Chapter-6

Recovery Measures of Non-Performing Assets of Commercial Banks

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The previous chapter has analyzed the asset quality and level of NPAs of scheduled commercial banks at the national scenario. It is observed that banks have been committed towards the reduction and management of NPAs. The quality of asset portfolio has improved quite impressively over the period. In order to survive and compete with private and foreign banks, it is crucial for the banks to clean up their balance sheets by increasing the equity capital. Unless the problem of NPA is checked to the possible extent and brought down to the global standards, it is bound to weaken the performance of SCBs. The present chapter is devoted to reiterate the measures and relevant guidelines taken by Reserve Bank of India and government of India from time to time to arrest unbridled virus of NPAs of commercial banks. It has also verified the performance of various recovery channels at the national level.

1. Introduction:

The malady of high level of NPAs eroding the profitability of banks is not confined to public sector banks alone, but it is equally present in the private sector banks too. Thus the problem of NPA is multidimensional and unless the same is checked and the NPA level is brought down to the international standards, it is bound to weaken the banking system. A major stumbling block for the banks to reduce their NPAs has been the prevailing legal system in the country. The RBI in this respect proposed prompt corrective action (PCA) mechanism for arresting the menace of NPAs. On the other hand, RBI has introduced various measures like credit risk management models, compromise settlement methods, effective use of debt recovery tribunals, lok Adalats and so on (Rajeev and Mahesh, 2010)[1]. Furthermore, to provide an additional option and developing a healthy secondary market for NPAs, the guideline relating to sale/ purchase of NPAs were issued in July 2005 covering the procedure for purchase/ sale of NPAs by banks valuation aspects, prudential norms. The guideline were partly modified in May 2007 whereby it was stipulated that atleast 10 per cent of the estimated cash flows should be realized in the first year and atleast 5 per cent in each half year thereafter subject to full recovery within three years. The following discussions have highlighted the various measures for recovery of NPAs of SCBs in detail.

2. Measures for Tackling Non-Performing Assets of Banks:

The management is seriously concerned about the growing NPA menace, which is taking its toll on efficiency and profitability. NPAs are serious strain on the

[1] Rajeev, M. and Mahesh, H. P. (2010) "Banking Sector Reforms and NPA: A Study of Indian Commercial Banks" *Working Paper-252*, The Institute for Social and Economic Change, Bangalore.

profitability because the banks cannot book income on such accounts. Further, they are required to charge the funding cost and provision requirement to their profits. High level of NPAs adversely affects the financial strength of banks and enforces the government to recapitalize the weak banks from time to time. On the other hand, the banks have failed to conform to stringent international standard. The various measures introduced by RBI to check/ arrest the emerging problem of NPAs of banks. At this juncture, the following paragraph delineates the notable measures adopted from time to time.

2.1. Compromise Settlement Schemes:

The RBI / Government of India have been constantly goading the banks to take steps for arresting the incidence of fresh NPAs and have also been creating legal and regulatory environment to facilitate the recovery of existing NPAs of banks. The significant of them, has been recapitulated here under.

- The broad framework for compromise or negotiated settlement of NPAs advised by RBI in July 1995 continues to be in place. Banks are free to design and implement their own policies for recovery and write-off incorporating compromise and negotiated settlements with the approval of their Boards, particularly for old and unresolved cases falling under the NPA category. The policy framework suggested by RBI provides for setting up of an independent Settlement Advisory Committees headed by a retired Judge of the High Court to scrutinize and recommend compromise proposals.
- Specific guidelines were issued in May 1999 to public sector banks for onetime non discretionary and non discriminatory settlement of NPAs of small sector. The scheme was operative up to September 30, 2000. (Public sector banks recovered Rs. 668 crore through compromise settlement under this scheme).

- Guidelines were modified in July 2000 for recovery of the stock of NPAs of Rs. 5 crore and less as on 31 March 1997. (The above guidelines which were valid up to June 30, 2001 helped the public sector banks to recover Rs. 2600 crore by September 2001).
- An OTS Scheme covering advances of Rs.25000 and below continues to be in operation and guidelines in pursuance to the budget announcement of the Hon'ble Finance Minister providing for OTS for advances up to Rs.50, 000 in respect of NPAs of small/marginal farmers are being drawn up.

2.2. Debt Recovery Tribunals and Recovery of Debts:

The establishment of Debt Recovery Tribunals (DRTs) under "the Recovery of Debts, due to Banks and Financial Institutions Act 1993" was one of the most important step taken by the government for recovery of debts. The Narasimham Committee identified the shortcomings of DRTs and had recommended that DRTs should be vested with the powers of attachment before judgment, for appointment of receivers and for preservation of poverty. Recognizing the importance of DRTs, Reserve Bank of India constituted Deshpande Working Group under the chairmanship of N. V. Deshpande to review the functioning of DRTs and to suggest appropriate measures to improve their efficacy for recovery of debts. The group submitted its report on August 1998, recommended structural aspects relating to the debts as well as legal lacuna of the Act. The Govt. of India constituted Andhyarujina Expert group (1998-99) under the chairmanship of T. R. Andhyarujina, former Solicitor General of India. It suggested that various external legislation affecting the banking sector such as transfer of property act, foreclosure laws, DRT Act etc to review appropriate amendment in the legal framework. On the basis of the committee's recommendations recovery of debt due to Banks and Financial Institutions (amendment) Bill 1999 was introduced in the parliament seeking amendments to certain provisions of the Act.

