

LEGALFOXES LAW TIMES

RISE IN NON-PERFORMING ASSET.

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ABSTRACT

Non-performing Asset is an imperative thing to the inspection of financial performance of a bank. Non Performing Assets exhibit the competence of the banks and its overall performance. Non Performing Assets mean which amount is no longer yet obtained by the bank in return for payment of loans. In the Indian economy the banking industry known for its importance and essential role. To measure and to maintain the quality of bank asset is very important for the banking sector in its development. It is well observed that in the present scenario, the quality of asset mostly in the Public Sector Banks is declining in a continuous manner and hence inflicting insupportable stress and burden on the Indian economy, banks and regulators. Along with the financial institution, Non Performing Assets have an effect on the total financial system. In today's era banks are not solely determined on the basis of quantity of branches and extents of its deposits, however also on the foundation of standard assets. NPAs have a negative impact on banks in terms of its liquidity, profitability, and solvency. NPAs are the prime symbols to display the overall performance of the banks. The RBI governs the whole banking system and, as defined by it if for a time period of more than 90 days, the installment or interest amount is overdue or unsettled then that account of loan considered as a Non-Performing Asset. This article talks about the Non performing assets, its regulation and the role of RBI. It also draws attention to some suggestion for the speedy recovery of NPAs and the methods to be adopted by the banks to resolve the situation of NPAs.

INTRODUCTION

With the introduction of reforms in financial sector 1991 the Indian Banking sector bought extreme level of changes. Indian economy affected by the problems associated with the banking sector. Collapsed of the economy also affected the banking system. In the process of recovery, banking sector also has a vital role. India adopted an open economy in the year of

1991-1992. The role of banks gone through an extreme level of changes with the introduction of liberalization and globalization. The occurrence of non-performing assets (NPAs) is affecting the overall performance of the financial institutions providing credit facility.

As per the Narasimham Committee Report (1991), those assets for which the interest remains due for a period of 180 days considered as NPAs but from March 1995 onwards this period had reduced and now if it is remain unpaid for 90 days, It will be considered as NPAs. Thus, we can conclude that NPA established a vital factor in the banking sector as it sincerely affects the bank's profitability. Banks, in their books, have different types of assets, for example, cash in hand, investment, loans and advances. The concept of Non-Performing Asset (NPA) is confined to investments, loans, and advances. Depending upon the circumstances If an asset, creates an earnings expected from it and does not reveal any atypical risk other than normal commercial risk, it is considered as performing asset, but when it fails to produce the expected earnings it is considered as a "Non-Performing Asset". In short, a loan asset becomes a Non Performing Asset (NPA) when it ceases to generate income, for more than 90 days for the bank.

For banks their main source of income is the interest earned by them on loans and repayment or any advances of the principal amount. If those assets fail to generate any income for banks, then they are classified as non-performing assets (NPA). Rise in the level of NPA proves that the problem is clearly seen not only with the banks operating at small-sized but also with big and well known banks. The bad asset in the balance sheet of the banks is a problem because as per the RBI guidelines, banks are required to keep some amount as provision which depends on their quality of asset thereby leading to declining rate of the banks profitability. In this way it impacts on the level of profitability of these banks and also disturb the wealth of shareholders. RBI has been playing a very vital role with stringent norms so that the growth in these assets can be put under control. The Insolvency and Bankruptcy Code of 2016 is playing a vital role in those cases which are associated with the recovery of assets of those creditors whose case has been filed with the National Company Law Tribunal. It is very important to push the trigger very hard as bad loans are having a serious impact on the banks with regard to their liquidity position as well and even on the economic growth as the banks are behaving in a slow manner when it comes to lending.

Regulations For Non Performing Assets & the role Of Government and RBI.

NPAs defined by Reserve Bank of India (RBI): An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank. as defined by the country's central bank, if for a period of more than 90 days, the interest or installment amount is overdue then that loan account can be termed as a Non-Performing Asset.¹ NPAs is not something which is very new in our country India and there have been various initiatives taken by the Government of India on various financial and legal issues, such as :-

