

Recovery of NPAs in banks - Impact of legal and non- legal measures

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Abstract

Banking Sector plays a pivotal role in the development of an economy and its upliftment. .Since the time of financial sector reforms (by Sri M. Narasimham Committee 1991), which followed and adopted the international best practices and introduction of several prudential and provisioning norms, the banking system in the country has experienced sea-change and a massive transformation ... But the expectations of banks in ensuring a healthy and sound advance portfolio has been belied and the issue of NPAs is recognized as the main cause of recent banking crisis. Everybody in the banking fraternity is highly concerned for the mounting NPAs in the banks. It not only indicates the weakness in the banking sector but also impacts the profitability of the banks in various counts. The provisioning exercise for the NPAs also puts a strain on bank's Capital because of the maintenance of desired level of Capital adequacy. This article attempts to analyse the magnitude of NPAs in Banks ,its causes ,effect on profitability of banks , status of recovery through various legal and non legal measures and various steps taken by Government and RBI to boost up recovery.

Keywords ; financial reform, NPAs ,Recovery, capital adequacy, legal and non-legal measures etc

Introduction

Presently, prevalence of NPAs is considered as a big threat to banking sector. . Credit is one of the important functions of any bank. But there is risk involved in this. Banks raise resources not just through various deposit schemes but also the funds lent are recycled back into the system when payment is received. A loan when becomes NPA stops this recycling of fund and the credit creations is disrupted. NPAs require provisioning and accordingly the amount is kept aside from profit seriously impacts the bottom-line of the bank. Thus NPA is a great concern not only for the bank itself but also for the policy makers including the stake holders.

Before the liberalization and reforms in the banking industry, NPA was not a matter of concern because income recognition concept was not there. There was no priority of thinking on this important area. But after the liberalization and financial reforms, which was introduced in view of the recommendation of the Report of Narasimham Committee on the Financial System in the year 1991, international banking practices came into being, the attention of all concerned was on NPAs.

The Indian Banking Industry consists of 27 Public Sector Banks, 25 Private sector Banks, 43 Foreign banks, 56 RRBs, 1589 Urban Co-Operative banks, and 93550 rural Co-Operative banks, besides Co-operative credit institutions. However, after the amalgamation of Dena Bank, Vijaya Bank and Bank of Baroda for consolidation with effect from 1st April,2019 followed by merger of 10 PSBs to 4 effect from 1st April,2020 the number of Public Sector Banks has come down to 12 from 27 two years ago.

In banking industry presently technology is acting as catalyst. There has been a razor-thin competition among the banks. But the problem of the swelling NPAs is drawing attention of all An effective risk management in this area has assumed a great importance. Management of NPA has become the most covenant priority to all the bankers and the Government .

2. Magnitude of NPAs in Indian Banks

The magnitude of NPAs can be understood from the following table

Table No-1

The bad loans of state owned banks from 2015 to 2020

Banks	Mar 2015 (Rs.in Cr)	Mar 2016 (Rs.in Cr)	Mar 2017 (Rs.in Cr)	Mar 2018 (Rs.in Cr)	Mar 2019 (Rs.in Cr)	Mar 2020 (Rs.in Cr)
Allahabad bank	8358	15385	20688	26563	28705	32150
Andhra Bank	6877	11444	17670	28124	28974	30951
Bank of Baroda	16261	40521	42719	56480	48233	73140
Bank of India	22807	49879	52045	62328	60661	61730
Bank of Maharashtra	6402	10386	17189	18433	15324	15746
Canara Bank	13040	31638	34202	47468	39224	36645
Central Bank	11873	22721	27251	38131	32356	33259
Corporation Bank	7107	14544	17045	22213	20724	19557
IDBI Bank Ltd	12685	24875	44753	55588		
Indian Bank	5670	8827	9865	11990	13353	13862
Indian Overseas Bank	14922	30049	35098	38180	33398	23734
Oriental Bank Of Commerce	7666	14702	22859	26134	21717	21634
Punjab and Sind Bank	3082	4229	6298	7802	8606	8923
Punjab National Bank	25695	55818	55370	86620	78473	76809
State Bank of India	56738	98185	112343	223427	172750	159661
Syndicate Bank	6442	13832	17609	25759	24680	25330
UCO Bank	10186	20908	22541	30550	29888	22140
Union Bank of India	13031	24171	33712	49370	48729	49924
United Bank of India	6553	9471	10952	16552	12053	11457
TOTAL	255395	501585	600209	871712	717848	716652