However, the recovery management has been impeded by the fact that the relevant laws have not been suitable enough to provide comfort to bank's efforts in reducing the level of NPAs. Various measures have been taken recently with a view to empowering the DRTs include:

- Setting up seven more debt recovery tribunals in the country
- Strengthening the infrastructure of debt recovery tribunals
- Amendment of the recovery of debts due to Bank and Financial Institution Act

The Reserve Bank of India issued guidelines to PSBs the constitution of settlement advisory committee for compromise settlement of chronic NPAs of small scale sector in May 1999. RBI issued another guideline in July 2000, covering all sectors, to provide a simplified, non discretionary and non-discriminatory mechanism for the recovery of NPAs with outstanding balance of up to Rs. 5 crores as at end march 1997 with an operation of up to end-march 2001 (RBI, 1999- 2000)[2].

The Recovery of Debts due to Banks and Financial Institutions (amendment) Act, passed in March 2000 has helped in strengthening the functioning of DRTs. Provisions for placement of more than one Recovery Officer, power to attach defendant's property/assets before judgment, penal provisions for disobedience of Tribunal's order and appointment of receiver with powers of realization, management, protection and preservation of property are expected to provide necessary teeth to the DRTs and speed up the recovery of NPAs in the times to come.

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[2] Reserve Bank of India, Trend and Progress of Banking in India, (1999-2000)

Though there are 22 DRTs set up at major centres in the country with Appellate Tribunals located in five centres viz. Allahabad, Mumbai, Delhi, Calcutta and Chennai, they could decide only 9814 cases for Rs. 6264.71 crores pertaining to public sector banks since inception of DRT mechanism and till September 30, 2001. The amount recovered in respect of these cases amounted to only Rs. 1864.30 crores. In the year 2010-11 through DRT, Rs. 3,930 crores has been recovered out of amount involved Rs. 14,092 crores.

2.3. Asset Reconstruction Companies and Recovery of Debts:

The non-performing assets is a major cause of weakness and poor performance of commercial banks and more particularly in public sector banks which are carrying a total gross NPAs worth Rs. 45,653 crores, constituting 16 per cent of the total gross advances as on march 1998 (Shrivastava et al, 2002)[3]. The measures have been undertaken by the PSBs to reduce the outstanding NPA level with a view to improve credit management by preventing its fresh accretion. However, the pace of reduction in net NPA in terms of percentage to net advances has declined over the years. When this contamination is viewed in the context of prudential norms applicable in India, which are lenient as compared to international standard, the enormity of the problem has increased significantly.

The committee on banking sector reforms (Narasimham Committee II, 1998)[4] against this backdrop has suggested the constitutions of Asset Reconstruction

[3] Shrivastava, M.P., Kumari, N., Shrivastava, K.P. and Shrivastava, V.P. (2002) "*Second phase of Banking and Financial Sector Reforms and Non-Performing Assets: Relevance, Mechanism, Management and Cost Structure of Assets Restructuring Companies*", Banking and Financial Sector Reforms in India, Deep and Deep Publications Pvt. Ltd, New Delhi, p – 181.

[4] Govt. of India, (1998) "*Report of the Committee on Financial System*", Ministry of Finance

Companies (ARC) for taking over the NPAs of banks which carry high NPA portfolio. The committee has suggested:

- formation of Asset Reconstruction Company by a bank individually/number of banks jointly or in the private sector.
- the assets in the "doubtful" and "loss" category which are generally hard core NPAs, should be identified and realizable value should be ascertained.
- the identified assets should be transferred to the ARC at the ascertained realizable value and the ARC should issue NPA swap bonds for this value to the transferring bank.
- in case the ARC is constituted by banks, the staff from the banks should be deployed in the ARC in order to transfer the institutional memory regarding problem loans to the ARC
- financing the ARCs should be treated at par with venture capital for tax incentives.

Though the Narasimham Committee mooted the concept of ARC, the other companies also supported it as well. The term ARC is still wrapped up in considerable ambiguity. It is to be noted that Indian Banking system still suffers from lack of in appropriate legal system for quick recovery of bank dues. The DRTs were set up to expedite disposal of high value claims of banks. The performance of ten DRTs currently working may also not be considered satisfactory. Out of Rs. 8900 crores transferred to DRTs by March 1997, only a sum of Rs. 178 crores has been recovered. The suggestion of ARC is itself debatable and it hardly provides any solution to the bulging problem of NPA. The midterm review of monetary and credit policy for 2000-01 has proposed to discontinue the RBIs prudential norm with effect from March 31, 2001 (GOI, 2001)[5]. The regulatory model for safer banking is not yet known (D'Souza, 2000)[6]. The global norm of NPA as percent of assets is about 5 per cent. In Indian context, NPA of the banking system amounted to Rs. 60,841 crores for 2000-2001, a little over 16 per cent of the total assets of the nationalized banks (Economic Times, 2001)[7]

An Assets Reconstruction Company with an authorized capital of Rs. 2000 crores and initial paid up capital Rs. 1400 crores is to be set up as a trust for under taking activities relating to assets reconstruction. It would negotiate with banks and financial institutions for acquiring distressed assets and develop markets for such assets. Government of India proposes to go in for legal reforms to facilitate the functioning of ARC mechanism.

