - like defective credit in recovery mechanism, lack of professionalism in the work force.

Impact of NPA

NPA impact the performance and profitability of banks. The most notable impact of NPA is change in banker's sentiments which may hinder credit expansion to productive purpose. Banks may incline towards more risk-free investments to avoid and reduce riskiness, which is not conducive for the growth of economy. If the level of NPAs is not controlled timely they will:

- Reduce the earning capacity of assets and badly affect the ROI.
- The cost of capital will go up.
- The assets and liability mismatch will widen.
- Higher provisioning requirement on mounting NPAs adversely affect capital adequacy ratio and banks profitability.
- The economic value additions (EVA) by banks gets upset because EVA is equal to the net operating profit minus cost of capital.
- NPAs causes to decrease the value of share sometimes even below their book value in the capital.

1.2. RESEARCH PROBLEM

There exist effective regulations/legislations with respect to the internal management of banks except for the guidelines as set-forth by the RBI which in turn has an impact in recovery or reducing the levels of NPA. There is a need to identify such lacunae within the laws prevailing in India which regulate such aspects available within the internal management of banks in key areas of legal domain. These key areas include securitization, asset reconstruction, constituting an expert team for monitoring of borrowers, provisioning norms, effective accountability by employees of the bank and such other areas under various legislations such as SARFAESI Act,

2002, Recovery of Debts Due to Banks and Financial Institutions Act, 1993, Insolvency and Bankruptcy Code, 2016.

The increasing levels of NPA's with banking sector and recovery measures available within the internal management of the banks have not been effectively addressed in any of the legislations in India and therefore immediate recommendations and regulation within the internal management of bank to reduce/recover the level of NPA's is of critical importance.

1.3. AIM & OBJECTIVES OF RESEARCH

- To study the concepts and significance of NPA in Banks.
- To elucidate the contemporary NPA Management Practices of Banks
- To examine the causes of NPA To know the impact of NPA's on banks with respect to its profitability and various issues & aspects of NPA.
- To study the various steps taken by the banks to bring down the NPA's in respective bank branches.
- To recommend measures for Improving performance and reduction of Non-Performing Assets.

1.4. HYPOTHESIS OF STUDY

- Whether there exist any lacunae under SARFAESI Act, 2002 and Insolvency and Bankruptcy Code, 2016 with respect to regulation of internal management of bank which can regulate recovery of NPA's?
- Whether the existing laws in India relating to recovery of NPA's will have to be amended in order to incorporate faster and beneficial measures to recover NPA's?

1.5. REVIEW OF LITERATURE

The literature review is very vital in any dissertation or project as it provides information which provides the author to get a better perspective regarding the past and helps in bringing a good conclusion. The alarming of NPAs (Non-Performing assets) is posing a greater threat to functioning of the economy as a whole, this issue is also said to be discussed across the globe. In

this project, literature review mainly aims to look into the causes and reasons for increasing of NPAs and measures taken by government towards such increasing NPAs since the post liberalization period. This literature review has helped the author to get an overview on the causes of increasing NPAs in Indian Banking sector and such actions taken by government in curbing the same over several years. This review of literature has also helped the author to examine prevalence of NPA and its management both in private and public sectors.

The concept of NPAs became more prevalent during the 1980s when there was need to bring changes in the Indian banking system. At this period, various defects with regard to functioning of the banking industry was identified, was there was an immediate need to include prudential norms for provisioning, asset classification and income recognition. These studies helped the author to get a better overview on the stages of development in NPA management. Many published articles are available in the area of non-performing assets and a large number of researchers have studied the issue of NPA in banking industry. A review of the relevant literature has been described as under:

- Rajendran P and Karthikeyan K, *Strategies of NPA Management*, 17 INDIAN ECONOMIC PANORAMA, 2-7 (2007).

Rajendra K. and Karthikeyan K., a descriptive study which states that increase in high level of NPAs results in damage to the quality of loan portfolio which also results in the higher provisions of loans on the bank statements. The author analyzed such governmental measures adopted in reducing the level of NPAs such as OTS (One-time settlement), DRTs, ARCs, etc. and concluded that Non-Performing Assets cannot be put to an end in the banking industry, strengthening of effective internal management of the banks would result in drastic reduction of NPA levels and Thus, contributing for an effective growth of financial industry in the economy. The study concluded by stating that reduction in the levels of NPAs must be considered as a national priority.

- Istrate, E., Gupta, D.D., & Weissburg, P. *Towards Developing a Structured Approach to the Diagnosis and Resolution of Non-Performing Loans: The Case of China and India*, 24 REVIEW OF POLICY RESEARCH 345–365 (2009)

Istrate E., Gupta, D.D., & Weissburg, in this study, the author critically analyzed the causes, reasons and the solutions which are responsible for addressing and redressing of NPAs. The study divided the causes of NPAs into situation based and systematic based causes. One of the major highlights of the research is that identifying the various classifications of NPA and also provided such other measures for the treatment and and management of NPAs in the NPA sector.

- Rajeev, R, *Asset as Liability: NPAs in the Commercial Banks of India*, South Asia Network of Research Institutes, (2013).

Rajeev. R, a study on management of NPA in the commercial banks with reference to SSI (small scale industries). This study highlighted contribution of Non-Performing assets in rural banks branches which is comparatively higher in the Small scale sectors than in other sectors. It was also pointed that the efficiency of Public Sector Banks is relatively higher than the private and foreign banks. One of the major reasons for high levels of NPAs in Small Scale industries is mainly due lack of inadequate funds and existence of large number of NPAs.

- Rajendar, K, *Management of Non-Performing Assets in Public Sector Banks*, 62 THE INDIAN JOURNAL OF COMMERCE, (2009).

Rajendar K, a detailed study on the the various scopes of NPAs in PSBs by using the statistical data for the period during 1999 and 2006. The findings of the study pointed out that recovery management measures such as SARFAESI Act, Asset Reconstruction Companies, Lok Adalats, DRTs, etc. played a significant role in the decrease in the levels of NPA in the Public Sector Banks.

- Jayakumar, A and Amutha, R, *NPAs in Public Sector Banks - A Drag on Society*, ECONOMIC CHALLENGER, (2009).

Jayakumar A and Amutha R, the study noticed in the statistical data pointed that even if there was a decrease in the in the ratio of Non-Performing assets, it was seen that there was a high level of NPAs present in Public Sector Banks. It was also pointed that the level of NPAs were

comparatively higher in the private sector banks than the Public Sector banks. The study concluded the various reasons for the causes of such increase in the level of NPAs and also provided such curative measures which curb the increasing levels of NPAs.

- Debarshi, GD and Ghosh, S (2011), *Management of Non-Performing Assets in Public Sector banks- Evidence from India*, INTERNATIONAL CONFERENCE ON MANAGEMENT (2011).

Debarshi Ghosh, D and Ghosh, S, pointed the structure, trends and treatment of NPAs in Public Sector Banks. The study reports stated an expanded CRAR and increasing NPA level during the period 2009-2010. The examination provided for a general view that NPA is a vital threat that ought to be overseen the progress of effectiveness of managing account segment.

- Michele Cavallo and Giovanni Majnoni, “*Do Banks Provision for Bad Loans in Good Times? Empirical Evidence and Policy Implications*”, 7 THE ICAI JOURNAL OF APPLIED FINANCE, 56-72 (2001).

The pro-cyclical effect of capital regulation ignores the important role of bank loan loss provisions in the overall minimum capital regulatory framework. Insufficient assessment of expected credit losses resulted in a shortage of supply of loan loss reserves at the time of crisis. Therefore, capital must offset both expected and unexpected, giving rise to bad impact of minimum capital requirements on economic activity during a recession. Along with this, when the expected losses are properly reflected in lending rate and are not reflected in the provisioning practice, the bank's earnings volatility will amplify the real bank profitability fluctuations.

It was found that protecting foreigners' claims against banks had a negative impact on loan loss provisions. Due to the lack of appropriate incentives, banks may not be able to avoid the negative impact of cyclical declines in profits and capital, but are expected to have an impact. Their results show that rational supply should be seen as an integral part of capital regulation, & only by reasonable supply practices, minimum capital regulation can lose its essential characteristics.

- Sarkar Jayati, Subrata Sarkar and Suman K Bhaumik, *Does Ownership Always Matter? Evidence from the Indian Banking Industry*, 26 JOURNAL OF COMPARATIVE ECONOMICS, 262-281 (1996).

This is a comparative study on different banks in India that proposes two profitability and four efficiency measures, including two years, 1993-94, with a total of 73 banks. The study focuses on the hypothesis of testing the superiority of private ownership in terms of performance.

Private banks are divided into transactional and non-transactional categories; variables include total bank assets, government securities investment ratio, priority sector loan ratio, & non-interest income as a percentage of total income. They found that the coefficient of foreign ownership is positive and important for both groups of regressions. Except Return On Assets (ROA) and Operating Profit Ratio (OPR), all other efficiency indicators, private domestic banks are no better than public banks.

- Shivpuje, C.R and Kaveri, IDENTIFICATION OF FACTORS AFFECTING NON-PERFORMING ASSETS, (1997).

The research was limited to identification of factors affecting NPAs and proposed measures to prevent the growth of NPAs and affect their rapid recovery. The main focus is on internal factors directly controlled by banks and financial institutions.

To this end, some branches were investigated, interviews with branch managers and borrowers were conducted, and inspection reports were studied. In addition, discussions were held with credit officers, legal officials, executives, bank lawyers and civil judges. At the same time, analyze secondary data to find out all aspects of NPAs. Their conclusion is that if the internal factors are properly taken care of, or in other words, if the efforts of banks and financial institutions are strengthened, recovery of NPA problem will be solved. They pointed out that the eight branches include above-mentioned accounts in Health Law No. 2, and six managers classified them in Health Code No. 4. Finally, they also made recommendations for changes to within internal management, systems, procedures and practices.

- Sudhakar, V K, *"Policies and Perspective of NPA Reduction in Banks"*, IBA BULLETIN, 8-16 (1998).

This research attempts to analyze the policies pursued by banks, with a focus on PSBs because their NPA levels are quite enormous. Policies of different banks differ, depending on the severity of the issue and the restrictions imposed by the practices followed. The author in his research connects the incidence of NPAs to geographies of various industries, financial plans, departments, etc.

He also proposed the concept of *CAD (Critical Amount Dues)* to avoid the fresh NPA and increase in the existing NPAs. It is also recommended to use ready-to-use relationship model to identify the “*Critical Amount Dues*” in existing NPAs. This enables such accounts and potential NPA categories under the NPA to be short lists in priority actions. The study also focuses on some aspects of organizing shortcomings of management of NPAs as a large-scale movement, from its main administrative functions. The author also believes that in almost all banks, managing NPA is seen as a reactive rather than an active function. The important findings of the study are:

1. The assessment is only a reason for the sanctions, that is, the sanctions are decided before the assessment.
 2. Monitoring and evaluation of credit should be considered complementary and the current system is ineffective.
 3. Lack of Management Information System. The lack of staff accountability and the lack of a legal department are the main factors leading to the resumption of the National Action Plan.
- Others have observed that some bank executives have been inspired and worried about this issue, but the staff below do not seem to have the same view. However, as management seems obsessed with setting NPA recovery targets, strict hierarchies and bureaucratic methods are posing problems to public security bureaus to restore NPA.

- Indira Rajaraman, SumonBhaumik and Namita Bhatia, *NPA Variations across Indian Commercial Banks: Some Findings*, 34 ECONOMIC AND POLITICAL WEEKLY, 161-163, 165-168, (1999).

