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SIXTH REPORT

ESTIMATES COMMITTEE
(2004-2005)

(FOURTEENTH LOK SABHA)

MINISTRY OF FINANCE
(DEPARTMENT OF ECONOMIC AFFAIRS – BANKING DIVISION)

PUBLIC SECTOR BANKS - NON PERFORMING ASSETS

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Presented to Lok Sabha on 25.04.2005

LOK SABHA SECRETARIAT
NEW DELHI

April 2005/Vaisakha 1927(S)

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(2004-2005)

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INTRODUCTION

I, the Chairman of the Estimates Committee, having been authorised by the Committee to submit the report on their behalf

present this Sixth Report on the Ministry of Finance (Department of Economic Affairs – Banking Division) – 'Public Sector Banks – Non Performing Assets'.

2. The subject, 'Public Sector Banks – Non Performing Assets' was selected for detailed examination by the Estimates Committee (2002-2003). The Estimates Committee examined every aspect of the subject by calling for detailed written information and taking evidence of the representatives of the Ministry of Finance (Department of Economic Affairs – Banking Division) and RBI on 10.12.2003 and 2.12.2004. During their study tours the Committee held informal discussion with 26 Public Sector Banks to get first hand information on the subject. The Committee wish to express their thanks to the Officers of the Ministry of Finance (Department of Economic Affairs – Banking Division), RBI and the Public Sector Banks for placing before them detailed written notes on the subject and for furnishing information desired in connection with the examination of the subject. The Committee also appreciate the frankness with which the officers shared their views, perceptions and constraints with the Committee.

3. The Committee would also like to express their gratitude to the

Estimates Committee 2002-2003 and 2003-2004 for the able guidance and right direction provided by them in obtaining information for indepth and comprehensive study of the subject.

4. The Report was considered and adopted by the Committee at their sitting held on 22nd March, 2005.

5. The Report consists of eight chapters. The Committee have inter-alia made the following important observations/recommendations :-

(i) With a view to further improve the performance of the public sector banks in relation to their control and containment of NPAs and to develop a healthy and sound financial system in the country, the following measures may be taken by the Ministry of Finance/RBI:-

1. RBI may require to impress upon banks about the need to set up/strengthen their corporate research capabilities and to furnish to credit evaluation officials updated information on macro-economic trends and the current state of global competitiveness; near-term prospects of various industries; and the likely shifts in relevant Government policies so that potential NPAs can be detected at the incipient stage and necessary corrective measures taken by the banks for recovery of the loans.

2. It should be ensured that corporate governance is implemented by all the Public Sector Banks on priority basis over a time-bound period.
3. 'Governance' audits should be conducted and penalties imposed through increased capital charge on non-compliant and errant banks.
4. Special training modules for staff in credit supervision and monitoring and recovery management be developed.

(ii) As per the extant rules, bank officials of the rank of Scale III and above in the Public Sector Banks are covered under the ambit of Central Vigilance Commission. The Ministry of Finance should take up the matter with the CVC to restrict the coverage of bank officials coming under the purview of CVC so that officials of the banks are able to concentrate better on the core banking activity of lending credit and recovery of loans without being under the grip of undue fear.

(iii) The Working Group headed by Shri Vinod Rai should go into the entire gamut of functioning of DRTs and suggest comprehensive measures for complete overhaul of the DRT structure for speedy recovery of bad loans. The Working Group

may also examine the feasibility of streamlining the existing procedures so that DRTs can take up high value cases on a priority basis and also for their expeditious settlement so that it would have a bearing on the overall recovery position of NPAs by the banks/FIs.

(iv) The Ministry of Finance should explore the possibility of constituting a separate cadre for manning the DRTs and till such time, steps should be taken in the right earnest to fill up the existing vacancies expeditiously. The Working Group headed by Shri Vinod Rai may also examine if there is a need of setting up more DRTs in the country, besides, providing proper infrastructure and other amenities to the existing DRTs for their efficient functioning.

(v) The Committee are given to understand that at present the Asset Reconstruction Company (India) Ltd., (ARCIL) is buying the bad assets of the Banks at 70 to 80% discount and besides banks have no guarantee that they will get any return from these assets, with the result that most banks are hesitant to transfer their assets to Asset Reconstruction Companies (ARCs). The Committee feel that setting up of more Asset Reconstruction Companies will lead to healthy competition which in turn will

force the Asset Reconstruction Companies (ARCs) to acquire bad loans at better valuations.

(vi) Banks should further streamline their Loan Recovery Policy and also evolve innovative methods such as setting up of Special Recovery Teams for recovery of bad loans and explore the possibility of franchising the job of recovery of bad loans to an outside agency as has been done by some private banks such as ICICI Bank and HDFC Bank. They should also explore the possibility of deploying other Value Added Services that will aid banks in effective recovery of loans.

(vii) Due diligence should be exercised by banks while writing off loans and the number of accounts as well as the amount written off should be kept to the barest minimum. There should not be any let up on the part of banks with regard to loans written off and concerted efforts should be made for their recovery.

(viii) Banks should make concerted efforts to strengthen their credit appraisal and sanctioning system and post-disbursement supervision so that the incidence of wilful default can be detected at the incipient stage and corrective measures taken to check it.

(ix) Banks should adopt a proactive approach in filing criminal cases against the wilful defaulters and RBI should periodically review the progress made by the banks in this regard. The efficacy of the existing penal provisions under sections 403 and 415 of IPC in relation to action against wilful defaulters by banks may be got reviewed by the STAFCR set up by Ministry of Finance/RBI, and legal and other procedural changes, if any, that may be required may also be made so that the menace of wilful default can be contained effectively.

