Management of Non-Performing Assets – Study of Banks in India

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Our focus in the present paper is on the problem of Non-Performing Assets (NPAs) which seems to be confronting the Indian Banking Sector with several far-reaching implications. Taking cognizance of the fact that banking business involves a great deal of risk in terms of its borrowing and lending operations, it is observed that transactions involving credit risk are a key source of earnings in consonance with a bank's business strategy. It is argued that even though the banks conduct comprehensive risk management from the perspective of their over all credit risk portfolio in addition to an assessment of individual credit risk assets including loans and advances, in actual practice these turn out to be non-productive and non-rewarding and eventually tend to become Non-Performing Assets. Needless to emphasise, these Non-Performing Assets obviously have a deleterious impact on banks' ability in the matter of recycling of the credit as also on their overall profitability. It is mainly on account of the fact that the amount of money get locked up in Non-Performing Assets and, as such, is not available for further productive use. In the ultimate analysis it also adversely impacts the profitability of our banking sector. Indian Banking Sector is set to be plagued to a considerable extent by the problem of NPA and is crying for the appropriate policy measures to cope with the said problem which is considered to be relatively more severe as compared to the international standards. Against such a backdrop, an objective assesment of the problem and the search for appropriate remedial measures in respect of the commercial banks in India is likely to be both informative and rewarding from the view point of its academic worth as also from that of policy making for the future. This attempt of ours is motivated by such considerations.

Liberalization and deregulation of the Indian market has resulted in a spurt in banking activity in India. Significant advances in communication have enabled banks to expand their reach, both in terms of geographical spread and introduction of the new products. With increased competition in wholesale banking due to the entry of foreign banks and new private sector banks, the Indian banking system was made to face several challenges to improve upon the profitability. Therefore, the banks decided to reorient their strategies in the light of their own strengths and the kind of markets in which they were operating. Some of the challenges were external, e.g., phenomenal growth in the volume of capital inflows, integration of financial markets across the globe etc. But at the same time, there were home grown challenges such as cost of doing business, level of customer satisfaction, level of Non-Performing Assets (NPAs) etc.

The problem of Non-Performing Assets (NPAs) is very severe and reducing it is very significant for banks' profitability. In fact, it is a pre-condition for the stability of the banking system. NPAs have become a first charge on banks' funds for provisioning and these affect banks' performance by eating into their profitability. In an effort to build a banking system of international stature, reduction in NPAs should be accorded the top most priority. Risk is inherent in any commercial activity and banking is no exception to this rule. Rising global competition, increasing deregulation, introduction of innovative products, and delivery channels have introduced new challenges in the field of risk management. Ability to gauge the risks and take appropriate position is the key to success. The banks have to deal with different types of the risks like the credit risk, exchange rate risk, interest rate risk, liquidity risk, transfer risk, operational risk, market risk, settlement risk, counter party risk, and country risk. It is said that risk takers will survive, effective risk managers will prosper and those averse to risk are likely to perish.

Banking business is mainly that of borrowing and lending, and hence a great deal of credit risk in involved. For a bank, transactions involving credit risk are a key source of earnings in line with its business strategy. In addition to assessment of individual credit risk assets including loans, the banks conduct comprehensive risk management from the perspective of its overall credit risk portfolio. In this way, the banks seek to generate earnings commensurate with their level of credit risk. But despite maintaining the comprehensive credit risk management, the loans and advances by banks turn out to be non-productive and non-rewarding and hence become Non-Performing Assets. NPAs have a deteriorating impact on bank's profitability because of provisioning for doubtful debts and writing off of bad debts. Return on investment is also reduced. The interest income of banks fall as interest is to be accounted only on receipt basis. The cost of capital goes up, and the Capital Adequacy Ratio is disturbed as NPAs enter into its circulation.