2.4. Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SRFAESI) Act–2002:

The SARFAESI Act brought a greater change in the debt recovery scenario in the country. One of the important changes that SARFAESI Act has brought is that it allowed the banks (According to Sec.13.4 of Act) to take over possession from the defaulter, without going through the stringent court procedure, once the loan account has been categorized as a NPA. The SARFAESI Act allows the secured creditor to sell or lease the secured asset, or appoint a receiver to take care of the asset which is classified as a NPA. The Govt. has enacted the Act to recover their dues. The Act has empowered the banks and FIs with vast powers to enforce the securities charged to them. These are as under –

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[5] Govt. of India, Economic Survey, (2000-2001).

[6] D' Souza, E. (2000) "Prudential Regulation in Indian Banking", *Economic and Political Weekly,* (January 29).

[7] RBI Tightens NPA Recognition Norm, *The Economic Times,* November (2001).

(1) The banks can issue notices to defaulters to pay up the dues and if they fail to do so within 60 days the banks are allowed to take over the possession of assets of the borrowers - factory, land and building, plant and machinery etc charged to them including the right to transfer by way of lease, assignment or sale and realize the secured assets. In case the borrowers refuse peaceful handing over the assets, banks can also file an application before the relevant Magistrate for taking possession of assets.

(2) Banks can take over the management of secured assets of the borrower. Moreover it can also take over the management of the company and appoint any person to manage the secured assets.

(3) Banks can package and sell loans via securitization and the same can be treated in the market like bonds and shares.

(4) The powers can be exercised in all cases involving dues exceeding Rs. 1 lakhs, where the banker is either a sole banker or in case of joint lending where lenders representing 75 per cent of the contractual amount due and outstanding agree to take action.

Thus it is evident from the discussion that, the SRFAESI Act, has given the much strong weapon to the bankers, to fight the menace of NPAs and redress a historic imbalance between lenders and borrowers. However the success rate hinges on proper utilization of power vested on the banks under the act. In this respect some loopholes still need to be plugged;

(a) Can assets seized from the defaulters be sold? Without sale of assets the idea of setting up ARCs and creating market for securitized assets won't work. On the other hand assets should be disposed-off fast as delay in that process would erode the value of assets.

(b) What happens when there is a conflict of interest among lenders? Sec. 13 (9) of SRFAESI, Act states that, secured creditors cannot exercise rights unless those who are three-fourths ($3/4^{th}$) of the amount outstanding agree.

(c) Proper valuation of assets and finding out suitable market for selling the assets at reasonable prices to be ensured by the banks while assets without having ready market should be avoided.

(d) Where the banks decided to take over a running unit.

With a view to recover the dues the bank had to recourse to the long winding legal route against the defaulting borrowers. Beginning from filling of claims in the courts a lot of time was spent in getting decrease and execution there of before the banks could make some recoveries. In the mean time promotes could seek the protection of BIFR and could also dilute the securities available to banks. The DRT's set up by the Govt. also did not prove to be much help as this got gradually over burdened by huge volume of cases referred to them.

The banks were handicapped in the absence of any powers for seizure of assets charged to them and, therefore, there had been persistent demand from banks to empower them in their war against NPAs.

2.5. The Implication of Asset Reconstruction Companies and Securitization Act-2002:

The problem of NPA is multidimensional and unless the same is checked and its level is brought down to international standard of 2-3 per cent of total loan assets the whole banking sector will definitely lose its grip in the competitive market. In this respect the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 is an important landmark in Indian banking scenario. With the passage of the Act, the banks and the financial institution (FIs) have been quick to initiate action against the defaulters on loans.

About 9000 notices have been issued for the recovery of the loan amounting to Rs. 70 billion as on March 2003. Furthermore, the banks and the FIs are empowered to take over the assets of the defaulting borrowers.

This apart, for speedier resolution of the default cases the Asset Reconstruction Companies (ARCs) were established by the banks and the FIs. The ARCs are the centralized agencies for resolving bad loans. They are further expected to help the promoting institutions to spruce up the balance sheet by taking bad loans off their books. The ARCs are not peculiar in India. Several countries; Czech Republic (1995), Sweden (1992), Thailand (1998) have tried variants of ARCs rescue the troubled banks. The United States (1889) Korea (1997) and Malaysia (1998) during their savings and loan crisis has established single asset Management Corporation to purchase NPAs of number of banks.

The guidelines, issued by the RBI to operational the provisions of the Act, cover wide range of activities include registration and operations of ARCs, financing, permissible business operational structure, and transfer of financial Assets sections 7 (1) and 7 (2) of the Act provides specific guidelines enabling ARC to.