Indira Rajaraman, SumonBhaumik and Namita Bhatia (1999) have tried to check the NPA variations across Indian Commercial Banks which is considered to a significant indication of banking health. RBI classifies 4 Ownership categories. They are:

- 1) Foreign Banks

- 2) Old Private Domestic Banks
- 3) Domestic Public Banks
- 4) New Private Domestic Banks

The important indicator of banks is capital adequacy ratio. Operating profits report as a % of working Funds and is used as a performance indicator. By considering the above, it is clear that capital adequacy ratio works as a prudential indicator while operating profit works as a performance indicator.

- Saumitra Chaudhuri, *Some Issues of Growth and Profitability in Indian Public Sector Banks*, 37 ECONOMIC AND POLITICAL WEEKLY, (2002).

Saumitra Chaudhuri (2002) has tried to observe that the Public sector banks are losing market share, decreasing profits and no strong balance sheet, etc. These gave rise to some issues in public sector banks which are stated as follows: -

- 1) There is inevitable generation of NPA in banks.
- 2) The rate of NPAs is higher in public sector banks as compared to the private sector banks, which in turn increases risk of leading to lower profits.

By considering the above, it is clear that there is no efficient banking system without proper recovery of NPA's and it is suggested that the government has formulate such regulation which make banks to overcome the above issues.

- P. N. Joshi, *Banking Sector Reforms: The Other Side of the Coin*, 34 ECONOMIC AND POLITICAL WEEKLY, 797-798, (1999).

P.N Joshi (1999) has tried to check the other side of banking sector reforms is overemphasis on profits and weak distributive role of the banks. Only some banks are capable of raising funds at a reasonable low interest rate that have strong net worth. According to the Narasimham Committee recommendation (1991), there was a rise to series of reforms:

- 1) Income recognition
- 2) Asset Classification
- 3) Provisioning and
- 4) Capital adequacy.

Through this Committee, they introduced many reforms to rectify the defects in banking system because heavy cost was paid by society. Hence it is the duty of the government to rectify the defects of the other side.

- Kalakkar and Sudeep, *Key Factors in Determining the Financial Performance of the Indian Banking Sector*, (2012).

This research report looks into several factors which will affect the financial performance with reference to banking sectors impact on profitability considering the econometric approach using regression model for identification which financial indicators will have an implication and which do not have on the financial performance of the banks, more specifically related to profitability. The financial performance depends on many factors with reference to profitability of Indian Banking Sector. To know the financial performance, it is suggested to use ratio analysis, liquidity ratio, profitability index, capital adequacy ratio, return on assets, income growth rate, etc. Even Regression is also suggested by using econometric approach. Income growth rate will be affected by several external factors such as market share, investment to deposit ratio of foreign banks, etc. Hence foreign banks also play an important role in determining the financial performance of Indian Banking Sector.

- Singh, Dr. Sultan, *Impact of Reforms on the Soundness of Indian Banking and Need of Third Generation Reforms*, (2011).

Singh and Dr. Sultan (2011) have tried to find out the soundness of Indian banking system. In early 90's, the government had pledged gold to acquire foreign currency to meet balance of payments temporarily. In 1990's India had abundant amount of gold reserves which made Indian banks rich in their ratios compared to other banks. But after 90's due to transfer of gold reserves, the soundness of Indian banking system had reduced gradually. Hence the Narasimham Committee (1991) comes out with a series of reforms which includes capital adequacy ratio, operating ratio, etc. Banking reforms in India have indeed transformed banks into stable, strong, prosperous entities and profitable institutions. Indian banking system can now claim their non-performing asset levels are in relevant standards, with prudential provisioning and classification of an adequate capital base. But effective recovery management, cost management, technological

intensity of banking, risk management and governance, financial inclusion are the areas, which will have a key impact on the ability of Indian banks to remain competitive and enhance soundness.

- M. G. Bhide, A. Prasad and Saibal Ghosh, *Banking Sector Reforms: A Critical Overview*,³⁷ ECONOMIC AND POLITICAL WEEKLY, 399-401, 403-408, (2002).

M. G. Bhide, A. Prasad and Saibal Ghosh (2002) has tried to find the critical overview of banking sector reforms. The Narasimham Committee (1991) was considered to be the first committee to provide for reforms in the financial sector. This article provides for various weaknesses of Banking Sector in India which include:

- 1) Interest rate deregulation
- 2) Ownership structure
- 3) Non-performing Assets
- 4) Direct Lending
- 5) Corporate Governance

In most of the emerging economies, the banking sector is facing with such challenging difficulties. A discussion and regulation of these issues and challenges by way of reforms is very vital for the functioning of the banking system.

1.6. RESEARCH METHODOLOGY

The project is descriptive in nature, as the author aims at obtaining the relevant information regarding Banking Sector that will be useful in future, as Banking is an Inevitable Part of Life in the current World. So, this study will be an eye-opener for those who take the Bank repayments lightly.

Descriptive method of research based on the secondary data available on the various locations of the internet, books, and also includes statistical and survey reports the facts and figures stated would be referred and stated from various websites and reports conducted by RBI and such other

financial institutions. The other relevant information and the comparison of the same shall be a reasonable inference collected from various other sources.

The paper is both qualitative and quantitative in nature as it analyses the quality and applicability of the existing legal framework in India that is applicable to recovery of NPA's. It also depends on the statistical surveys and balance sheets of various banks to determine the increasing or decreasing level of NPA's. If the existing law is not applicable, a recommendation is made as to what adaptations the law in India has to make with regard to the same.

CHAPTER 2

ORIGIN AND RISE OF NPAs IN INDIA

2.1 STUDIES FOR IMPLEMENTATION OR DEVELOPMENT OF NPAs

The term “*Non-Performing Assets*” plays a major role in affecting the functioning of banks and NBFCs. Although the emphasis has laid on the treatment of NPAs is now widespread, this is not new to the Indian banking system. Earlier, bankers used to handle sticky advance payments and made such advance payments. In 1992, the Asset Classification, Income Recognition and provisioning norms introduced by the Reserve Bank of India is a clear model for credit risk assessment, that banks or financial institutions assume in their balance sheets. In addition to being recognized in the domestic and global markets, the industry is also implementing uniformity, transparency, and objectivity in assessing credit risk. This is the main reason for the current policy deviation from the mid-1980s policy. The prudential norms introduced by the Reserve Bank of India are not only objective, instead considering the actual risk position in an appropriate way so that banks can take effective measures to maintain health and profitability of the credit portfolio.

This chapter attempts to present research conducted at the individual and group level in India and abroad over the past two decades. Many of them have delved into all aspects of over-lending and the practices that commercial banks have taken to overcome these loans, drawing attention to the various weaknesses associated with them. These groups have made a number of recommendations from time to time, many of which have been implemented by the Reserve Bank of India.

The history of banking tells that the primary function of banking system in India deals with lending and collection of money. This is followed by the basic law of demand and supply where persons having surplus money lend to persons who needs it for more beneficial purposes and were willing to pay a price for this which is interest. The operations were limited to the money lender knowing every person he lent money to.

The role of Banking system in India plays a vital role in the growth and development of the economy. Banking is said to be one of the important sectors which influences the economic

progress of the country. The structure of Indian financial system which is comprised of public sector banks, private sector banks and non-banking financial institutions are regulated as per the guidelines set by the RBI. Commercial and public sector banks play a vital role in the development of the economy. One of major threats to the banking sector is occurrence and increasing NPA's. NPA's reflect the efficiency and performance of the banks.

2.2. ORIGIN OF NPA

The origin of Indian banking system can be divided into Pre-liberalization and Post-liberalization era. During the Pre-liberalization era, some of the reasons responsible for increasing Non-Performing assets can be noted as:

- Poor performance in the agricultural sectors due to sudden changes in the climatic conditions.
- Industrial certification, in industrial business the cost of production is said to higher which is off set by the lower manual labor cost. In the present working conditions such manual labor is done along with the use of modern technology.
- Government investment in various sectors is said become a mandate especially post-independence for reasons such as lack of effective private capital.

2.2.1.Post-Liberalization Era:

It is seen that until early 1980's India's macroeconomic policies were said to be conservative in nature. The spread of liberalization led to the de-licensing of particular industries which permitted change in the products within the overall capacity and relaxation of imports. In the 1980s, the Indian economy is said to hit the average growth rate of 5.3 % per year, which is much higher than the average growth of 3.5 % per year during the previous 30 years. Prior to 1991 economic reforms 1991, it is said to follow the policies of the Basel group. In 1992, RBI issued comprehensive guidelines on prudential norms on Income Recognition and Asset Classification. The RBI, with a cautious move, adopted provisioning of asset classification, income recognition method; rather than writing-off the entire loan asset amount based on present value of realizable cash flow upon recognition of Non-Performing assets. The banking

system in India places significant importance on identification of net NPA as percentage of gross assets. Net NPA percentage is important for regulatory purpose; it does not capture the shareholders' perspective. The focus should be on recovery of gross NPA including fully written off accounts in present value terms using cost of carrying NPA as the discounting factor at minimum value if not the opportunity cost.

It has been noticed since 1970s, the bank under study is following well established norms regarding treatment to identify of bad accounts. The bank insisted its branches to stop charging interests on doubtful advances, on the basis of the criteria as stated below, irrespective of whether such cases are filed for recovery of the dues or not. In furtherance of this regard, the following criteria was adopted: -

- Failure to pay interest on the loan during the last four relevant periods which may be in terms of month; quarters; half years; years depending on the case-to-case basis.
- In the cases of such guaranteed advances by CGO it advances, once doubtful asset of an advance becomes evident, as any subsequent interest whether accounted or debited for separately would not be eligible to be included in the “amount in default” and claimed from the corporation.
- Presence of a provision for bad and doubtful debts or such a provision is said to be made. ¹

The concept of “Non-Performing Asset” or NPA as introduced by the RBI in the year 1992 is the result of the recommendations on financial sector reforms made by Narsimham Committee. This Committee obtained the policy of income recognition to which the main objective is to base on record of recovery, rather than any other considerations. It should be noted that in global practice, that an asset is treated as “Non- performing” when interest is overdue for at least two quarters. ²According to this committee, advances would be treated

¹Shruti J Pandey, Vishakha G Tilak and Bipin Deokar, *Non-Performing Assets of Indian Banks: Phases and Dimensions*, 48, ECONOMIC AND POLITICAL WEEKLY, 91-93, (2013), <https://www.jstor.org/stable/23527401>

²*Report of the Committee on the Financial System*, 54, (1991).

as NPA, as stated in the balance sheet date.

1. With respect to term loans, interest remains past due for a period greater than 180 days.
2. In case of cash credits and overdrafts, account remains in out of order status for a period greater than 180 days.
3. With respect to bills discounted and purchased, the bill remains overdue and unpaid for a period greater than 180 days.
4. In case of any other accounts, any amount to be received remains past due for a period greater than 180 days. An amount is said to be post due when it remains outstanding 30 days beyond the due date.³

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

2.2.2. Health Code System

A system of comprehensive and uniform credit monitoring was introduced in 1985-86 by RBI via through the Health Code System in banks which specified information regarding the quality of credit portfolio, and the health of individual advances. Such information was considered to be of great use for the banks for the purpose of taking control measures.⁴ The apex bank or RBI has advised all commercial banks (excluding foreign banks, most of which had similar coding system) on 7th November, 1985 to introduce the classification of Health Code which indicates the quality (or health) of individual advances in the following eight different categories, with a health code assigned to each borrowing person's account:

³*Ibid*, pp. 55.

⁴A.Q. Siddiqi, A.S. Rao & R.M. Thakkar, *"Some aspects and issues relating to NPAs in commercial banks"*, Department of Banking Supervision, Reserve Bank of India.

