

R Gandhi: Banks, debt recovery and regulations – a synergy

Talk by Mr R Gandhi, Deputy Governor of the Reserve Bank of India, at the “Workshop for Judges of DRATs and Presiding Officers of DRTs”, conducted by the Centre for Advanced Financial Research and Learning (CAFRAL), Lonavala, 29 December 2014.

* * *

Assistance provided by Ms Sadhana Varma is gratefully acknowledged.

1. Honourable Judges of Debt Recovery Appellate Tribunals (DRATs) and the Presiding Officers of Debt Recovery Tribunals (DRTs) and other distinguished guests. It is an honour for me to address you all here at this Workshop organised under the aegis of CAFRAL. This Workshop comes at a very opportune time when banks are facing multi-dimensional challenges to recover their debts. The rising level of non-performing assets is a major concern of the banking system. In spite of the fact that various legislations have been enacted and repeated efforts are made to emphasize importance of recovery, the non performing assets continue to increase.

What is debt recovery?

2. A bank begins a debt recovery process when it seeks money it is owed. A bank takes recovery action for a number of reasons, but the most common is when a customer fails to make loan repayments.

Debt recovery may include:

- Referring the matter to a specialist debt recovery team within the bank
- Employing an external debt collection agency to act on its behalf
- Selling property over which the bank holds security
- Seeking a judgment from the courts to enforce the debts

Why timely recovery of loans is important

3. Timely recovery of a normal loan between two parties may not be of critical importance to anyone, except to those two. A bank loan is not just a contract between the bank and the borrower. Entwined with this contract is the general welfare of the public, out of whose deposits the bank loan has been granted. However, timely recovery of bank loans are important for variety of reasons and from various perspectives. From the borrower's angle, the longer the delay in settlement, the outstanding liabilities of the borrower increase; the likely penalties may also increase with time. From the bank's perspective, the longer the delay in recovery, they lose the opportunity to earn income in alternative investments, the security and collateral may lose value and hence may incur capital loss as well. More importantly, the delays in recovery proceeds can lead to liquidity crisis in the bank, run on the bank and consequent failure of the bank. From the society's angle, the productive assets are held up, not producing value, not creating employment and income. From the government's perspective, if such loan losses cascade and turn into systemic risk and endanger the financial and economic stability, the tax payers' money will have to be used up for rescuing these banks, otherwise the depositors, meaning the ordinary, general public will have to bear losses. Thus from very many perspectives, timely recovery of loans are critical for the borrower, the bank, the society and the government.

Restructuring a bank loan

4. Recognising the importance of contribution of productive assets for generating employment, income and value, banks world over are expected to have forbearance towards loans for those assets. In many countries, banks are, by law and/or regulations, required to show such forbearance. In India also such provisions exist in law and regulations. SICA, BIFR, CDR, JLF and several other regulations of the Reserve Bank are the examples. Viable businesses, though not repaying the loans, are required to be supported by the banks; variety of concessions are being extended by the banks; the concessions include additional moratorium, elongated repayment schedules, lower interest rates, write offs and waiver of interest, penalties, charges and even principal etc. Compromised settlements are common for almost every type of loans.

5. Thus the banks do not proceed to recovery of bank loans just like that. As mentioned, they have to first establish the possibility of restructuring and restoration, before initiating recovery proceedings.

Recovery through Debt Recovery Tribunals (DRTs)

6. The Reserve Bank, along with the Government, has initiated several institutional measures to speed up recovery of bank loans. Prior to 1993, banks had to take recourse to the long legal route against defaulting borrowers, beginning with the filing of claims in the courts. Many years were therefore spent in the judicial process before banks could have any chance of recovery of their loans.

7. The Committee on the financial system headed by Shri M. Narasimham had recommended setting up of the Special Tribunals with special powers for adjudication of such matters and speedy recovery as critical to the successful implementation of the financial sector reforms. Another Committee under the Chairmanship of Shri T. Tiwari had examined the legal and other difficulties faced by banks and financial institutions and suggested remedial measures including changes in law.