- Securitize non-performing assets.
- Issue security receipts to qualified institutional buyers (QIBs) include, FIs, Insurance companies, card companies Asset management companies making investment on behalf of banks, mutual fund, pension funds, gratuity or provident funds and FIIs registered by the SEBI.
- Transfer the acquired assets from the originators to the trust.
- Hold and administer the financial assets for the benefits of the QIBs.

Thus, it is apparent from the discussion that there are certain issues of process, accounting and fiscal aspect relating to transfer of NPAs portfolios and their subsequent recoveries. An attempt, therefore, has been made hereunder to float up the issue particularly the accounting aspect to reveal how the ARCs and transferring banks are affected with the transfer of the bad loan portfolios for their balance sheet.

The Accounting Aspect: The accounting aspect relating to transfer of loan portfolio to ARCs should follow relevant Accounting Standard and GAAP. However, recoveries should be recorded only on cash basis. Furthermore, when the ARCs mango to generate enough surpluses through the sale of bad and doubtful loans transferred to them, it will be shared among the sponsors. However, the accounting entries in this respect may be proposed in the books of the originators and the ARCs / Trust if created as under-

In the books Banks / Financial Institutions:

a) On transfer of the NPAs portfolios :

Debit *ARCs A/C (negotiated value of loan portfolio)*
Debit *P/L A/C (difference between book value of the loan portfolio i.e. less provision if any and agreed value)*
Credit *Borrowers (loan Portfolio) A/C (net book value)*
Credit *P/L A/C (excess of negotiated value over net book value)*

b) When the part of consideration is paid by the ARCs :

Debit *Security Receipts A/C*
Credit *ARCs A/C (with value of instruments received)*

c) On recovery of NPAs portfolio by ARCs and settlement of transaction :

Debit *Bank A/C*
Debit *P/L A/C* * *(portion of lower side of the recovery)*
Credit *ARCs A/C*
Credit *P/L A/C* * *(portion of upper side of the recovery)*

d) On substitution of security receipts issued earlier if any

Debit *Bank A/C*
Credit *Security Receipts A/C*

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* Since the loss or gain on the recovery of loan portfolio transferred to the ARCs is shared.

In the Books of the ARCs/Trust if created:

a) **On receipt of Loan portfolio from the Banks :**

Debit *Borrowers (Loan Portfolio) A/C (at negotiated/agreed value)*
Credit *Banks / FIs A/C (originators)*

b) **On payment of the portion of consideration through Security Receipts :**

Debit *Banks / FIs A/C (originators)*
Credit *Security Receipts A/c (if any)*

c) **On the issue of Security receipts to the QIBs :**

Debit *Bank A/C*
Credit *Security Receipts A/C*

d) **On the recovery of loan portfolio from the borrowers :**

Debit *Bank A/C*
Debit *P/L A/C (loss on recovery)*
Credit *Borrowers (Loan portfolio) A/C*
Credit *P/L A/C (excess recovered over negotiated value)*

e) **On payment to the QIBs and substitution of security receipts issued to originator :**

Debit *Security Receipts A/C*
Debit *P/L A/C (on redemption and interest if any paid)*
Credit *Bank A/C*

The Tax Implications: In the Income Tax Act, 1961, there are no specific provisions governing income of different entities involved in the securitization transactions. However, when the NPAs portfolios of the banks/FIs are transferred to the ARCs and subsequently to the trust created by the ARCs, then such transfer would conform to the principles of 'true sale'. The question therefore crops up about tax liability. Who, QIBs, or ARCs, will pay tax? When the trust pays tax then it will restrict the QIBs' to adjust any loss brought forward against the income from security receipts representing the NPAs pool.

To avoid confusion it may be argued that trust fund may be treated as pass through entity in the same manner as the law allows for MFs and Venture capital funds. As a result the investor would undertake risk of realization of NPAs portfolios and directly taxed when they realize the income or offset losses in case of under recoveries.

It is evident that, the Securitization Act 2002 has facilitated the investors to deploy their funds in the NPAs portfolios of banks and financial institutions. With a view to create a vibrant secondary market ARCs were formed as independent body corporate to expedite the process of resolving the bad loan portfolios. However, an appropriate set of substantial financial sector regulation clarity including changes in tax laws is imperative for the banking system to get rid off NPAs as well as for the QIBs to look forward to the investment opportunity. Thus apart, ARCs should have clear distinct 'financial acquisition policy' and guidelines relating to proper diligence and valuation of NPA portfolio. The Act however is silent in this respect. The Section 3 (1) (viii) of the Act emphasizes only that ARCs should apply the principles of valuation consistently across all the schemes. This has warranted the need to create some kind of standard to make the process transparent and consistent. Moreover, some tax incentives including capital gain tax exemption, carry forward the losses to set off the same with other income, tax exemption on interest income and the like may be allowed to the QIBs as their active participation by way of investing sizeable amount in distressed assets of the banks and FIs only pave the way of success of the entire asset restructuring scheme. The retail marketing on the other hand, has been excluded in this respect as it was felt that retail investors may not be in a position to make a sound value judgment about the risk component of such investment. However, with the robust credit rating mechanisms, securitization of NPAs portfolio could be opened for retail investment.