1. **“Satisfactory** - It means that all terms and conditions are complied with; all accounts are in perfect in order; conduct is completely satisfied; and safety of the advance is not in doubt.
2. **Irregular** - the safety of the advance is not suspected, though there may be occasional Irregularities which may be considered as a short-term phenomenon.
3. **Sick - viable** - advances to units which are sick but viable, under nursing and units in respect of which nursing or revival programmes are taken up.
4. **Sick: nonviable or sticky** - the irregularities continue to persist and there are no immediate prospects of regularization; the accounts could soon turn out to show some of the usual signs of emerging sickness.
5. **Advances recalled** - These include those accounts where the repayment is highly doubtful and nursing is not considered worthwhile; includes where decision has been taken to recall the advance.
6. **Suit filed accounts** - Accounts where lawful action or recovery proceedings have been initiated.
7. **Decreed debts** - where decrees have been obtained.
8. **Bad and Doubtful debts** - where the recoverability of the bank's dues has become doubtful on account of decreasing value of security; struggle in enforcing and realizing the securities; the unwillingness or inability of the borrowers to repay the bank's dues partly or wholly. Under the above Health Code System Reserve Bank of India categorized the problem loans of each bank into 3 different categories: -

- a. Such advances categorized as Bad & Doubtful by the bank (related to Health Code No.8)
- b. Such advances where lawful suits were filed or decrees obtained (related to Health Codes Nos.6 and 7) and
- c. Also those advances with major undesirable features (broadly related to Health Codes Nos. 4 and 5).”

2.2.3 Efficacy of the Health Code System

In 1989, the concept of income recognition was introduced based on the Health Code, under which the banks were guided to determine income on the basis of realization basis with respect to all the accounts under Health Code No. 6 and all those under Health Code No. 5 also. Though the

Health Code system served its purpose of Management Information Mechanism and useful monitoring, there was lack of a transparent, objective and uniform measurement for problem or sticky advances which was considered to be the major disadvantage of this system. Also, it was not suitable as an enforcement mechanism due to lack of a benchmark with respect to the amount of time to be taken by banks for retracting the loan once it becomes problematic.

2.2.4 Prudential Norms on Income Recognition, Asset Classification and Provisioning

The Reserve Bank of India, as a part of reforming the financial sectors has taken up such measures to revolutionize the Indian domestic financial system with an attempt to adapt with the international financial system. With this regard, in the year 1991 a committee under the chairmanship of Sri M. Narasimham on the financial system was formed, to evaluate the functioning of banking system in India and compare with other global banking systems. The committee was established with the main objective to suggest such solutions to strengthen the domestic financial system for smooth integration with the international system. In the view of enabling greater transparency in the borrowable accounts and to expose real health of banks in their balance sheets, the Reserve Bank of India introduced prudential regulations relating to income recognition, asset classification and provisioning as recommended by M. Narasimham Committee with certain changes in a phased manner over a three-year period beginning from 1992 till 1993. These regulations have laid down the objective criteria for provisioning, asset classification and income recognition, which was lacking previously. As a result of this change has brought in the necessary mechanism for assessment of Non-Performing assets and provisioning in respect of problem credits.⁵

2.2.5 Reporting of NPAs

All the banks are mandated to furnish a Report on NPAs as on March 31st each year after the completion of audit. The report on NPAs would relate to the banks also includes global advances made at the foreign branches. The Report should be furnished in such given prescribed format.

⁵ Reserve Bank of India, "*Master circular - prudential norms income recognition, asset classification and provisioning pertaining to advances portfolio*".

While reporting the amount of Non-Performing Assets to RBI, the amount held in interest suspense account, should be shown as a deduction from Gross Non-Performing Assets as well as gross advances while arriving at the net Non-Performing Assets. Banks which do not maintain Interest Suspense account for receiving such due interest on non-performing advance accounts, may furnish the amount of interest receivable on NPAs as attached to the Report.

Today the Indian banking system has undergone significant transformation following financial sector reforms, adopting international best practices. Several prudential norms, payment, integrating and provisioning norms have been introduced, and these are pressurizing banks to improve efficiency and cut down NPAs to improve the financial health of the banking system. RBI and Government have made some notable changes in policies and regulations to strengthen the sector. NPA involves the necessity of provisions, any increase in which brings down the overall profitability of banks and is the indicator of banking health in a country. ⁶

An example of NPA: Suppose the State Bank of India (SBI) gives a loan of Rs.10 crores to accompany (E.g., Kingfisher Airlines). Consider that they agreed upon for an interest rate of say 10% per annum. Now suppose that initially everything was good and the market forces were working in support to the airline industry, therefore Kingfisher was able to service the interest amount Later, due to administrative, technical or corporate reasons suppose the company is not able to pay the interest rates for 90 days. In that case, a loan given the Kingfisher Airlines is a good case for the consideration as NPA.

NPAs definition by Reserve Bank of India (RBI)An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank. Technical definition by RBI on NPA on different cases NPA is a loan or an advance where...

- Interest and/ or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan.

⁶ RBI, Report on *Trends and Progress of Banking in India*, Chapter I - Banking Developments and Policy Perspectives, 13, (1996-1997).

- The account remains 'out of order' in respect of an Overdraft/Cash Credit (OD/CC).
- The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.

The instalment of principal or interest there on remains overdue for two crop seasons for short Banks play a pivotal role in the economic development of any country. Banking industry is a major sector of the economy that has achieved renewed focus after financial sector reforms and the entry of private sector banks. This sector is the foundation of modern economic development and linchpin of development strategy. It forms the core of the financial sector of an economy. Through mobilization of resources and their better allocation, commercial banks play an important role in the development process of underdeveloped countries. Commercial banks improve the allocation of resources by lending money to priority sector of the economy. Among the various indicators of financial stability, bank's non-performing loan assumes critical importance since it reflects on the asset quality, credit risk and efficiency in the allocation of resources to productive sectors. A common perspective is that the problem of bank's non-performing loans is ascribed to political, social technological, legal and other environmental factors.

In present times, banking in India is fairly mature in terms of supply, product range and reach. But reach in rural India still remains a challenge for the public sector and private sector banks. The Reserve Bank of India is mainly concerned with providing finance to weaker section of the society, development of priority sectors and providing credit under differential rate of interest scheme. After reforms in 1991, the entry of many private players has been permitted. Post liberalization demand Public Sector Banks to compete with well diversified and resource rich private banks and to provide fine funded services and unique products to suit customers need.

Public Sector Banks have already sacrificed a lot of their profits for achievement of social objectives. Due to cut throat competition and technology, the Public Sector Banks are thinking to improve productivity and profitability which is essential to survive in a globalized economy.

The banking industry has undergone a sea change after the first phase of economic

liberalization in 1991 and hence credit management. While the primary function of banks is to lend funds as loans to various sectors such as agriculture, industry, personal loans, housing loans etc., in recent times the banks have become very cautious in extending loans, this is due to mounting non-performing assets (NPA). Therefore, an NPA account not only reduces profitability of banks by provisioning their carrying cost is also increased. Apart from this, a high level of NPA also puts strain on a bank's net worth because banks are under pressure to maintain a desired level of Capital Adequacy and in the absence of comfortable profit level, banks eventually look towards their internal financial strength to fulfil the norms thereby slowly eroding the net worth. Considering all the above facts banking industry has to give more importance to NPA and to structure proper remedial solutions.

The Indian banking system has undergone significant transformation following financial sector reforms as laid out by Narasimham Committee in 1991. It is adopting international best practices with a vision to Strengthen the banking sector and its operations in the economy.

Appropriate prudential and provisioning norms have been introduced, and these are expecting the banks to usher overall efficiency, bring down NPA, to improve the profitability and overall financial health in the banks, in general.

Over a period of time, because of the frequent occurrences of non-servicing loans by the borrowers, there is an increasing trend in the decreasing quality of loan assets having highly negative impact on the financial performance of banks. If the loans are not duly serviced it will lead to loss of current as well as potential income of the bank with attendant ill-effects of poor quality of loan assets and will have negative impact on the survival and sustainability of banks. This warrants greater attention of bank management towards reducing the occurrences and the impact of NPA.

Most of the existing literature emphasized on the reduction of NPAs in Indian banks at national and/or state level and studies the macro aspects of managing NPAs i.e., managing loans after slipped into non performing category. Micro i.e., branch level monitoring and

reporting plays a major role in controlling the NPAs, works before account slipped into NPA category.

In order to tackle the menace of NPA, an in-depth study at branch level is utmost important. In the region of Barak Valley of Assam, where banking services has achieved limited success so far, no remarkable study on the subject has been undertaken so far. So, we felt a gap in the existing literature and in the present study an attempt has been made to bridge up the gap.

CHAPTER - 3

COMMITTEES FORMED FOR BANKING SUPERVISION

3.1 BASEL COMMITTEE

The Basel Committee issued an accepted framework for international convergence of capital measurement and capital standards in July 1988. The committee uses weighted risk assets to assign weights to the bank's on- and off-balance risks based on its perceived risk, as a measure of capital adequacy, and sets the minimum standard to 8% by the end of 1996. Although the banking regulators in G-10 countries have applied the framework, the committee has recommended that banking supervisors in non-G-10 countries also try to adopt the framework for banks that conduct major international operations in the following areas within their jurisdiction. The basic goal of the Basel Committee's was the framework should be fair and highly consistent in terms of application. Banks in different countries aim to reduce the root causes of existing competition inequalities between international banks⁷. Compared with Basel II and II, Basel III was established with a main motive to improve the efficiency of each bank. The main objectives of Basel III are to increase in the quality of capital, and bring in modifications in provisioning norms.⁸

3.2 NARASIMHAM GROUP (1991)

The ownership of the Indian PSBs by government led to the negative belief that the bank's capital base was low. Lack of proper specifications leads to problems being covered up. Customer service quality cannot keep up with frequent changes in modern technology, affecting speed & accuracy of the service. Lack of effective internal control seriously affects the integrity of the system. This is reflected in the need for higher spreads, which indicates that the system is inefficient. At the same time, the country's macroeconomic crisis in 1991 paved the way for broad financial sector reform. Although the number of banking systems has increased significantly over the past three periods, it is widely believed that it is not as vibrant

⁷ Basel Group (1988)

⁸Subhasish Roy, *Cost of Implementing Basel III*, Vol. 48, No. 35, Economic and Political Weekly, pp. 17-20, (August 31, 2013), <https://www.jstor.org/stable/23528746>

as it is now. By 1990, due to the ineffective financial situation of public sector banks and other financial institutions, serious concerns were raised. Some of them have become unprofitable, capitalized and high-level non-performing assets. Recognizing the urgent need to address this growing problem before the issue becomes a threat to the health of the country's entire financial system, the government has appointed a high-level committee led by former RBI governor Mr. M. Narasimham to address this issue. And recommend remedies.