(x) There is a need for rationalisation of tenure of packages approved under CDR mechanism, which is presently divided into four time slabs. The feasibility of reducing the time slabs from 4 to 3 and the possibility of limiting the maximum tenure of package for repayment of loan to 15 years under CDR mechanism, should be examined.

6. For facility of reference, the observations/recommendations of the Committee have been printed in bold type in the body of the report and have also been reproduced in consolidated form in the Appendix.

New Delhi **C. Kuppusami**

April 5, 2005 **Chairman**
Chaitra 15, 1927(Saka) **Committee on Estimates**

CHAPTER-I

SYSTEM OF INCOME RECOGNITION ASSET CLASSIFICATION AND PROVISIONING

INTRODUCTORY

Developing of sound and healthy financial institutions, especially banks, is a sine qua non for maintaining overall stability of the financial system of the country. The high level of NPAs in banks and financial institutions has been a matter of grave concern to the public as bank credit is the catalyst to the economic growth of the country and any bottleneck in the smooth flow of credit, one cause for which is the mounting NPAs, is bound to create adverse repercussions on the economy. When the loans taken are not repaid, much of the funds go out of financial system and the cycle of lending-repaying-borrowing is broken. The banks have also to repay their depositors and others from whom the money had been borrowed. If the borrowers do not pay, the banks have to borrow additional funds to repay the depositors and creditors. This leads to a situation where banks are reluctant to lend fresh funds to new projects or the on-going projects thus choking the system. Once the credit to various sectors of the economy slows down, the economy is badly hurt. There is slow down in GDP growth and industrial output and fall in the profit margins

of the corporates which resultantly cause depression in the market.

The most important business implication of the NPAs is that it leads to credit risk management assuming priority over other aspects of bank's functioning. The bank's whole machinery would thus be pre-occupied with recovery procedures rather than concentrating on expanding business. A bank with a high level of NPAs would be forced to incur carrying costs on non-income yielding assets. Other consequences would be reduction in interest income, high level of provisioning, stress on profitability and capital adequacy, gradual decline in ability to meet steady increase in cost, increased pressure on net interest margin (NIM) thereby reducing competitiveness, steady erosion of capital resources and increased difficulty in augmenting capital resources.

Prudential Norms on Income Recognition, Asset Classification and Provisioning

In order to ensure greater transparency in the borrowal accounts and to reflect actual health of banks in their balance sheets, the RBI introduced prudential regulations relating to income recognition, asset classification and provisioning as recommended by the Narasimham Committee (1991) with certain modifications in a phased manner over a three-year period beginning 1992-93. These regulations have put in place objective criteria for asset classification, provisioning and recognition of income, which was lacking hitherto. This change has brought in the necessary quantification and objectivity into

the assessment of NPAs and provisioning in respect of problem credits. The evolution of the system of asset classification, income recognition and provisioning since its introduction in April, 1992 to the present, is briefly enumerated below :-

1. **Definition**

An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank. A `Non-Performing Asset'(NPA)' was defined as a credit facility in respect of which the interest and/or instalment of principal or any other amount due to the bank has remained `past due' for a specified period of time. The specified period was reduced in a phased manner as under:-

Year ending March 31	**Specified period**
1993	four quarters
1994	three quarters
1995 onwards	two quarters

An amount due under any credit facility is treated as "past due" when it has not been paid within 30 days from the due date. Due to the improvements in the payment and settlement systems, recovery climate, upgradation of technology in the banking system, etc. it was decided to dispense with `past due' concept, with effect from March 31, 2001. Accordingly, as from that date, a Non-performing Asset (NPA) shall be an advance where-

(i) interest and/or instalment of principal remain overdue for a period of more than 180 days in respect of a Term Loan.

(ii) the account remains `out of order' for a period of more than 180 days, in respect of an Overdraft/Cash Credit (OD/CC).

(iii) the bill remains overdue for a period of more than 180 days, in the case of bills purchased and discounted.

(iv) Interest and/or instalment 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 agricultural purposes, and

(v) Any amount to be received remains overdue for a period of more than 180 days in respect of other accounts.

With a view to moving towards international best practices and to ensure greater transparency, it has been decided to adopt the `90 days overdue' norm for identification of NPAs from the year ending March 31, 2004. As a facilitating measure for smooth transition to 90 days norm, banks have been advised to move over to charging of interest at monthly rate by April 1,2002. However, the date of classification of an advance as NPA should not be changed on account of charging of interest at monthly rate. Banks should, therefore, continue to classify an account as NPA only if the interest charged during any quarter is not serviced fully within 180 days from the end of the quarter with effect from April 1,2002 and 90 days from the end of the quarter with effect from March 31, 2004.

An account should be treated as `out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where the

outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for six months as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as **`out of order'**. Any amount due to the bank under any credit facility is `overdue' if it is not paid on the due date fixed by the bank.

2. Income recognition

Internationally income from non-performing assets (NPA) is not recognised on accrual basis but is booked as income only when it is actually received. Therefore, the banks should not charge and take to income account interest on any NPA.

3. System of Assets Classification

Asset classification system was introduced by RBI in April, 1992. It had been decided that banks should classify their advances into four broad groups (i) standard assets (ii) sub-standard assets, (iii) doubtful assets and (iv) loss assets by compressing the existing eight health codes. Broadly speaking, classification of assets into the above categories should be done taking into account the degree of well defined credit weaknesses and extent of dependence on collateral security for realisation of dues. Banks should, therefore, keep the following definitions in mind while classifying the assets.

(i) **Standard assets**

Standard asset is one which does not disclose any problems and which does not carry more than normal risk attached to the business. Such an asset is not a NPA.