Non-Performing Asset means an asset or account of borrower, which has been classified by bank or financial institution as substandard, doubtful or loss asset, in accordance with the directions or guidelines relating to asset classification issued by the RBI. From time to time, Reserve Bank of India has issued guidelines in respect of recognition of NPAs and their classification. Below given is the summary of these guidelines for NPAs recognition :

Table-1
Summarised RBI Guidelines for NPAs Recognition

Loans & Advances	Guidelines applicable from 31-3-2001 (*)	Guidelines applicable from 31-3-2004
Term loan interest and/or instalment remains over due for more than	180 days	90 days
Overdraft / Cash Credit a/c	Remains out of order (!)	Remains out of oreder
Bills purchased and discounted remains over due for more than	180 days	90 days
Agricultural loan interest and /or instalment remains over due for more than	Two harvest seasons but not	Two harvest seasons but not
Other accounts-any amount to be received remains over due for more than	180 days	90 days

(*) Prior to 31-3-2001 NPAs were to be reckoned on "past due" basis. As per these guidelines if the amount remained "past due" for more than two quarters, it would be considered as NPA. When the advance remains out standing for 30 days beyond the due date it is "past due".

(!) "out of order means the outstanding balance in overdraft/CC account which remains continuously in excess of the sanctioned limit for 6 months. If the outstanding balance in principle OD/CC is less than the sanctioned limit but there is no credit balance for 6 months or the balance is not enough to cover interest debited in the period then also such account is taken as out of order.

RBI Guidelines on Provisioning Requirement of Bank Advances

As and when an asset is classified as an NPA, the bank has to further sub-classify it into **sub-standard**, **loss** and **doubtful assets**. Based on this classification, bank makes the necessary provision against these assets.

Reserve Bank of India (RBI) has issued guidelines on provision requirements of bank advances where the recovery is doubtful. Banks are also required to comply with such guidelines in making adequate provision to the satisfaction of its auditors before declaring any dividends on its shares.

In case of loss assets, guidelines specifically require that full provision for the amount outstanding should be made by the concerned bank. This is justified on the grounds that such an asset is considered uncollectible and cannot be classified as bankable asset.

Also in case of doubtful assets, guidelines require that the concerned banks provide entirely the unsecured portion and in case of secured portion an additional provision of 20%-50% of the secured portion should be made depending upon the period for which the advance has been considered as doubtful. For instance, for NPAs which are up to 1-year old, provision should be made of 20% of secured portion, in case of 1-3 year old NPAs - up to 30% of the secured portion, and finally in case of more than 3 years old NPAs - up to 50% of secured portion should be made by the concerned bank.

In case of a substandard asset, a general provision of 10% of total outstanding amount should be made. Reserve Bank of India (RBI) has merely laid down the minimum provisioning requirement that should be complied with by the concerned bank on a mandatory basis. However, where there is a substantial uncertainty to recovery, higher provisioning should be made by the concerned bank.

Summarised RBI Guidelines for NPAs Classification and Provisioning

Classification Of NPAs	Guidelines for Classification prior to 31-3-2001	Guidelines for Classification from 31-3-2001	Provisioning Norms
Sub Standard Assets	NPAs for a period less than Or equal to 2 years	NPAs for a period less than or equal to 12 months	10% of outstanding principal plus entire out standing interest
Doubtful Assets	NPAs for a period exceeding 2 years	NPAs for a period exceeding12 months	For advances not covered by realizable securities, provide at 100% of advances For advances covered by realizable securities provide at : 20% of advances, if doubtful for below 1 year 30% of advances, if doubtful for 1-3 years 50% of advances, if doubtful for 3 & above 3 years.
Loss Assets	Which are identified as lost by the bank or auditors or by RBI on inspection.	Which are identified as lost by the bank or auditors or by RBI on inspection.	Write off entire asset or provide at 100%
Standard Assets	Which are not NPAs, but has business riscks	Which are not NPAs, but has business riscks	A minimum of 0.25% on "Global Portfolio" but not on "Domestic Portfolio"

