



## INTERNATIONAL JOURNAL OF RESEARCH IN COMPUTER APPLICATION AND MANAGEMENT

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**MANAGING NON PERFORMING ASSETS: A STUDY OF INDIAN COMMERCIAL BANKS**

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**ABSTRACT**

*The reform in the banking sector which has followed the guidelines issued by Basel-II recommendations has brought many positive changes in the Indian banking sector. The present capital adequacy of Indian banks is comparable to those at international level. There has been a marked improvement in the asset quality. The reform measures have also resulted in an improvement in the profitability of banks. The promulgation of SARFAESI Act, 2002 has been a benchmark reform in the Indian banking sector. This act has given much needed power to the banks to tackle the Non Performing Loans particularly those bad loans which arise due to willful default of the borrowers. This paper tries to study the effectiveness of various NPA recovery mechanisms for the period 2004-08. The paper also tries to examine how fruitful this act has been in providing real improvement in the quality of assets. It is being seen that after the implementation of SARFAESI Act 2002, banks have got much needed power to tackle the non performing loans. The activities of Asset Reconstruction Companies have increased over the years. The popularity of SARFAESI is welcomed but with some apprehensions by the economists particularly after the sub-prime crisis in United States of America. The paper is aimed to examine all these issues.*

**KEYWORDS**

NPA, NPA Recovery Mechanism, SARFAESI.

**INTRODUCTION**

Defaults in the payments of interests and principal amount by the borrowers pose a very serious problem for the health of banking sector. Non-recovery of installments as also interest on the loan portfolio negates the effectiveness of the process of the credit cycle. Non recovery of the dues affects the profitability of the banks. Banks are forced to maintain reserves and provisions against the non-performing loans.

The main objective of banking sector reforms was to promote a diversified, efficient and competitive financial system with the ultimate goal of improving the allocative efficiency of resources through operational flexibility, improved financial viability and institutional strengthening. Special emphasis was placed on building up the risk management capabilities of Indian banks while measures were initiated to ensure flexibility, operational autonomy and competition in the banking sector. Second, active steps were taken to improve the institutional arrangements including the legal framework and technological system (Mohan, 2007).

The banking sector as a whole and particularly the public sector banks still suffer from considerable NPAs, but the situation has improved over time. New legal developments like the SARFAESI (Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests) Act provide new options to banks in their struggle against NPAs (Chakrabarti, 2004). Muniappan (2002) points out that till 2001, DRTs reached a decision in less than 23% of the cases with them involving less than 13% and even in those cases, the recovery rate was below 30%.

There are broadly two ways to financially restructure a banking system out of the NPA situation. One can either follow the Asset (Management/Reconstruction) Company (AMC/ARC) approach to clean the balance sheet of banks of their NPAs (at a discount) and use the greater efficiency of the (government-funded) specialized AMCs in realizing the bad debts. Alternatively one could follow the creditor-led reconstruction approach. Both channels have been tried out by countries around the world with mixed results Mukherjee (2003). He further argues that given the illiquid nature of securities backing the NPAs and the level of development of the legal system and financial markets, the Indian situation is more amenable to the second approach.

Various measures have been taken by the regulatory bodies in India to provide more power to creditors and ensure their rights. Some of these are (Mohan, 2007):

- Setting up of Lok Adalats (people's courts), Debt Recovery Tribunals, Asset Reconstruction Companies, and Settlement Advisory Committee, Corporate Debt Restructuring Mechanism etc. for quicker recovery and or restructuring.
- Promulgation of Securitization and Reconstruction of Financial Assets and Enforcement of Securities Interest (SARFAESI) Act, 2002 and its subsequent amendments to ensure creditors rights. It is aimed to develop a market for securitized assets in the country.

SARFAESI Act, 2002 mainly has two objectives:

- a) Providing banks and financial institutions a summary procedure for recovery of their secured dues which have been classified as non-performing assets on their books.
- b) Setting up of Securitization Company or Reconstruction Company (SCRC) for taking over the defaulted loans of banks and financial institutions and recovery thereof.

Under this act the Debt Recovery Tribunals (DRTs) now have the role of the court of first appeal under section 17 and the debts recovery appellate Tribunals have the role of the court of the second appeal under section 18. There is no recourse to the civil courts including the High Courts and the Supreme Courts (Chatterjee, 2003).

