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A Comparative Study of SARFAESI Act 2002 and Other Tools Available For the Recovery of NPAs

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Abstract: Rising non-performing assets is growing as a cancer in Indian banking sector. Almost all banks in India are affected with this death worthy disease. However, Government of India has enacted many legislatures to recover the dead amount of loan advanced by banks from time to time. Although all such laws have tried to recover the NPA's and these laws have proved successful to some extent. Still there is a need to investigate as which recovery mechanism has been more successful as compared to other tools. In this research paper, an attempt has been made to analyze the effectiveness of major recovery mechanisms in comparison of SARFAESI Act 2002.

I. INTRODUCTION

Banking sector in India is going through a transformation since the beginning of liberalization. Interest rate has been declined considerably. The performance of banks has been improved slightly over time. However public sector banks are doing the worst among all banks. The banking sector as a whole especially the public sector banks still suffer from considerable Non-performing Assets. The growing NPAs have been reeling under high level of bad debts. But the situation has improved over time. In the recent past, the bank regulators have introduced a number of measures to link the regulation of commercial banks to the level of risk and financial liability of these banks (Naresh, Parvesh 2012). New legal developments like the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act provide new option to banks in their struggle against Non-Performing Assets.

According to section 69 of Transfer of Property Act, mortgagee can take possession of mortgaged property and sell the same without intervention of court only in case of English mortgage. English mortgage is where mortgager binds himself to repay the mortgaged money on a certain date and transfer the mortgaged property absolutely to the mortgagee, but subject to provision that he will re-transfer the property to the mortgager, upon the payment of mortgage money agreed. In addition, mortgagee can take possession of mortgaged property where there is a specific provision in mortgage deed and the mortgaged property is situated in town of Kolkata, Chennai or Mumbai. In other cases, possession can be taken only with the intervention of court. Therefore, till now Bank/Financial institution had to enforce their security through court. This was a very slow and time consuming process. There was also no provision on any of the present law in respect of hypothecation though hypothecation is one of the major security interest taken by Bank/ Financial Institution. Keeping in mind the above factor among many other, Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act was enacted with effect from 21-6-2002

A. The Act deals with three aspects

1) Enforcement of security Interest by secured creditor (Bank/Financial Institution)
2) Transfer of non-performing assets to Assets Reconstruction Company, which will then dispose of those assets and realize the proceeds.
3) To provide legal framework for securitization of assets.

One of the major problems faced by Banks/Financial Institutions in India is that of Bad debts termed as "Non-Performing Assets" in official terminology. There are many reasons for the sorry state of affairs, major among them are

a) Political interference
b) Poor Law Enforcement
c) Corruption at various levels
d) Archaic Laws and Procedures
e) Misuse of sick industrial company act

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f) Low level of expertise
g) No effective mechanism for gathering and disseminating credit information
h) Dilatory judicial system

B. Non-performing assets

An asset is classified as non-performing asset (NPA) if the borrower does not pay dues in the form of principal and interest for a period of 180 days. However, with effect from March 2004, default status would be given to a borrower if dues were not paid for 90 days.

If any advance or credit facilities granted by a bank or the financial institution to a borrower become non performing, then the bank have to treat all the advances/credit facilities granted to that borrower as non performing without having any regard to the fact there may still exist certain advances/credit facilities having performing status.

With a view to moving toward international best practices and to ensure greater transparency, it has been decided to adopt the '90days overdue' norms for identification of non-performing assets, from the year ending 31 march 2004. Thus *with effect from* March 2004, a non-performing asset (NPA) shall be a loan or an advance where: -

1) Interest and/or installment of principal remain overdue for a period of more than 90 days in respect of a Term Loan.
2) The account remains 'out of order for more than 90 days, in respect of an overdraft/cash credit.
3) The bill remains overdue for a period of more than 90 days in the case of bill purchased and discounted.
4) Interest and/or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agriculture purpose and
5) Any amount to be received remains overdue for a period of more than 90days in respect of other accounts.

C. Classification of assets

The classification of assets flows from the Reserve Bank of India definition of Non-Performing Asset is categorized as follows.

1) Standard Assets: Assets which do not disclose any problem or once which carry only the normal risk to be classified as standard.

2) Sub- Standard assets: It is one which has been classified as Non-performing asset for a period not exceeding 12 months. With effect from 31 March 2005 a substandard asset is one which has remained NPA for a period less than or equal to one year (12 months) Thus the earlier period of 18 months has been reduced to 12 months.