From the above it is revealed that bad loans have gone up from Rs.255395 crore to Rs.716652 crore registering a growth of about 180% over the years though in March 2018 it was about Rs.871712 crore wherefrom there has been steady decline due to sound recovery through IBC route. However since the occurring of NPAs is slowing down The GNPA ratio of all SCBs declined in 2018-19 after rising for seven consecutive years . The GNPA ratio recoded an improvement because of declining slippage ratio and reduction in outstanding GNPA's

. Many loans were old and a major portion of the write-off constituted these loans. Moreover due to implementation of IBC recovery activities got a major philip and after introduction of AQR, the ratio of restructured standard advances to gross advances came down drastically . All banks be it public or private registered an improvement in the quality of asset and as a result the GNPA and in the net NPA ratios of PSBs dropped. With the IDBI Bank reclassified as a private bank from January 2019 the quality of asset of private sector bank deteriorated in terms of the GNPA ratio . But if it is excluded, the GNPA ratio has registered a reduction . According to RBI data the GNPA ratio of SCBs remained stable at 9.1% as on 30th September 2019. Along with these developments coupled with improved performance of PSBs , the ratio of standard assets in total advances of Scheduled Commercial Banks(SCBs) went up in 2018-19.

3. Categories of NPAs

On the basis of assets remaining NPA and on the basis of realizability of the dues Banks are required to classify NPAs further into the following three categories namely Substandard Asset, Doubtful Assets and Loss Assets.

3.1 Substandard Assets : A substandard asset would be one, which has remained NPA for a period but or adequate to 12 months. This is applicable from 31.3.2005.. These substandard assets have credit weaknesses which hampers the liquidation of the debt and are characterized by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.

3.2 Doubtful Assets :If an asset remains in substandard category for 12 months, an asset would be classified as doubtful with effect from March 31, 2005. Such account has all the substandard asset weakness and collection and recovery on the account is highly questionable and improbable.

3.3 Loss Assets : When the bank itself or the internal and external auditors or RBI Inspection team have marked certain assets not been written off wholly, the assets are treated as loss assets and the dues are considered unrealizable..

The position of NPAs in different categories of assets during the last three years is given below

Table No :2

Classification of Loan Assets-Bank Group wise during 2018,2019 and 2020

Rs.in crore

Bank Group	End March	Standard Assets Amount	%	Sub standard Assets Amount	%	Doubtful Assets Amount	%	Loss Assets Amount	%
PSBs	2018	4602125	84.5	205340	3.8	593615	10.9	46521	0.9
	2019	5086874	87.8	137377	2.4	506492	8.7	66239	1.1
	2020	5327903	89.2	132530	2.2	404724	6.8	107163	1.8
Pvt Bs	2018	2450552	96	27203	1.1	69978	2.7	5243	0.2
	2019	3103581	95.2	42440	1.3	104696	3.2	9576	0.3
	2020	3414554	94.9	56588	1.6	92396	2.6	37986	1.0
FBs	2018	349475	96.2	3831	1.1	8364	2.3	1635	0.5
	2019	394690	97	3163	0.8	7985	2.0	1034	0.3
	2020	425857	97.7	3273	0.8	5775	1.3	1161	0.3
SCBs	2018	7402152	88.1	236374	2.8	671957	8.0	53308	0.6
	2019	8585154	90.2	182980	1.9	619173	6.5	76849	0.8
	2020	9258114	91.7	193413	1.9	503543	5.0	143349	1.4

PSB : Public Sector Banks , Pvt Bank : Private Banks : FBs : Foreign Banks: SCBs;Schedule Commercial Banks

The above table indicates the under noted scenario :

- As compared to the figure in 2018 for PSBs the standard assets have gone up but there has been sharp increase in Loss Assets because of write off and considerable amount of haircut due to resolution process with IBC. The doubtful assets have come down due to migration to Loss assets . The loss assets have gone up to 1.8% from 0.9% and 1.1% in 2018 and 2019 respectively.
- The same has happened in case of Pvt Banks, where though the figure standard assets has come down in percentage from 96% in 2018 to 94.9% in 2020 , the loss assets % has gone up from 0.2 and 0.3 in 2018 and in 2019 respectively to 1.% in 2020. It has also resulted in fall in net profit because the write off has affected the profitability.
- The Standard Assets in SCBs has a marginal growth from 2018 (88.1%) and 90.2% in 2019 to 91.7% in 2020 as the credit culture was almost subdued and an sharp in NPA in 2019. However the migration to loss assets continued and it has gone up from 0.6% to 1.4% during the 3 years period from 2018 to 2020.
- In case of Foreign banks the scenario has not much changed due to their reluctance to credit.