Classification of Loan Assets

Foreign banks operating in India have the least NPAs, while old private sector banks account for the highest share of NPAs (Table-3). Foreign banks were able to reduce the NPAs from 6.9 per cent in the year 2000 to 2.9 per cent in 2005. New private sector banks have also been able to reduce NPAs considerably from 8.9 percent in 2002 to 3.8 per cent in 2005. The standard assets for the foreign banks in 2005 are the highest in terms of percentage (97%). This confirms the considerable reduction in NPAs of foreign banks. Another solace is the fact that the loss assets for all different types of banks have been minimum, which is 0.6 per cent in the year 2005 for SCBs. The banks need to improve upon their standard assets and reduce the sub-standard, doubtful and loss assets. Loss assets are a big worry for the banks and hence a lot of efforts are made to take care of these. SCBs had a very big amount of loss assets upto the year 2003. From Rs.7558 crore in the year 2000, loss assets for SCBs increased to Rs.8971 crore in 2003 before heading towards the slide down. There was an increase in the doubtful assets of SCBs upto 2002 which were Rs. 41201 crore in that year. PSBs also have loss assets to the tune of Rs. 5929 crore in the year 2005. Old private sector banks also pose a worry as in 2005, the loss assets of these banks were 549 crore in absolute terms. There is an urgent need to control the NPAs of SCBs, Public Sector Banks and old private sector banks, when compared to new private sector and foreign banks.

Table-3
Classification of Loan Assets of Scheduled Commercial Banks

(As At End March) Amount in Rs. Crores

Bank Groups/ Years	Standard Assets		Sub Standard Assets		Doubtful Assets		Loss Assets		Total NPAs	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Scheduled Commercial Banks										
2000	414917	87.2	19594	4.1	33688	7.1	7558	1.6	60840	12.8
2001	494716	88.6	18206	3.3	37756	6.8	8001	1.4	63963	11.5
2002	609972	89.6	21382	3.1	41201	6.1	8370	1.2	70953	10.4
2003	709260	91.2	20078	2.6	39731	5.1	8971	1.2	68780	8.9
2004	837130	92.8	21026	2.3	36247	4.0	7625	0.8	64898	7.1
2005	1093523	94.9	14016	1.2	37763	3.3	7382	0.6	59161	5.1
Public Sector Banks										
2000	326783	86	16361	4.3	30535	8.0	6398	1.7	53294	14
2001	387360	87.6	14745	3.3	33485	7.6	6544	1.5	54774	12.4
2002	452862	88.9	15788	3.1	33658	6.6	7061	1.4	56507	11.1
2003	523724	90.6	14909	2.6	32340	5.6	6840	1.2	54089	9.4
2004	610435	92.2	16909	2.6	28756	4.3	5876	0.9	51541	7.8
2005	830029	94.6	11068	1.3	30799	3.5	5929	0.7	47796	5.5
Old Private sector Banks										
2000	31447	88.8	1577	4.5	2061	5.8	347	1.0	3985	11.3
2001	35166	88.7	1622	4.1	2449	6.2	413	1.0	4484	11.3
2002	39262	89	1834	4.2	2668	6.0	348	0.8	4850	11

(As At End March)							Amount in Rs. Crores			
Bank Groups/ Years	**Standard Assets**		**Sub Standard Assets**		**Doubtful Assets**		**Loss Assets**		**Total NPAs**	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
2003	46761	91.1	1474	2.9	2772	5.4	321	0.6	4567	8.9
2004	53516	92.4	1161	2	2727	4.7	504	0.9	4392	7.6
2005	66212	94	784	1.1	2868	4.1	549	0.8	4201	6
New Private sector Banks										
2000	21870	95.9	560	2.5	294	1.3	92	0.4	946	4.2
2001	29905	94.9	963	3.1	620	2.0	11	0.0	1594	5.1
2002	70010	91.1	2904	3.8	3871	5.0	41	0.1	6816	8.9
2003	87487	92.4	2700	2.9	3675	3.9	856	0.9	7231	7.7
2004	113560	95	1966	1.6	3665	3.1	321	0.3	5952	5
2005	122577	96.2	1449	1.1	3061	2.4	334	0.3	4844	3.8
Foreign Banks in India										
2000	34817	93	1096	2.9	798	2.1	721	1.9	2615	6.9
2001	42285	93.1	876	1.9	1202	2.6	1033	2.3	3111	6.8
2002	47838	94.5	856	1.7	1004	2.0	920	1.8	2780	5.5
2003	51288	94.7	995	1.8	944	1.7	954	1.8	2893	5.3
2004	59619	95.2	990	1.6	1099	1.8	924	1.5	3013	4.9
2005	74705	97	715	0.9	1035	1.3	570	0.7	2320	2.9

Source: RBI Report on Trend and Progress of Banking in India 2000–01, 2004–05.