(ii) **Sub-standard assets**

Sub-standard asset is one which has been classified as NPA for a period not exceeding two years. With effect from 31 March, 2001, a sub-standard asset is one which has remained NPA for a period less than or equal to 18 months. In such cases, the current net worth of the borrower/guarantor or the current market value of the

security charged is not enough to ensure recovery of the dues to the bank in full. In other words, such an asset will have well defined credit weaknesses that jeopardise the liquidation of the debt and are characterised by the distinct possibility that the bank will sustain some loss, if deficiencies are not corrected. With effect from 31 March, 2005, a sub-standard asset would be one, which has remained NPA for a period less than or equal to 12 months.

(iii) **Doubtful assets**

A doubtful asset is one which has remained NPA for a period exceeding two years. With effect from 31 March, 2001, an asset is to be classified as doubtful, if it has remained NPA for a period exceeding 18 months.

A loan classified as doubtful has all the weaknesses inherent in assets that were classified as sub-standard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable. With effect from March 31, 2005, an asset would be classified as doubtful if it has remained in the sub-standard category for 12 months.

(iv) **Loss assets**

A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off, wholly. In other words, such an asset is considered uncollectable and of such little value that its continuance as a bankable asset

is not warranted although there may be some salvage or recovery value.

Special Mention Accounts

With a view to enable banks to look at accounts with potential problems in a focussed manner right from the onset of the problem so as to impart efficacy to monitoring and remedial action, RBI had issued guidelines in 2003 whereunder banks have been advised to introduce a new asset category- "Special mention accounts", in between "Standard" and "Sub-Standard" categories for their internal monitoring and follow-up.

4. Asset classification to be borrower-wise and not facility-wise

It is difficult to envisage a situation when only one facility to a borrower becomes a problem credit and not others. Therefore, all the facilities granted by a bank to a borrower will have to be treated as NPA and not the particular facility or part thereof which has become irregular.

5. **Provisioning norms**

In conformity with the prudential norms, provisions should be made on the non-performing assets on the basis of classification of assets into prescribed categories. Taking into account the time lag between an account becoming doubtful of recovery, its recognition as such, the realisation of the security and the erosion over time in the value of security charged to the bank, the banks should make provision against sub-standard assets, doubtful assets and loss assets as below:-

Loss Assets

The entire asset should be written off. If the assets are permitted to remain in the books for any reason**, 100 per cent of the outstanding** should be provided for.

Doubtful assets

(i)**100 percent of the extent to which the advance is not covered by the realisable value of the security** to which the bank has a valid recourse and the realisable value is estimated on a realistic basis.

(ii)In regard to the secured portion, provision may be made on the following basis, **at the rates ranging from 20 percent to 50 percent of the secured portion** depending upon the period for which the asset has remained doubtful:

Period for which the advance has been considered as doubtful	Provision requirement (%)
Upto one year	20
One to three years	30
More than three years	50

With the enactment of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 and the chances/extent of recovery of an asset reducing over a period of time, RBI in its Annual policy statement for 2004-2005 had decided to introduce the following graded higher provisioning requirement according to the age of

NPAs, under `doubtful for more than three years' category, with effect from March 31, 2005:-

(a) Unsecured portion

Portion of the advance, which is not covered by the realisable value of tangible security to which the bank has a valid recourse and the realisable value is estimated on a realistic basis, provision will be to the extent of 100 per cent as hiterto.

(b) Secured portion

Period for which the advance has Remained in `doubtful' category	Provision requirement on secured portion
More than three years	
(i) Outstanding stock of NPAs as on March 31,2004	(i) 60 per cent as on March 31, 2005. 75 per cent as on March 31, 2006 100 per cent as on March 31, 2007
(ii)Advances classified as `doubtful more than three years' on or after April 1, 2004.	(ii) 100 per cent

Sub-standard Assets

A general provision of **10 percent on total outstanding** should be made.

Standard Assets

Banks should make a general provision of a minimum of 0.25 percent on standard assets on global loan portfolio basis.

Floating provisions

Some banks make a `floating provision' over and above the specific provisions made in respect of accounts identified as NPAs. Considering that higher loan loss provisioning adds to the overall financial strength of the banks and the stability of the financial sector, banks are urged to voluntarily set apart provisions much above the minimum prudential levels as a desirable practice.

6.Norms for Agricultural advances

(i) In respect of advances granted for agricultural purpose a non performing asset is one where interest and/or instalment of principal and/or any other amount due to the bank, remains unpaid after it has become overdue for two harvest seasons but for a period not exceeding two half-years. The above norms are made applicable to all direct agricultural advances.

(ii) In respect of agricultural loans, other than those specified above, identification of NPAs would be done on the same basis as non agricultural advances which, at present, is the 180 days delinquency norm. The delinquency norm would become 90 days with effect from March 31, 2004.

(iii) Where natural calamities impair the repaying capacity of agricultural borrowers, banks may decide on their own as a relief measure- conversion of the short-term production loan into a term loan or reschedulement of the repayment period; and the sanctioning of fresh short-term loan, subject to various guidelines contained in RBI circulars issued by the Rural Planning and Credit Department.

(iv) In such cases of conversion or re-schedulement, the term loan as well as fresh short-term loan may be treated as current dues and need not be classified as NPA. The asset classification of these loans would thereafter be governed by the revised terms & conditions and would be treated as NPA if interest and/or instalment of principal remains unpaid, for two harvest seasons but for a period not exceeding two half years.

7.Government guaranteed advances

(i) The credit facilities backed by guarantee of the Central Government through overdue may be treated as NPA only when the Government repudiates its guarantee when invoked. This exemption from classification of Government guaranteed advances as NPA is not for the purpose of recognition of income.