This paper tries to review the development and effectiveness of these regulatory measures in the Indian Banking Sector for the period 2003-04 to 2007-08. NPA recovery mechanisms like Lok Adalat, Debt Recovery Tribunals (DRTs) and SARFAESI Act are analyzed in detail. Details of financial assets acquired by ARCIL have also been studied in the paper. A comparative study has been done over the above mentioned period and the effectiveness and popularity of various mechanisms has been studied.

The paper is divided into four sections. Section I has introduced the topic, Section II points out the data sources and the ways with which the data has been analyzed. Section III discusses the findings of the research and section IV concludes the things with conclusions and suggestions.

**RESEARCH METHODOLOGY**

Considering definitions and analyzing the utility of research methods to the present research study, analytical research or exploratory research has been considered fit for the research analysis.

To achieve the above stated objective and after reviewing the related literature the study has been carried out in the following way:

**Data Collection:** Data collection has mainly been derived from the official website of Reserve Bank of India. Annual Reports of all the scheduled commercial banks are submitted to the RBI, and RBI present various trend and progress of commercial banks year after year, thus the major source of information has been the official website of RBI. The data for the period 2003-04 to 2007-08 has been compiled to deduce the findings. Data is collected starting financial year 2003-04 assuming that SARFAESI Act 2002 would have started showing its effect with this financial year. Moreover the balance sheets of the banks have also started disclosing the various NPA recovery mechanisms with this financial year.

**Data Analysis:** The statistical analysis for this study is descriptive analysis. Mainly the time series analyses have been done over the period of the study. The trend patterns have been drawn for various dimensions of the study.

The following trend patterns are visible with respect to NPA recovery mechanism:

**FINDINGS**

**A. NPAs recovered by scheduled Commercial banks through One-Time Settlement/ Compromise Schemes**

Table 1 recognizes the data for the NPAs recovered through one time settlement/ compromise scheme for the period 2004 to 2008.

**TABLE 1: NPAS RECOVERED BY SCHEDULED COMMERCIAL BANKS THROUGH VARIOUS CHANNELS- ONE-TIME SETTLEMENT/COMPROMISE SCHEMES**

Year	No of Cases Referred	Amount Involved (Rs. Crore)	Amount Recovered (Rs. Crore)
2003-04	139562	1510	617
2004-05	132781	1332	880
2005-06	10262	772	608
2006-07	nil	nil	nil
2007-08	nil	nil	nil

Source: Report on trend and Progress of Banking in India, Various Issues; RBI

It is evident that with the time and implementation of new changes has really undermined the compromising scheme which was the popular course of action in the initial years. Though the popularity has come down with the years but it is still considered to be a good way out to resolve the matter amicably if the defaulters are sincere towards their loan obligations.

**B. NPAs recovered by Scheduled Commercial Banks through other channels**

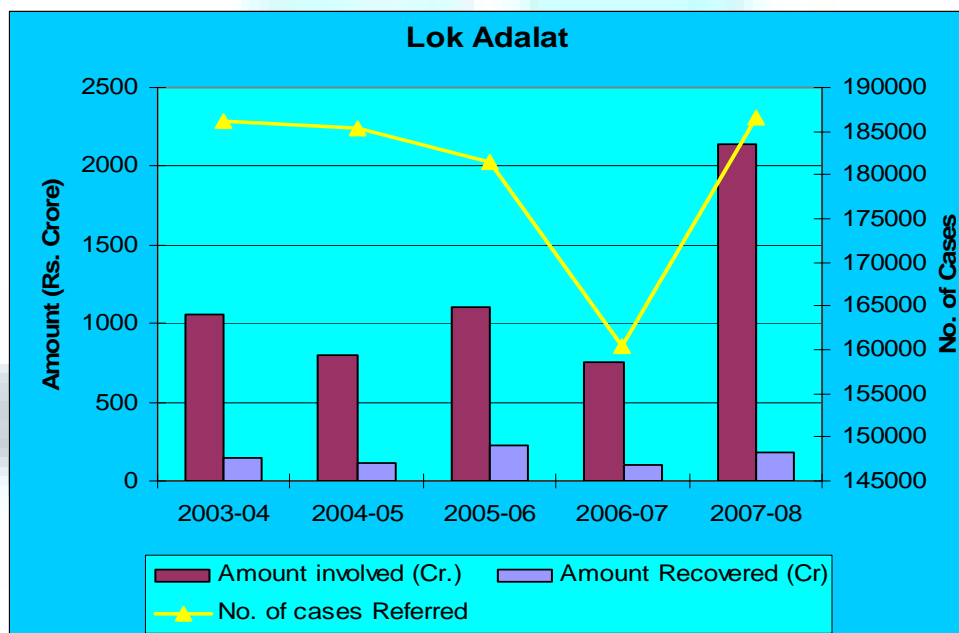
**Through Lok Adalat:** Table 2 shows the data regarding the NPAs recovery through Lok Adalat. It is seen that many cases have come for the recovery through Lok Adalat. Amount recovered in comparison to the amount involved is not very promising stating the problems in recovery of NPA through this channel.

