STATUS OF NON PERFORMING ASSETS (NPAs) AFTER THE ENACTMENT OF SECURITISATION (SARFAESI) ACT

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ABSTRACT

The present study about the Impact of Securitisation Legislation for the Management of Non-Performing Assets requires statistical data and information from various sources. The requisite methods adopted by the organizations in the developed countries for undertaking the securitization transactions are elaborate. In the developing economies like India as the financial markets are not developed the same methods do not seem practicable in the organizations. At the same time organizations in these countries need to have a high level of effective management control and effective utilization of scarce financial resources. They can't afford to circumvent the concept of converting the illiquid assets in to liquid assets i.e. securitization. The law enacted by the Indian Parliament in 2002 for the recovery of bad loans by enforcing the Security Interest was the need of the hour as NPAs according to an estimate were of more than Rs 1,00,000 crore.

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The principal objectives of commercial banking operations are to generate profits and contribute to growth process of the country. The technique that commercial banks adopt to fulfil these objectives has a direct bearing on their assets and liabilities. Banks always strive to adopt an appropriate operational approach with a view to maintain liquidity and profitability of their assets. But there are many assets in the banking system, where there is an imbalance between the liquidity and profitability. Such assets are known as non performing assets, for instance, term loan, overdraft, cash credit account, government securities, etc. The amount to be received from these assets remains unpaid or remains overdue. The government securities, bonds and debentures of corporations can also be included in non performing assets, if interest is not received regularly from them and if still there are some recoverable arrears. In other words, an asset will become non-performing asset, if it does not generate income to the bank.

An asset is classified as non-performing asset if dues in the form of principal and interest are not paid by the borrower for a period of 180 days. However, with effect from March 2004, default status would be given to a borrower if dues are not paid for 90 days. If any advance or credit facilities granted by banks to a borrower becomes non-performing, then the banks will have to treat all the credit facilities granted to that borrower as non performing without having any regard to the fact that there may still exist certain credit advances having performing status.

FACTORS RESPONSIBLE FOR NPAS:

The banks and financial institutions in India have made significant contributions to almost all the sectors of the Indian economy such as agriculture, industries of all categories and sizes, trade, employment and infrastructure. The ever-increasing trends in deposits and credits speak the volumes for the performance of Indian banks. However, the NPAs in the credit portfolios of the banks and financial institutions have become thorn in the flesh during the last one decade or so. NPAs have not only affected the profitability and productivity of the banks and financial institutions, but also put a stigma on the image of Indian banking and a drain on the very value system of the society. According to an estimate the NPAs have risen to an alarming level of more than Rs. 1, 00,000 crore in year 2000[1].

A large number of factors are responsible for this menace of NPAs. The causes can be described as internal and external or causes inherent in the banks and borrowers, etc.

STATUS OF NPAS:

Inspite of reform measures undertaken by banking sector, the problem of NPAs has assumed an alarming proposition and occupied a central place in banking sector. Some of the experts opined that NPAs problem should be viewed in the context of transition that the Indian economy in general and banking sector in particular are undergoing. The gaps that arose as a result of an implementation of first phase of financial sector reforms, especially the prudential, accounting and capital standard, have been met by the government to a larger extent.

The total NPAs of PSBs, which were about Rs. 39,251 crore at the end of March 1993, have grown up to Rs. 56,507 crore at the end of March 2002. In terms of percentage of total advances the NPAs have declined from 23.27 percent to 11 percent for the respective periods. The quantum of NPA level in public sector banks is quite large and may be considered a fundamental weakness in the public sector banks[2]. The problem of increasing NPAs can be attributed to the credit system followed in the Indian banks particularly after the nationalisation of 14 commercial banks in 1969. The banks were assigned the role of the agents of economic and social development where the risk return approach could rarely be used.

Moreover, the deficiencies in the credit recovery system played a major role in fueling the problem. The implementation of prudential norms has indeed created awareness among the bankers and they have been sensitised. They measure the risk in lending. The RBI has found in a study of 800 NPA accounts of 17 banks that diversion of funds for expansion for promoting associate concerns, marketing failure, inefficient management, inappropriate technology, labour unrest, unfavourable macro economic environment like recession, infrastructural bottlenecks, time and cost overruns, changes in government economic policy and delays in the sanction of loans by the banks being responsible for the growth of NPAs in India.

In order to understand the status, certain valuable information have been presented in different tables covering sector wise NPAs of PSBs; gross and net NPAs of scheduled commercial banks; group wise classification of loan assets as per RBI norms; scheduled commercial banks gross and net NPAs as percentage of advances and total assets and PSBs and private sector banks priority sector NPAs in advances to weaker sections.

NEED FOR MANAGEMENT OF NPAS:

Since the adoption of liberalisation, privatization, globalisation and financial sector reforms, banks and financial institutions are under tremendous pressure to reduce and bring down their NPAs at par with international standards. The reduced NPAs will improve the profitability of such institutions. The concept of NPAs introduced during the year 1992-93 in Indian banking industry forced the financial institutions to keep their lending rates high because NPAs results in higher operational cost and erode the capital. The NPAs also have a double effect on the profit and loss account, firstly the income arising on accrual basis is not recognised and secondly the sufficient provision is to be made in the balance sheet. This is definitely going to strain the profit and loss account which, in turn, jeopardises the solvency of the financial institutions. The guidelines issued by the Reserve Bank of India on income recognition, assets classification and provisioning norms have compelled banks in India not only to show the true financial picture in the balance sheet but also to take corrective steps for improving their loan portfolio.