Magnitude of NPAs

The gross and net NPAs of SCBs in absolute terms had an increasing trend upto 2002 (Table-4). Gross NPAs rose to Rs. 70861 crore in the year 2002 from Rs.60408 crore in 2000, while net NPAs increased to Rs. 35554 crore from Rs. 30073 crore during the same period. Stricter prudential norms of classification of assets and recognition of NPAs are one of the reasons for increase in NPAs. With implementation of 90 days in NPAs recognition rule from 31-03-2004, NPAs increased in absolute terms. Various banks' Annual Reports have been citing this as one of the reasons of their increased NPAs. But the Gross and Net NPAs of Commercial banks declined in absolute terms from the year 2003 onwards with the exception of new private sector banks where the declining trend started in 2004. The decline was, however, more pronounced in respect of net NPAs. Net NPAs as per cent of Net Advances has declined across all bank groups from the year 2000 to 2005. The Net NPAs as per cent to Net advances for SCBs was 2 per cent in the year 2005, and Net NPAs as per cent to Total assets for foreign banks was 0.9 per cent in the same year. The Net NPAs as per cent to Total assets of foreign banks is 0.4 per cent in the year 2005 as compared to 1.0 per cent in the year 2000. For all the categories of banks, the Net NPAs as per cent to total assets has generally been less than half the Net NPAs as per cent to Net advances. Various factors such as improved risk management practices, greater recovery efforts under SARFAESI Act and Corporate Debt Restructuring Mechanism, interalia, contributed to the decline in the Net NPAs.

Table - 4

Gross and Net NPAs of Scheduled Commercial Banks

(As At End March) **Amount in Rs. Crores**

Bank Grups/ Years	Gross Address	Gross NPAs			Net Advances	Net NPAs		
		Amount	Per cent to Gross Advance	Per cent to Total Assets		Amount	Per cent to Net Advances	Per cent to Total Assets
Scheduled Commercial Banks								
2000	475113	60408	12.7	5.5	444292	30073	6.8	2.7
2001	558766	63883	11.4	4.9	526329	32468	6.2	2.5
2002	680958	70861	10.4	4.6	645859	35554	5.5	2.3
2003	778043	68717	8.8	4.0	740473	32671	4.4	1.9
2004	902026	64785	7.2	3.3	862643	24615	2.9	1.2
2005	1110986	58300	5.2	2.6	1074044	21441	2.0	0.9
Public Sector Banks								
2000	379461	53033	14.0	6.0	352714	26187	7.4	2.9
2001	442134	54773	12.4	5.3	415207	27969	6.7	2.7
2002	509368	56473	11.1	4.9	480681	27958	5.8	2.4
2003	577813	54090	9.4	4.2	549351	24867	4.5	1.9
2004	661975	51538	7.8	3.5	631383	18860	3.0	1.3
2005	836128	47325	5.7	2.8	807293	16642	2.1	1.0
Old Private sector Banks								
2000	35404	3815	10.8	5.2	33879	2393	7.1	3.3
2001	39738	4420	11.1	5.2	37973	2770	7.3	3.3
2002	44057	4851	11.0	5.2	42286	3013	7.1	3.2
2003	51329	4550	8.9	4.3	49436	2740	5.5	2.6
2004	57908	4393	7.6	3.6	55648	2140	3.8	1.8
2005	70412	4206	6.0	3.2	67742	1859	2.7	1.4
New Private sector Banks								
2000	22816	946	4.1	1.6	22156	638	2.9	1.1
2001	31499	1619	5.1	2.1	30086	929	3.1	1.2
2002	76901	6811	8.9	3.9	74187	3663	4.9	2.1
2003	94718	7232	7.6	3.8	89515	4142	4.6	2.2
2004	119511	5961	5.0	2.4	115106	2717	2.4	1.1
2005	127420	4576	3.6	1.6	123655	2292	1.9	0.8
Foreign Banks in India								
2000	37432	2614	7.0	3.2	35543	855	2.4	1.0
2001	45395	3071	6.8	3.0	43063	800	1.9	0.8
2002	50631	2726	5.4	2.4	48705	920	1.9	0.8
2003	54184	2845	5.3	2.4	52171	921	1.8	0.8
2004	62632	2894	4.6	2.1	60506	898	1.5	0.7
2005	77026	2192	2.8	1.4	75354	648	0.9	0.4