3) Doubtful Assets: A doubtful asset is one which remains sub- standard for a period of 12 months. With effect from 31 march 2005, an asset was classified as doubtful, if it has remained substandard for period of 12 months. Thus the earlier period of 18 months has now reduced to 12 months.

4) Loss assets: Assets where the losses are confirmed or these are considered as uncorrectable are categorized as loss assets. These are the assets where the bank or external auditors or reserve bank of India, inspectors has identified loss but the amount has not been written off, wholly or partly.

D. Tools for recovering npa

For the recovery of NPA there are many tools available. The main purpose of all mechanisms is to recover the overdue amount from the borrowers. However selection of tool depends upon the amount under consideration. Thus following are the most common ways, which are used to recover the Non-performing assets.

1) *Lok Adalat:* Lok Adalat is a mechanism to resolve the matters relating to recovery of dues, out of court. Debt Recovery Tribunals / Debt Recovery Appellate Tribunals convene these. Lok Adalat have no judicial powers. It is a mutual forum for the bank and the borrower to meet and arrive at a mutual settlement. Once both the parties sign the settlement, the same is placed before the court. The court would then pass suitable orders as per the terms of settlement. Such orders cannot be challenged in the next higher courts. At present, accounts in doubtful and loss category with amount outstanding above Rs. 5 lacs can be referred to this forum. Lok Adalats proved to be quite effective for speedy justice and recovery of small loans.

II. DEBT RECOVERY TRIBUNALS(DRT'S)

When a bank finance turns bad and categorized as NPAs, the lender bank has to immediately initiate legal action against the borrower to recover its dues. The recovery of the dues through DRT's proceeding is the one of such tools available with the lender bank. The lender bank can prefer to initiate recovery proceeding through DRT, if the dues exceeding rupees 10 lacs from borrower. There is no upper monetary ceiling for filing application with DRT for interim order.

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III. SECURITIZATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT 2002(SARFAESI)

SARFAESI Act provides for Enforcement of security interest for realization of the dues without the intervention of courts or Tribunals. Thus SARFAESI is treated as one of the most effective tools for recovery of NPAs. The Securitization Act proposes to securitize and reconstructs the financial assets through two special purpose vehicles viz. 'Securitization Company ('SCO')' and 'Reconstruction Company (RCO)'. The Securitization Ordinance was brought in to speed up the debt recovery process of Banks and Financial Institutions by attachment of their assets without having to obtain a decree through normal legal process from a competent Court of Law. Although the trade and industry had a mixed reaction after the promulgation of this Ordinance, one of the reasons for which they felt unsecured with the Ordinance was that the Ordinance did not make any difference between the willful defaulters and the normal business defaulters. They felt that, due to various factorssuch as the economic slowdown in the country and political interference, most of the loan of Banks and Financial Institutions became bad for reasons beyond their control but as per the Central Government an estimated amount of about Rs.4 lac crore was locked into Non -Performing Assets (NPA) with different Banks and Financial Institutions. Committees have recommended introduction of some such kind of law which will provide faster mechanism to the lenders to recover their dues and to be able to not only attach the assets of the defaulters but also to encash them. The present law does not provide such a relief and it was taking a very long time in realization of dues, which was detrimental to public interest and affected national growth. With this back -ground, the Central Government has brought in the Securitization Law and this has sent right signals not only to the defaulters concerned but also to the borrowers in general. It is needless to mention, that a lasting solution to the problem of NPAs can be achieved only with proper credit assessment and risk management mechanism (Karunakar,2008). There is a need to investigate the effectiveness of such hard act in order to recovery of the curse i.e. NPA over other mechanism i.e Lok Adalat and DRT's.

