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Litigation: A boon or bane for NPA in Indian banking sector

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Abstract

From a RBI study conducted in 1999, which though confined to only big borrowal accounts, it was inferred that the factors, responsible for creation of NPAs, external to the bank are more predominant than those attributable to the bank. In such a case the role of the Government and the RBI assumes critical importance in ensuring a credit market climate wherein the legal system is more responsive and there is sufficient deterrence to willful defaulters and those who take recourse to litigation for just buying time. Once such environment is created the NPAs levels for different banks will depend to a large extent on their own policies, systems, and judgements and perhaps will gravitate to reasonably low levels reflecting the time credit market risks. From the regulator's perspective, there are four steps to the management of NPAs, viz., Assessment, Provisioning, Recovery and Prevention of fresh NPAs. This research paper highlights the legal recovery measures to control the NPA.

Keywords: Borrowal accounts, origin of growing, collision, alternate techniques

Introduction

Bankers are the custodians and distributors of the liquid capital of the country. The banks are commercial organization and the main business of banking is to collect the deposits from the public and lead it to the individuals, business concerns, institution etc. The lending business is associated with risk. One of the risks in lending is the possibility of account becoming non-performing assets. Non-performing assets do not earn interest income and repayment of loan to bank does not take place according to the repayment schedule affecting income of the bank and their by profitability.

The non-performing assets do not generate interest but at the same time require bank to make provision for such non-performing assets out of their current profit.

The term non-performing assets figured in the Indian banking sector after introduction of financial sector reform in 1992. The Prudential norms on income recognition assets classification and provisioning there are implemented from the financial year 1992-93 as per the recommendation of the committee on financial system (Narasiham Committee). These norms have brought in qualification and objectivity into the assessment and provisioning for NPAs. Reserve Bank of India constantly India endeavors to ensure the prescription in this regard is close to international norms.

The efficiency of a bank is not always reflected only by the size of kids balance but by the level of return on its assets. NPAs do not generator interest income for the bank but at the same time banks are required to make provision for search and page from their current outputs.

NPS have on adverse effect on the return on essay aids in several ways

1. They erode current profile provisioning requirement.
2. They result introduced income.
3. They require higher provisioning requirement affecting profit and equation to capital fund and capacity to describe good quality.
4. They limit recycling of funds set in asset liability mismatch.

The bank as per the directives of RBI classified their credit portfolio and make provisions to the quality of the assets.

Scope of the study

The study has the following scope:

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1. The study could suggest measures for the banks to avoid future NPAs & to reduce existing NPAs.
2. The study may help the government in creating & implementing new strategies to control NPAs.
3. The study will help to select appropriate techniques suited to manage the NPAs and develop a time bound action plan to check the growth of NPAs.
4. The present study is concerned with NPA of Indian Banks in general.

Research methodology

The Secondary data is collected from the Annual Report published by various Commercial Banks, RBI Bulletin, Research Articles published in national and international journals, References books, various libraries, Government and NGOs Websites, etc.

The causes of rising trends of NPAs

In real world, NPAs arise due to genuine reasons, wrong assumptions/inefficiencies and misdemeanor. The causes can be categorized into external environment and internal environment.

Under the external environment falls

Global slowdown, fall in domestic demand, policy logjam & disputed contracts.

Under the internal environment falls

Banks: Governance deficit, poor credit appraisal; weak risk management; all debt-no equity; infra financing particularly highways- 'gold plated' contracts; power – faulty FSAs, pass through arrangement, termination payments; chasing quick growth; pretend and extend

Corporate India: Complex web holding company, step down entities; high leverage; overseas acquisitions; unhedged exposures; siphoning, diversion and so on

Value sale v/s distress sale: Minsky's Financial Instability Hypothesis- 3 types of borrowers (Hedge, Speculative and Ponzi)

Beyond Corporate Universe: Kisan Credit Card and Agriculture distress vis-a-vis crop insurance; Small/medium enterprises.... lack of timely support and delayed payments.