The ratio of capital funds to bank deposits or their assets is recognized as a generally accepted indicator of institutional strength and stability. According to international standards, the capital ratio of Indian banks is generally low, and some capital is seriously insufficient. Banking Regulatory and Regulatory Practices Appointed by the Bank for International Settlements (BIS) The Basel Committee sets certain standards for capital adequacy that commercial banks should follow. As we all know, the BIS standard aims to measure the capital adequacy ratio as the ratio of capital to risk-weighted assets. It sets weights for different categories of assets, including certain off-balance sheet items. The Commission believes that Indian banks must comply with these standards in different stages.⁹

In 1991, the BIS norm for Capital Adequacy Ratio guidelines accounted for 8% of risk assets. The committee also suggested that all Indian banks achieve this percentage in these stages. For all banks functioning at international level, the rules should be implemented at the earliest, within 3 years, before 1994. The remaining banks should meet the capital adequacy ratio of 4% by 1993 and the 8% standard for the next two years, that is, until March 31, 1995. However, before the actual revaluation of assets based on their realizable value, the capital adequacy ratio is observed. Banks and Domestic Finance Institutions have not followed a uniform approach to income recognition, investment valuation and provisioning against doubtful assets. In this regard, necessary adjustments must be made, and then it is necessary to invest additional funds to achieve capital adequacy specifications. The committee recommends banks with a steady track record and having good repute in the market should enter into the capital market by

⁹ Government of India: *Report of the (Narasimham) Committee on the Financial System, 1991.*

issuing new capital to the public. The government may need to supplement capital by direct subscription of shares or through loans, which can be considered as subordinated debt.¹⁰

3.2.1 The Ghosh Committee

The Ghosh Committee made some recommendations on the valuation of investments in the bank's portfolio. They recognize that a large size of the bank's investment will be held until expiry, so there is no need to stipulate a reduction in the value of those investments, so it is suggested that the bank's investment be divided into 2 parts, namely, "permanent investment" and "current investment." The Narasimham Committee recognized the Ghosh Committee's recommendations on this issue because they believed that proper income recognition and supply systems were essential in maintaining the functioning of the banking system. However, since appropriate classification of assets should be carried out prior to this work, the RBI requires all advance payments to fall under the following health Code guidelines:

"Code No. and Title

1. *Satisfactory*
2. *Irregular*
3. *Sick: viable/under nursing*
4. *Sick: non-viable/sticky*
5. *Advances recalled*
6. *Suit-filed accounts*
7. *Decreed debts*
8. *Debts classified by the banks as bad/doubtful"*

The Committee believes that the income recognition policy should be objective in nature and based on recovery records rather than any subjective considerations, which is consistent with global practice & therefore recommends that interest on NPAs should not be credited to income on the accrual basis. Accordingly, Reserve Bank of India has indicated that for advance payments covered by Health Codes No. 5 to No. 8, income on interest should not be recognized prior to

¹⁰ K. M. Shajahan, *Non-Performing Assets of Banks: Have They Really Declined? And on Whose Account?* Vol. 33, No. 12, *Economic and Political Weekly*, pp. 671-674, (Mar. 21-27, 1998), <https://www.jstor.org/stable/4406554>

implementation. In addition, in order to provide funding, banks should classify their assets by compressing them into the following categories:

- I. Standard assets,
- II. Sub-standard assets,
- III. Doubtful assets, and
- IV. Loss assets.

It was also believed that Reserve Bank of India should clearly provide definitions for these four categories to ensure a uniform & reasonable basis for asset classification. In a nutshell, substandard assets will be those that have problems, including assets that are classified as NPAs in less than two years. Doubtful assets are those non-performing assets that are more than two years old. Loss assets are accounts that have determined the loss but have not yet write off.

The committee also states in case of any delay in legal procedure, an account becomes suspected of recovery, and there must be a time lag between its recognition and the realization of security. In addition to the market value of guarantees received from banks and financial institutions, this factor must be kept in mind when making the provisions¹¹. Therefore, the Committee recommends that the basis for the provision of doubtful debts and bad debts should be as follows during the four-year period beginning in 1992-93:

1. Regarding “loss” assets, either all assets should be written off in the books or, for some reason, the assets are allowed to remain in the books, and 100% of the outstanding assets should be specified.
2. In the case of doubtful debt, it is necessary for the bank to provide a 100% guarantee difference, i.e., the full range of loans and advances that are not within the realizable value of the guarantee. In addition, banks and institutions need to make further specific provisions within a certain percentage or even the scope of the guarantee. This percentage may vary between 20% and 50%, depending on the duration of the asset in the suspicious category.

¹¹ RBI, Report on *Trends and Progress of Banking in India*, Chapter II - Commercial Banking, pp. 57, 1992-1993.

3. For substandard assets, a general rule of 10% of the total outstanding amount should be established.¹²

With regard to expediting the process of recovery, the Committee accepted the Tiwari Committee's recommendation to establish a special court, which is essential for accelerating the recovery process, as an appropriate legal framework would help banks & other financial institutions to quickly enforce claims against their customers, without which, there will arise problems in the functioning of the financial system.

The committee studied the mechanisms used in similar situations in some other countries and recommended the establishment of an independent agency called the "*Asset Restructuring Fund*" (ARF), with a clear purpose to collect such assets from banks & sell at a discounted price in the market. The advantage of banks for this arrangement is that part of their bad debts will be replaced by interest generating bonds, which will be an important aspect from the perspective of revenue generation. The sale of these assets to the fund at a discounted price clearly means that the bank/DFI is obliged to write off these losses, which in many cases may not be completed due to poor financial conditions. The Commission recommended that in order for banks to be able to fund write-offs at a discount, the government should use external assistance for the rupee counterparts to provide subprime loans in order to carry out financial sector reforms for this purpose.¹³

The committee also believes that the new agency should not assume a large number of accounts that are disproportionate to the infrastructure that may be available. Therefore, this transfer of assets must be carried out in stages. First, all consortium accounts involving multiple banks or institutions should be transferred to the Asset Restructuring Fund. The no. of such accounts will not be large, but the amount involved will be sufficient to affect the balance sheet of banks/domestic financial institutions. At the same time, banks and institutions should pursue recovery through special courts. Tribunals & Asset Restructuring Fund mechanisms are designed to facilitate effective recovery of contributions from customers with respect to banks and

¹²Report of the Committee on the Financial System, 56, 57, (1991).

¹³ N.P. Kurup, *Banking Sector Reforms and Transparency*, 31 ECONOMIC AND POLITICAL WEEKLY, 745, 747-749 (1996).

Domestic Financial Institutions have decided to recall loans and continue to implement guarantees. These accounts represent the contributions of units that are considered generally viable, & he is expected to improve if given appropriate and timely assistance.¹⁴

In conclusion the committee stated that targeted investment & targeted credit programs are responsible for higher national action plans. In both cases, banks can earn interest rates below market-related rates because they can be obtained from the deployment of alternative funds. The quality of the loan portfolio has deteriorated, which in turn has affected the bank's income generation and capital appreciation.

The Narasimham Committee stated: *"However, both banks and the DPI have suffered from excessive administrative and political interference in individual credit decision-making and internal management. The deterioration in the financial health of the system has reached a point where unless remedial measures are taken soon, it could further erode to real value of and return on the savings entrusted to them and even have adverse impact on depositor and investor confidence."*¹⁵

3.3 PANNIR SELVAM GROUP (1998)

The 1990s was an era of economic and monetary policy changes brought about by the government and the Reserve Bank of India to achieve the globalization of India's economy. The process of liberalization swept the foreign trade sector, is not without an impact on the investment policies on the domestic sector but on the financial sector. The implementation of the Narasimham Group's recommendations sparked reforms in the Indian banking industry. As a result, Indian banks have embarked on the path of increasing productivity, efficiency and global competitiveness. Awareness was spread to keep the non-performing assets at a low level, especially due to strict prudential norms on asset classifications, income recognition and the provisioning requirements. Although Indian banks have adopted international accounting standards and turned to prudential regulation rather than structural supervision in the past, the

¹⁴ P. N. Joshi, *Banking Sector Reforms: The Other Side of the Coin*, 34 ECONOMIC AND POLITICAL WEEKLY, 797-798 (1999), <https://www.jstor.org/stable/4407813>

¹⁵Narasimham Group (1991)

level of NPAs continues to rise in absolute numbers. This led the government to set up a committee to analyze in depth the root causes of the continued increase in national action plans by public sector banks¹⁶. The measures recommended by the group to effectively recover dues and reduce NPAs are broadly classified into the following three categories:

I.Measures required to be initiated by Government and RBI.

II.Measures required to be adopted by Banks.

- Arresting fresh Generation
- Reduction of existing NPAs
- Other measures

III.Measures for restructuring BIFR, DRT and Judiciary system.

3.4 NARASIMHAM GROUP-II - 1998

The Indian banking sector followed the suggestions of the Committee on Financial Systems (CFS) which was reported in 1991, drastic changes have taken place in economic and institutional fields, which coincides with the global integration of financial services. These improvements reinforce the importance of building an effective financial system. In view of these improvements, the govt. nominated the second Narasimham Committee in 1998. The recommendations of the committee have been widely accepted by Reserve Bank of India & are known in the name of the second generation of norms. This generation of reforms can be easily viewed from three broad interrelated issues:

1. Such actions to be taken to strengthen the banking system.
2. Related to this, restructuring procedures, technology upgradation and development of human resources.
3. Structural changes in the system. These would cover aspects of banking policy, institutional, supervisory and legislative dimensions.¹⁷

¹⁶ Patel, Urjit R, *Emerging Reforms in Indian Banking: International Perspective*, ECONOMIC AND POLITICAL WEEKLY, 32-42, (1997).

¹⁷ M. G. Bhide, A. Prasad and Saibal Ghosh, *Banking Sector Reforms: A Critical Overview*, 37ECONOMIC AND POLITICAL WEEKLY, 399-401, 403-408, 2002, <https://www.jstor.org/stable/4411685>

3.5 RBI STUDY

The RBI in its study analyzed the reasons contributing for increasing level of NPAs in banks.¹⁸A research of 800 NPA accounts was conducted, the RBI study has found the following, were considered to be main factors: -

- Segregation of funds, mainly for modernization, expansion, etc.
- Internal factors of business-like product failure, inefficient management, primitive technology, product outmodedness, etc.
- Cost and time overruns at the time of implementation stage of the project.
- Implementation of government policies such changes in import and export duties, controlling of pollution, etc.
- Committing of fraud, misappropriation, and willful default by promoters in their disputes in the companies.
- Negligence by the banks such as delay in giving the limits sanctioned, delay in payments by the banks.

The RBI report in conclusion, *"Reduction of NPAs in banking sector should be treated as a national priority item to make the Indian banking system more strong, resilient and geared to meet the challenges of globalization. it is necessary that public debate be started soon on the problem of NPAs and their resolution. ¹⁹It is hoped that this paper will provide a base and generate a healthy public debate, which may be helpful in evolving suitable strategies for satisfactory resolution of tile problem".²⁰*

¹⁸ Published in RBI Bulletin, July 1999

¹⁹ Dr. Vibha Jain: "Non- Performing Assets in Commercial Banks", Regal publication, New Delhi, 28-38, 39-40, 49-53, 57-64, 75-76, 1st Ed. (2007).

²⁰ RBI Study (July 1999)

CHAPTER - 4

STATUTORY AND CONSENSUAL MECHANISMS FOR RECOVERY OF NPA'S

4.1 LEGAL MECHANISMS

4.1.1 Debt Recovery Tribunal

One of the problems faced by banks is the rate of recovering loan is low. In case of any default in repayment of loan within the stipulated time, banks and financial institutions can file a suit under the *Recovery of Debts Due to Banks and Financial Institutions Act, 1993*, and the amount due can only be recovered when such due is provided under the Act.

Thus, the “*Recovery of Debts*” due to “*Banking and Financial Institutions Bill*” was passed on August 17, 1993, and the facilities of the Debt Recovery Tribunal were passed on August 17, 1993 for recovery of debts due to the Banks and financial institutions. If the debt amount of any bank or financial institution is less than Rs. 10,00,000 or the amount is not less than Rs. 100,000 rupees, the provisions of this Act do not apply, unless the central government specifies by notice.

These courts will quickly process applications from banks or financial institutions and attempt to dispose of such applications. One provision is to dispose of such an application within six months from the date of receipt of such application. The appellant deposits 75% of the debt into the Court of Appeal, which will also prevent unnecessary delay in the recovery process. These recovery courts will help clean up the balance sheet and help improve capital recovery and bank liquidity.