Source: RBI Report on Trend and Progress of Banking in India 2000–01, 2004–05

Decreasing Number of Banks with Net NPAs / Net Advances

Increasing number of banks have been able to reduce their NPAs over a period of time for all the categories of banks (Table-5).

Table - 5
Distribution of Scheduled Commercial Banks by Ratio of Net NPAs to Net Advances

(No. of Banks)

Net NPAs / Net Advances	As at End March				
	2001	2002	2003	2004	2005
Public Sector Banks	**27**	**27**	**27**	**27**	**28**
1. Up to 2 per cent	1	—-	4	11	19
2. Above 2 and up to 5 per cent	5	9	14	13	7
3. Above 5 and up to 10 per cent	16	15	7	3	2
4. Above 10 per cent	5	3	2	—-	—-
Old Indian Private Sector Banks	**23**	**22**	**21**	**20**	**20**
1. Up to 2 per cent	1	2	2	2	4
2. Above 2 and up to 5 per cent	4	2	4	9	12
3. Above 5 and up to 10 per cent	11	13	13	7	4
4. Above 10 per cent	7	5	2	2	—-
New Indian Private Sector Banks	**8**	**8**	**9**	**10**	**9**
1. Up to 2 per cent	1	1	3	4	5
2. Above 2 and up to 5 per cent	5	3	2	5	3
3. Above 5 and up to 10 per cent	2	4	3	—-	1
4. Above 10 per cent	—-	—-	1	1	—-
Foreign Banks in India	**42**	**40**	**36**	**33**	**31**
1. Up to 2 per cent	21	21	20	21	23
2. Above 2 and up to 5 per cent	6	4	2	3	2
3. Above 5 and up to 10 per cent	4	1	6	3	2
4. Above 10 per cent	11	14	8	6	4

Source : RBI Report on Trend and Progress of Banking in India 2000–01, 2004–05

In the year 2005, except 4 foreign banks, no other bank had Net NPAs/Net Advances more than 10 per cent. The heartening fact is that increased number of banks has been able to maintain their Ratio of net NPAs to net Advances below 2 per cent. 19 public sector banks, 9 Indian private sector banks, and 23 foreign banks have less than 2 per cent ratio of net NPAs to net Advances in the year 2005. In 2001, only one public sector, two private sector Indian banks and twenty one foreign banks were having their ratio of net NPAs to net Advances up to 2 per cent.

Sector-wise NPAs of Commercial Banks

Non Performing Assets in the agriculture sector seem to be out of the reach of bank control.

NPAs in agriculture, over a period of 2001 to 2005 have increased in percentage terms irrespective of the nature of bank (Table-6). NPAs in agriculture increased for the PSBs from 13.87 per cent in the year 2001 to 15.21 per cent in the year 2005. For the total private sector banks, this increased from 5.03 to 5.29 per cent over the same period. Out of the total private sector banks, big chunk of NPAs came from old private sector banks. The Nationalised Banks have shown the increase in NPAs for the priority sector from 2001 to 2005. These were Rs. 15227.89 crore in 2001 which rose to Rs. 16380.50 crore in 2005. Public Sector Banks have been able to reduce the NPAs in absolute terms for the priority as well as non priority sector from 2001 to 2005. From Rs. 27307.01 crore in 2001, the NPAs in non priority sector have reduced to Rs. 23848.61 crore in 2005. One of the reasons for this is the policy of the government to improve the efficiency of this sector. NPAs in absolute terms for the small scale industries have decreased for all the banks over the period from 2001 to 2005. In the non priority sector, NPAs for New private sector banks have increased to 90.35 per cent (Rs. 1125.19 crore) in the year 2005 as compared to 84.79 per cent(1356.29 crore) in the year 2001. Public sector is also a source of NPAs for the banks. The public sector banks had Rs.450.49 crore as NPAs in 2005 from this sector, while Rs. 42.34 crore NPAs were there with private sector banks in the same year from public sector. There needs to be a proper check on this sector as the government needs to put at least its own house in order.