Table No : 3

Movements in Non - Performing Assets by Bank Group

Rs.in crore

	PSBs	PVBs	FBs	SFBs	All SCBs
1.Closing Balance for 18-19	739541	183604	12242	1087	936474
2.Opening balance for 19-20	717850	183604	12242	1660	915355
3.Addition during the year 19-20	238464	131249	6751	1764	378228
4.Reduction during the year 19-20	99692	51335	3832	1046	155905
5.Written off during the year 19-20	178305	53949	4953	669	237876
6.Closing balance as on 19-20	678317	209568	10208	1700	899803
7.Gross NPA as % of Gross Advances					
2018-2019	11.6	5.3	3.0	1.7	9.1
2019-2020	10.3	5.5	2.3	1.9	8.2
8.Net NPA as % of Net Advances					
2018-2019	4.8	2.0	0.5	1.0	3.7
2019-2020	3.7	1.5	0.5	0.9	2.8

PSB : Public Sector Banks , PVBs : Private Banks : FBs : Foreign Banks: SFBs :Small Finance banks :SCBs :Schedule Commercial Banks

(Source :Report on trend and progress of Banking in India 2019-20)

- The difference between 1 and 2 above is due to the amalgamation of Vijaya Bank and Dena bank with Bank of Baroda.
- The quantum of GNPA's of SCBs declined for the second consecutive year.
- With substantial increase in provisioning, the net NPA ratio of SCBs moderated to 2.8 per cent by end-March 2020 .
- According to Supervisory Returns with the Reserve Bank, the net NPA ratio of SCBs further declined to 2.2 per cent by end-September 2020.
- The reduction in NPAs during the year was largely driven by write-offs .
- NPAs older than four years require 100 per cent provisioning and, therefore, banks may prefer to write them off.

- In addition, banks voluntarily write-off NPAs in order to clean up their balance sheets, avail tax benefits and optimise the use of capital. However written off loans remain in the bank's book in Shadow Register.

4. Impact of Non- Performing Assets on Banks

NPAs has direct impact on the bank's profitability which is affected in following ways:

- Liquidity position: The bank is forced to raise resources at higher cost because NPA cause mismatch between the total liabilities and total assets
- Undermine bank's image: Because of high NPA the profitability is also affected by the undermine image of the bank
- Effect on funding: Since NPAs do not yield any income for the bank and results in scarcity of funds for lending to the borrower.
- Rise in cost of capital: NPAs raise cost of capital as more working capital is required .
- Higher risk: NPA also adversely affects the risk-taking capacity of the bank
- Declining productivity:/effect on ROI/profitability : A lot of time is required for preparation of documents, filing of suit, follow up for recoveries necessitating involvement of huge manpower are required and expenses also are incurred but there is no income from the NPA accounts. It affects the profitability and productivity in banks.
- Ultimate burden on society: Since no income is generated from NPA accounts, banks in order to survive charges higher rate of interest and new borrowers suffer which is affecting the welfare of the society.
- Effect on capital adequacy: As NPAs occur banks need capital infusion and capital adequacy ratio is affected badly because of higher provisions.
- Impacting share price: Because of high NPAs people lose confidence on banks and the market acts adversely when it is revealed that the share price is impacted downward and sometimes dips below the face value of the share..

5. Causes responsible for rising NPAs in Banks

The factors attributed for turning the performing assets into NPA can be summarised as follows :-

a) External factors	b) Internal factors
Wilful defaults	Defective lending process (principles of lending to be mentioned)
Natural calamities	Inappropriate technology
Industrial sickness	Improper and unrealistic repayment schedule on compliance of all terms and conditions before disbursement.

Lack of demand	The character and capacity of the promoter is not assessed properly
Unfavourable change in Government policies	Lacuna in appraisal techniques
Non availability of clearances for appropriate authority	Absence of regular industrial visit
Recessions in the industry	Managerial deficiencies (detection of borrower)
Diversion of funds	Wrong assessment of project requirement with references to technical know- how, scale of production, etc.
Lack of seriousness in recovering the money through legal steps	Improper SWOT analysis
Influence of political leaders	Poor credit appraisal system
Debt relief scheme announced by the Government from time to time	Improper follow up and supervision at post disbursement stage.
Government Risk Management policies are not fully complied	Re-loaning process

There are some other reasons which also result in accumulation of NPAs:

- Most of the borrowers do not repay loans wilfully/intentionally.
- Lack of strong legal action against NPA defaulters.
- Corruption in the banking sector leads to increase in NPA.
- Prominent people or politicians influence the lending process of banks.
- Diversion of funds from the stated purpose increases the possibility of its becoming NPAs.
- High rate of interest leads to more NPA as burden of repayment increases on the borrower.
- Inadequate staff in banks to manage loan portfolio, supervision and follow-up.
- Training regarding Credit Risk Management to bank staff is inadequate.
- Mortgage lending is generally misled by legal experts / inspecting officers /valuers which results in poor credit appraisal.
- Risk management policies framed by governing bodies are not properly complied with.
- Risk analysis tools like track record verification, pre sanction audit system for early detection of default are not effectively used..
- Loans given to economically weaker section increase NPAs to a large extent.
- Natural calamities are one of the main reasons responsible for increased NPA in agriculture loans.
- Government schemes of debt waivers, debt restructuring increase the chances of being NPAs.
- One time settlement by banks or through LokAdalat increases the chances of being NPAs.
- Credits guarantee schemes and waiving collateral security increases chances of being NPA.
- CIBIL score has been ineffective in controlling NPAs.

6. Recovery Mechanism :

In the event of default of payment of loan and the account turning NPA, it is imperative that robust recovery measures are to be initiated as soon as possible. Any delay and slackness in this area will land the lender in dire problem as the possibility of recovery through recovery action will become useless. Recovery Mechanism is a process through which different recovery procedures are required to recover fund from the NPAs. As bank is deprived of any revenue income when the account turns bad, quick recovery action plays a great role in recycling of fund into the lenders' hand. The position of entire banking industry across all banks in respect of GNPA has been mentioned in Table no 1 and 2 above which indicates a worst scenario of accumulation of NPAs. For effecting recovery banks have two options available : Non-legal measure and legal measure.

6.1 Legal and Non-Legal measures

6.1.1 Lok Adalat : Lok Adalats, formed under the Legal Services Authorities Act 1987, are intended to bring about a compromise or settlement in respect of any dispute or potential dispute. The monetary ceiling of amount of settlement through Lok Adalat is Rs. 20.00 lakhs. This is a compromise induced settlement and recovery. Lok Adalats derive jurisdiction by consent of parties or on an application made by to the court by one of the parties in the dispute or the court is satisfied that the dispute between parties could be settled by Lok Adalat.

6.1.2 The Sarfaesi Act : The act provides the banks and financial institutions with a mechanism to higher recovery of assets by enabling them to require possession of securities and sell them to scale back the burden of the Non-Performing Assets (NPAs). The rationale behind enacting the Act was to regulate securitization financial assets and enforcement of security interest created in respect of Financial Assets to realization of such assets. The Act provides for the manner of enforcement of security interest by a secured creditor without the intervention of court or tribunal. The Act also provides a structured platform to the Banking sector for managing NPAs and to allow the banks and FIs to take possession of the securities and sell them to recover the dues. Setting up of Central Registry of securitization Asset Reconstruction and Security Interest of India (CERSAI) under this Act by Central Government in 2011 is another provision available for noting and registering of the charges created in favour of secured creditors against the properties that would eventually be enforced.

6.1.3 Debt Recovery Tribunal (DRT) : In 1993, the Recovery of Debts due to Banks and Financial Institutions (RDDBFI) Act was passed which led to the establishment of Debt Recovery Tribunals (DRT) to facilitate the debt recovery involving banks and other financial institutions. The RDDBFI Act is one of the first creditor friendly mechanisms put in place where the banks can resort to confiscating secured assets via DRTs. Prior to that the recovery law was found ineffective and inadequate. Thousands of cases were pending in various courts which adversely affected the financial sector. DRT Act is applicable to debts above Rs.10 lakhs. The Government also decides their jurisdiction. The power, duties and jurisdiction are well declared and defined. The DRT is fully empowered to pass comprehensive orders like in civil courts. But there are various issues for which NPA recovery through DRT was not successful as it was anticipated at the time of its establishment. Most DRTs are over-burdened with some Tribunals handling far more cases than they are capable of. This is adversely affecting the success rate of the Tribunals. The reluctant borrowers also try to delay the proceedings by filing claims against lenders in civil courts. DRTs are not equipped to deal with difficult questions pertaining to banking law and finding out methods and techniques of committing fraud. Moreover the DRTs remain busy with peripheral issues such as state dues, dues of workmen, etc. The present number of DRT (40) is quite inadequate to handle the massive volume of cases of banks.

6.1.4 Insolvency and Bankruptcy Code (IBC) 2016 : The IBC was enacted to for the taking over management of the affairs of the corporate debtor at the beginning of the resolution process. The wilful defaulters and concerned persons associated with NPA accounts were barred from the resolution process. Accordingly the creditor-debtor relationship was adversely affected. The BR Act 1949 also authorized RBI to direct banks to commence the insolvency resolution process under IBC. The amended provision will also allow the banks to file case before the NCLT for the borrowers who have been selected by RBI..