(ii) With effect from Ist April, 2000, advances sanctioned against State Government guarantees should be classified as NPA in the normal course, if the guarantee is invoked and remains in default for more than two quarters. With effect from March 31, 2001 the period of default is revised as more than 180 days and with effect from March 31, 2004 the period of default would be revised as more than 90 days.

8.Advances granted under rehabilitation packages approved by BIFR/term lending institutions

(i) In respect of advances under rehabilitation package approved by BIFR/term lending institutions, the provision should continue to be made in respect of dues to the bank on the existing credit facilities as per their classification as sub-standard or doubtful asset.

(ii) As regards the additional facilities sanctioned as per package finalised by BIFR and/or term lending institutions, provision on additional facilities sanctioned need not be made for a period of one year from the date of disbursement.

(iii) In respect of additional credit facilities granted to SSI units which are identified as sick and where rehabilitation packages/nursing programmes have been drawn by the banks themselves or under consortium arrangements, no provision need be made for a period of one year.

Statements showing the total number of NPA accounts and amount involved therein and the Gross and Net NPAs as a percentage of total advances as well as total assets in respect of Public Sector Banks during the year ending 2003 and 2004 are shown in Annexure .

Factors responsible for NPAs

The Ministry of Finance (Deptt. Of Economic Affairs – Banking Division) have stated that the following factors are responsible for incidence of NPAs in the banks:-

(i) Diversion of funds for expansion/modernisation/setting up new projects/helping promoting sister concerns.

(ii) Time/cost overrun while implementing projects.

(iii) External factors like raw-material shortage, raw-material/ Input price escalation, power shortage, industrial recession, excess capacity, natural calamities like floods, accident etc.

(iv) Business failure like product failing to capture market, inefficient management, strike/strained labour relations, wrong technology, technical problem, product obsolescence, etc.

(v) Failure, non-payment/overdues in other countries recession in other countries, externalization problems, adverse exchange rate, etc.

(vi) Government policies like excise, import duty changes, deregulation, pollution control orders, etc.

(vii) Wilful default, siphoning of funds, fraud, misappropriation, promoters/management disputes etc.

Besides above, factors such as deficiencies on the part of the banks viz. deficiencies in credit appraisal, monitoring and follow-up; delay in release of limits; delay in settlement of payments/subsidies by Government bodies, etc. are also attributed for the incidence of NPAs.

Provisioning made by Banks for NPAs

Asked whether RBI had advised/prescribed any norms with regard to provisioning for NPAs by banks, such as amount to be set out/earmarked as a percentage from out of the profits earned by them during a financial year, the Ministry of Finance in a written reply stated that banks should comply with the minimum requirements of provisioning towards different classes of NPAs (substandard/doubtful/loss) and also towards standard assets as a precaution. The banks are however free to set apart higher provisions to improve the provision coverage towards NPAs to strengthen the bank's financial position. Higher coverage provides additional buffer towards NPAs. While banks are encouraged to enhance the coverage ratio by setting out higher allocation from operating profits, the practice is mainly Board driven. RBI had not advised/prescribed any norms with regard to provisioning for NPAs by banks as a percentage of the profits earned by them during a financial year.

The total amount of provisioning made by each of the Public Sector Banks and its percentage to the total profits earned during the last three years, is given in Annexure .

Under-Reporting of NPAs

Asked to state whether Reserve Bank of India takes action against those Banks which indulge in under-reporting of NPAs either due to wrong classification of assets or/and non-adherence to the prudential norms for asset classification etc., the Ministry of Finance (Deptt. Of Economic Affairs – Banking Division) in their reply have stated that public sector banks have been generally adhering to the prudential norms on asset classification. However, instances of under-reporting of NPAs due to wrong classification of assets/non-adherence to prudential norms for asset classification are brought out in the Annual Financial Inspection (AFI). The shortfall in provisions identified during the AFI are detected by the RBI while assessing the bank's net worth and its Capital Risk Weighted Assets ratio and the bank is required to take necessary action to make additional provisions to improve capital immediately. The need to strictly adhere to the prudential norms is also impressed upon the CMD and other senior executives of the bank during the course of the discussions held by RBI on the findings of the inspection. The bank's compliance to the inspection findings, including additional provisioning is ensured through regular follow-up. The under reporting of NPAs generally arise on account of erroneous interpretation of the prudential guidelines on asset classification and the divergence is normally not significant. In the recent past, significant

divergence was detected in the case of Global Trust Bank and after the steps to augment the capital did not succeed, it was merged with OBC, to protect depositors' interests.

CHAPTER-II

SANCTION OF LOANS/ ADVANCES

Sanction of loans by bank functionaries at various levels is governed by clearly laid down delegation of powers, which may not be exceeded under normal circumstances. The management of credit exposure to individuals /group borrowers, loan sanctioning and loan recovering activity in a bank is purely a management function and each bank's Board of Directors is authorised to frame suitable policies in this regard. The loan sanctioning and recovery activity at each level is required to be monitored by the prescribed higher authority under the delegation of powers and both the activities are under the overall control of the Chairman and the Board of Directors. Each bank should also evolve a credit approving system, where the loan proposals beyond pre-specified limits are approved by an "Approval Grid" or a "Committee".

The Ministry of Finance (Department of Economic Affairs-Banking Division) have stated that management of credit risk should receive the prime attention of the top management of the banks. As a prudential measure aimed at better risk management and avoidance of concentration of credit risks, the Reserve Bank of India had advised the banks to fix limits on their exposure to specific industry or sectors and prescribed regulatory limits on banks exposure to individuals and group borrowers in India and unsecured

guarantees and unsecured advances. In addition, banks are also required to observe certain statutory and regulatory exposure limits in respect of advances against investments in shares, debentures & bonds.