4.1.2 Corporate Debt Restructuring

The Corporate Debt Restructuring mechanism was set up in the year 2001, providing a timely and transparent system for banks and financial institutions to restructure

corporate debt of Rs 20 crores and above. The CDR process will also enable viable corporate entities to realign their contributions beyond the existing legal framework and reduce the incidence of new NPAs

The main objective of the Corporate Debt restructuring mechanism has been to ensure timely and transparent restructuring of corporate debt outside the preview of the Board for Industrial and Financial Reconstruction (BIFR), DRT or other legal proceeding. The framework is intended to preserve viable corporates affected by such factors and minimize losses to creditors / other through an orderly and coordinated restructuring programme.²¹

RBI has issued guidelines to the CDR mechanism in February 2003. Corporate borrowers are effectively borrowed from banks to reduce their recommendations as quickly as possible, and may suggest guidelines for effective control and supervision by the bank's board of directors over credit management and NPA preventive measures

By establishing a rigorous and appropriate credit appraisal mechanism for credit and then overseeing tolerance to regulators/ supervisors, owners or strategic partners can provide assistance to better avoid increase of NPAs in the early stages of credit management.

Second, the mindset of the borrower needs to change in order to establish a culture that makes appropriate use of credit facilities and timely repayment. One of the main reasons for business entities should be to avoid this practice for a strong and sound financial system.

Finally, extended credit involves both lenders and borrowers, both of which should fulfill their roles and responsibilities. They should understand each other's difficulties

²¹ M. K. Datar, *Redefining the Debtor-Creditor Relationship: NPA Ordinance*, 37, ECONOMIC AND POLITICAL WEEKLY, 3786-3789, (2002), <https://www.jstor.org/stable/4412597>

and should strive to contribute to a healthy financial system.²²

4.1.3 Lok Adalat

In order to handle cases more simply, faster and more cost-effectively, banks are approaching the Lok Adalats system organized by the State and/or Regional Legal Services Committee under the Legal Services Authority Act, 1987. If necessary, the branch should consult the local Legal Services Committee to organize Lok Adalats.

Lok Adalat is a process of law enforcement without going to court. This process is voluntary and its working principle is that all parties to the dispute are willing to resolve disputes in an amicable manner. The operation of Lok Adalat is entirely voluntary and conciliatory. The proceedings are relatively simple.

All suits and disputes that are heard in court or may be brought before the court can be submitted to Lok Adalat. Lok Adalat's award has the same force as that of a civil court and is binding on the parties to the dispute. Either of the parties cannot file an appeal. The maximum amount that Lok Adalat can handle is Rs. 200,00,000 rupees.

4.1.4 Decreed Account

After the case is decided to benefit the bank, all necessary steps are completed within one month. Immediately after obtaining a degree, measures should be taken to enforce the decree, and the respective authorities should ensure that the statutory dues are restored within a maximum of one year. If the bank is unable to enforce the decree due to the inability to provide details of the assets owned by the judgment debtor and the bank is unable to perform the recovery of the statutory membership fee within the maximum period of one year, the bank shall file an application to the court under Order 21 Rule 41 of the Civil Procedure Code, Section 28(4)(a) of the DRT Act, that requires the judgment debtor to disclose the specific circumstances of its assets.

²²MuniyappanG.P, *The NPA Overhang: Magnitude, Solutions, & Legal Reforms, Bank Credit-Emerging Trends*ICFAI, Hyderabad, 122, 132 &133, (2002).

4.1.5 Assignment of decrees

Banks may also consider transferring or complete sale of decrees. For the purposes of the sale or transfer of the decree, the value of the decree will be the amount prescribed by the court and the interest rate specified in the decree, but the decree is not marked as satisfactory and is handed over to the entire dues of the decree after deduction is received.

When appointing a recovery agent or law enforcement officer, it must be carried out on a case-by-case basis. The branch office should sign a written agreement with the agent in the form of an agent, which explicitly mentions the recovery and charging terms must be clearly mentioned. A copy of the agreement formally accepted by the agent shall be recorded. This program helps to avoid any controversy in the future. Most importantly, individuals and companies acting as bank agents have a reputation and do not violate any of the guidelines set by the Reserve Bank of India.

4.2 SARFAESI Act of 2002:

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI) 2002. When the borrower fails to repay the loan, the Act authorizes banks and financial institutions to auction residential and commercial properties. It enables banks to reduce their NPA by taking recovery or reconstruction measures. The Act provides for three recovery methods:

- I. *Securitization* - This is the process of converting the assets of the borrower's dues into securities that can be sold to investors.
- II. *Asset Re-construction*, that is, reconstruction of assets by Asset Reconstruction Companies (ARC) make them available for sale. ARCs buy bad assets from banks, reconstruct them and sell them on the market. It must be noted that the bank can only sell the NPA to the ARC, only when the NPA is retained as an NPA for two years. Therefore, ARCs help to

clean up bad loans on the balance sheet.

- III. *Enforcement of Security Interests* - The SARFAESI Act requires banks and financial institutions to own securities for financial assistance and sell the securities in case of default without any judicial intervention.²³

Before enforcing a security interest, the branch office should ensure that the loan account meets the following criteria -

1. Contractual dues in the account should be greater than Rs. One lakh.
2. The default value must have occurred, i.e. the account should have become as Non-Performing asset according to the RBI specification.
3. The guarantees charged to the bank must be specific, clear and available to the bank, so if the borrower fails to pay as notified, it can be enforced. The security documents in the prepaid account are effective as of the date of delivery, 60 days' notice in advance. As a matter of sufficient caution, it should be ensured that they will take effect even at least one year after the date of the offer of the guarantee, even if the action will be taken.
4. Security documents should be properly filled out and the columns must not be left blank.

Either the bank must be the sole banker of the borrower, that is, 100% of the loan is completed by the bank, or in the case of a joint loan, at least the lender representing at least 75% of the contract amount agrees to take action. If it is a multi-bank business, if the securities are specifically charged, the bank can proceed because it is the only

²³ Carlton Pereira, *Investing in NPAs: Will Investors Bite?* Vol. 39, ECONOMIC AND POLITICAL WEEKLY, 4602-4604, 2004, <https://www.jstor.org/stable/4415668>

banker. Even in BIFR referral cases, it is applicable to bring a case and action can be taken.²⁴

4.2.1 Exemptions

The following exemptions are subject to the scope of the Act: -

- a. Accounts where the contractual dues are less than Rs. One lakh.
- b. When establishing a security interest in agricultural land. However, if it is a guarantee for bank advance payments, other agricultural-related assets, such as tractor tools, can be enforced.
- c. The remaining unpaid amount of the contract is less than 20% of the principal, which is the total amount and interest paid.
- d. Pledged assets, liens/assets for lease or hire purchase financing are not included.

4.3 SICK INDUSTRIAL COMPANIES ACT, 1985

4.3.1 Board for Industrial and Financial Reconstruction (BIFR)

Board for Industrial and Financial Reconstruction (BIFR) is a body constituted under *Sick Industries Companies (Special Provision) Act (SICA) 1985*. It is a quasi-judicial body with the power to take legal action against promoters who commit errors and fail to comply with SICA rules. It has the power to summon and record evidence and has powers to override certain provisions of the company law.

Reference

1. All sick industrial companies which are -
2. Engaged in manufacturing/processing activities, employing 50 workers or more.

²⁴ M. K. Datar, *Redefining the Debtor-Creditor Relationship: NPA Ordinance*, Vol. 37, ECONOMIC AND POLITICAL WEEKLY, 3786-3789, (2002), <https://www.jstor.org/stable/4412597>

3. Registration for 5 years or more.
4. Whose net worth has completely been eroded as at the end of any^[1]_{SEP} financial year required to make reference to BIFR, within 60 days from the date of adoption of annual accounts/ audited balance sheet at the Annual General Body of the concerned company or where the Board of directors have come to the conclusion that the company has become sick Industrial company.²⁵_{SEP}

4.3.2 Appellate Authority for Industrial and Financial Reconstruction (AAIFR)

If either party is dissatisfied with any of BIFR's orders, the affected party may appeal to the to *Appellate Authority for Industrial and Financial Reconstruction (AAIFR)* within 45 days of the order's effective date.²⁶

4.4 BID POLICY

Although the bank successfully obtained an auction order from the court or the DRT, the actual implementation and realization of the benefits were repeatedly excluded mainly for the following reasons: -

- Due to the influence of the defendant, no bid offers were not received many times by DRTs, resulting in the scheduled auction being postponed more than once.
- Instances shows that in the absence of a bidder in the lawsuit, the court or Debt Recovery Tribunal has indicated to the bank that such an execution request will be treated as ungratified.

²⁵*NPAs and Beyond*, ECONOMIC AND POLITICAL WEEKLY, Vol. 37, 2839-2840, Jul. 13-19, 2002, <https://www.jstor.org/stable/4412342>

²⁶Prof. Reddy C. Sivarami and Smt. Alavathi V.K., *Non-Performing Assets in Banks-Causes and Remedies*, Edited by B.Ramchandra Reddy, Management of Non performing assets in Banks and Financial Institution.

This would mean that our resource for recovery is affected adversely. In all cases where the court or Debt Recovery Tribunal has issued a bid or auction order, and the bid price has not been received prior to the auction bid, the bank may consider purchasing the bid of suit property after obtaining appropriate approval, as appropriate level²⁷.

4.4.1. Revenue Recovery Act

The Talwar Committee recommended a simplified procedure to recover the commercial bank dues financed by the state government funding program. These recommendations have been accepted by most major states. However, the results of recovery are not encouraging.

4.5. ASSET RECONSTRUCTION COMPANY

The Securitization and Reconstruction of financial Assets and Enforcement of Security Act 2002 requires financial institutions to sell financial assets to securitization companies/reconstruction companies. The salient features of these guidelines as decided by the Reserve Bank of India to sell assets to Asset Reconstruction Companies (ARCs) are as follows.

- Financial assets can be sold to ARC through any Financial institution or banks where the assets are
 - NPA including Non-Performing bond / debenture. [SEP]
 - A standard asset where asset is under consortium or such banking arrangement wherein 75% by value is classified as NPA and and available to sale as ARC. [SEP]
- The sale of the above assets should on the “without recourse” basis, which means that it is being transferred to ARC and bears all the credit risks associated with the assets.

²⁷ Dr. Kulkarni J.B., *Non-Performing Assets Management*, Shivaji University.

- Financial institutions that recommend the sale of assets to ARC must ensure that sales are carried out in a prescribed manner and in accordance with policies approved by the Board of Directors. The policy of the board of directors should cover the type of financial assets to be sold, the specifications and sales procedures, and the valuation. In cases of consortium/multiple bank arrangements, if 75% (by value) of the bank/financial institution decides to accept the offer, the remaining banks/financial institutions will be obliged to accept the offer.

- Banks that sell assets to ARC will be required to make the following disclosures in the accounts of their balance sheets.
 - No of accounts
 - Aggregate value (Net of provision) sold to ARC
 - Aggregate consideration.
 - Additional consideration received, if any, in respect of accounts transferred earlier years.

There are currently two asset rebuilding companies in India, they are-

- *ARCIL (Asset Reconstruction Company of India Ltd.)* is promoted by ICICI Bank, SBI, Punjab National Bank, IDBI, etc.²⁸

- *ARECI (Asset Reconstruction Company of India Ltd.)* where main sponsors are UTI, Bank of India, Allahabad Bank Standard Ban, etc. Based on available data, ARC has obtained more than 475 accounts from banks/financial

²⁸*NPAs and Beyond*, ECONOMIC AND POLITICAL WEEKLY, Vol. 37, 2839-2840, Jul. 13-19, 2002, <https://www.jstor.org/stable/4412342>

institutions, with outstanding dues of Rs 20,000 crores and security receipts are worth more than Rs. 5300 crores.²⁹

4.6 INSOLVENCY AND BANKRUPTCY CODE, 2016

Under the *Insolvency and Bankruptcy Code, 2016* with regard to NPA's, the moment a case is referred to the NCLT, banks have to make a 50 per cent provisioning for the loans in their accounts. If it goes into liquidation, banks have to make a 100 per cent provision for the loan. Under the Code it states that in case of sale of a NPA, if the banks get a buyer for the asset, there are high chances of enormous cut. In cases of failure to find a buyer, the property goes into liquidation and banks end up losing almost all the money they lent. Thus, IBC finally provides a way to end the issue of NPA's in the balance sheets of the banks, but does not help banks in recovering the money lent.