IBC which was introduced in May 2016, is an important act in the resolution of NPAs in India because it provides a framework for time-bound insolvency resolution (6 months extendable by another 3 months) for promoting entrepreneurship and availability of loans while balancing the interests of all stakeholders. The IBC indicated a sea change in the system in which creditors take control of the assets of the defaulting debtors, in contrast to the earlier system in which assets remained in possession of debtors till resolution or liquidation. It is felt that introduction of IBC Act has made the recovery exercise very encouraging because it has provided resolutions to some large corporate debtors. Since the inception of the Code in December 2016, 4,117 applications have been admitted as on December 31, 2020. Nearly 23 per cent of the cases admitted were settled or withdrawn after the commencement of Corporate Insolvency Resolution Process (CIRP). Out of the 1420 cases for which the CIRP process has been completed, liquidation as an outcome has happened nearly 3.6 times the resolution. However, this does not represent an accurate picture of the performance of the Code. This is because 73 per cent (799 cases) of cases undergoing liquidation and 33 per cent of cases (101 cases) undergoing resolution had been brought in from earlier Board for Industrial and Financial Reconstruction (BIFR) regime. Most of these cases have been considered to be dead corpus with most of the net worth being eroded by the time they entered CIRP. Having been able to revive 101 of such cases is an achievement in itself. The CIRP for non-BIFR legacy has yielded 195 resolutions and 288 liquidations till date. This also means that the resolution rate for non-BIFR legacy cases is more than three times higher at 40 per cent when compared to BIFR cases

In view of COVID-19, the following measures were undertaken by the government:

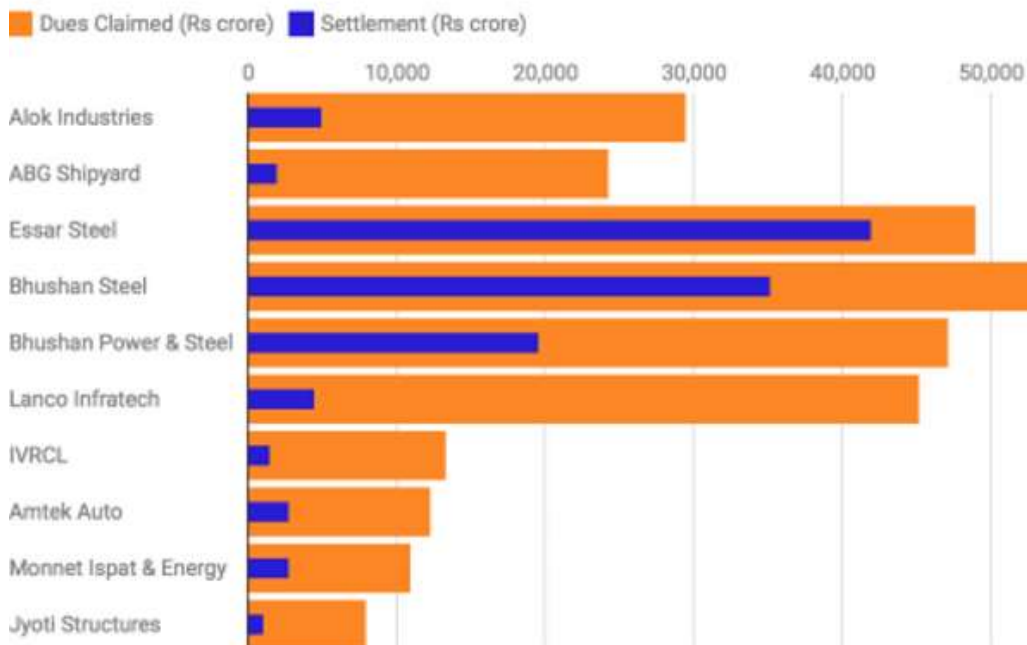
- The Government increased the threshold amount of default required to initiate an insolvency proceeding from ₹ 1 lakh to ₹ 1 crore in end March 2020.
- The Insolvency and Bankruptcy (Amendment) Ordinance, 2020, inserted section 10A to suspend initiation of the CIRP of a corporate debtor (CD) under section 7, 9 and 10 for any default arising on or after March 25, 2020 which was further extended twice for 3 months each on September 25, 2020 and December 22, 2020.
- 4.66 Further, various measures were undertaken by judiciary and the regulator, including:
 - For the matters already under a CIRP in accordance with the provisions of the IBC, the Supreme Court suo moto passed an order extending the limitation period for all matters with effect from March 15, 2020 till further orders.
 - The NCLAT, vide order dated March 30, 2020, decided that the period of lockdown ordered by the Central Government and the State Governments shall be excluded for the purpose of counting of the period for resolution process under section 12 of the Code, in all cases where CIRP has been initiated and pending before any Bench of the NCLT or in appeal before NCLAT. Any interim order/ stay order passed by the NCLAT in any one or the other appeal under the Code shall continue till next date of hearing it was ordered. Monetary Management and Financial Intermediation.