8. Debt Recovery Tribunals (DRTs) were established consequent to the passing of Recovery of Debts Due to Banks and Financial Institutions Act, 1993 to assist the banks in the speedy adjudication of matters relating to recovery of NPAs of ₹10 lakh and above. Appeals against orders passed by Debts Recovery Tribunal (DRT) lie before Debts Recovery Appellate Tribunal (DRAT).

9. Presently, there are 33 DRTs and 5 DRATs functioning all over the country. The recent amendments to DRT Act vide the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act, 2012 have been carried out to improve the functioning of the DRTs, to prescribe time frame for filing of pleadings, adjournments etc. and to give recognition and validity to the settlements / compromises entered into between banks and borrowers.

10. Within a lesser period than a decade it was observed that DRTs could not give desired results and a need was felt that banks should be given adequate powers to recover their dues without intervention of Courts and Tribunals. SARFAESI Act was brought into existence in 2002. It was indeed a good piece of legislation which gives adequate strength to the Banks and Financial Institutions to expedite recovery of their dues but clever defaulters found their ways to move the Court / Debt Recovery Tribunal to delay the course of recovery and entangle the banks with endless litigation. SARFAESI Act was enacted to avoid going to DRTs but banks get dragged to DRTs on flimsy grounds.

11. The Government has formed a committee to examine the need for strong Bankruptcy law.

Asset quality

12. The gross NPAs to gross advances of scheduled commercial banks have increased from 3.4 per cent as at end March 2013 to 4.1 per cent as at end March 2014. During the same period net NPAs to net advances increased from 1.7 per cent to 2.2 per cent. The gross NPAs were ₹ 2,511 billion as on March 31, 2014 as compared to ₹ 1,839 billion as on March 31, 2013. Banks' ratio of restructured assets to gross advances stood at 5.9 per cent as of the end of March 2014, compared with 5.8 per cent a year ago. In absolute terms, the restructured assets amounted to ₹ 3,579 billion as at end of March 2014. Thus the total stressed assets, meaning the loans which are not being recovered despite having become due, amounted to ₹ 6,090 billion as at the end of March 2014, as against total gross advances of ₹ 61,018 billion as on that date.

13. These data should be seen in the light of the total capital and profits of the banks. The total capital amounted to ₹ 7,278 billion as at end March 2014 and the total profits in 2013–14 were ₹ 722 billion during 2013–14. It can be seen easily the extent of damage that can happen to the profitability, liquidity and solvency of banks, if timely recovery of such large amount of stressed assets do not materialise.

Regulatory measures

14. Reserve Bank has been making constant efforts to enable banks to improve the quality of lending. Information sharing is very critical in financial transactions and any gap in information can transform into risk cost for the bank. This entails significant consequences for lending as it results in misallocation of credit. Keeping in view the importance of credit discipline for reduction in NPA level of banks, banks have been advised to scrupulously ensure that their branches do not open current accounts of entities which enjoy credit facilities (fund based or non-fund based) from other banks without specifically obtaining a No Objection Certificate from the lending bank(s). Banks should take a declaration to the effect, if the account holder is not enjoying any credit facility with any other bank.

15. Credit Information Companies (CICs) play a major role in information sharing. Banks and Financial Institutions are required to submit the list of suit-filed accounts and wilful defaulters of ₹ 25 lakh and above every quarter to CICs. CICs have also been advised to disseminate the information pertaining to suit filed accounts and Wilful Defaulters on their respective websites. After examining the recommendations of the Committee to Recommend Data Format for Furnishing of Credit Information to Credit Information Companies (Chairman: Shri Aditya Puri), banks / Financial Institutions have been advised to furnish the data in respect of wilful defaulters (nonsuit filed accounts) of ₹ 25 lakhs and above to CICs on a monthly or a more frequent basis with effect from December 31, 2014. This would enable such information to be available to the banks / Financial Institutions on a near real time basis.