- Setting up the Debt Recovery Tribunals (DRTs) in the year of 1993 with an objective for speedy disposal of cases. However, they are very less in number and fails to achieve their objective of speedy disposal of cases and due to which cases are pending for many years.
- Credit Information Bureau was established in the year of 2000 to help the banks by maintaining records of creditors or customers associated with credit activities, Credit Information Bureau share data and information regarding the credit score of individuals and list of defaulters as these information's are vital to prevent any credit falling into bad trap and it also serve as a precautionary measure taken for NPAs.
- The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 This act was introduced for banks to recover their NPAs without any intervention of the court in case of secured creditor. This act permits banks to acquire or dispose of the assets secured after serving the notice period of sixty days and if borrower disobey the notice.
- ARC (Asset Reconstruction Companies): After SARFAESI ACT amendment recently 14 new ARCs permitted with license by RBI to take over the portion of NPAs of the banks.
- Corporate debt restructuring 2005 to serve the purpose of restoring the liquidity of a company to avoid any scenario related to bankruptcy. It reduces debt and the interest rate, and expands the time to pay back the debt.
- Insolvency and Bankruptcy code Act-2016 introduced the process associated with insolvency for individuals, companies and firms under the partnership. The act has

¹ [Click here](#)

introduced a vital change by giving powers to debtors and creditors to initiate proceedings against each other and provides clear, coherent and speedy and specific process for dealing with the cases of insolvency. **Hammond Power Solutions Pvt. Ltd vs Sanjit Kumar Nayak & Ors**² The issue that comes before the NCLAT for consideration was whether a resolution plan gives NIL amount to operational creditors could have been approved by the adjudicating authority.

The NCLAT held that providing NIL amount to operational creditors in a resolution plan would certainly not balance the interest of all stakeholders, or maximize the value of assets of the corporate debtor. The NCLAT further opined that a resolution plan needs to reflect that the interest of all the stakeholders, including operational creditors has to be taken care of and that it has taken into account the fact that the corporate debtor needs to be kept as a going concern.

The order of the adjudicating authority, whereby it approved a resolution plan which did not allocate any amount to operational creditors, was therefore set aside by the NCLAT.

Types of Non-Performing Assests.

1)Gross NPA is equal to the sum of all loan assets, classified as NPA on balance sheet as per the guidelines provided by RBI. Gross NPA Ratio is equal to the ratio of gross NPA to gross advances of the bank. $\text{Gross NPA Ratio} = \frac{\text{Gross NPAs}}{\text{Gross Advances}}$. 2) Net NPA refers to those NPAs in which the bank made deduction related to the provision regarding NPAs. It convey the actual burden of banks. $\text{Net NPA} = \text{Gross NPAs} - \text{Provisions}$.³

Impact and reasons for the rise in NPA in India:

Due to the larger number of NPAs banks suffers lower profit margins, causing stress in the banking sector as low monetary means available for funding purposes on other projects, therefore, it also has some negative impact on the national economy. Banks opt for high rate of interest to maintain their profit margin. Sometimes due to NPAs banks may shift the available funds for a better projects. It may also result in unemployment as investment got affected.

² 14 February 2014 [Click here](#)

³ [Click here](#)

Government of India would receive a less amount of dividend. The bad health in the scenario of public sector banks refers to a scenario of a shareholders getting affected due to bad return. It may affect the distribution of money for organizing infrastructure growth and its political and social cost. ⁴

Government sets up recovery tribunal for example a Debt Recovery Tribunal (DRT) for expeditious and speedy procedures of debt recovery and a Debt Recovery Appellate Tribunal (DRAT) an appellate tribunal for an individual or any entity unhappy or not satisfied with the order passed by the DRT may appeal against it to DRAT. Section 17 of SARFAESI Act provides a time duration to DRT of sixty days to disposed the matter and it is possible for DRT to extend time period with a valid reason in writing time to time, but not exceeding four months. But the working of these recovery tribunals is completely ineffective. It takes a long duration of time period for these recovery tribunals to resolve the matters related to NPA.

In **Satyawati Tondon case**, the court made this observation that even with many repeated announcements made by the court . High court continuously making a mistake to ignore the availability of recovery tribunals. ⁵

Many borrowers are making default with their full intent to do that. In some scenarios various natural calamities and other major uncertain situation creating the situation for borrowers when they are unable to repay there loans. When industries suffering from industrial sickness and losses borrowed the loans resulted to less recovery of loans. Many new changes and policies introduced by the Government also affecting the NPA. Various number of defects in the process of lending also leads to rise in NPA's. Banks give loans and advances to those who are not in a position to repay the amount bank due to poor credit appraisal. Ultimately which rises NPA's.

The Judgment according to the **Akshat Commercial** ⁶ should be maintained whereby the pertinence for giving a pardon of postponing will vanquish the genuine aim of the law since this will offer chance to the borrower to cause delay and the Bank will endure due to rising bad loans.