NPA management is a matter of concern to entire banking industry. Before drawing up a proper plan for the recovery of NPAs what one has to see is the background of an NPA and the reasons for its origin. A lot of NPAs result from lack of proper monitoring and control. There are NPAs which occur due to the factors beyond the control of the borrowers. Sometimes, NPAs occur due to diversion of funds by the borrower. But, effective monitoring and control will definitely restrict NPAs.

The eagerness shown by the banks to reduce NPAs is definitely a welcome step in a right direction. But, it should be ensured that NPAs are being reduced by taking stringent measures at the time of loans sanctioning, regular monitoring, systematic evaluation and legalised recovery and not through excessive provisioning to mislead the competitors, stakeholders and public at large.

SECURITISATION LEGISLATION

The non-performing assets of the banks and financial institutions have acquired the status of dangerous and calamitous problem all over the world. The survival of these institutions has been endangered as their viability and solvency are influenced by the NPAs. The main activity of such financial institutions i.e. lending activity gets adversely impacted due to the non recovery of the loan assets and interest on such assets influence the credit dispension process. As a consequence the profitability of such financial institutions also gets affected. This all results into greater need for funds by way of capital and extra provisions. Thus, the management of bad loans and keeping them at the lowest level is of paramount significance for the financial institutions as they are based upon public confidence.

The Indian economy has also been affected by bad and doubtful assets of its banks and financial institutions. Although no exact data is available on the amount of NPAs in Indian context as estimates vary between Rs. 70,000 crore and Rs. 1,00,000 crore of our banks and financial institutions. The multiplicity of factors is responsible for the present status of NPAs in these financial institutions in India. The factors can be classified as originating, internal, external and other factors. Originating factors are inefficient management, unavailability of inputs and misappropriation of funds. Internal factors consist of financial problems, project appraisal deficiencies and project management deficiencies. Political interferences, lop-sided laws and government policies are under the category of external factors. Other factors are lack of good credit risk management system, inadequate preventive measures and inadequate post-disbursement supervision.

The Reserve Bank of India and the Government of India took number of measures from time to time like One Time Settlement Scheme (OTS), Debt Recovery Tribunals (DRTs), Lok Adalats, etc. to stem the rot, but fell short of the desired results and high expectations of the concerned people in particular and society in general. The government of India was critised and faced scathic attack from different quarters of the economy and the society. Obsessed with the criticism, the Government of India promulgated Securitisation Ordinance in June 2002 and enacted the full fledged Act in December 2002 entitled Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002. This is also known as SARFAESI Act 2002 or simply the Securitisation Act.

Securitisation originated and developed in U.S.A. and the markets for it have grown at a very rapid pace over the years in that country. U.K. is the second nation to make the best utilization of this concept. Other European countries have also realised the significance of securitisation and started enacting the legislations to assist the development of markets. In India, the concept of securitisation began in nineties when Citi Bank securitised a pool from its auto loan portfolio and placed the paper with GIC Mutual Fund. The volume involved was Rs. 16 crore. Then, various financial companies, housing companies, investing companies and banks followed the suit.

Securitisation in a broader sense indicates the process of disintermediation where in the borrowers bypass the traditional intermediatation process by accessing the investors' community directly in the money and capital markets through issuing their own securities. Securitisation as an innovation in the financial market covers the process of converting the contractual debt into tangible securities and selling them to the investors after proper packaging and underwriting the same.

The Securitisation Legislation in India deals with NPAs through Asset Reconstruction Companies and Enforcement of Security Interest besides the Securitisation. Considering all this and the significance of the securitisation in the recovery of NPAs of the banks and financial institutions, an effort is made to probe the impact of Securitisation Legislation in improving the financial markets, increasing the profitability and solvency of the banks and financial institutions through effective management of NPAs.

RESEARCH DESIGN

The present study was undertaken for knowing the impact of Securitisation Legislation in the management of NPAs in selected financial institutions. To attain this target following banking institutions operating at their local, regional and zonal levels have been approached to provide the requisite data and information. Banks operating at all the three levels include State Bank of India, Oriental Bank of Commerce, Union Bank of India, Allahabad Bank, Bank of Baroda, Canara Bank and Punjab National Bank. Banks operating at two levels include Bank of India, Central Bank of India, Dena Bank, Punjab & Sind Bank, State Bank of Patiala, Syndicate Bank and Vijaya Bank. Banks operating at only one level include Andhra Bank, Bank of Maharastra, Corporation Bank , Indian Bank, Indian Overseas Bank, United Bank of India and UCO Bank.

In all 54 bank branches of 21 public sector banks have been included in the study. The performance at national level of the banks under study has been already discussed in previous chapter while various aspects of NPAs and Securitisation Legislation have been enquired from the respondent banks situated in Haryana, Punjab, Delhi, U.P. and Chandigarh.