IBBI amended the CIRP regulations and Liquidation Process regulations to provide that the period of lockdown imposed by the Central Government in the wake of COVID-19 outbreak shall not be counted for the purposes of time-line for any activity that could not be completed due to the lockdown, in relation to a CIRP and Liquidation process, subject to the overall time-limit provided in the Code. Since a few cases accounted for a large proportion of money involved in the resolution process, the resolution process of 12 large accounts was initiated by banks, as directed by RBI in June 2017. Together they had an outstanding claim of ₹ 3.45 lakh crore as against liquidation value of ₹ 73,220 crores. However, resolution plan in respect of eight CDs out of these have been approved and liquidation orders have been passed in respect of two CDs. Thus, CIRPs for two firms and liquidation in respect of two firms are ongoing and are at different stages of the process. The status of the 12 large accounts is presented below

Table 4
The status of 12 large accounts which were referred to IBC

Three Cases Push Total Recoveries To Nearly 40%

Top 12 IBC cases



Liquidation value taken for four companies, Era Infra and Jaypee Infratech not included

Source : “An analysis of Non- performing assets and loans by the Public Sector Banks in Pre-covid era” CFA by Vismay Basu and Neelamegan Kannan June 2020

Table 5

NPAs recovered through various channels during 2016-17 & 2017-2018 (Rs. In crore)

2016-17		2017-18				
Channels	No. of Cases referred	Amount involved	Amount Recovered	No. of Cases referred	Amount involved	Amount Recovered
Lok Adalat	3555678	36100	2300	3317897	45700	1800
DRTs	32418	100800	10300	29551	133300	7200
Sarfaesi Act	199352	141400	25900	91330	106700	26500
IBC	37	-	-	701	9900	4900
Total	3787485	278300	38500	3439477	295600	40400

DRTs : Debt Recovery Tribunals : IBC= Insolvency and Bankruptcy Code

Table No 6

NPAs recovered through various channels during 2018-19 and 2019-20
Rs. In Crore

Channels	2018-19		2019-20			
	No. of Cases referred	Amount involved	Amount Recovered	No. of Cases referred	Amount involved	Amount Recovered
Lok Adalat	4087555	53484	2750	5086790	67801	4211
DRTs	51679	268413	10522	40814	245570	10018
Sarfaesi Act	235431	258643	38855	105523	106582	52563
IBC	1153	145457	66440	1953	232478	105473
Total	4375823	725996	118647	6135084	742481	172565

DRTs : Debt Recovery Tribunals : IBC= Insolvency and Bankruptcy Code

Source : RBI (Trend and Progress in Indian Banking 2017-18, 2018-2019 and 2019-20) and Insolvency Board of India

It will be clear from the above tables that DRTs and Sarfaesi Act have been much successful but it is IBC Act implemented in 2017 (enacted in 2016) which has shown significant result .

Table No7

Percentage of Recovery of NPAs of SCBs recovered through various channels

Year	Lok Adalat(%)	DRTs (%)	Sarfaesi(%)	IBC (%)
2013-14	6	14	27	X
2014-15	6	10	27	X
2015-16	3	7	16	X
2016-17	4	9	17	X
2017-18	4	5.4	32.2	49.6
2018-19	5.1	3.9	15	45.7
2019-20(p)	6.2	4.1	26.7	45.5

DRTs : Debt Recovery Tribunals : IBC= Insolvency and Bankruptcy Code p=Provisional

Source : Economic Survey 1920-21

It will be evident from the above tables that introduction of IBC in 2016 has helped the banks in recovering a chunk of the locked NPAs of large amount in particular which were hitherto unsuccessful. The percentage of recovery has been satisfactory from IBC and gradually the accounts from the DRTs are being transferred to NCLT.