Loan Policy and Loan Recovery policy

According to Ministry of Finance (Department of Economic Affairs-Banking Division), banks have been advised by RBI to prepare well defined Loan Policy and Loan Recovery Policy approved by their Board of Directors. The loan policy of a bank, duly approved by its Board of Directors should cover the methodology for measurement, monitoring and control of credit risk. In order to control the magnitude of credit risk, prudential norms on bench mark financial ratios, single borrower-group borrowers exposure, substantial exposure, industry specific, region specific and sector specific exposures, exposures to sensitive sectors etc. should be covered in the Loan Policy. The Policy may also lay down documentation standards, delegation of powers including for write off and review procedures, maturity and pricing policies, factors taken into consideration while deciding interest rates above the floor rate, etc. The Loan Recovery Policy may lay down the manner of recovery of dues, norms for permitted sacrifice/waiver, factors to be taken into account before considering waivers and monitoring of write off/waiver cases. Bank officials are expected to act within the policy laid down with the approval of the Board of Directors.

During evidence, the Committee observed that there is no appropriate monitoring and supervision of the performance of the banks by RBI in the area of management of credit exposure, loan sanctioning and loan recovery, etc. In response, the Secretary,

Ministry of Finance (Department of Economic Affairs-Banking Division) deposed as follows:-

> "The most important question which you have raised is how far RBI is supervising the framing of the loan policies by the banks, their delegation and loan recovery policies. If there are transgressions and violations whether RBI in scrutiny finds that the credit appraisal systems in an institution are strong or not. I think, I would respond to it by saying that every year, the bank's balance-sheet and its head office and important large branches, where lots of loans are concentrated, are specifically inspected by our officers. They are called AFI, annual financial inspection by the RBI officers. This is a very stringent process. Previously, the focus was only on transaction based audit and now, we are moving from transaction based audit to risk based audit to identify what are the risks in a particular institution and if there is too much of exposure only to steel sector and that bank is becoming sick like that to a specific sector and somebody is dealing extensively in the money and foreign exchange markets or it has heavily invested in unrated paper and tomorrow, the bank can lose out sizeable sums of money because there is no market for these investments. So, the focus is changing from what it was to what it is.
>
> The RBI has given very clear general direction that it is the responsibility of the Board of each management to put in place a comprehensive loan policy document. I will assure this body that a loan policy document is placed before the Board and similarly, a loan recovery policy is also placed before the Board. When our officers from RBI go for inspection, they see whether the policies have been correctly framed-and merely framing them is not enough – and whether they have percolated down to every branch and whether every branch is observing these instructions or not because these things are also very relevant and important. Our inspectors comment on this part of it".

In their post-evidence reply, the Ministry of Finance have stated that Department of Banking Supervision (DBS), Reserve Bank of India exercises supervisory functions over banks

through on-site and off-site surveillance and monitoring systems, which are enumerated below in detail:-

(i) On-site Inspection

The main instrument of supervision of the banks is on-site inspection. The main objective of on-site inspection is to ensure that the bank is complying with the instructions issued by RBI from time to time. The inspection process focuses on aspects crucial to the bank's financial soundness with a recent shift in focus towards risk management. Areas relating to internal control, credit management, overseas branch operations, profitability, compliance with prudential regulations, developmental aspects, proper valuation of asset/liability, portfolio investment portfolio, and the bank's role in social lending are covered in the course of the inspection. The Department undertakes statutory inspections of banks on the basis of an annual programme, which is co-terminus with the financial year for public sector banks. After the inspection report is issued to the bank, followed by a `supervisory letter', based on the inspection findings, the concerns expressed in the inspection are discussed with the CEO of the bank and a Monitorable Action Plan is given to the bank for rectification of those deficiencies. The Department submits a memorandum covering supervisory concerns brought out in the inspection, to the Board for Financial Supervision (BFS) which had been set up to ensure integrated approach to regulation and supervision of the banks, FIs and NBFCs. Specific corrective directions of the BFS are conveyed to the banks concerned, for immediate compliance.

In terms of the new approach adopted for the on-site inspection of banks, the Inspecting Officers concentrate on core assessments based on the CAMELS model (Capital Adequacy, Asset Quality, Management, Earnings Appraisal, Liquidity and Systems & Controls). This approach eschews aspects which do not have a direct bearing on the evaluation of the bank as a whole or which should essentially concern the internal management of the bank.

(ii)Off-site Monitoring

In order to collect financial information from banks on a quarterly basis so as to assess the financial health of the

banks in between on-site inspections, and monitoring of functioning of banks on a continuous basis, a system of Off-site Surveillance and Monitoring System (OSMOS) was set up in 1995. The off-site surveillance and monitoring system has been designed to facilitate the following:

- To build a memory on the supervised institutions;
- To capture systemic trends in banking and to support policy initiatives;
- For better focus of supervisory effort and to optimise resource allocation; and
- Identification of banks showing financial deterioration and to act as an Early Warning System (EWS) and as a trigger for on-site inspections.

Under the OSMOS system, a set of periodical returns has been prescribed for banks which are received on half-yearly /quarterly/monthly basis. The off-site monitoring system monitors the compliance of banks with RBI instructions such as banks' exposure to sensitive sectors like real estate, capital market etc. on monthly basis.

Besides above, RBI also employs the following devices/schemes to monitor the financial health of the banks:-

(a)Quarterly Monitoring System

A Quarterly Monitoring System through on-site visits to the newly licensed banks in their first year of operation is in place. Old and new private banks displaying systemic weaknesses are also subjected to quarterly monitoring.