Table-6

Non-Performing Assets of Commercial Bank – Sector Wise(As at the end March)

	Agriculture				Small Scale Industries				Others				Priority Sector			
	2001		2005		2001		2005		2001		2005		2001		2005	
	Amt	%	Amt	%	Amt	%	Amt	%	Amt	%	Amt	%	Amt	%	Amt	%
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
													1+5+9	2+6+10	3+7+11	4+8+12
Nationalised Banks	4357.1	13.21	4979.86	15.58	6536.22	19.82	6004.95	16.43	4334.46	13.14	8308.37	17.42	15227.89	46.17	16380.50	51.25
State Bank Group	3019.44	14.95	2274.19	15.36	3803.19	18.84	1830.01	12.36	2105.72	10.43	2912.69	19.67	8928.35	44.22	7016.89	47.39
Public Sector Banks	7376.65	13.87	7254.05	15.21	10339.41	19.44	7834.96	16.43	6440.18	12.11	8308.37	17.42	24156.24	45.43	23392.38	49.05
Old Private Sector Banks	295.12	6.13	304.25	7.19	800.14	16.63	792.07	18.71	496.22	10.31	685.57	16.19	1591.48	33.08	1781.90	42.09
New Private Sector Banks	27.35	1.71	161.14	3.53	200.59	12.54	172.24	3.77	15.29	0.96	73.18	1.60	243.23	15.21	406.56	8.90
Total Private Sector Banks	322.47	5.03	465.40	5.29	1000.73	15.61	964.31	10.96	511.51	7.98	758.76	8.62	1834.71	28.62	2188.46	24.87

Continued :

Table No. 6 to be pasted

	Public Sector				Non Priority Sector				Total	
	2001		2005		2001		2005			
	Amt	%	Amt	%	Amt	%	Amt	%	Amt	Amt
	17	18	19	20	21	22	23	24	25	26
									13+17+21	15+19+23
Nationalised Banks	498.09	1.51	282.74	0.88	17257.44	52.32	15300.80	47.87	32983.42	31964.03
State Bank Group	1212.78	6.01	167.75	1.13	10049.57	49.77	7623.55	51.48	20190.70	14808.19
Public Sector Banks	1710.87	3.22	450.49	0.94	27307.01	51.35	23848.61	50.00	53174.12	47696.48
Old Private Sector Banks	123.37	2.56	8.27	0.20	3095.97	64.35	2443.84	57.72	4810.82	4234.01
New Private Sector Banks	N.A.	N.A.	34.07	0.75	1356.29	84.79	4125.19	90.35	1599.52	4565.82
Total Private Sector Banks	123.27	1.92	42.34	0.48	4452.26	69.45	6569.03	74.65	6410.34	8799.83

Source : RBI Report on Trend and Progress of Banks in India 200001, 2004 05.

It is always important to take care of the early warning signals depicted by the potential defaulters. These warning signals, if taken care of in advance, prove to be good in recovering loans and advances before these become Non-Performing Assets. The early warning signals for the rise in NPA's can be :

(A) Financial

- Persistent irregularity in the account
- Default in repayment
- Lower credit summation
- Opening accounts with other banks

(B) Operational and Physical

- Low activity levels
- Disorderly Diversification
- Overdue Receivables
- Dishonour of cheques
- Adhoc borrowings, time and again

(C) Loss of Market Credit

- Court cases against the unit
- Inability to raise supplies on usual credit items

(D) Attitudinal Changes

- Avoids contact with the bank

- Non / delayed submission of data / financials
- Fudging of financial statements

Legal Measures to Prevent and Recover NPAs

In order to bring the problem of NPAs under control, some steps have been taken by the government/ banks. These include the formation of Debt Recovery Tribunals (DRTs), Lok Adalats (People Forum), Asset Reconstruction Companies (ARCs), Corporate Debt Restructuring (CDR). Settlement Advisory Committees have also been formed at Regional and Head office levels of commercial banks. The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 was passed by Parliament, which is an important step towards elimination or reduction of NPAs.