4.7 CONSENSUAL MECHANISMS:

- *Remind system:* One of the cost-effective ways to recover is to send a reminder to the loan borrower before the loan installment falls due. This encourages the borrower. However, banks need to strengthen these efforts when sending reminders in a timely manner.
- *Visit the borrower's business residence:* This recovery is said to be the best and must be planned accordingly. The staff who from employees to the managers must be called. The cost of recovery must be at a very low price. Regular visits must be made only in case of high amount of loan borrowers. Nowadays, it is observed that the number and quality of visits are reducing.

²⁹ Vora K.H., *Management of Non –Performing Assets and Role of Asset Reconstruction Company*, Recent Trend in banking.

- *Recovery camp:* In case of agricultural loans, various recovery camps should be set up during the harvest season. For maximum advantage, recovery camps need to be effectively planned. It is also vital to take the help of outsiders like revenue officers in the state government and also local panchayat officer's regional approach to give a wide publicity of the recovery camps which are to be organized in the local areas and mobilize as many farmers as possible and motivate the staff in the recovery drive.
- *Rephrasing the Unpaid Loan Installments:* With respect to the small loans taken, the bankers need to give extra time with respect of sincere and hardworking borrowers. And if such borrowers fail to pay loan installments due to various natural calamities or for some other convincing reasons, the unpaid loan installments may be replaced. Banker's efforts need to be strengthened and made flexible in this regard.
- *Rehabilitation of Sick Units:* Both the Sick units SSI and non SSI sectors should be identified on timely. The causes of sickness should be genuine and not duplicate. If the project is found free from defects in terms of Debt Service Coverage Ratio (DSCR), rehabilitation package has to be prepared keeping in mind the broad parameters suggested by the Reserve bank. The package should be implemented at the earliest by borrower and the bank. Close supervision of the progress of implementation is called for. It is observed that the success rate in revival of sickness is to be discouraging. Secondly, in the process of reforms made in financial sector, financial institutions and banks are hesitant to rehabilitate due to threat of failure in the rehabilitation process.
- *Loan Compromise:* It should be voluntary. This calls for a professional approach in preparing the compromise proposal for which, each bank is expected to introduce a scheme. Committee approaches should be adopted to decide on the loan compromise. Any delays in taking decisions should be avoided. OTS or (one

Time Settlement) scheme was introduced by the Reserve bank. The overall response to this scheme was limited. And hence, each bank is expected to come out with its own OTS. In addition, training of operating staff is essential to change their mindset. For efficient and effective non legal recovery mechanism, this method must be given priority.

- *Appointment of Professional Agencies for Recovery.*The IBA has worked out certain guidelines for the banks on matters concerning for the appointment of outside professional agencies whose services can be used to ascertain the position of the borrowers and enforcement of securities. As there is some hesitancy on the part of public sector banks in engaging them for the recovery purposes due to unpleasant experiences in certain cases. It should be done after examining the credentials of these professionals. It is also necessary to keep a constant watch on their practice.

CHAPTER 5

ROLE OF DEBT RECOVERY TRIBUNALS AND NATIONAL COMPANY LAW TRIBUNALS

5.1 DEBT RECOVERY TRIBUNALS

Prior to the establishment of Debt Recovery Tribunals, all loan recovery cases were heard in the civil courts. This delayed the process of deciding the cases. Thus, there was an immediate need to establish separate tribunals called Debt Recovery Tribunal (DRT). The Debts Recovery Tribunal has been constituted under Section 3 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993. The main aim objective of DRTs was to hear applications from Banks and Financial Institutions against their defaulting borrowers. To aid the procedure thereof, the Debts Recovery Tribunal (Procedure) Rules 1993 were also drafted.

During the initial stages, the Debts Recovery Tribunals was ineffective in its functioning and helped the Banks and Financial Institutions recover substantially significant parts of their NPAs, but their progress was stunted when it came to large and influential borrowers. The borrowers used various reasons to delay the progress in the Debts Recovery Tribunals on various grounds, primarily on the ground that their claims against the lenders were pending in the civil courts, and if the DRT were adjudicating the matter and auction off their properties irreparable damage would occur to them.

Despite the problems stated above, there still exists drawbacks. The dues of employees against a firm, the dues of the State, and the dues of other non secured creditors all got trapped before the DRTs. It was also noticed that there was clash of jurisdiction between the Official Liquidators appointed by the High Courts and the Recovery Officers of the DRTs. The High Courts were unfair against the activities of the Recovery Officers who took away the entire amounts and paid off to the banks leaving

nothing for the other claimants, including the work men. Such loopholes lead to drastic amendments to the Recovery of Debts Due to Banks and Financial Institutions Act by means of a notification in 2000.

The notification issued in the year 2000 was rational towards the jurisdiction of DRT, yet it was not sufficient to coax the big borrowers to acquiesce to the jurisdiction of the Debts Recovery Tribunal easily. The lender continues to squat under the weight of NPAs. This has led to a more intense act, The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2000, SARFAESI or SARFAESIA. The Debt Recovery Tribunal now deals with two different bills, the “Recovery of Debt for Banks and Financial Institutions Act” and “The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act”, purpose of the two bills is the same, their route is different.

The debt recovery court must deal with very complex commercial laws within the narrow scope of the two laws. Over the years, the debt recovery court has evolved into an excellent institution with a varied expertise. The Supreme Court and the various High Courts have decided too many judgments, which have paved the way for the DRT to develop its own curriculum. The Debt Recovery Tribunal in India has become a model institution that many countries follow.

When the borrower fails to repay the funds to the bank, the bank can take measures to recover the loan, that is, file a civil lawsuit in advance. We all know that traditional civil courts have delayed the delivery of justice, and because of the inevitable delays, banks are unable to effectively recover their contributions, leading to liquidity problems. Banks pay interest to deposit holders; however, banks cannot make money by using such deposits because they often delay the recovery process. This led the

government to establish various committees for financial reforms. Among other factors, effective recovery by banks and financial institutions was mainly focused.³⁰ As a result, the government enacted a law called the “The Recovery Debts Due to Banks and Financial Institutions in 1993”, under which a DRT was formed to recover the loans due by certain banks and financial institutions. The RDDBI Act of 1993 required banks and financial institutions to approach the DRT by submitting an application for reimbursement of payment. According to the RDDBI Act of 1993, only in accordance with the provisions of the Act, banks and financial institutions can approach the debt recovery court, only when the due amount qualifies under the Act. When the bank approaches the DRT for recovery, the court will investigate the bank’s claim, in accordance with the procedures set out in the RDDBI Act 1993, the finally decision is passed and the award can be executed by the bank.

5.1.1 Debt Recovery Tribunal as a Non-Performing Asset

Although special tribunals such as the DRTs were established under the RDDBI Act of 1993, the bank was unable to recover its dues within the extent expected. This led to further reforms in the process and reduced delays in its ruling.

With the implementation of financial reforms and extending the aim and object of RDDBI Act,1993 the government promulgated the “The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002”. The SARFAESI Act of 2002, aims to reduce the delay between the process of rulings between banks and their borrowers. When the borrower defaults on debt repayment, banks and financial institutions; there arises the question of recovery problem. When there is a default, the bank will classify the account as “NPAs” according to the standards set by the Reserve Bank of India.

³⁰ Sujata Visaria, *Legal Reform and Loan Repayment: The Microeconomic Impact of Debt Recovery Tribunals in India*, Vol. 1, American Economic Association, 59- 81, (July 2009).

The DRTs established by the Government of India under the Parliamentary Act (Act 51 of 1993) to for effective and faster recovery of the debts due to banks and financial institutions. If a bank or financial institution must recover any debt from anyone, it submits an application to the tribunal called the Original Application (OA) against such defaulter. The DRT operates under “The Recovery of Debts of Banks and Financial Institutions Act, 1993 and the Debts Recovery Tribunals (Procedures) Rules, 1993. The provisions of “Recovery of Debts Due to Banks and Financial Institutions Act, 1993 are not applicable, if the debt of a bank or financial institution or a consortium of banks or financial institutions is less than Rs. 100,000 rupees or any other amount (not less than 100,000 rupees), the central government may, specify through a notification.

According to the regulations, the applicant should submit the application with the Registrar within the jurisdiction of the applicant, and such an applicant is currently operating as a bank or financial institution (as the case may be). Each application submitted under section 4 of the DRT (Procedures) Rules, 1993, shall be stated under the different heads. The reasons for such applications and such grounds shall be numbered consecutively and shall be doubled on one side of the paper.

It is noticed that the Act seems to be misused. However, it is unreasonable to say that the Act oppresses borrowers. This is a special and balanced Act with good objectives and is said to be implemented effectively. Given the many transactions and issues, banks and financial institutions may make some mistakes in the course and cause the borrower to seek stay in the tribunal’s proceedings. Typically, the borrower seeks from the bank to allow him to settle the account under the “One Time Settlement” scheme. According to the guidelines set by the Reserve Bank of India, banks may accept the “One Time settlement plan” or not.

In majority of cases, the borrower ignores the bank's notice issued under Section 13(2) and then approaches the DRT when the bank takes steps to seize the property and take

such steps to sell the property, which is said not be right. When receiving a notice under section 13(2), the borrower must provide a detailed objection, otherwise, his appeal under section 17 of the Act may not be sustain normally.

Therefore, borrowers should be cautious when the bank exercises its powers under the SARFAESI Act of 2002 and with expert guidance and assistance; they can effectively protect their rights.

Critics pointed that:

- Failure due to lack of proper appointments and infrastructure
- Delay
- There are many grey areas in the law
- The process of recovery did not improve

Section 17 of the “Recovery of Debts Due to Banks and Financial Institutions Act, 1993 “RDB Act” stipulates that DRT has the jurisdiction to “accept and decide institutions that banks and financial institutions apply to recover such debts due to banking and financial services”. The term “Debt” is defined in Section 2(g) as “any liability the bank has to deal with during the course of its business activities”. Therefore, DRT’s jurisdiction extends not only to traditionally understood debt, but also to any claims made by banks in the course of their business. Section 18 stipulates that there is no court other than the Supreme Court and the High Court under Article 226 shall have any jurisdiction over these matters. In 1995, the constitutionality of the DRT was successfully questioned in the Delhi High Court, which held that the court could not function effectively because it did not make any provision for filing a counterclaim. Subsequently, the “RDB Act” was amended and the Supreme Court upheld the constitutionality of the amendment Act. In fact, the borrower has the right to file a “counterclaim” under Section 19 of the “RDB Act”.

5.1.2 Impact of Failure of Debt Recovery Tribunal

1. *Profitability*

NPA refers to the booking of money due to bad assets, which is caused by customer/borrowers. This, NPA will not affect current profits, but will also affect future profit flows, which may lead to some long-term favorable opportunities to lose. Another impact of the decline in profitability is the low return on investment (ROI), which has a negative impact on current bank earnings.

2. *Liquidity*

The funds were blocked and the profit was reduced, resulting in insufficient cash on hand and the shortest time to borrow, which led to the company to increase costs. The difficulty of operating functions of the bank is another reason for NPA due to lack of funds.