Recovery and Prevention of NPAs by Securitisation Legislation – A query was raised to the respondents about the help rendered by the Act in recovery of NPAs and whether it has also helped in the prevention of NPAs. The responses have been summarised in Table 1.1

Table 1.1

NPAs versus Securitisation Act

Act has helped in	**Respondents**			
	Yes	**No**	**Can't say**	**Total**
Recovery of NPAs	51 (94.44)	3 (5.56)	—	54(100)
Prevention of NPAs	40 (74.07)	9 (16.67)	5(9.26)	54 (100)

Source: Sample Survey

Figures given in parentheses represent percentages

As regards the help by Securitisation Act in recovery of NPAs is concerned, a very vast majority (94.44 percent) of respondents replied 'affirmatively'. This conforms to the results of previous two queries of this section underlining the success of Securitisation Act in dealing with the menace of NPAs. About ¾th respondents also recognized that Securitisation Act help in prevention of NPAs while remaining either denied its help in preventing NPAs or preferred to keep mum.

The statistical tool χ^2 applied for both aspects of recovery and prevention of NPAs under Tables 1.1 (a) and 1.1 (b) led us to the acceptance of null hypotheses that levels of operation of banks are independent of recovery and prevention under Securitisation Legislation. It indicates that the Securitisation Act has helped in the recovery and prevention of NPAs at all the three levels of banks under study.

On the basis of above discussion, it may be concluded that legislation of Securitisation has succeeded in its mission and thus enabled the banking industry to come at par with international standards and making Indian economy capable of facing the challenges of W.T.O.

TABLE 1.1(a)

Help in Recovery of NPAs by Securitisation Act

Level	**Status**			
	Yes	**No**	**Can't say**	**Total**
Local	28 (100)	—	—	28 (100)
Regional	13 (86.67)	2 (13.33)	—	15 (100)
Zonal	10 (90.91)	1 (9.09)	—	11 (100)
Total	51 (94.44)	3 (5.56)	—	54 (100)

Source: Sample Survey χ^2=3.66(df: 2)

Figures given in parentheses represent percentages

TABLE 1.1 (b)

Help in Prevention of NPAs by Securitisation Act

Level	Status			
	Yes	**No**	**Can't say**	**Total**
Local	19 (67.86)	5 (17.86)	4 (14.28)	28 (100)
Regional	13 (86.67)	2 (13.33)	—	15 (100)
Zonal	8 (72.73)	2 (18.18)	1 (9.09)	11 (100)
Total	40 (74.07)	9 (16.67)	5 (9.26)	54 (100)

Source: Sample Survey χ^2=2.76(df: 4)

Figures given in parentheses represent percentages

Decline in NPAs to Advances Ratio - The examination of the previous tables of this section of the research study has proved beyond doubt that Securitisation Legislation has resulted into reduction and prevention of NPAs across the banks and levels. To look into the matter from the perspective reduction of NPAs in terms of advances, Table 1.2 and 1.3 have been constructed.

TABLE 1.2

Decline of Gross NPAs to Advances Ratio after the Passage of Securitisation Act

Level	**Respondents**			
	Yes	**No**	**Can't say**	**Total**
Local	23 (82.14)	5 (17.86)	—	28 (100)
Regional	14 (93.33)	—	1 (6.67)	15 (100)
Zonal	10 (90.91)	1 (9.09)	—	11 (100)
Total	47 (87.04)	6 (11.11)	1 (1.85)	54 (100)

Source: Sample Survey χ^2=5.62(df: 4)

Figures given in parentheses represent percentages

A large majority of the bank respondents has recognised the decline of gross NPAs to advances ratio at all the levels of their operations. Aggregately 11.11 percent replied 'negatively' except regional level.

The statistical analysis for χ^2 also led us to believe that reduction of gross NPAs to advances ratio is taking place at all the levels.

TABLE 1.3

Decline of Net NPAs to Advances Ratio after the Passage of Securitisation Act

Level	Respondents			
	Yes	**No**	**Can't say**	**Total**
Local	21 (75.00)	7 (25.00)	—	28 (100)
Regional	10 (66.67)	—	5 (33.33)	15 (100)
Zonal	8 (72.73)	2 (18.18)	1 (9.09)	11 (100)
Total	39 (72.22)	9 (16.67)	6 (11.11)	54 (100)

Source: Sample Survey χ^2=13.59** (df: 4)

Figures given in parentheses represent percentages

The declined has also been observed for net NPAs to advances ratio. This ratio has been admitted 'affirmatively' by less percentage of respondents as compared to reduction in gross NPAs to advances ratio.

It may be summed up that reduction in NPAs to advances has taken place for both gross and net amounts but gross reduction is noted to be more as compared to net reduction in banks.

The statistical tool χ^2 lead us to rejection of null hypothesis. It means the reduction in net NPAs to advances ratio is not taking place uniformly at all the levels. This is also in conformation with the analysis.

On the basis of above discussions, it may be concluded that decline in gross and net NPAs has been observed at all levels of banking operations but degree may not be same for gross and net decline of NPAs to advances.

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