Debt Recovery Tribunals (DRTs)

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 judgement, penal provisions for disobedience of Tribunal's order or for breach of any terms of the 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.

Compromise Settlement

This can be resorted to when there is no scope for rehabilitation and the legal position of the bank is weak. The execution of the suit may be doubtful. The main advantage of compromise settlement is that it reduces NPAs with minimum sacrifice and enables the bank to recycle funds. The bank tries to recover as much as possible by negotiation. Compromise should be wielded as a strategy and should not be sold as a product. The compromise is generally agreed at a LOK ADALAT. Lok Adalat institutions help banks to settle disputes involving accounts in "doubtful" and "loss assets" with outstanding balance of Rs. 5 Lakh. One important condition in this process is that both parties in dispute should agree for settlement. The central government, in consultation with Reserve Bank of India, decided to increase the monetory ceiling of cases to be referred to the Lok Adalats organized by civil courts. Accordingly, on August 3, 2004, the Reserve Bank of India enhanced the necessary ceiling of Rs. 5 lakhs.

SARFAESI Act

The background to the act was the quantum of NPAs amounting to Rs. 63883 crores as on March 2001 which forms 11.40 per cent of bank advances. The recommendations of the various committees formed by the government (Narsimham Committee 1 and 2, Andhyarjuna Committee Legal Reforms) finally paved the way for the Act. The three main aspects of the Act are Enforcement of Security Interest by the secured creditor (bank), transfer of non performing asset to an Asset Reconstruction Company, and legal framework for securitisation of assets.

Asset Reconstruction Companies (ARCS)

The committee on Banking Sector Reforms (CBSR) Report suggests remedies to recover the NPAs as well their subsequent transfer as asset through Asset Reconstruction Companies. The most effective way of removing NPAs from the books of the weak banks would be to move these out to a separate agency which will buy the loans and make its own efforts for their recovery. The ARC's operations are profit oriented and its aim is to recover from the acquired assets (NPAs) more than the price paid for it. These companies are to be registered with the RBI with a minimum capital base of Rs. two crores.

Circulation of Information on Defaulters

The RBI has put in place a system for periodic circulation of details of wilful 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 amount aggregating Rs. 1 crore and above) against whom suits have been filed by banks and financial institutions for recovery of their funds as on 31st March every year.

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 debt of Rs. 20 crores and above with the banks and financial institutions. The CDR process enables viable corporate entities to restructure their dues outside the existing legal framework and reduce the incidence of fresh NPAs.

Special Mention Accounts

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 account is 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.

Banks have been able to Recover NPAs through the use of legal measures (Table-7) which is a good sign for bank's health. The SCBs successfully implemented various channels to recover NPAs. A new channel ARCs has shown impressive results in 2004 –05. Rs. 14,506 crore has been recovered through ARCs in that year. The recovery of NPAs through Lok Adalats and DRTs has been Rs. 2801 crore in 2004-05. There has been a satisfactory increase in the recovery of NPAs through SARFAESI Act. It has given adequate power to the banks to recover their NPAs. Banks, which recovered Rs.1156 crore in 2003-2004, were able to recover Rs. 2391 crore in 2004-05 through SARFAESI Act. Through one time settlement / compromise schemes the banks have been able to recover 66.06 per cent of amount involved i.e. Rs. 880 crore out of Rs. 1,332 crore in the year 2004-05. The recovery, in the year 2003-04 was 40.86 per cent i.e. Rs.617 crore out of Rs. 1510 crore of amount involved.