16. The Central Electronic Registry under SARFAESI Act has become operational on March 31, 2011 with the objective of preventing frauds in loan cases involving multiple lending from different banks on the same immovable property. Initially transactions relating to securitization and reconstruction of financial assets and those relating to mortgage by deposit of title deeds to secure any loan or advances granted by banks and financial institutions, as defined under the SARFAESI Act, are to be registered in the Central Registry. The records maintained by the Central Registry will be available for search by any lender or any other person desirous of dealing with the property. Availability of such records would prevent frauds involving multiple lending against the security of same property as well as fraudulent sale of property without disclosing the security interest over such property.

17. Despite the information sharing mechanisms as detailed above, if the loans still go bad, restructuring mechanisms have been spelt out to help a borrower who has a viable project or a viable business proposition. With a view to putting in place a mechanism for timely and transparent restructuring of corporate debts of viable entities facing problems, a

Scheme of Corporate Debt Restructuring (CDR) was started in 2001 for quicker recovery/ restructuring of stressed assets.

18. In the backdrop of the slowdown of the Indian economy resulting into stress to a number of companies / projects and increase in Non-Performing Assets (NPAs) and restructured accounts in the Indian banking system during the recent years, a need was felt to recognise the stress in the economy early on a real time basis and take preventive and / or corrective actions in order to preserve the economic value of banks' assets. In view of this, the Reserve Bank envisaged and released the "Early Recognition of Financial Distress, Prompt Steps for Resolution and Fair Recovery for Lenders: Framework for Revitalising Distressed Assets in the Economy" on January 30, 2014. The framework outlines a corrective action plan to incentivise: (i) early identification of problematic accounts, (ii) timely restructuring of accounts that are considered to be viable, and (iii) lenders taking prompt steps for recovery or sale of unviable accounts.

19. The Framework outlines an early recognition of stress in all large value accounts and their reporting to a centralised repository at the RBI for dissemination among all the concerned lenders for taking corrective actions as per the broad guidelines given in the Framework. Accordingly, a Central Repository of Information on Large Credits (CRILC) has been set up in April 2014 to collect, store, and disseminate credit data to lenders. Banks are required to furnish credit information to CRILC on all their borrowers having aggregate fund-based and non-fund based exposure of ₹ 50 million and above with them. Notified systemically important non-banking financial companies (NBFC-SI) and NBFC-Factors would also be required to furnish such information. CRILC's essential objective is to enable banks to take informed credit decisions and early recognition of asset quality problems by reducing information asymmetry.

20. Banks are also required to monitor both qualitative and quantitative stress building up in their large accounts at an early stage under three categories of Special Mention Accounts (SMA), viz., SMA-0, SMA-1 & SMA-2. While, SMA – 1 and 2 will be based on past due criteria, SMA – 0 will contain non-past due qualitative and quantitative stress in the account.

21. Once an account is reported to CRILC as SMA – 2, lenders will be required to form a Joint Lenders Forum (JLF) and take prompt corrective action. The corrective action plan (CAP) includes (a) Rectification (b) Restructuring and (c) Recovery. Restructuring can be carried out either under the corporate debt restructuring mechanism or under JLF, but if not found to be feasible, JLF will initiate recovery measures. JLF formation will be mandatory for distressed borrowers, engaged in any type of activity, with aggregate fund based and non-fund based exposure (AE) of ₹ 1000 million and above. Non-adherence to regulatory guidelines has been disincentivised by way of accelerated provisioning.

22. Since in terms of Section 128 of the Indian Contract Act, 1872, the liability of the surety is coextensive with that of the principal debtor, when a default is made in making repayment by the principal debtor, the banker will be able to proceed against the guarantor / surety even without exhausting the remedies against the principal debtor. As such, where a banker has made a claim on the guarantor on account of the default made by the principal debtor, the liability of the guarantor is immediate. In case the said guarantor refuses to comply with the demand made by the creditor / banker, despite having sufficient means to make payment of the dues, such guarantor would also be treated as a wilful defaulter.