IV. REVIEW OF LITERATURE

India's legal system has traditionally been friendly towards borrowers and famously slow and inefficient. Consequently, once a bank makes a loan to a company, it has very little bargaining power in terms of calling the loan back or getting its hands on assets that formally securitize the loan. In 1993, (DRTs) were set up precisely to avert this problem, to give banks faster access to justice. In 2002, a major step in empowering banks in their loan recovery efforts came in the form of the NPA Ordinance, later turned into the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act. The Act paves the way for the establishment of Asset Reconstruction Companies (ARCs)that can take the Non-Performing Assets off the balance sheets of banks and recover them. It also allows banks and financial institutions to directly seize assets of defaulting borrowers who fails to respond within 60 days of a notice. In this section, a review of some important studies carried out on the various aspects of Non-Performing Assets is undertaken. This will help us to formulate the precise contours of the problem under study and also develop a rationale for undertaking this work. The review will also set the necessity guidelines for research and explore the possible area, which need to be studied. Parvathy Menon(2015) The level of NPA in private sector banks is lower than their nationalized counterparts. This could be due to better credit standards maintained by these private players. However, the authorities should ensure that the interest of customers is protected by the banks and they are not exceeding the limits, so as to reduce the NPA levels Saikat Ghosh Roy(2014)The alarming thing is that all the developed and developing countries have already managed to curb the NPA level from the high of 2008-09 at the time of global recession, where it is still rising in India. Mukund P(2011)found that the cases get delayed inordinately in a Debt Recovery Tribunal much against the spirit and motive of its very establishment. Banks have expressed their dissatisfaction with the system that was instituted to ensure speedy recovery.

V. OBJECTIVE OF THE STUDY

To make a comparative study of SARFAESI Act 2002 and other tools available for the recovery of NPAs

A. Sources Of Data

The data collected is mainly secondary in nature. The sources of data for this paper include theliterature published by Indian Bank and the Reserve Bank of India, various magazines, Journals, Books dealing with the current banking scenario and research papers.

VI. RESEARCH METHODOLOGY

Research design used to carry out this study is empirical research because it deals with statistical data and the main aim of the report is to analyse the effectiveness of recovery mechanisms as compared to SARFAESI Act 2002. For the pupose of this study, data

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related to recovery of NPA's through Lok Adalat, DRTs and SARFAESI Act has been taken. The study is done on the basis of data for the period of 10 years from the financial year 2006-07 to 2015-16. Data is presented with the help of Graphs, charts and tables etc.

VII. TOOLS OF ANALYSIS

In order to achieve the above mentioned objective, the data collected are entered, arranged and presented using Microsoft Excel and SPSS 23.All information collected for the purpose of the study has been arranged in cross sectional tables, depending upon the requirements of the analysis. The tabulation encompasses absolute figures supported by simple percentage and subjected to statistical analysis using Average, Standard Deviation, F-test using One-way ANOVA technique.

A. Hypothesis Of The Study

1) *Ho:* There is no significant difference between recovery of Non-Performing Assets through Lok Adalat, Debt Recovery Tribunals as compared to SARFAESI act.
2) *H1:* There is a significant difference between recovery of Non-Performing Assets through Lok Adalat, Debt Recovery Tribunals as compared to SARFAESI act.

B. Analysis And Interpretation

Table-1 NPA recovered by Scheduled Commercial Banks through various channels(In Crores)

Year		Lok Adalat	DRTs	SARFAESI act
2006-07	No. of Cases Referred	160368	4028	60178
	Amount Involved	758	9156	8517
	Amount Recovered	106	3463	3363
	%age of Amount Recovered	13.98	37.82	39.48
2007-08	No. of Cases Referred	186535	3728	83942
	Amount Involved	2142	5819	7263
	Amount Recovered	176	3020	4429
	%age of Amount Recovered	8.21	51.89	60.98
2008-09	No. of Cases Referred	54308	2004	61760
	Amount Involved	4023	4130	12067
	Amount Recovered	96	3348	3982
	%age of Amount Recovered	2.38	81.06	32.99
2009-10	No. of Cases Referred	778833	6019	78366
	Amount Involved	7235	9797	14249
	Amount Recovered	112	3133	4269
	%age of Amount Recovered	1.54	31.97	29.96
2010-11	No. of Cases Referred	616018	12872	118642
	Amount Involved	5254	14100	30600
	Amount Recovered	151	3900	11600
	%age of Amount Recovered	2.87	27.65	37.90
2011-12	No. of Cases Referred	476073	13365	140991
	Amount Involved	1700	24100	35300
	Amount Recovered	200	4100	10100
	%age of Amount Recovered	11.76	17.01	28.61
2012-13	No. of Cases Referred	840691	13408	190537
	Amount Involved	6600	31000	68100
	Amount Recovered	400	4400	18500