(b) Quarterly Informal Meeting

In order to give an opportunity to meet the supervisor at regular intervals for discussing compliance related issues and agreeing on regulatory and supervisory requirements in respect of new business initiatives, a quarterly informal meeting system for banks with the officials of Department of Banking Supervision had been designed and put in operation from January, 2000. Some of the public sector banks have also been placed under special monitoring, with a Senior Officer in the jurisdictional Regional Office of the Bank entrusted with the special monitoring efforts. The Deputy Governor/Executive Director in-charge of banking supervision call the CEOs of those banks, wherein serious deficiencies have been reported in the inspection reports, for a discussion on the specific steps the bank's top management would need to take to improve its financial strength and operational soundness.

(c)Use of External Auditors as Supervisory Resources

The role of external auditors in bank supervision had since been enhanced. The auditors have been directed to verify certain other aspects like adherence to statutory liquidity requirement, prudential norms relating to income recognition,

classification of assets, provisioning, capital adequacy and various other financial parameters being disclosed in the Balance Sheet of the banks. External auditors are also entrusted to carry out focussed audit of specific areas of supervisory concerns.

Banks were advised to introduce a system of concurrent audit in 1993 by using external auditors as a major resource. RBI had also issued instructions to set up an Audit Committee of the Board for overseeing the audit function in banks.

(d)**Prompt Corrective Action (PCA)**

A scheme of prompt corrective action based on certain triggers had been introduced in December 2002 as a supervisory tool on an experimental basis. The trigger points are CRAR, Net NPA and Return on Assets (ROA). The scheme is aimed at taking action at an early stage, when banks show incipient sign of weaknesses. For every trigger point certain structured and mandatory actions have been laid down.

The Ministry have stated that banks, by and large, do follow the guidelines issued by RBI. The banks' branches/ROs are audited/inspected by Statutory Auditors/internal inspectors of the banks. The deviations from the prescribed Loan Policy on a sample basis are also looked into at the time of on-site inspections of these banks by RBI and if any deviations of guidelines are observed, the matter is taken up with the top management of concerned bank for early redressal.

Asked to state how far non-observance of prescribed norms while processing the applications for sanction of loans are responsible for NPAs, the Ministry of Finance (Department

of Economic Affairs-Banking Division) in a written reply stated that it was not possible to quantify as to how far non-observance of prescribed norms while processing applications for sanction of loans, had contributed to NPAs.

Enquired as to how the Ministry would find out whether prescribed norms while processing of applications for sanction of loans are being observed by banks, the Deputy Governor, RBI during evidence held on 10.12.2003 stated as under:-

"Data in that particular format, there is no return in which we can capture this particular data. But in the course of the inspection either by the Reserve Bank of India or by the bank's own inspection and audit team, if any wrong doing is found out then staff accountability is fixed. This will explain that."

Sanction of credit in excess of prudential exposure limit

The number of banks that have granted credit limits in excess of the prudential exposure limits, as observed by RBI in their Annual Inspections during the last three years, is furnished below:-

Annual Financial Inspection	No. of Banks		
	Public Sector Banks	Pvt. Sector Banks	Foreign Banks
2000-01	22	---	30
2001-02	25	3	34
2002-03	25	8	16

Asked to state the punitive action taken against the banks for exceeding the prudential exposure limits, the Ministry of Finance, in a written reply had stated that approval of RBI for sanction of the credit limits in excess of the prudential exposure

ceiling had been sought by the banks subsequently in all the cases. Approval was granted by RBI after examination on merits, and no punitive action was taken in view thereof.

In the Budget for 2004-05, the Finance Minister had announced that banks with strong risk management systems would be allowed to have greater latitude in their exposure to the Capital market.

Compliance of banks with the Inspection Reports by RBI

According to Ministry of Finance (Department of Economic Affairs-Banking Division) during RBI inspection, the Inspecting Officers examine the systems and procedures in banks. As regards borrowal accounts, test checking of some accounts above a certain cut off point is resorted to. The irregularities noticed during the inspection generally relate to deficiencies in appraisal of credit proposals, lack of post-sanction/disbursement supervision, laxity in recovery of non-performing assets (NPAs), delay in review/renewal of credit limits, non-observance of instructions/guidelines issued by RBI/Head Office, arrears in balancing of books of accounts, etc. The irregularities/deficiencies are brought to the notice of the respective banks for corrective action and compliance is closely monitored through RBIs Regional Offices. Discussions are also held with the banks' Chief Executive Officers and Directors. A summary of the findings of RBI's' inspection of banks, is placed before the Board for Financial Supervisions (BFS) and necessary follow up action is taken on the advice/directions of the BFS.

Asked to state the penal measures taken by RBI against those banks who do not submit compliance reports in time and repeatedly

indulge in the irregularities which normally are pointed out by RBI during their inspections, the Ministry of Finance (Department of Economic Affairs – Banking Division) in their reply had stated that RBI had strengthened the system of "follow up of Inspection findings" and had issued the following instructions to its Regional Offices on May 29, 2002:-

(i) Statement of non-compliance with the earlier AFI report has been made integral part of the latest AFI report.

(ii) Two months time is given for submission of first compliance by the banks.

(iii) Penal action has been envisaged in case of delay in submission of compliance by the bank.

(iv) Regional Offices were also advised to complete scrutiny of first compliance within one month of its receipt.

In the light of observations made by JPC on stock market scam and matters relating thereto, and with a view to further streamline the existing system of inspection, and improving the quality of Inspection Reports and their focussed follow-up, Regional Offices of RBI were further advised on 18th July, 2003 as under:-

(i) Inspecting Officers should focus more on identifying the causative factors which give rise to persisting deficiencies rather than on deficiencies in individual transactions.

(ii) Based on the deficiencies observed in the individual transactions, Inspecting Officers should be able to clearly identify the gaps/lacunae in the systems and same should be highlighted in the reports.