23. Last week, we have defined the norms for classifying the borrowers as non-cooperative where there is a deliberate attempt to delay and inhibit the process of recovery after the due process has been followed. A non-cooperative borrower is one who does not engage constructively with his lender, by defaulting in timely repayment of dues while having ability to pay, thwarting lenders' efforts for recovery of their dues, not providing necessary information sought, denying access to assets financed / collateral securities, obstructing sale of securities, etc. In effect, a non-cooperative borrower is a defaulter who deliberately stone

walls legitimate efforts of the lenders to recover their dues. Higher capital and higher provisioning would be required in further lending to these borrowers.

Role of DRTs in the financial sector

24. The expectation from DRTs and DRATs is very high. This is so because these institutions were set up for a specific purpose. The underlying purpose is improving credit culture. If the borrower gets the message that he cannot delay recovery and get away with it, repayment culture is expected to improve. That will provide more funds to lend. If the cycle of lending and recovery goes on smoothly, the economy will grow. In this process DRTs and DRATs have a very big role to play.

25. It is not suggested that all judicial and legal principles should be dumped for improving recovery. In majority of cases our understanding is that there is no doubt that the money has been lent and not repaid. When the bank lends money, it pays through banking channels and when recovery is made it also comes through banking channels. Thus documentary evidence is easily discernable. In such transactions processed through banking channels there is hardly any doubt about the fact of lending and recovery. There could be disputes about calculation or some technicalities. If they are not allowed to be blown out of proportion, it is believed that delays can be avoided. Even if undisputed portion of loan is required to be paid forthwith by DRTs and DRATs, that could contribute in a big way.

26. The total number of cases filed in DRTs by scheduled commercial banks as a whole up to March 2014 was 1,50,503 and the amount involved was ₹ 2,601 billion. The total amount recovered up to March 2014 was ₹ 427 billion which amounted to only 16.43% of the total amount involved. Looking at the huge task on hand with as many as 66,971 cases involving ₹ 1,415 billion pending before them as on March 31, 2014, I would like to say that Reserve Bank has a lot of expectations from the Debt Recovery Tribunals. Banks approach DRTs as a last recourse, so cases before DRTs need to be dealt with more strictly.

27. We are very much concerned that the sanctity of debt contracts has been continuously eroded in India, especially by large borrowers. The system protected large borrowers and their right to stay in control, rendering bankers helpless vis-a-vis large and influential promoters. As explained earlier, we are separately dealing with this issue through the treatment towards wilful defaulters and non-cooperative borrowers.

28. Since pendency of large number of cases in DRTs is one of the prime issues that needs to be addressed, I would like to draw your attention to some of our other concerns and need for better efficiency of DRTs:

- It is understood that in a number of cases, DRT grants time to borrower / applicant to make payment and subject to payment, bank's SARFAESI action is stayed and matter lingers on for a long period.
- Though section 17 (5) provides that an application under section 17 shall be disposed of within 60 days of date of application (extendable up to 4 months) the said time frame is not being strictly followed in practice. There is long delay in passing orders by the DRTs.
- The officials of DRTs / DRATs should be given proper training so that they appreciate the very purpose and adjudicate the cases in a way to meet the purpose for which these Tribunals are established.
- As per the RDDBFI Act, though the cases are to be disposed of within six months, in some cases, the next date itself is given after six months to one year.
- When an appeal is filed before DRAT against the order of DRT, though there is provision for stipulation of deposit of 75% of the amount of debt due as a pre-condition for admission of appeal, most DRATs are exercising their discretion and

do not insist for deposit of any amount despite the specific pleas made by the bank in this regard.

- In many DRTs, even frivolous applications filed by the parties are entertained despite the fact that the very subject matter does not fall under their jurisdiction. When an application is filed before the DRT, if they do not have jurisdiction on the subject matter, on the first day itself, the Presiding Officer is expected to dismiss the petition for want of jurisdiction so that no time is wasted on those frivolous applications being filed by the parties only to delay the bank's recovery process.

Conclusion

29. To conclude, I do hope that DRTs and DRATs would put their best foot forward in creating an environment where a healthy, vibrant and sound financial system can be built-up and sustained. We are also aware of some of the difficulties faced by DRTs and DRATs. We may not be aware of many others. A workshop like this should help us understand your difficulties also, so that appropriate solutions can be worked out.

30. Thank you all for your patient attention.