6.1.5 Asset Reconstruction Companies (ARCs)

Apart from recovery through various resolution mechanisms, banks also clean up balance sheets through sale of NPAs to assets reconstruction companies (ARCs) for a quick exit. During 2019-20, asset sales by SCBs to ARCs declined which could probably be due to SCBs opting for other resolution channels such as IBC and SARFAESI. The acquisition cost of ARCs as a proportion to the book value of assets declined suggesting lower realisable value of the assets

Table 8**Details of Financial Assets secured by Asset Reconstruction Companies(ARCs)**

Particulars	Rs. In crore		
	March 2018	March 2019	March 2020
Book Value of assets acquired	327400	379389	431339
Security Receipts issued by ARCs	118351	142885	151435
Security Receipts subscribed by			
a) Banks	95299	99840	100934
b) ARCs	18924	26470	29435
c) FIIS	505	1681	10366
d) Others (Qualified Institutional Buyers)	3622	14805	10700
Amount of Security Receipts redeemed	8413	12240	17947
Security Receipts outstanding	98203	112651	107877

Source : REPORT ON TREND AND PROGRESS OF BANKING IN INDIA 19-20

6.1.6 Frauds in the Banking Sector

Banks are experiencing a massive loss due to excessive frauds that have taken place in the banking sector and it has become a matter of serious concern in operational risk. About nine tenth of the frauds are in credit portfolio. Frauds are basically related to off-balance sheet operations, foreign exchange transactions during the year. In 2017-18, however, deposit accounts and cyber-activity frauds have also increased to a great extent. The modus operandi of large value frauds involves opening of current accounts with banks outside the lending consortium without a no objection certificate from lenders, deficient and fraudulent services/certification by third party entities, diversion of funds by borrowers through various means, including through associated/shell companies, lapses in credit etc.

Table No 9

Frauds in various banking operations from 2017-18 to September 2020

(Rs.in Crore)

Area of operation	2017-18		2018-19		2019-20		Upto September 20	
	No of frauds	Amount involved	No of frauds	Amount involved	No of frauds	Amount involved	No of frauds	Amt. involved
Advance	2525	22558	3604	64548	4611	182117	2441	110639
Off B/S	20	16288	33	5538	34	2445	22	2059
Forex	9	1426	13	695	8	54	3	52
Card/ Internet	2059	110	1866	71	2677	129	1234	53
Deposits	691	457	593	148	530	616	274	484
Inter Br Accounts	6	1	3	0	2	0	2	0
Cash	218	40	274	56	371	63	208	24
Cheques/ DD etc	207	34	189	34	202	39	98	13
Clearing	37	6	24	209	22	7	15	6
Others	144	247	200	244	250	174	113	44

Total	5916	41167	6799	71543	8707	185644	4410	113374
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Source RBI (Trend and Progress in Indian Banking 19-20)

It is evident from the above table that Operational Risk in banks have become a major source and a matter of concern. It is revealed from the above table that frauds in advance portfolio are large in number and in amount involved. In 2017-18 the no of frauds in advance portfolio is 42.68% and with reference to amount involved it is 54.79%. In 18-19 the same has gone up to 53% in number and as high as 90.22% in amount involved. In 2019-20 the same sector shows 52.95% in number of frauds and 98.10% in amount involved. The same trend is continuing in September 20 when number of frauds amounts to 55.35% in number and 97% in amount involved. In very cases banks have been able to recover money from the fraudsters resulting in loss assets whereas per RBI guidelines 100% write off is to be made affecting the profitability of banks. Although around 80 per cent of the frauds involving amount of 'more than one lakh' were reported by PSBs, their share in total reporting – both number of cases as well as amounts involved – declined in 2019-20.

7. Measures for arresting occurrence of Non- Performing Assets

- Credit appraisal techniques should be developed to avoid fresh slippage of accounts.
- The loan applications are evaluated properly so that unviability of any project can be detected ab initio
- Separate credit monitoring Cell should be set up to look after the borrowal accounts at short intervals.
- Robust credit risk management system which is sensitive and responsive to various factors affecting credit risk.
- Measurement of risk through credit scoring.
- Quantifying the risk through estimating expected loan losses and unexpected loan losses.
- Risk pricing on a scientific basis.
- Controlling the risk through effective Loan Review Mechanism and portfolio management.
- Half-yearly and annual industry studies.
- Periodic credit audit which is to be documented.
- Periodic visits of plants and business sites.
- Quarterly management reviews of troubled exposures/weak credits.
- Personal visit and face to face discussions.
- Regular inspection for ensuring a smooth running of plant and machinery, no breakdowns, no bottlenecks, no income leakage etc.
- Special mention category of borrowing accounts are to be monitored very closely.
- Credit Information sharing system among banks regarding their experience of borrowers repayment tendency needs to be strengthened
- Banks need to cultivate an efficient Market Intelligence system to know more about their borrower.
- Recovery measures should be enhanced and strengthened to reduce NPA.
- Associations of manufacturers, Exporters, Industrialists can play an important role in recovering bank dues from their members
- Effective Corporate governance in corporate bodies itself may be helpful in reducing NPA.
- Banks should be given liberty to reduce rate of interest for economically weaker section.
- Appropriate arrangements should be made by banks to ensure efficient surveillance and governance of credit portfolio to reduce NPA.
- The appraisal followed by sanctioning responsibility and then having effective post disbursement supervision can arrest NPA. Asset reconstruction companies (ARC) can help to expedite the recovery of amounts locked in NPAs.
- The wilful defaulters should be chased and strict legal action as far as possible within the existing legal system need to be taken by the lenders.