2. 6. Lok Adalats:

Lok Adalats formed as under Legal Service Authority Act, 1987 provide a means by which banks can be assured of asset-recovery. Banks, apart from fighting it out in the Tribunal also try to engage in out-of court settlements. At times, it is the Tribunal itself that refers the case to the Lok Adalat. The Lok Adalats are conducted by the State Legal Service Authorities for ensuring speedy settlement. Lok Adalat institutions help banks to settle disputes involving accounts in "doubtful" and "loss" category, with outstanding balance of Rs. 5 lakhs for compromise settlement under Lok Adalats. Debt Recovery tribunals have now been empowered to organize Lok Adalats to decide on case of NPAs of Rs. 10 lakhs and above. The public sector banks had recovered Rs. 40.38 crores as on September 30, 2001, through the forum of Lok Adalat. The progress through this channel is expected to pick up in the coming years particularly looking at the recent initiatives taken by some of the public sector banks and DRTs in Mumbai. In 2010-11 through Lok Adalat Rs. 151 crores has been recovered out of involved amount of Rs. 5,250 crores.

2.7. Circulation of Information on Defaulters:

The RBI has put in place a system for periodical circulation of details of willful defaults of borrowers of banks and financial institutions. This serves as a caution list while considering requests for new or additional credit limits from defaulting borrowing units and also from the directors/proprietors/partners of these entities. RBI also publishes a list of borrowers (with outstanding aggregating Rs. 1 crore and above) against whom suits have been filed by banks and FIS for recovery of their funds, as on 31st March every year. It is our experience that these measures had not contributed to any perceptible recoveries from the defaulting entities. However, they serve as negative basket of steps shutting off fresh loans to these defaulters. It is viewed that a real breakthrough can come only if there is a change in the repayment psyche of the Indian borrowers. It shows that the banks have taken strenuous efforts to contain the NPAs. Moreover the percentage of recovery to gross NPAs is also in the increasing trend.

2.8. Corporate Debt Restructuring (CDR):

Corporate Debt Restructuring mechanism has been institutionalized in 2001 to provide a timely and transparent system for restructuring of the corporate debts of Rs. 20 crores and above with the banks and financial institutions. The CDR process would also enable viable corporate entities to restructure their dues outside the existing legal framework and reduce the incidence of fresh NPAs. It is a voluntary system based on debtors and creditors agreement. It will not apply to accounts involving one financial institution or one bank instead it covers multiple banking accounts, syndication, consortium accounts with outstanding exposure of Rs. 20 crores and above by banks and institutions. The CDR system is applicable to standard and sub – standard accounts with potential cases of NPAs getting a priority. In addition to the steps taken by the RBI and Government of India for arresting the incidence of new NPAs and creating legal and regulatory environment to facilitate for the recovery of existing NPAs of banks, the following measures were initiated for reduction of NPAs.

2.9. Credit Information Bureau:

The institutionalization of information sharing arrangements through the newly formed Credit Information Bureau of India Ltd. (CIBIL) is under way. RBI is considering the recommendations of the S.R. Iyer Group (Chairman of CIBIL) to operationalize the scheme of information dissemination on defaults to the financial system. The main recommendations of the Group include dissemination of information relating to suit-filed accounts regardless of the amount claimed in the suit or amount of credit granted by a credit institution as also such irregular accounts where the borrower has given consent for disclosure. This would prevent those who take advantage of lack of system of information sharing amongst lending institutions to borrow large amounts against same assets and property, which had in no small measure contributed to the incremental NPAs of banks.

2.10. Proposed Guidelines on Willful Defaults/Diversion of Funds:

RBI is examining the recommendation of Kohli Group on willful defaulters. It is working out a proper definition covering such classes of defaulters so that credit denials to this group of borrowers can be made effective and criminal prosecution can be made demonstrative against willful defaulters.

2.11. Corporate Governance:

A Consultative Group under the chairmanship of A.S. Ganguly was set up by the Reserve Bank of India to review the supervisory role of Boards of banks and financial institutions and to obtain feedback on the functioning of the Boards vis-à-vis compliance, transparency, disclosures, audit committees etc. and make recommendations for making the role of Board of Directors more effective with a view to minimizing risks and over-exposure. The Group recommended for effective control and supervision by bank board’s over credit management and NPA prevention measures.

2.12. Special Mention Accounts - Additional Precaution at the Operating Level:

In a recent circular, RBI has suggested to the banks to have a new asset category - `special mention accounts' - for early identification of bad debts. This would be strictly for internal monitoring. Loans and advances overdue for less than one quarter and two quarters would come under this category. Data regarding such accounts will have to be submitted by banks to RBI.

However, special mention assets would not require provisioning, as they are not classified as NPAs. Nor are these proposed to be brought under regulatory oversight and prudential reporting immediately. The step is mainly with a view to alerting management to the prospects of such an account turning bad, and thus taking preventive action well in time. An asset may be transferred to this category once the earliest signs of sickness/irregularities are identified. This will help banks look at accounts with potential problems in a focused manner right from the onset of the problem, so that monitoring and remedial actions can be more effective. Once these accounts are categorized and reported as such, proper top management attention would also be ensured.