Table-7

NPAs Recovered by Scheduled Commercial Banks through Various Channels

(Amount in Rs. Crores)

Item	2003 – 04				2004 – 05			
	No of cases refered	Amount involved	Amount recovered	%age of Amt. recovered	No of cases referred	Amount involved	Amount recovered	%age of Amt. recovered
1. One Time settlement Compromise Schemes*	139562	1510	617	40.86	132781	1332	880	66.06
2. Lok Adalats	186100	1063	149	14.01	185395	801	113	14.10
3. DRTs	7544	12305	2117	17.20	4744	14317	2688	18.77
4. SARFAESI Act	2661	7847	1156	14.73	39288	13224	2391	18.08
5. Asset Re-construction Companies	—-	—-	—-	—-	368	—	14506	—-

* The Scheme was operational upto July 31, 2004

Source : RBI Report on Trend and Progress of Banking in India 2000 – 2001, 2004 – 2005

Suggestions for NPAs Retrieval

NPAs need to be curbed. Government is serious about it and the banks are taking a number of measures to prevent NPAs. A few suggestions are given below to help the banks to manage their NPAs more effectively;

- **Holding Period for Sale**

The banks may be given flexibility to decide their NPA management policy including the basis for sale and purchase of NPAs as a Balance Sheet management tool.

- **Sale on Swap Basis**

Banks may also be permitted to buy and sell Non-Performing Assets on a swap basis – NPAs for standard assets and vice-versa, depending on the Balance Sheet strength, need and skill sets to acquire/shed NPAs.

- **Compulsory Holding Period for Resale**

The compulsory holding period for acquired NPAs may be left to the banks. As the transaction would generally occur as a balance sheet management exercise such leverage for the banks would be necessary.

- **Classifying Acquired NPAs as Standard Assets**

The permission to classify acquired NPAs as standard assets for a period beyond one quarter may be considered to provide incentive to the purchasing bank and to promote the sale of NPAs between banks.

- **Leveraged Buy-Outs**

The banks may be permitted to acquire / build NPA portfolio and leverage the same through junk bond issues. Banks having skills to manage NPAs and capacity to issue such bonds only should be permitted to acquire NPAs beyond a certain percentage of total assets (say 2 per cent to begin with). This will also serve as a comfort to banks deposit and other stake holders.

- **Pooling of Assets**

RBI through its policy prescriptions may consider encouraging banks through their voluntary actions to pool single type of NPAs related to similar industry / group so that enforcement and cost effective management of recovery actions could be initiated against such pooled assets.

- **Staff Participation**

Create awareness among staff and elicit their co-operation in following up and recovery efforts. Involve them while doing inspection. Bring attitudinal changes among staff and giving incentives to staff for excellence.

- **Task Force Formation**

Forming task force at branches for personal contacts and follow up of NPA accounts and reviewing their performance regularly is necessary. Have personal contacts as many times as is possible.

- **Proper Identification**

The borrower should be properly identified with the help of staff through staff meetings. Local enquiry through other valuable customers / others should be done.

- **Educating Borrowers**

Exhibiting a positive outlook towards the borrower should be there. Educating the customers about the importance and need for prompt repayment before disbursal itself should be done.

- **Defaulters List**

Putting defaulters list in branch notice board, discussing the same in informal meetings is required to help the defaulters shed their ill-intentions.

- **Proper Record and Follow-up**

Keeping proper records of accounts, name, address, family, assets etc. and meticulous inspection and follow up of loans is a must.

- **Change in Attitude of Banks**

The change in attitude of the banks towards legal action is required which was traditionally viewed as the last resort measure.

- **Improvement in Managerial Efficiency**

There is a need to improve the managerial efficiency and hone the skills of the banking personnel for proper assessment of credit worthiness of the customers.

The NPAs have always been a big worry for the banks in India. It is just not a problem for the banks, they are bad for the economy too. The money locked up in NPAs is not available for productive use and adverse effect on banks' profitability is there. But a declining trend in NPAs of banks is witnessed since the enactment of new legislative measures in 2002. Given the current socio-political scenario in the country such tough legislations are required to bring down the level of NPAs. The formulation of ARCs have helped disposal of debt ridden assets in a very smooth manner. DRTs have speeded up the judicial process of reclaiming an asset to a great extent. The concept of settlement of dues between the bank and its creditors through Lok Adalats has taken off in a big way. This has led to decline in the level of NPAs of the Indian banking sector. But a lot more needs to be done. The level of NPAs of our banks is much higher than the international standards. One can not ignore the fact that a part of the reduction in NPAs is due to the writing off of bad loans by the banks. The Indian banks should take care to ensure that they give loans to credit worthy customers. Prevention is always better than cure.

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