- Banks need to cultivate an efficient Market Intelligence system to know more about their borrowers.
- The borrowers should be regularly connected and a continuous rapport to be maintained with them so that they may not distance themselves from the lenders and there may be a possibility of avoiding and reducing NPA.
- Most of the large borrowers and industrialists including exporters are members of different clubs and associations. Thus a connection with such associations and clubs may be helpful in recovering bank dues from such member-borrowers.
- Proper Training should be given to staff for effective supervision, follow up and risk management.
- Appropriate arrangements should be made by banks to ensure efficient surveillance and governance of credit portfolio to reduce NPA.
- Limiting action for Export Credit Guaranty Corporation (ECGC)
- Repossession of hypothecated assets and effecting sale.
- Compromise settlement.
- There exists a much simpler mechanism for restructuring of loans availed by Small and Medium Enterprises (SMEs). The operational rules of the mechanism have been left to be formulated by the banks concerned. This mechanism will be applicable to all the borrowers which have funded and non-funded outstanding up to Rs.10 crore under multiple /consortium banking arrangement
- Under this mechanism, banks may formulate, with the approval of their Board of Directors, a debt restructuring scheme for SMEs within the prudential norms laid down by RBI. Banks may frame different sets of policies for borrowers belonging to different sectors within the SME if they so desire.
- While framing the scheme, banks may ensure that the scheme is simple to comprehend and will, at the minimum, include parameters indicated in these guidelines.
- The main plank of the scheme is that the bank with the maximum outstanding may work out the restructuring package, along with the bank having the second largest share
- Banks should work out the restructuring package and implement the same within a maximum period of 90 days from date of receipt of requests.
- The SME Debt Restructuring Mechanism will be available to all borrowers engaged in any type of activity.
- Banks may review the progress in rehabilitation and restructuring of SMEs accounts on a quarterly basis and keep the Board informed

8 Conclusion

- The burgeoning NPAs and pending recovery cases are hurting the banking industry and the economy
- In spite of not having expected result DRTs must be strengthened because failure in debt management will impact banking, investment negatively. The future economic development of the country is also going to be jeopardised.
- For the purpose of clearing pending cases establishing more DRTs, specifying strict timelines for various stages of adjudication and equipping them to deal with complicated cases will go a long way in clearing the pending cases.
- Further, the RBI also needs to develop more stringent policy measures to address NPA issues. Due to the coronavirus pandemic the country was in lockdown and the courts were closed and thus the cases had kept piling up. Also because plenty of the Micro Small and Medium enterprises (MSMEs) haven't been ready to survive the cash crunch during the pandemic and hence there'll be more cases of debt recovery filed than the standard average. However, as mentioned above the govt. has taken certain steps to combat this problem but still the answer is simply temporary.
- The government must support the banking industry and the MSMEs and other companies as well to prevent them from being pushed into insolvency. If India aspires to take care of the healthy and fast-

growing economy it had before the pandemic the govt must take more drastic and long-lasting steps to stay the expansion sustainable.

- The government promulgated an Ordinance to amend the Banking Regulation Act to speed up recovery of bad loans for tackling the menace of mounting bad loans. In fact such burgeoning NPAs has affected the bottom line of the banks which is preventing smooth credit flow to industry and in turn jeopardizing the economy. Such an important move actually came from the affected lenders who have been experiencing huge stressed assets about Rs 10 lakh crore:
- The RBI should be given more powers by the Banking Regulation Act so that RBI can monitor and oversee (through a committee) the bank accounts of large ticket defaulting borrowers. RBI also desires tougher rules for joint lenders' forum (JLF) and an oversight committee (OC) as well to arrest and reduce NPAs. The Sarfaesi Act of 2002 which was further amended in 2016 with stringent clause allowed banks and government to recover assets of defaulters. Banks took years to recover money from selling the assets of the borrowers. The amendment in 2016 was little tough as it provided for taking over the assets and management of the defaulting company if it fails to furnish the details of its assets took banks years to recover the assets. It was pointed out by the experienced bankers that Banks should identify the early signals of default and take necessary steps for follow up.

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