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	%age of Amount Recovered	6.06	14.19	27.16
2013-14	No. of Cases Referred	1636957	28258	194707
	Amount Involved	23200	55300	94600
	Amount Recovered	1400	5300	24400
	%age of Amount Recovered	6.03	9.58	25.79
2014-15	No. of Cases Referred	2958313	22004	175355
	Amount Involved	3098	6037	15678
	Amount Recovered	98	421	2560
	%age of Amount Recovered	3.16	6.97	16.32
2015-16	No. of Cases Referred	4456634	24537	173582
	Amount Involved	7203	6934	8010
	Amount Recovered	322	637	1318
	%age of Amount Recovered	4.47	9.18	16.45

Figure - 1

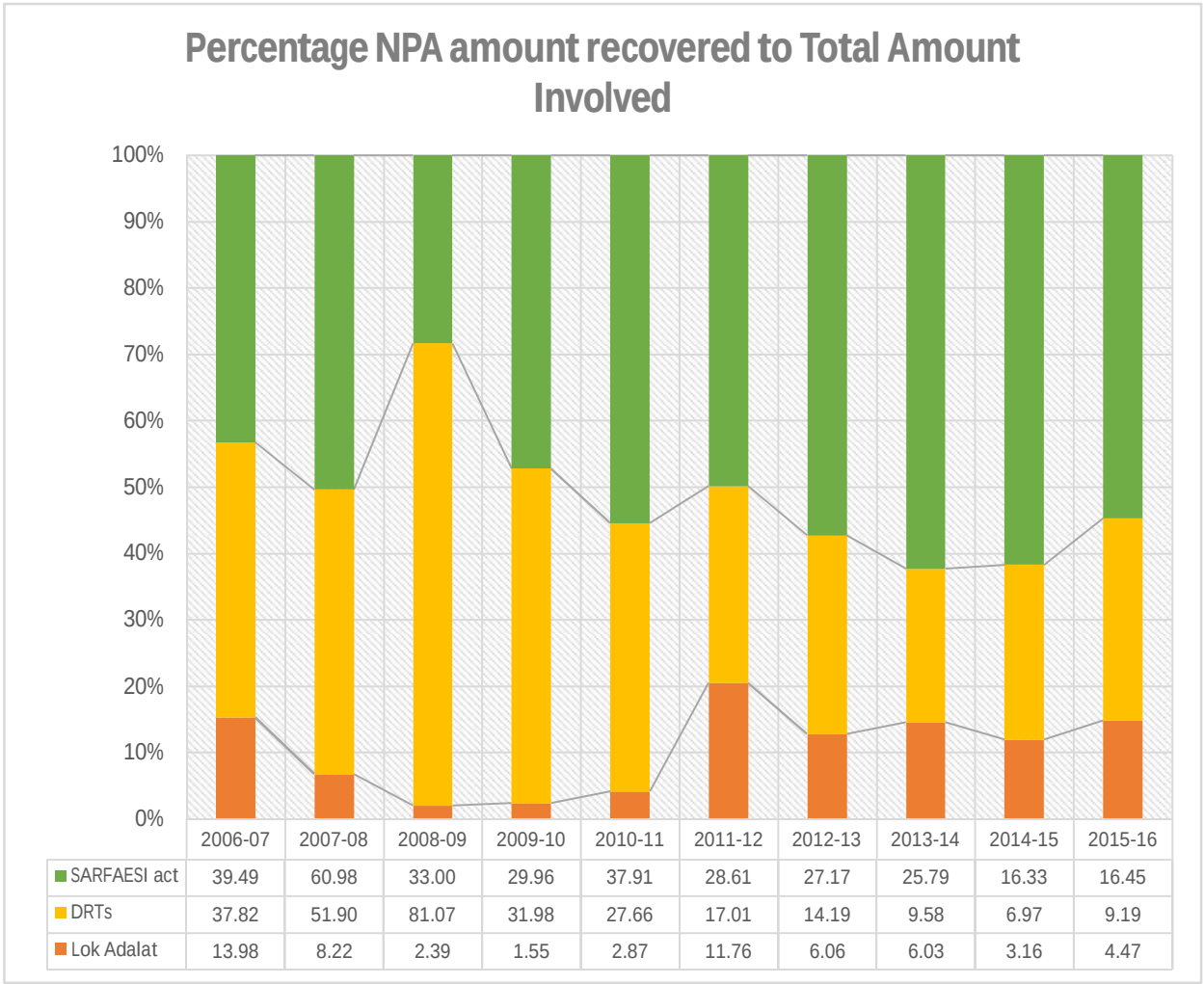


Figure 1 shows that the percentage NPA amount recovered through DRT's was higher till 2008-09 in comparison to SARFAESI act and Lok Adalat i.e 81.07% through DRT's in comparison to 33% in SARFAESI and just 2.39% in Lok Adalats. However, from 2009-10, SARFAESI Act has shown incredible performance in recovery of non-performing assets. To verify our results, statistical technique One way ANOVA is applied.