Borrowers having genuine problems due to temporary mismatch in funds flow or sudden requirements of additional funds may be entertained at the branch level, and for this purpose a special limit to tide over such contingencies may be built into the sanction process itself. This will prevent the need to route the additional funding request through the controlling offices in deserving cases, and help avert many accounts slipping into NPA category. Introducing a `special mention' category as part of RBI's `Income Recognition and Asset Classification norms' (IRAC norms) would be considered in due course.

With a view to provide an additional option and developing a healthy secondary market for NPAs, the guideline relating to sale/ purchase of NPAs were issued in July 2005 covering the procedure for purchase/ sale of NPAs by banks valuation aspects, prudential norms. The guideline were partly modified in May 2007 whereby it was stipulated that at least 10 per cent of the estimated cash flows should be realized in the first year and at least 5 per cent in each half year thereafter subject to full recovery within three years.

2.13. Risk Assessment and Risk Management:

Risk management is a discipline for dealing with the possibility that some future event will cause harm. It provides strategies, techniques, and an approach to recognizing and confronting any threat faced by an organization in fulfilling its mission. There can be minimum risk in a captive controlled economy, where industry is protected by high tariff walls and banks by directed credit and directed interest rates, and directed investments. But along with such minimum risk, there would also be minimum growth of the economy. In India after total regulation for several decades, the economy witness around 3 per cent average growth. The Indian economy has now been freed of State controls. Consequently in today's corporate world, it is a challenge for corporate leaders to run a business with the objective of maximizing shareholders' value.

The changing environment, on account of on-going process of liberalization and reforms all round, of easing of import restrictions, are resulting in an emerging new economic order increases risks content whilst also unfolding new opportunities. In this environment while decision making is the prerogative of the management, sound risk management is also their prime responsibility - as it provides them with the frame work to proactively identify and manage risk associated with their decisions. Banks in the process of financial intermediation are confronted with various kinds of financial and non-financial risks viz., credit, interest rate, foreign exchange rate, liquidity, equity price, commodity price, legal, regulatory, reputation, operational, etc. These risks are highly interdependent and events that affect one area of risk can have ramifications for a range of other risk categories. It therefore becomes very essential for top management of banks to attach considerable importance to improve the ability to identify measures, to monitor and control the overall level of risks undertaken.

2.14. Organisational Restructuring:

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

2.15. Reduce Dependence on Interest:

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

2.16. Potential and Borderline NPAs under Check:

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

2.17. E-Banking and VRS:

The influence of these areas of banking reforms may not appear directly relevant for handling reduction of NPAs. But computerization provides for data-accuracy and operational efficiency and results in better Management Information Service. VRS rationalizes the work force, which in turn results in better productivity and operational efficiency.

2.18. Regular Training Programmes:

Executives have to undergo regular training program on credit and NPA management. It is very useful and helpful to the executives for dealing the NPAs properly.

2.19. Recovery Camps:

The banks should conduct regular or periodical recovery camps in the bank premises or some other place, such type of recovery camps reduced the levels of NPA in the banks

2.20. Spot Visit:

The bank officials should visit to the borrower's business place / borrowers field regularly or periodically.

2.21. Other Methods:

- Persistent phone calls.
- Media announcement.

3. The Performance of Recovery Channels:

The RBI concerning to the issue of bad loans proposed prompt corrective action (PCA) mechanism for controlling the threat of NPA and has introduced various measures like Credit risk management models, Compromise settlement methods, effective use of Debt Recovery Tribunals (DRTs), Asset Reconstruction Companies, Securitization and Reconstruction of Financial Assets and Enforcement of security interest (SARFAESI) Act-2002, Circular of Information on Defaulters, Corporate Debt Restructuring (CDR), Lok Adalats and so on to curb the epidemics of NPAs. In the following paragraph, an attempt has been made to measure the performance of various recovery channels through which the bad loans of commercial banks in India have been recovered. The various recovery channels have been introduced from time to time for expediting the recovery of bad loan amount of banks. Among the several channels of recovery available with the banks, debt recovery tribunals (DRTs) and SARFAESI Act have been the most effective in terms of amount recovered.

The following table-6.0 presents the implications of various recovery channels of NPAs of banks. The table indicates that among the several channels of recovery available to banks for dealing with bad loans, the debt recovery tribunals (DRTs) and the SARFAESI Act have been the most effective in terms of amount recovered. The total number of cases referred to DRTs during 2010-11 was 12,872 and out of the total amount Rs 14,092 crores involved in the cases, Rs. 3,930 crores has been recovered. Likewise out of the amount Rs. 30,604 crores, a sum of Rs. 11,561 crores was recovered in case of referred cases in SARFAESI Act. The number of cases referred to the *Lok Adalats* remained the largest but the amount recovered under *Lok Adalats* and DRTs was lowest throughout the years considered.