**TABLE 2: NPAS RECOVERED BY SCHEDULED COMMERCIAL BANKS THROUGH OTHER CHANNELS- THROUGH LOK ADALAT**

Year	No of cases Referred	Amount Involved (Rs. Crore)	Amount Recovered (Rs. Crore)
2003-04	186100	1063	149
2004-05	185395	801	113
2005-06	181547	1101	223
2006-07	160368	758	106
2007-08	186535	2142	176

Source: Report on trend and Progress of Banking in India, Various Issues; RBI

**FIGURE 1: NPA RECOVERY OF SCBS THROUGH LOK ADALAT**



Source: Report on trend and Progress of Banking in India, Various Issues; RBI

Figure 1 shows the trend line regarding the utility of Lok Adalat as the recovery mechanism for the period 2004 to 2008. It is visible that with time the popularity of Lok Adalat has come down as number of cases referred has decreased during the period 2004 to 2007. But in the last year of study it has again become one of the important mechanisms to resolve the issues. But the amount recovered through this channel is not much promising.

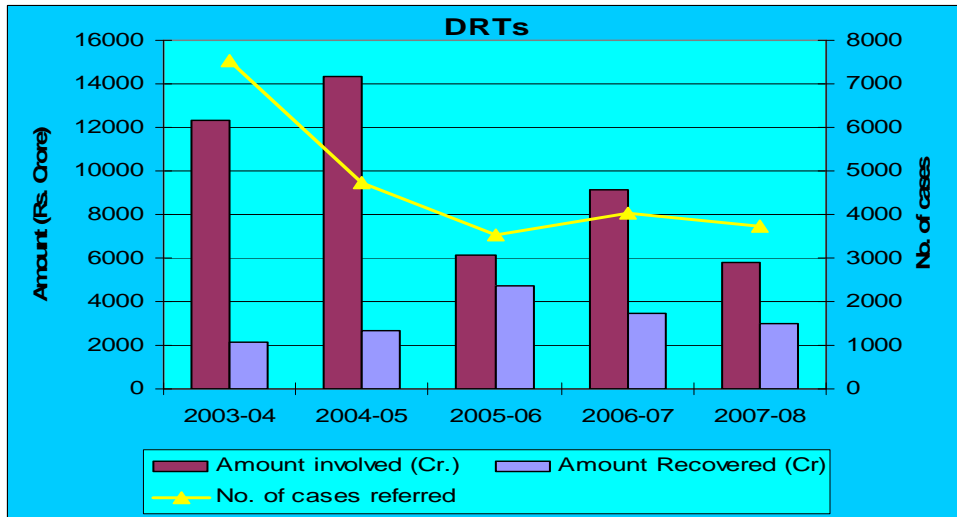
**Through Debt Recovery Tribunals:** Table 3 compiles data of the NPAs cases referred to DRTs and amount recovered for the period 2004 to 2008. Analysis of data suggests that the amount of NPAs recovered has gone up with the passage of time. The efficiency of DRTs has been quite encouraging as recoveries as compared to the no of cases referred have increased with time. It seems that DRTs are able to accomplish to recover NPAs.