3. *Involvement of Management*

The time and effort of management is another indirect cost that banks must bear for NPA. The time and effort of management in managing and treatment of NPA will shift to some fruitful activities that could have paid off. Now, banks have special employees to handle and process NPA, which is the extra cost of the bank.

4. *Credit Loss*

If a bank faces an NPA problem, it has a negative impact on value of bank of the credit market. It will lose its goodwill, brand image and credibility, and will have a negative impact on those who invest in the bank.³¹

³¹Shobhit Batta, *Debt Recovery Tribunal - A Non - Performing Asset*, Live Law, 28thFebruary, 2019, <https://www.livelaw.in/debt-recovery-tribunal-non-performing-asset/>

5.2 ROLE OF NATIONAL COMPANY LAW TRIBUNAL (NCLT)

According to the announcement made budget in 2001-2002, Sick Industrial Companies Act (SICA) will be repealed and the Industrial Finance and Reconstruction Commission (BIFR) will be wound up. As another arrangement, it is recommended to establish the NCLT by modifying the "Company Law", 1956. It is expected that NCLT will consolidate the powers of BIFR, the High Court and the Company Law Board to avoid multiple forums. In the case of rehabilitation of sick units, all parties concerned should abide by the NCLT order. There should be 10 benches, which will deal with rehabilitation, reconstruction, and winding up of companies. It is estimated that the entire process will be completed in two to three years, currently 10 to 12 years.

A rehabilitation and revival fund will be constituted to make interim payment of dues to workers of a company declared sick or under liquidation, for protection of assets of sick company and to rehabilitate sick companies. While NCLT will be acting on the lines of BIFR in the matter of rehabilitation, viability of the projects will be assessed on 'cash test' and not the present 'net worth' test. Another important change will be in respect of time limit for completing each formality relating to rehabilitation and winding up. Although the bill is well drafted to ensure that NCLT is more time-efficient and more effective than BIFR in rehabilitation and liquidation, the implementation of the bill is questioned given the current political organization.

In India, the IRP (Insolvency Resolution Process), in the past involved many statutory instruments in its operation. This included, SICA (Sick Industrial Companies Act, 1985, the SARFAESI Act (Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act) 2002, RDDBI Act (Recovery of Debt Due to Banks and Financial Institutions Act), 1993 and the Companies Act, 2013³². All these statutes provided for effective methods of or restructuring of debt, seizure of assets,

³² The two main statutes dealing with insolvency and associated resolution proceedings among individuals. These are the Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920.

etc. in order to recover the debts³³. It is clear that a large number of statutes involving bankruptcy and liquidation has led to a huge chaos in the legal system and a thorough overhaul. All of these various legal measures, as well as the delaying of a justice in the court system, have led India to witness the accumulation of a large number of non-performing assets, and creditors have finally waited for many years to recover their funds. The “*Bankruptcy Code*” aims to comprehensively reform the improper corporate insolvency system so that credit flows more freely in India and gradually instill confidence in investors in order to deal with their claims quickly. The Code incorporates existing legislation relating to the insolvency of corporate entities and individuals into a single piece of legislation. The Code harmonizes laws relating to the enforcement of creditors’ statutory rights and simplifies the way in which debtor companies can recover their debts to maintain their debts without undermining the rights of creditors.

The Insolvency Resolution Settlement procedure is initiated in the event that the debtor is unable to repay the debt. The “Code” distinguishes between operating creditors and financial creditors. A financial creditor means that the relationship with the debtor is a pure financial contract in which the amount has been provided to the debtor who objected to the consideration of the time value of money (“financial creditors”). Recent reforms have attempted to address concerns of homebuyers’ by treating them as “financial creditors.” According to the recently enacted Ordinance, The Insolvency and Bankruptcy Code (Amendment) Ordinance (2018) (the “Ordinance”), the amount raised from allottee of a real estate project (the buyer of a residential or commercial property under construction) will be treated as “financial debt” due to such amount has the commercial impact of borrowing³⁴. The Ordinance

³³ It must be noted that creditors having outstanding debts continue to have the right to approach an appropriate forum like civil courts or arbitral tribunals for recovery of debts which would be a contractual right of recovery.

³⁴Explanation to Section 5(8), Insolvency and Bankruptcy Code, 2016 (As amended by the Insolvency and Bankruptcy (Amendment) Ordinance, 2018).

does not clarify whether its allottee' is a secured or unsecured financial creditor. Such classification will be subject to an agreement between the purchaser and the corporate debtor. In the absence of a clear allottee, their priority may be uncertain when collecting contributions from insolvency proceedings. An Operational creditor is a creditor that provides goods or services to the debtor, including central or state governments, employees ("operating creditors").

If the debtor company wants to use the clearing mechanism i.e. take recourse to the Code, it can Code for liquidation. If the creditor cannot be repaid, the company can choose a voluntary IRP (Insolvency Resolution Process) settlement procedure - the company can approach the NCLT itself to recover or liquidate the measures.

All procedures relating to corporate insolvency under the Code should be determined by the NCLT, which is designed to be a special forum for addressing all aspects of a insolvency resolution. NCLT is known as the adjudicating authority in respect of corporate persons in insolvency. Other courts or tribunals may not issue a stay order for litigation previously initiated by NCLT. Appeals from the NCLT order are filed by the National Company Law Appellate Tribunal ("NCLAT").³⁵All appeals of the NCLAT Order shall be filed in Supreme Court of India³⁶. The NCLT shall have jurisdiction and powers as that of the civil courts under the IBC³⁷.In addition the provisions of Limitation Act of 1963 shall be applicable under the Code³⁸. Therefore, time-barred claims cannot be initiated for insolvency.

In cases where restructuring of debts is not possible, the Company Law Tribunal may direct for dissolution of the company. The Code provides for a two stage process, firstly, revival and then second, liquidation:

³⁵ Section 61, Insolvency and Bankruptcy Code, 2016.

³⁶ Section 182, Insolvency and Bankruptcy Code, 2016.

³⁷Section 231, Insolvency and Bankruptcy Code, 2016.

³⁸Section 238A, Insolvency and Bankruptcy Code, 2016 (As amended by the Insolvency and Bankruptcy (Amendment) Ordinance, 2018).

1. Corporate Insolvency Resolution Process (“*Insolvency Resolution Process*”)
2. Fast-Track Corporate Insolvency Resolution Process (“*Fast Track Resolution Process*”)
3. Liquidation

IRP (Insolvency Resolution Process and Fast-Track Resolution Process are measures to help recover a company. The Code seeks to first examine the possibility of a company debtor’s failure to reinstate, and the entity will be liquidated.

It is clear that the Indian government is making every effort to improve the convenience of doing business in India. So far, the legislature, the Reserve Bank of India, the SEBI and the judiciary have proposed a unified front in India. Any loopholes arising will be removed at the earliest and the law will be developed. So it's no surprise that, in 2019, India has ranked in top in 30 developing countries around the world, for retail investment and insolvency resolutions processes have become more streamlined, consolidated and fast.

5.3 JUDICIAL DEVELOPMENTS

Recently, the judiciary has played a vital role in delivering judgments which has contributed to the growth of Insolvency and Bankruptcy Code. These common theme in these decisions are: -

- Effective implementation of Insolvency and Bankruptcy Code.
- To maximize the value for creditors, shareholders, and investors.
- Treating all the creditors in fair and equitable manner, without any particular category.
- Protecting the spirit of the Code through adopting innovative measures.

In the case of *ArcelorMittal India Private Limited &Ors v. Satish Kumar Gupta &Ors*, determined the eligibility of the bidders. The eligibility criteria as stated under Section 29A of IBC applies to a resolution applicant, entity or any person acting jointly with

such resolution applicant fulfilling specific conditions. “The Supreme Court discussed the provisions of Article 29A of the IBC and considered that Section 29A required the company for lifting of corporate veil. The Supreme Court further held that basis the facts of the case,^[1] it can be deduced that if certain persons were acting jointly in a manner so as impute that such persons were acting together then such persons will fall under the expression of “persons acting jointly”. In addition, while the phrase “persons acting in concert” has not been specifically defined under the IBC, the Supreme Court, while taking into consideration precedents and existing laws, held that the phrase shall have the same meaning as assigned under the SEBI Takeover Code. The Supreme Court also discussed the meaning of the terms “management” and “control” under Section 29A where it held that management refers to de jure management of the corporate debtor and “control” will only cover positive or proactive control and not any sort of negative control”.³⁹

In *Jagmohan Bajaj v. Shivam Fragrances Pvt. Ltd & Another*⁴⁰, dealt with the overriding powers of Insolvency and Bankruptcy Code. In this case the NCLAT held that the CIRP cannot be defeated when the Directors of Corporate Debtor file an application, when there is already existing internal dispute for allegations of oppression and mismanagement. The Insolvency and Bankruptcy Code is a special law that has an overriding effect on any other law as provided under Section 238 of the Code. Therefore, the statutory rights of financial creditors cannot be subservient to such proceedings pending under sections 241 and 242 of the “Companies’ Act 2013” dealing with oppression and mismanagement.

In the case of *Leo Edibles & Fats Limited and The Tax Recovery Officer (Central), Income Tax Department, Hyderabad and others*⁴¹, discussed that in case of conflict

³⁹CA No. 9402 – 9405 of 2018.

⁴⁰CA (AT) (Insolvency) No. 428 of 2018.

⁴¹Writ Petition No. 8650 of 2018.

between the provisions of IBC and Income Tax Act, 1961, the provisions of IBC shall prevail over the IT Act, 1961. The main issue in this case was that settling of dues by the IT authority during the company's liquidation. The High Court of Telangana held that, where an Assessee company is under liquidation process under the Insolvency and bankruptcy Code, the IT authority cannot ask for clearing of tax dues, under the Income Tax Act. In addition, the High Court further held that moratorium as stated under IBC ensures any suit initiated prior to the commencement of the Insolvency Resolution Process, shall be suspended.

In *Binani Industries Limited v. Bank of Baroda & Another*⁴², dealt with the disparity in making payments to financial creditors. The NCLAT held the insolvency resolution plan as submitted by the petitioner was discriminatory as the treatment between the financial and operational creditors was different and unequal. Thus, the NCLAT held that such disparity or unintelligible discrimination among equally placed creditors would result in invalidating such a resolution plan under IBC by the Company Law Tribunal.

According to the author some of the findings for the increase of NPAs include:

1. Default caused by the customer.
2. Lack of inspection of the borrower.
3. Lack of professional management.
4. Lack of proper balance of inventories.
5. Very poor credit allocation.
6. Lack of proper trained staff.

⁴²CA (AT) (Insolvency) No. 82 of 2018.

CONCLUSION AND SUGGESTIONS

CONCLUSION

Non-performing assets is considered to be one of major threats faced in the Indian Banking system. The value of Non-Performing Assets reflects the efficiency and performance of the banking industry in India. Through this study it was noted that increasing level of NPAs affects the efficient circulation of funds in the banks, as a result the economy as a whole is affected. The author, in literature review has made an in-depth study on the various studies conducted by groups and individuals, wherein a few article reviews include on the meaning, causes and reasons for the growth of NPAs; while the other articles majorly dealt with various measures initiated by RBI, measures and suggestions made by groups and individuals, for reducing the level of NPAs. The author also focused on such internal and external factors responsible for the rise of NPAs. In chapter three, the author analyses various existing legal statutes and other consensual mechanisms which were established to curb NPAs. Various legislations enacted by government include Recovery of Debts Due to Banks and Financial Institutions (RDDBFI) Act, 1993, Debt Recovery Tribunals, Corporate Debt Restructuring mechanism (CDR), Strategic Debt Restructuring (SDR), Lok Adalats, SARFAESI (The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest) Act 2002, Asset Reconstruction Companies (ARCs), and recently Insolvency and Bankruptcy Code, for effective, efficient and faster recovery of NPAs.