(iii) Whenever, the findings of the report bring out deficiencies in the systems, the compliance also should address the same.

The compliance given by the bank for having rectified the deficiencies in respect of instances/transactions, based on which the Inspecting Officer had identified the gaps in the system, may not be accepted as full compliance.

(iv) The follow-up of inspection findings should be based on action plan (agreed with bank) which contains direction to banks to take corrective action regarding deficiencies, within a specified time frame.

The Ministry had stated that non-compliance of banks with irregularities observed during RBI Inspection, would be dealt with in accordance with the aforestated instructions issued in May, 2002 and July, 2003.

CHAPTER-III

STAFF ACCOUNTABILITY

Transgression of Delegated Powers

During Annual Financial Inspection (AFI), RBI Inspecting Officers look into the aspect of transgression of delegated powers by Bank functionaries and instances, if any, found are adversely commented upon in their inspection report. In the cases of large NPAs, the system/practice of fixing of staff accountability is examined. If any weaknesses are noticed, the fact is commented as a deficiency in the inspection report. Wherever the banks have not examined staff accountability, they are asked to take necessary action without further delay. As per RBI guidelines, staff accountability aspect is required to be examined by the concerned bank as soon as there is a shift in the asset classification of an

advance from standard to sub-standard. The Bank management takes necessary action in this regard in consultation with the CVC. The management of the Bank does make a distinction between malafide acts and genuine action on the part of the functionaries in respect of instances of transgressions reported and take action against the erring officials accordingly. Wherever malafide acts are observed in sanctioning excess over delegated powers, disciplinary action is taken against the concerned officials. Punishments ranging from reprimand, reduction of increment, transfer, demotion, compulsory retirement, etc. were meted out against the erring officials depending on the degree of accountability of the erring officials. The details of punitive actions, if any, taken by individual banks against erring officials are not centrally maintained.

The Ministry of Finance (Department of Economic Affairs-Banking Division) had stated that there is no system in RBI for compiling information relating to transgression of delegated power by bank functionaries on account to account basis. Hence it is not possible to indicate as to how many accounts have turned into Non Performing Assets on account of transgression of delegated powers. It has also been stated that RBI had not issued any direction to the banks to report to it cases of staff accountability in NPAs.

In this regard, Deputy Governor, RBI during evidence held on 10.12. 2003 deposed before the Committee as under:-

> "As regards transgression, the answer is that some people tend to violate the limits laid down. I would not say that they violate the limits for the purpose of profit, but it is violated so that the unit starts functioning. Some transgression in exuberance- if I may be permitted to say – do take place, but there is a judgement call taken by the management to see whether the transgression done has benefited the person who has

sanctioned it and if that is the case, then it is manifestly irregular and it will attract vigilance. If it is only a judgmental error, then I think, that the benefit of the doubt should be given in favour of the official who took that decision.

In this context, I think, the steps which the CVC are now taking- for example by announcing that they will only look at very large amounts and leave it to the Bank Management, etc. – are definitely a confidence booster for the Banking Sector. As a result of this all the people will come forward very freely and revive the activity of lending. At one point of time this actually had, more or less, totally slowed down. So, the supervision of Reserve Bank has been far and wide."

On 22nd February, 2005 the Ministry of Finance had unveiled a package giving managerial autonomy to the Public Sector Banks, and advised them to take further action thereon. While giving further operational autonomy to the Board of Directors, the Ministry of Finance proposed Banks to lay down a policy of accountability and responsibility of Bank officials and take action against erring Bank officials in conformity with such policy. The policy framework should provide for stringent punishment for all mala fide actions but, at the same time, recognize that bona fide errors do occur while making decisions relating to commercial judgment.

Central Vigilance Commission (CVC)

Jurisdiction over Bank functionaries/officers

As per the provision in Para 3 of the Special Chapter on Vigilance Management in Public Sector Banks, issued in April 2003 by the Central Vigilance Commission (CVC), officers of the rank of scale III and above in the Public Sector banks are covered under the

ambit of Central Vigilance Commission. However, in composite cases involving officials who fall in the Central Vigilance Commission's jurisdiction and others who do not, the case as a whole has to be referred to the CVC for its advice.

The Committee, during informal discussions held with representatives of various Public Sector Banks during study tours, it came to notice that bank managers of the rank of scale III and scale IV lacked initiative to muster new accounts or enroll new clientele because of their coming under the purview of CVC.

Asked to state whether it had been proposed to restrict the level/grade of bank officers coming under CVC upto Deputy General Manager (DGM) only, the Ministry of Finance (Department of Economic Affairs – Banking Division) in their written reply have stated that as per provision in the Central Vigilance Commission Bill, 1999, a notification had to be issued specifying the level of officers of Corporation, established by or under the Central Act, Government Companies, Societies and Local Authorities, owned or controlled by the Central Government in respect of whom the CVC is empowered to enquire, or cause an enquiry or investigation to be made into any complaint alleging offences under the Prevention of Corruption Act, 1988. The DOPT had called for proposals from various Ministries/Departments with regard to the level of officers of the Government Companies etc. under their administrative control, who could be covered under the jurisdiction of the CVC, for the above purpose. The Ministry of Finance (Department of Economic Affairs – Banking Division) had informed the DOPT as well as Cabinet Secretariat that in respect of banks and financial institutions, the CVC's jurisdiction should be restricted to the officers of the level of

Scale VI and above i.e. Deputy General Manager and above. After the lapse of the CVC Ordinance 1999, a Resolution was passed on 04.04.1999 to continue the provisions of the CVC Ordinance 1999, which ceased to operate from 05.04.1999. Since the CVC Bill had not been passed, the notification envisaged in the said bill/resolution could not be finalised.