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Table-2 ANOVA Summery

	N	Mean	Std. Deviation	Std. Error
Lok Adalat	10	6.0503	4.14875	1.31195
DRTs	10	28.7376	23.42985	7.40917
SARFAESI	10	31.5687	12.88728	4.07532
Total	30	22.1189	19.03114	3.47459

Table-3 ANOVA Results

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	3913.073	2	1956.536	8.016	.002
Within Groups	6590.267	27	244.084		
Total	10503.340	29			

Table-4 Tukey HSD POST HOC test

(I) NPA measures	(J) NPAmeasures	Mean Difference (I-J)	Std. Error	Sig.
Lok Adalat	DRTs	-22.68730*	6.98690	.008
	SARFAESI	-25.51847*	6.98690	.003
DRTs Mean	Lok Adalat	22.68730*	6.98690	.008
	SARFAESI	-2.83117	6.98690	.914
SARFAESI	Lok Adalat	25.51847*	6.98690	.003
	DRTs	2.83117	6.98690	.914
*The mean difference is significant at the 0.05 level.				

It can be seen in Table -2 that Lok Adalat is numerically associated with smallest mean level of percentage recovery of Non-Performing Assets to total amount involved i.e. Mean $_{\text{Lok Adalat}}$= 6.05 and SARFAESI Act associated with numerically highest mean level of percentage recovery of Non-Performing Assets to Total Amount involved i.e. Mean $_{\text{SARFAESI}}$ = 31.568. Whereas DRT's is associated with numerically in between Mean $_{\text{DRT's}}$=28.73 level to compare with Lok Adalat and SARFAESI Act. In order to test hypothesis i.e to evaluate the relationship between effectiveness in recovery mechanisms of Lok Adalat, DRT's and SARFAESI Act, one way ANOVA is performed. There is a statistically significant difference between groups as determined by one way ANOVA in Table - 3 i.e. F_{STAT} (2, 27) = 8.016 > F_{CRITC} = 3.354. □□□□0.05 > 0.002. Thus, null hypothesis of no significant difference between recovery of Non-Performing Assets through Lok Adalat, Debt Recovery Tribunals and SARFAESI act was rejected. To evaluate the nature of difference between three means further, the statistically significant ANPVA was followed up with Tuckey Post hoc test in Table – 4. Table-4 explains difference between the recovery mechanism of Lok Adalat and DRT's is significantly different i.e . □□□□0.05 > p = 0.008. Similarly, difference between the recovery mechanism of Lok Adalat and SARFAESI Act is significantly different i.e. □□□□0.05 > p =0.003. Finally, difference between the recovery mechanism of SARFAESI Act and DRT's is not significantly different i.e . □□□□0.05 < p = 0.914. Thus in order to find out highly effective mechanism, it can be seen in Table – 2 the Mean $_{\text{Lok Adalat}}$ = 6.05 is lower than Mean $_{\text{DRT's}}$= 28.73 and Mean $_{\text{SARFAESI}}$ = 31.568. Hence, it can be concluded that there is no significant difference between effectiveness of DRT's and SARFAESI act. These two tools are more effective rather than Lok Adalat in recovery of NPA.