In 2017, it was noticed that India was ranked 130 out of 190 countries, published by world bank in its report "*Doing business*". The main problem for such rapid increase in NPAs was said to be due to inefficient insolvency resolution mechanism in India. Thus, finally Insolvency and Bankruptcy Code was notified in 2016, wherein it incorporated all the existing insolvency resolution laws into one unified Code for both corporate and individual debtors.

The enactment of Insolvency and Bankruptcy Code,2006, the recovery of NPAs was said to have taken comparatively longer time i.e. years and not months. The “*Bankruptcy Code*” aims to comprehensively reform the improper corporate insolvency system so that credit flows more freely in India and gradually instill confidence among the investors in order to deal with their claims quickly. The Code incorporates all existing legislations relating to the insolvency of corporate entities and individuals into a single piece of legislation. This code has brought about stringent recovery mechanisms for NPA’s, it is the moment a case is referred to NCLT, banks have to make a 50 % provisioning for the loans in their accounts. If it goes into liquidation, banks have to make a 100% provision for the loan. Thus, in either way, the banking business is affected drastically under the Code.

In future, the problem of non-performing assets will continue to be the main cause of concern for banks. To improve the bottom line of the banking industry, it will become more important to absorb credit management skills. Access to expertise in monitoring exposure levels, industry scenarios and timely action in troubled industries becomes critical. NPA management skills, including negotiation, compromise, formation of an active settlement advisory committee, restructuring and recovery, effective resort to appropriate legal remedies, etc., to supplement the government's most appropriate legal reforms, timely recovery of dues, so that the financial stability of the banking industry is not undermined. There must be clear distinction between real and willful defaulters, and any strategy addressing the problem of Non-Performing Assets, should be developed to truly combat willful defaulters. Regardless of whether it has an effect on banks or not, its assets should be declared as national assets and disposed of in a transparent manner without any legal impediments.

Overall, it was observed by the author that neither of these statutes exclusively or specifically dealt with the regulation of internal management/ staff of the banks. It is suggested that there is a need for enactment of a separate and exclusive Act which establishes rules of professional conduct and punishment for such

professional misconduct. It is further suggested that perks, gifts and other incentive must be given to employees for early identification and taking sincere action against the defaulters. In this way, every employee will be motivated to perform his duties and avoid insider dealings with the influential borrowers. In addition, there must be a fixed criterion for selecting genuine borrowers and consider factors such as past loan repayment history, current status, borrower's business status, etc. Different amounts must be categorized according to the credibility and status of the borrowers. The author concludes, in doing so, along with the existing legal regime, the separate Code for regulation of internal management would drastically reduce the increasing level of NPAs at very nascent stage.

SUGGESTIONS

As the Reserve Bank of India for asset classification in 2004 becomes more stringent, there will be increase in NPAs substantially. Although some measures have recently been introduced, including CDR mechanisms, "One Time Settlement" scheme, the establishment of the SARFESI Act, the setting up of ARCIL, etc., there is still a lot of need for the effectiveness of these measures.

The process of winding up companies' sale of assets must be simplified. An important factor in the detection of NPAs is the need to strengthen Early Warning Signals (EWS). Some of the suggestions for improvement that have been identified are discussed below:

➤ *Credit risk management*

It is recommended that a credit risk management framework be established as part of the integrated risk management, and RBI has issued a detailed description. At present, some banks have begun to follow the RBI directives, but there is still a lot of work to be done. This requires recording the credit risk assumed at the time the credit is granted and periodically reviewing it. CRM focuses on matching credit risk to capital

adequacy or setting rules to compensate for anticipated losses at the time of default. Increasing global competition, increasing deregulation, introducing innovative products and delivery channels, have pushed risk management to the forefront of today.

➤ *Setting up of Research Department for the Evaluation of Risk*

One area that banks lack is a strong database in every industry. Therefore, it is recommended that banks should set up research institutions to understand the risks associated with individual industries in the economy. This is not only the risk of the entire industry, it should be continuously studied, but also the risks of the main factors affecting industry performance. Although banks are currently using various industry data provided by the Centre for Monitoring Indian Economy (CMIE), these data are more relevant to performance indicators than to any risk exposure guidelines. Since setting up a research institution is an expensive proposal, all banks can first concentrate resources and start a joint research institution or a few banks to work together. Each bank will conduct detailed research and share the results of two or three industries among themselves.

➤ *Internal Checks and Systems for Early Identification of NPAs.*

The main objective of these systems should be to “*reveal not conceal*” the NPA issue. The continuous monitoring of credit officers is the first line of defense to identify problem loans. The next step should be a term loan review. External inspection is the last line of defense. It is recommended to increase the frequency of preparing for “*Know Your Customer*” (KYC)/Credit Report. Currently, this information was originally compiled at the time of sanctioning of credit facility and is updated more frequently, at least quarterly. It is also recommended that if the borrower does not comply with the loan contract, the loan rating must be reviewed immediately and the matter reported to the headquarters. In addition, management information systems

must be improved to facilitate detection of "early warning signals." Key reports will help loan officers detect recommended problem accounts, including:

- A monthly loan concentration report should be provided at the branch level to show the concentration of portfolios by industry, geographic location, etc.
- Monthly account activity report to identify any unusual transactions.

It is also recommended to gradually shift to international norms in order to classify and provide national action programmes. Once banks critically review loan portfolios, identify assets that show signs of initial disease, and classify them based on disease severity, banks will be more likely to monitor them effectively, make regulations as needed, and take corrective actions to ensure that these assets do not migrate to non-performing category. This will also enable banks to control the growth of national action plans due to the 90-day regulated asset classification.

➤ *Special investigation Audit*

If the lender suspects that the funds are transferred, the management is not good, genuinely of the promoters, etc., it is recommended to conduct a special investigation and audit of all financial/commercial transactions and books of the borrower's company to identify the real factors that cause the disease. It is useful to appoint a consultant as early as possible to check the following:

- Analyze the borrower's three- to four-year history and current financial statements based on the financial performance of comparable companies in the industry, covering key revenue and expense leaders to identify significant differences and seek explanations from company management.
- Assess the current state of major assets and liabilities.
- Review the relationship between the use of funds and the purpose for which they are raised.

- Benchmark capital expenditures and company working capital based on industry norms to identify differences and seek the same interpretation from management.
- Review the company's transactions with sponsors and their associates, as well as rights that are closely related to their reasonableness and property.

➤ *Analysis of strategic choices.*

It is recommended that a detailed strategic selection analysis be conducted or outsourced, based on the following methods, prior to determining the appropriate reorganization of the NPA:

- Analyze the company's current financial situation.
- The company's expected future performance.
- Analyze the history of the borrower's company and current financial statements.
- SWOT analysis should be evaluated through various parameters, namely the strengths, weaknesses, opportunities and threats associated with each compromise proposal. Each parameter should be awarded some points based on its relative weight, so the overall marks will be determined for each proposal and the concessions will be determined based on these ratings.

➤ *Negotiation settlement.*

It is recommended that where banks have gone in for negotiated settlement in such NPAs where restructuring option was not feasible and to avoid legal delays, transparent procedures should be put in place to ensure effectiveness of compromise settlement entered into by banks with borrowers to ensure that vigilance issues do not arise at a later stage.

➤ *Asset Reconstruction Company Market in India*

It is important to eliminate legal, tax and procedural barriers as early as possible to ensure the development of the Asset Reconstruction Company market in India. Under the SARFAESI Act, the proper environment for the development of defective asset markets and various institutions to help them carry out their activities must be taken care of. It is recommended to use a bidding procedure to sell NPAs that can find prices in a transparent and objective manner. Initially, this may not be possible in the early stages of ARC market development, in which case the lender may find it useful to have independent and experienced professional consultants participate in the evaluation of the NPA, which are proposed to be transferred.

➤ *Effectively supervising of Restructured loans.*

If the restructured account is not properly monitored, it is possible for the loan to re-enter the NPA category. It is recommended that an independent monitoring agency monitor restructured accounts with credit risks exceeding a certain amount. An important tool in monitoring is the company's lender development of Trust and Retention Mechanism (TRM) to ensure proper monitoring and utilization of the company's cash flow. On this basis, the company's cash flow should be collected in an account and held by the lender or company on behalf of all stakeholders in a trust. Cash collection should apply to the company's operating expense requirements. Interest and other fees can then be paid to the company's working capital provider, and then the interest of the term lender and the term of the loan can be paid.

➤ *Improve the legal framework.*

Legal proceedings must be initiated; once the bank is confident and concludes, rehabilitation or any other reorganization alternative is not possible. Although many steps have been taken recently to change the legal environment to promote the recovery of national action plans, much more stringent provisions must be enacted which overcomes the influential borrowers, corrupting the entire process. It is

recommended that legal barriers be prioritized to improve the recovery of national action plans through legal channels. In addition, guidelines for management buyouts need to be released as soon as possible. The provisions of the SARFAESI Act need to be revised based on feedback from banks and financial institutions to make the Act more effective. It is also suggested that since the trust set up by ARCs are similar to the nature of mutual funds, the income and TDS in the hands of ARCs should be exempted.

➤ *Special exercise units*

Some banks maintain “*Stress Management Teams*” at their headquarters, while others manage complex assets in rehabilitation and recovery branches. It is recommended to establish a “*Special Workout unit*” (a separate unit within the bank). These should be created through a fair and professional workout process to maximize the value of the distressed non-performing assets portfolio. In these respects, each loan officer's skills, knowledge, practical experience and negotiation skills should match the complexity or difficulty of the various assets being managed.

➤ *Training*

As a result, professional credit skills are inadequate, credit automation and risk-based pricing tools prevent most participants, especially public sector banks, from effectively allocating funds to attractive and underserved SMEs and retail customers. Therefore, it is recommended that regular staff be trained at the appropriate levels.

➤ *Employee incentives awards.*

Staff members play an important role in preventing and reducing Non-Performing Assets. In order to motivate the entire workforce to make recovery action with missionary zeal, a competitive environment between regional, zonal and National level branches should be created. Reduce national action plan reward plans by issuing shields to outstanding affiliates and present gifts to employees at these branches to

express their enthusiasm in order to produce good results and engage in a competitive spirit. Branches that can reduce NPA to zero/no NPA should have the right to display the board "This is an NPA branch." The name and photo of the branch team can also be published in the bank's employee journal.

➤ *Appointment of Professional Auditors.*

It has been observed that in the past few years, financial scams, fraud and manipulation have occurred in the financial market, with private sector banks participating heavily; foreign banks and large cooperative banks have been noted. It was also pointed out that the Reserve Bank of India regulatory mechanisms for these banks were severely affected by the lack of independent audits and detailed reports. This is because the management of the bank, its actions and misconduct needs to be reviewed by the statutory auditor to determine the auditor's appointment, salary and rotation. Independence was further weakened by appointing these audit firms for multiple consultations and other transfers from the same bank. Therefore, it is recommended that the government and the Reserve Bank of India should make the necessary regulatory changes to ensure that all private sector banks, cooperative banks and foreign banks operating in India receive detailed independent audits by RBI-appointed auditors. Same as public sector banks. A separate auditor should be appointed on a similar basis for each of these banks' branches to ensure an independent, in-depth review in addition to the appropriate scope, coverage and reporting requirements in constitution with The Institute of Chartered Accounts of India.

Although NPA management has made significant progress, there is still much work to be done in credit risk management, identification and treatment of NPA issues. Banks can also introduce some of the international approaches to NPA and make recommendations on them; to some extent they are related to Indian conditions.

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