The impacts of NPAs

The impacts of NPAs which are as follows:

- Lenders suffer a lowering of profit margins.
- Stress in banking sector causes less money available to fund other projects, therefore, negative impact on the larger national economy.
- Higher interest rates by the banks to maintain the profit margin.
- Redirecting funds from the good projects to the bad ones.
- As investments got stuck, it may result in it may result in unemployment.
- In the case of public sector banks, the bad health of banks means a bad return for a shareholder which means that the government of India gets less money as a dividend. Therefore it may impact easy deployment of

money for social and infrastructure development and results in social and political cost.

- Investors do not get rightful returns.
- Balance sheet syndrome of Indian characteristics that is both the banks and the corporate sector has stressed balance sheet and causes halting of the investment-led development process.
- NPAs related cases add more pressure already pending cases with the judiciary.

The various steps taken to tackle the NPAs

NPAs story is not new in India and there have been several steps taken by the GOI on legal, financial, policy level reforms. In the year 1991, Narsimham committee recommended many reforms to tackle NPAs. Some of them were implemented.

The debt recovery tribunals (DRTs) - 1993

To decrease the time required for settling cases. They are governed by the provisions of the Recovery of Debt Due to Banks and Financial Institutions Act, 1993. However, their number is not sufficient therefore they also suffer from time lag and cases are pending for more than 2-3 years in many areas.

Credit information bureau - 2000

A good information system is required to prevent loan falling into bad hands and therefore prevention of NPAs. It helps banks by maintaining and sharing data of individual defaulters and willful defaulters.

Lok Adalats - 2001

They are helpful in tackling and recovery of small loans however they are limited up to 5 lakh rupees loans only by the RBI guidelines issued in 2001. They are positive in the sense that they avoid more cases into the legal system.

Compromise Settlement - 2001

It provides a simple mechanism for recovery of NPA for the advances below Rs. 10 Crores. It covers lawsuits with courts and DRTs (Debt Recovery Tribunals) however willful default and fraud cases are excluded.

Sarfaesi Act - 2002

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 – The Act permits Banks / Financial Institutions to recover their NPAs without the involvement of the Court, through acquiring and disposing of the secured assets in NPA accounts with an outstanding amount of Rs. 1 lakh and above. The banks have to first issue a notice. Then, on the borrower's failure to repay, they can:

1. Take ownership of security and/or
2. Control over the management of the borrowing concern.
3. Appoint a person to manage the concern.

Further, this act has been amended last year to make its enforcement faster.

ARC (asset reconstruction companies)

The RBI gave license to 14 new ARCs recently after the amendment of the SARFAESI Act of 2002. These

companies are created to unlock value from stressed loans. Before this law came, lenders could enforce their security interests only through courts, which was a time-consuming process.

Corporate debt restructuring - 2005

It is for reducing the burden of the debts on the company by decreasing the rates paid and increasing the time the company has to pay the obligation back.

5:25 rule - 2014

Also known as, Flexible Structuring of Long Term Project Loans to Infrastructure and Core Industries. It was proposed to maintain the cash flow of such companies since the project timeline is long and they do not get the money back into their books for a long time, therefore, the requirement of loans at every 5-7 years and thus refinancing for long term projects.

Joint lenders forum - 2014

It was created by the inclusion of all PSBs whose loans have become stressed. It is present so as to avoid loan to the same individual or company from different banks. It is formulated to prevent the instances where one person takes a loan from one bank to give a loan of the other bank.

Mission Indradhanush - 2015

The Indradhanush framework for transforming the PSBs represents the most comprehensive reform effort undertaken since banking nationalization in the year 1970 to revamp the Public Sector Banks (PSBs) and improve their overall performance by ABCDEFG.



Fig 1: Broad Aspect of Mission Indradhanush

A-Appointments: Based upon global best practices and as per the guidelines in the companies act, separate post of Chairman and Managing Director and the CEO will get the designation of MD & CEO and there would be another person who would be appointed as non-Executive Chairman of PSBs.