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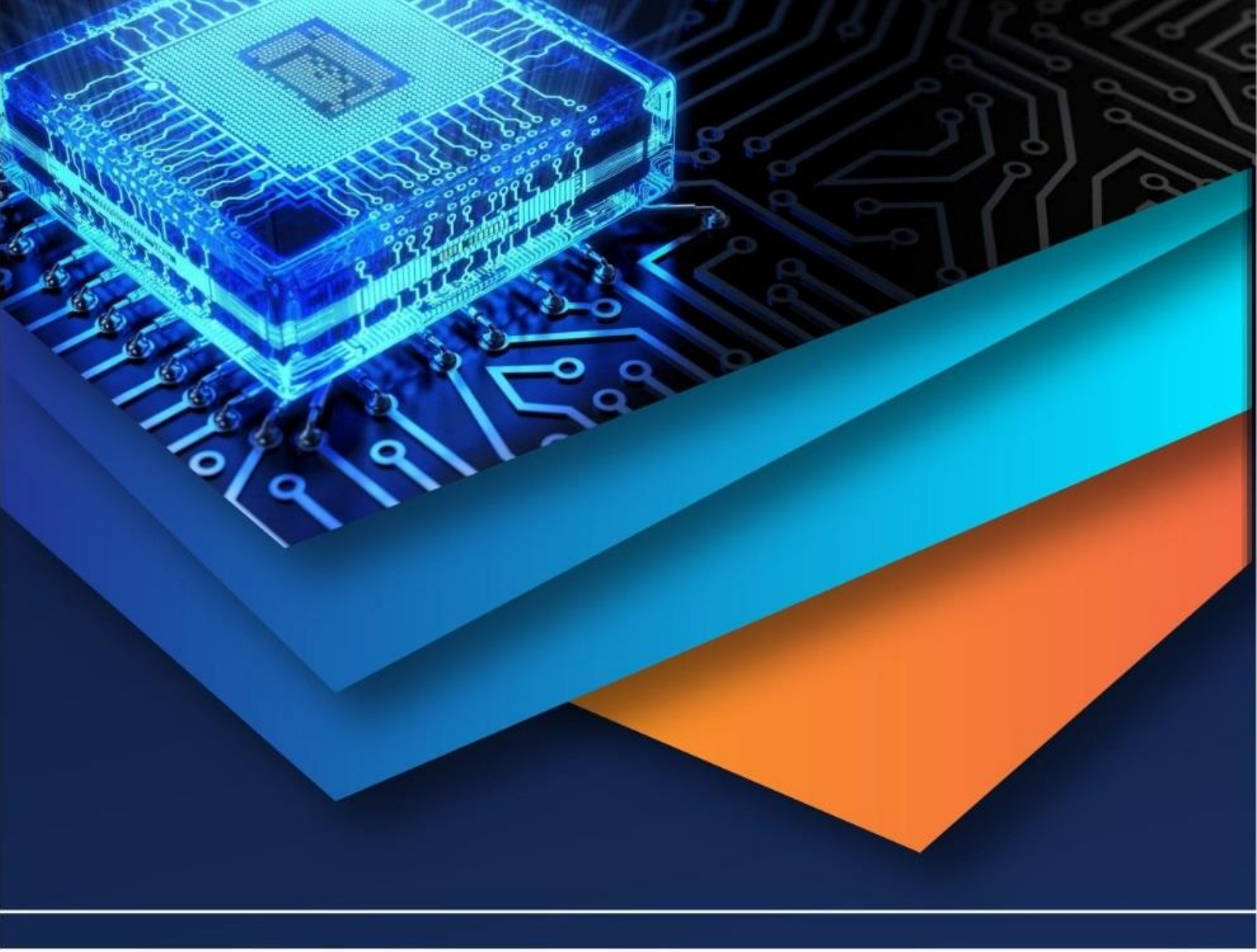
VIII. CONCLUSION

The NPAs have always created a big problem for the banks in India. It is just not only problem for the banks but for the economy too. Profitability of banks is adversely effected due to growth in non-performing assets. This study shows that, to recover the amount covered under shadow of NPA, various mechanisms have been introduced by government. The study shows that Lok Adalat has not shown considerable success in recovery of NPA i.e percentage of recovered amount to total has not touched even double figures except during 2006-07 and 2011-12. SARFAESI Act and the debt recovery tribunals (DRTs)have proved to be most effective in terms of amount recovered among the various channels of recovery for dealing with bad loans (Samir, Deepa, N. S Rana.(2010). To the contrary, DRT's and SARFAESI act has shown considerable performance in recovery of NPAs. In initial years SARFAESI has performed very well. However from 2010-11, recovery process through SARFAESI act got slower. This may be due to high dependence of recovery shifted to SARFAESI act than DRTs. Thus there is need to widen the scope of SARFAESI act so that recovery mechanism could be faster. However, Indian Bank has slippages during the period of study in controlling of NPAs in the early years of the decade.(Selvarajana, Vadivalagan 2013).

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