TABLE 3: NPAS RECOVERED BY SCHEDULED COMMERCIAL BANKS THROUGH OTHER CHANNELS- THROUGH DEBT RECOVERY TRIBUNALS

Year	No of cases Referred	Amount Involved (Rs. Crore)	Amount Recovered (Rs. Crore)
2003-04	7544	12305	2117
2004-05	4744	14317	2688
2005-06	3524	6123	4710
2006-07	4028	9156	3463
2007-08	3728	5819	3020

Source: Report on trend and Progress of Banking in India, Various Issues; RBI

FIGURE 2: NPA RECOVERY OF SCB THROUGH DEBT RECOVERY TRIBUNALS



Source: Report on trend and Progress of Banking in India, Various Issues; RBI

Figure 2 draws the pattern of performance of DRTs over the time. It is seen that number of cases referred to DRTs have come down since year 2004 to year 2006. Number of referred cases again takes increasing trend in the year 2006-07, after this it again decreases marginally. It is also noticed that the amount of NPAs recovered with compared to amount of cases referred has gone up in the last phase of study, the best performance being in the year 2005-06.

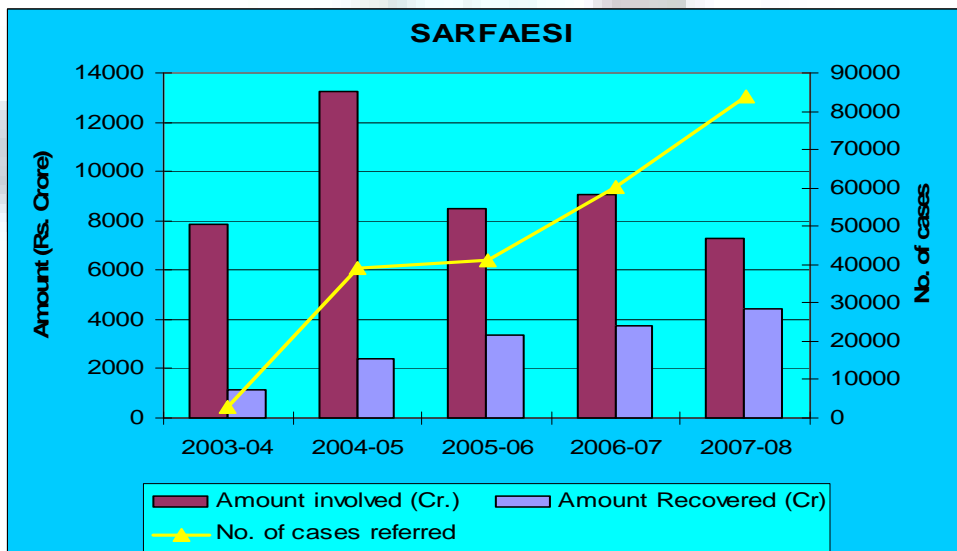
**Through SARFAESI:** Table 4 compiles the data for the amount of NPAs recovered through SARFAESI. Analysis of data shows that number of cases that are referred to SARFAESI has increased magnificently. The number of cases referred was 26661 in 2003-04 and it has gone up to 83942 in 2008. Similarly the amount recovered has also gone up. It was Rs1156 crore in 2004 and gone up to Rs.4429 in 2008. It seems that after the implementation of SARFAESI Act in 2002, banking sector has started using this scheme to their benefits.

TABLE 4: NPAS RECOVERED BY SCHEDULED COMMERCIAL BANKS THROUGH OTHER CHANNELS- THROUGH SARFAESI

Year	No of cases Referred	Amount Involved (Rs. Crore)	Amount Recovered (Rs. Crore)
2003-04	2661	7847	1156
2004-05	39288	13224	2391
2005-06	41180	8517	3363
2006-07	60178	9058	3749
2007-08	83942	7263	4429

Source: Report on trend and Progress of Banking in India, Various Issues; RBI

FIGURE 3: NPA RECOVERY OF SCB THROUGH SARFAESI



Source: Report on trend and Progress of Banking in India, Various Issues; RBI



Figure 3 depicts clearly the increasing trend in the number of cases referred under SARFAESI since inception. Amount involved have also increased gradually with time, exception being 2004-05 where it is too high. Amount recovered through this act has also increasing trend suggesting its efficiency in handling the NPA management.

#### Detail of Financial Assets acquired by ARCIL:

Detail of financial Assets acquired by ARCIL has been compiled for the two financial years 2004-2005 and 2005-2006 in the Table 5. The data show the increasing trend of each factor under consideration in the table for each bank categories. Operation of ARCIL in India is picking up as the purchase of dues by these companies has increasing trend.