⁴ [Click here](#)

⁵ 26 July 2010 [Click here](#)

⁶ 30 April 2010 [Click here](#)

The SARFAESI is a unique law which was ordered to ensure the legal and special protection is to be given to the organization.

Financial Stability Report

The financial stability report is a biannual report published by the RBI since 2010 with an objective to evaluate the scenario of financial stability in our country, which is also considered as one of the three important goals of monetary policy other than credit support and price stability. The report for July 2020 was released which revealed that crisis due to Covid pandemic the Gross Non-performing Assets (GNPA) ratio of all Scheduled Commercial Banks (SCBs) may increase from 8.5% in March 2020 to 12.5% by March 2021.⁷ According to experts, at least 5% of the moratorium loans could turn into NPA if Covid-19 impact persists in the economy. Because of lockdown during the phase of Covid pandemic had an adverse impact on all activities associated with industries within the economy resulting in major earnings loss. It has also influenced their ability towards loan repayment. This may lead to Gross Domestic Product (GDP) contraction by 8.9% in 2020-21.⁸

Some suggestion for the speedy recovery of NPAs and the methods to be adopted by the banks to resolve the situation of NPAs.

The proper supervision to reduce the number of NPAs is a very tough and challenging task. It requires both the measures such as Preventive measures and Curative measures. It is a responsibility of banks not only take each and every preventive measure to reduce the existing NPAs but also to take all the measures with full precaution to ignore the NPAs which may arise in future NPAs.

Observations made by experts regarding the matter related to NPAs states that there is a need to tackle the NPAs problem before a borrower starts defaulting. Some of Preventive measures also include the practice of teaching the ethics in borrowers regarding the significance of timely credit repayment. It is also vital to adhere the techniques regarding the proper credit appraisal.

⁷ [Click here](#)

⁸ [Click here](#)

Proper evaluation of each and every aspect and payment and timely sanction of credit its proper monitoring is also required to avoid any misuse of it and fund diversion.

Many numbers of entrepreneurs are borrowing as per their need to fulfill the requirements of finance, an initiative to assist the borrowers in developing good entrepreneurial decision and required skill set may introduced a positive change. The root of the issue of rising NPAs lies in the nature of overseeing by banks related to credit chance and willful defaulters. Some more crucial amendment in law is required related to the banking sector to hand over some more power to RBI to monitor and to supervise the accounts of defaulters.

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act or SARFAESI Act of 2002 was amended in 2016 as it took banks years to recover the bad loans. This act mainly focused on strengthening the secured creditors against the defaulters.

Pandurang Ganpati Chaugule and Others v. Vishwarao Patil Murgud Sahakari Bank Ltd.

In this case, the court had recently pronounced that the Cooperative Banks established by the Cooperative societies to be recognized as banks as per the SARFAESI Act, 2002.⁹

Mardia Chemicals Ltd. And Anr. vs Union Of India (Uoi) And Ors. on 4 October, 2002 , Supreme Court¹⁰ In this case made the observation that the SARFAESI Act put one party in a beneficial situation, but because of only this reason the SARFAESI Act cannot be supposed to be declared as unconstitutional. Considering the way that the object of SARFAESI Act is to accomplish quick and speedy recovery of Non Performing Assets (NPA) and better accessibility of capital, liquidity and assets to help in the development of the economy of the nation and people welfare.

The Government of India is putting his all best efforts to save the banks with the problems associated with NPAs. But still However, there is a strong need felt for strict laws to regulate and manage the NPAs. With the changing time willful defaulters must be treated under a separate law. Rigorous practices need to be adopted to take mostly correct and valid decisions making process for granting loans to an individual seeking for it.

Conclusion

⁹ [Click here](#)

¹⁰ [Click here](#)

When it comes to public sector banks NPA comes first in the list. The government is making efforts to reduce NPAs but there's lots more to do to overcome this problem. When compared to foreign banks NPAs stands ahead. It's nearly impossible to have zero NPAs. There is need to accelerate the recovery process as soon as possible. The main problem of recovery lies with the large borrowers. There is an urgent need to imply strict policy to cope up with this issue. In addition, government should make more provisions for faster settlement of pending cases n reduce the mandatory lending to priority sector as it significantly adds to the problem. Problem of NPA needs lot of concern otherwise NPAs will keep killing the yield of the bank, which will hamper the growth of the economy and it would not be able to flourish well.



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