Table-6.0

NPA Recovered Through Various Channels

(Amount Rs in Crores)

Recovery Channels	**2005-06**			**2006-07**			**2009-10**			**2010-11**		
	No. of cases referred	Amount involved	Amount recovered	No. of cases referred	Amount involved	Amount recovered	No. of cases referred	Amount involved	Amount recovered	No. of cases referred	Amount involved	Amount recovered
1. One time Settlement	10,262	772	608	-	-	-	-	-	-	-	-	-
2. Lok Adalats	2,68,090	2,144	265	1,60,368	756	106	778833	7235	112	616018	5254	151
3. DRTs	3,534	6,273	4,735	4,028	9,156	3,463	6019	9797	3133	12872	14092	3930
4. SARFAESI Act	41,180	8,517	3,363	60,178	9,058	3,749	78366	14249	4269	118642	30604	11561

Sources: *RBI, Trend and Progress of Banking in India, various issues.*

The recovery rate has been improved in the case of direct agricultural advances while compared with other priority and non-priority sector NPAs. The rate of recovery in case of direct agricultural advances increased to 89.3 per cent for the year-ended June 2011 from 78.1 per cent in the last year (RBI, 2010-11)[8].

The Reserve Bank has so far issued certificate of registration to six securitization companies/ reconstruction companies (SCs/ RCs), of which three have commenced their operations. At end-June 2011, the book value of total amount of assets acquired by SCs/RCs registered with the Reserve Bank stood at Rs. 74,088 crores. The security receipts subscribed to by banks amounted to Rs. 11,233 crores. The security receipts redeemed amounted to Rs. 6,704 crores.

4. Reserve Bank's Guidelines on Purchase/ Sale of Non Performing Assets:

The Reserve Bank of India's Guideline relating to purchase/ sale of non performing financial assets can be presented in the following heads:

1. These guidelines would be applicable to banks, FIs and NBFCs purchasing/ selling non performing financial assets, from/ to other banks/FIs/NBFCs (excluding securitization companies/ reconstruction companies).
2. A financial asset, including assets under multiple/consortium banking arrangements, would be eligible for purchase/sale in terms of these guidelines if it is a non-performing asset/non performing investment in the books of the selling bank.
3. The reference to 'bank' in the guidelines would include financial institutions and NBFCs.

The Guidelines:

The guidelines to be followed by banks purchasing/ selling non-performing financial assets from / to other banks are given below. The guidelines have been grouped under the following headings:

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[8] RBI, Trend and Progress of Banking in India, (2010-11), p- 92

(i) The procedure for purchase/ sale of non performing financial assets by banks, including valuation and pricing aspects.

(ii) Prudential norms, in the following areas, for banks for purchase/ sale of non performing financial assets:

- Asset classification norms
- Provisioning norms
- Accounting of recoveries
- Capital adequacy norms
- Exposure norms
- Disclosure requirements

(iii) Procedure for purchase/ sale of non performing financial assets, including valuation and pricing aspects

(iv) A bank which is purchasing/ selling non-performing financial assets should ensure that the purchase/ sale are conducted in accordance with a policy approved by the Board. The Board shall lay down policies and guidelines covering, inter alia,

- Non performing financial assets that may be purchased/ sold;
- Norms and procedure for purchase/ sale of such financial assets;
- Valuation procedure to be followed to ensure that the economic value of financial assets is reasonably estimated based on the estimated cash flows arising out of repayments and recovery prospects;
- Delegation of powers of various functionaries for taking decision on the purchase/ sale of the financial assets; etc
- Accounting policy

(v) While laying down the policy, the Board shall satisfy itself that the bank has adequate skills to purchase non performing financial assets and deal with them in an efficient manner which will result in value addition to the bank. The Board should also ensure that appropriate systems and procedures are in place to effectively address the risks that a purchasing bank would assume while engaging in this activity.

(vi) The estimated cash flows are normally expected to be realized within a period of three years and not less than 5 per cent of the estimated cash flows should be realized in each half year.

(vii) A bank may purchase/sell non-performing financial assets from/to other banks only on 'without recourse' basis, i.e., the entire credit risk associated with the non-performing financial assets should be transferred to the purchasing bank. Selling bank shall ensure that the effect of the sale of the financial assets should be such that the asset is taken off the books of the bank and after the sale there should not be any known liability devolving on the selling bank.

(viii) Banks should ensure that subsequent to sale of the non performing financial assets to other banks, they do not have any involvement with reference to assets sold and do not assume operational, legal or any other type of risks relating to the financial assets sold. Consequently, the specific financial asset should not enjoy the support of credit enhancements / liquidity facilities in any form or manner.

(ix) Each bank will make its own assessment of the value offered by the purchasing bank for the financial asset and decide whether to accept or reject the offer.

(x) Under no circumstances can a sale to other banks be made at a contingent price whereby in the event of shortfall in the realization by the purchasing banks, the selling banks would have to bear a part of the shortfall.

(xi) A non-performing asset in the books of a bank shall be eligible for sale to other banks only if it has remained a non-performing asset for at least two years in the books of the selling bank.