B-Bank board bureau: The BBB will be a body of eminent professionals and officials, which will replace the

Appointments Board for the appointment of Whole-time Directors as well as non-Executive Chairman of PSBs

C-Capitalization: As per finance ministry, the capital requirement of extra capital for the next four years up to FY 2019 is likely to be about Rs. 180000 crore out of which 70000 crores will be provided by the GOI and the rest PSBs will have to raise from the market.

Financial Year	Total Amount
FY15-16	25,000 Crore
FY16-17	25,000 Crore
FY17-18	10,000 Crore
FY18-19	10,000 Crore
Total	70,000 Crore

Fig 2: Capital requirements of four years of Public Sector Banks (Four financial years)

D-DE stressing: PSBs and strengthening risk control measures and NPAs disclosure.

E-Employment: GOI has said there will be no interference from Government and Banks are encouraged to take independent decisions keeping in mind the commercial the organizational interests.

F-Framework of accountability: New KPI (key performance indicators) which would be linked with performance and also the consideration of ESOPs for top management PSBs.

G-Governance reforms: For Example, Gyan Sangam, a conclave of PSBs and financial institutions. Bank board Bureau for transparent and meritorious appointments in PSBs.

Strategic debt restructuring (SDR) - 2015

Under this scheme banks who have given loans to a corporate borrower gets the right to convert the complete or part of their loans into equity shares in the loan taken company. Its basic purpose is to ensure that more stake of promoters in reviving stressed accounts and providing banks with enhanced capabilities for initiating a change of ownership in appropriate cases.

Asset quality review - 2015

Classify stressed assets and provisioning for them so as to secure the future of the banks and further early identification of the assets and prevent them from becoming stressed by appropriate action.

Sustainable structuring of stressed assets (S4A) - 2016

It has been formulated as an optional framework for the resolution of largely stressed accounts. It involves the determination of sustainable debt level for a stressed borrower and bifurcation of the outstanding debt into sustainable debt and equity/quasi-equity instruments which are expected to provide upside to the lenders when the borrower turns around.

Insolvency and bankruptcy code Act-2016

It has been formulated to tackle the Chakravyuaha Challenge (Economic Survey) of the exit problem in India. The aim of this law is to promote entrepreneurship, availability of credit, and balance the interests of all stakeholders by consolidating and amending the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time-bound manner and for maximization of value of assets of such persons and matters connected therewith or incidental thereto.

Public ARC vs. private ARC - 2017

This debate is recently in the news which is about the idea of a Public Asset Reconstruction Companies (ARC) fully funded and administered by the government as mooted by this year's Economic Survey Vs. the private ARC as advocated by the deputy governor of RBI Mr. Viral Acharya. Economic survey calls it as PARA (Public Asset Rehabilitation Agency) and the recommendation is based on a similar agency being used during the East Asian crisis of 1997 which was a success.

Bad banks - 2017

Economic survey 16-17, also talks about the formation of a bad bank which will take all the stressed loans and it will tackle it according to flexible rules and mechanism. It will ease the balance sheet of PSBs giving them the space to fund new projects and continue the funding of development projects.

Summary

The need of the hour to tackle NPAs is some urgent remedial measures. This should include:

- Technology and data analytics to identify the early warning signals.
- Mechanism to identify the hidden NPAs.
- Development of internal skills for credit assessment.
- Forensic audits to understand the intent of the borrower.

Conclusion

It is suggested to review the existing system of staff incentives for recovery from hardcore NPAs and derecognized interest. Incentives may be offered to lawyers who can manage to get a decree in a record time. Close monitoring of suit-filed cases is also called for. Finally, in respect of small advances, loan write-off may be considered, if the chances of recovery are remote. RBI suggested that lenders should carry out their independent and objective credit appraisal in all cases and must not depend on credit appraisal reports prepared by outside consultants, especially the in-house consultants of the borrower company.

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