TABLE 5: DETAIL OF FINANCIAL ASSET ACQUIRED BY ARCIL- SCB (As at end March)

Year	Factors	Public Sector Banks	Old Pvt. Sector Banks	New Pvt. Sector Banks	Financial Institution	Total
2005	No of Cases	314	11	132	12	368
2006	No of Cases	599	34	152	51	559
2005	Principal Debt Acquired (Crore)	2584	153	4436	386	7559
2006	Principal Debt Acquired (Crore)	3638	186	5037	1460	10321
2005	Interest & Other Charges (Crore)	2920	84	4329	450	7783
2006	Interest and Other Charges (Cr.)	3917	150	4727	2011	10805
2005	Total Dues Purchased (Crore)	5504	237	8765	837	15343
2006	Total Dues Purchased (Crore)	7555	336	9764	3471	21126

Source: Report on trend and Progress of Banking in India, Various Issues; RBI

Table 6 collects the details of financial assets securitized by SCs/RCS as on June 30, 2007 and 2008. It is clear that new act and new policies are aimed at providing banks some power to manage their NPAs with the help of such companies and laws. The increasing importance of ARCIL can also be judged by the following examples. During the last financial year, SR investment by banks in Arcil was close to Rs1, 500 crore; this year too a similar level of investment is expected (Acharya, 2009). United Bank of India which has identified about Rs300 crore of bad assets for sale in the coming quarters, sold about Rs200 crore of NPA last year (Acharya, 2009).

TABLE 6: DETAILS OF FINANCIAL ASSETS SECURITIZED BY SCS/RCS- SCB (As on June 30)

Sr. No.	Item	Amount (in Rs. cr) 2007	Amount (in Rs. cr) 2008
1	Book Value of Assets Acquired	28544	41414
2	Security Receipts issued	7436	10658
3	Security Receipts subscribed by		
	(a) Banks	6894	8319
	(b) SCs/RCS	408	1647
	(c) FIs	--	--
	(d) Others	134	692
4	Amount of Security Receipts completely redeemed	660	1299

Source: Report on trend and Progress of Banking in India, Various Issues; RBI

The Reserve Bank as at the end of June 2007 had issued certificate of registration (CoR) to six securitization companies/reconstruction companies (SCs/ RCS), of which three had commenced their operations. As at end of June 2008, RBI issued CoR to eleven SCs/RCS of which of which six have commenced their operations. At end-June 2007, the book value of total amount of assets acquired by SCs/RCS registered with the Reserve Bank stood at Rs.28,544 crore which went up to 41414 in 2008 showing an increase of 45.1 percent during the year. The security receipts subscribed to by banks amounted to Rs.6, 894 crore (June 2007) and Rs.8319 crore in June 2008. The security receipts redeemed amounted to Rs.660 crore which increased to Rs. 1299 crore in June 2008.

## SUGGESTIONS AND CONCLUSIONS

SARFAESI Act has given much needed teeth to the Indian Banking Sector. It has indeed helped banks in their management of NPAs. Government needs to overview existing regulation and implement amendments so that these measures can be more effective. "Legislative amendments are necessary to give a legal status to securitization transaction. At present, transfer of property is regulated by a law that is more than 100 years old. Also since the securitized assets could be in various states, the incidence of stamp duty would be different across states. A new legislation is required to address all these issues" says M.R Umarji, legal advisor to Indian Banks' Association (as quoted by Shetty, 2009).

Some amendments are also needed at ARC front. ARCs are allowed to do restructuring activities provided that such an ARC holds 75% in value of the loan assets. But the present regulation does not treat ARC as Financial Institutions and prohibit one ARC to acquire assets from other ARC. Amendment can be enacted to remove these anomalies.

Further some apprehensions have also been placed as securitization is seen to have facilitated the spread of the sub-prime crisis across the world (Shetty, 2009). It is also the area of concern that the Indian financial sector had begun securitizing personal loans of all kinds. As the US experience had shown, this tends to slacken diligence when offering credit, since risk does not stay with those originating retail loans (Chandrashekhar, 2008)

The same views are echoed by Ram Mohan (2009), "Rampant securitization is seen as one of the causes of the sub-prime crisis. Banks had no qualms about originating large volumes of low quality loans because they know they were not going to have these on their own books for long. The loans would be palmed off to other investors through securitization".

Securitization if not regulated strongly can lead to the dilution of loan appraisal norms and diligence by the lenders.

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