(xii) The banks shall sell non-performing financial assets to other banks only on cash basis. The entire sale consideration should be received upfront and the asset can be taken out of the books of the selling bank only on receipt of the entire sale consideration.

(xiii) A non-performing financial asset should be held by the purchasing bank in its books at least for a period of 15 months before it is sold to other banks. Banks should not sell such assets back to the bank, which had sold the NPFA.

(xiv) Banks are also permitted to sell/buy homogeneous pool within retail non-performing financial assets; on a portfolio basis provided each of the non-performing financial assets of the pool has remained as non-performing financial asset for at least 2 years in the books of the selling bank. The pool of assets would be treated as a single asset in the books of the purchasing bank.

(xv) The selling bank shall pursue the staff accountability aspects as per the existing instructions in respect of the non-performing assets sold to other banks.

5. Prudential Norms for Banks for the Purchase/ Sale Transactions:

(A) Asset classification norms

(i) The non-performing financial asset purchased, may be classified as 'standard' in the books of the purchasing bank for a period of 90 days from the date of purchase. Thereafter, the asset classification status of the financial asset purchased shall be determined by the record of recovery in the books of the purchasing bank with reference to cash flows estimated while purchasing the asset which should be in compliance with requirements.

(ii) The asset classification status of an existing exposure (other than purchased financial asset) to the same obligor in the books of the purchasing bank will continue to be governed by the record of recovery of that exposure and hence may be different.

(iii) Where the purchase/sale does not satisfy any of the prudential requirements prescribed in these guidelines the asset classification status of the financial asset in the books of the purchasing bank at the time of purchase shall be the same as in the books of the selling bank. Thereafter, the asset classification status will continue to be determined with reference to the date of NPA in the selling bank.

(iv) Any restructure / reschedule / rephrase of the repayment schedule or the estimated cash flow of the non-performing financial asset by the purchasing bank shall render the account as a non-performing asset.

(B) Provisioning norms

Books of selling bank

i. When a bank sells its non-performing financial assets to other banks, the same will be removed from its books on transfer.

ii. If the sale is at a price below the net book value (NBV) (i.e., book value less provisions held), the shortfall should be debited to the profit and loss account of that year.

iii. If the sale is for a value higher than the NBV, the excess provision shall not be reversed but will be utilized to meet the shortfall/ loss on account of sale of other non performing financial assets.

Books of purchasing bank

The asset shall attract provisioning requirement appropriate to its asset classification status in the books of the purchasing bank.

(C) Accounting of recoveries

Any recovery in respect of a non-performing asset purchased from other banks should first be adjusted against its acquisition cost. Recoveries in excess of the acquisition cost can be recognized as profit.

(D) Capital Adequacy

For the purpose of capital adequacy, banks should assign 100 per cent risk weights to the non-performing financial assets purchased from other banks. In case the non-performing asset purchased is an investment, then it would attract capital charge for market risks also. For NBFCs the relevant instructions on capital adequacy would be applicable.

(E) Exposure Norms

The purchasing bank will reckon exposure on the obligor of the specific financial asset. Hence these banks should ensure compliance with the prudential credit exposure ceilings (both single and group) after reckoning the exposures to the obligors arising on account of the purchase. For NBFCs the relevant instructions on exposure norms would be applicable.

(F) Disclosure Requirements:

Banks which purchase non-performing financial assets from other banks shall be required to make the following disclosures in the Notes on Accounts to their Balance sheets:

A. Details of non-performing financial assets purchased: (Amounts in Rupees crores)

1. (a) No. of accounts purchased during the year

   (b) Aggregate outstanding

2. (a) Of these, number of accounts restructured during the year

   (b) Aggregate outstanding

B. Details of non-performing financial assets sold: (Amounts in Rupees crores)

1. No. of accounts sold
2. Aggregate outstanding
3. Aggregate consideration received

C. The purchasing bank shall furnish all relevant reports to RBI, CIBIL etc. in respect of the non-performing financial assets purchased by it.

6. Conclusion:

The foregoing discussion clearly revealed that various measures were introduced like credit risk management models, Compromise Settlement methods, effective use of debt recovery tribunals (DRT's), Asset Reconstruction Companies (ARC) and recovery of debts, Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SRFAESI) Act-2002, circulation of information on defaulters, Corporate Debt Restructuring (CDR), Lok Adalats etc to seize uncontrolled virus of NPAs of commercial banks. It has been ascertained that the cases get delayed inordinately in a Debt Recovery Tribunal much against the spirit and motive of its very establishment. Banks have expressed their dissatisfaction with the system that was instituted to ensure speedy recovery.

The number of claims in litigation is quite large and changes should be made urgently to revamp the existing model. Unless the system is overhauled, the rate of pendency at the Tribunal will rise unrestrained. Such a state of affairs will seriously put the banking system in depression. The government has to make sure that time-bound disposal of the cases is done mandatorily by adding the clause in the Act and making it a law. Even though the SARFAESI Act has mandated the DRTs to settle the original applications within six months, this is not obeyed strictly. The relevant efforts have to be taken to ensure this microbe from the banking sector.

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