Asked whether any progress was made by the Ministry of Finance in this regard, the Secretary, Ministry of Finance (Department of Economic Affairs-Banking Division) during evidence held on 10.12. 2003 deposed as under:-

> "Now, the CVC's jurisdiction extends over a very large number of executives in the banks. That has a counter-productive effect. Sometimes, it is restraining and inhibiting the executives from taking fair and bona fide decisions also. It also defeats the purpose of vigilance in the sense that there are far too many people and priority cases cannot be focussed upon. Therefore, the whole effort gets diluted. We have been discussing this issue with the Chief Vigilance Commissioner and he himself has been of this view. He feels that the current scope of coverage is far too wide and he has already worked out a draft revision which we have commented upon where he intends to focus only on the topmost levels of the banks so that the focussed action can be taken and certain examples can be made and vigilance action from the external agencies' point of view is restricted to the top echelons of the banks. The remaining levels will be corrected through self-regulating mechanism and vigilance departments of the banks themselves. This is in the process of being done and should the Committee make such a recommendation, it will only strengthen everybody's hands to do this. The idea is to make a focus and make examples and not just draw the net too wide.

Actually, the cut off level could be even higher. For instance, in our latest discussion, the suggestion has been that there should be one level below the Executive Director, in fact, the General Manager's level or the Chief General Manager's level. I think these orders are

likely to be issued very shortly. We need not even have to go to lower levels because that can be taken care of by other agencies and especially by the banks themselves."

CHAPTER-IV

RECOVERY OF NPAS

Debt Recovery Tribunals (DRTs)

The Recovery of Debts due to Banks and Financial Institutions Act, 1993 was enacted on 27th August, 1993 to provide for the establishment of Tribunals for the expeditious adjudication and recovery of debts due to banks and financial institutions and for matters connected therewith or incidental thereto.

At present there are 29 Debt Recovery Tribunals (DRTs) and 5 Debt Recovery Appellate Tribunals (DRATs) established in different States/UTs. Particulars of location of DRTs and DRATs, date of their establishment and jurisdiction are given in Annexure – .

The Act was amended in the year 2000 and some of the important provisions that had been incorporated in the Debt Recovery Act, 1993 for strengthening DRTs were as follows:-

i) Provision for placement of more than one Recovery Officer. -Section (7);

ii) Power to attach defendant's property/assets before judgement -Section 19(13);

iii) Appointment of Receiver with powers of realisation, management, protection and preservation of property – Section 19(18) (a) to (e);

iv) Penal provisions for disobedience of Tribunal's Order or for breach of any terms of the Order. – Section 19(17).

Also, all public sector banks were advised to set up special DRT cells at their Head Offices and to keep a close liaison with standing counsels who appear before the DRTs for the effective presentation of cases and to constitute Settlement Advisory Committees to deal with chronic recovery cases which will also cover the cases pending with DRTs.

Asked whether the above amendments to the Act have helped DRTs in speedy recovery of dues of bad loans from the borrowers, the Ministry in a written reply have stated that subsequent to the amendments made to the Act in the year 2000, there had been an improvement in the overall performance of DRTs. The percentage of cases decided by DRTs has increased from 13% as on 31.12. 1997 to 37.26% as on 31.3. 2004. The percentage of recovery to total dues has also concurrently increased from 1.67% as on 31.12.97 to 8.36% as on 31.3. 2004.

During evidence held on 2.12.2004, the Secretary, Ministry of Finance (Department of Economic Affairs – Banking Division) had stated that the number of cases filed in all the 29 tribunals, as on 30th June, 2004, were 76,384 involving an amount of Rs. 1,54,975 crore. Out of these, 46,208 cases involving an amount of Rs. 58,305 crore were disposed of by the DRTs. More than 50 per cent cases, which were filed have been disposed of and there are, of course, a number of cases which are of very high value and they have been pending for quite some time. The total number of cases with each DRT vary between 300 and 3000.

A statement showing the total number of cases pending with DRTs , the number of cases decided and the amount recovered etc., as on June,2004 is given in Annexure IV.

The Committee having noted the difficulty of banks and DRTs in recovering the amount even by way of auctions, because very often the bidders do not come forth, asked the Ministry to state the remedial measures contemplated to overcome this problem. Agreeing with the Committee's observation, the Ministry in a written reply have stated that efforts to realize securities covering bank dues, by auction of assets charged did not always succeed in the absence of suitable bidders and in some cases banks do find difficulty in finding ready buyers for the properties being auctioned. Sale by public auction is not the only recourse available to banks and DRTs. Following are some of the measures available/being contemplated, for realization of securities:-

1. Security Interest (Enforcement) Rules, 2002 notified under Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) provides for following additional methods for sale of seized assets:
    a. Obtaining quotations from parties dealing in the assets or otherwise interested in buying such assets.
    b. Inviting public tenders, and
    c. By private treaty.
2. Banks would be able to contact their other borrowers in the same line or those interested in the assets.

3. Instead of trying to sell the unit as a whole, sale could be attempted in parts as in some cases this might prove to be a better strategy.

4. Asset Reconstruction Companies (ARC) could prove to be a useful vehicle for realization of assets covered by impaired loans. By pooling together assets of similar nature from different banks, the ARCs would be in a better position to offer a more attractive package for potential buyers.

Asked to state the steps proposed to be taken to strengthen the DRTs for their effective functioning, the Ministry in a written reply furnished on 9th May, 2003 have stated that RBI is of the opinion that there is slow but steady progress in disposal of cases filed before DRTs and also in recovery of the amount decreed by them. RBI had come to these conclusions on the basis of performance of DRTs with reference to commercial banks. RBI had also observed that appointment of more than one Recovery Officer through DRT Amendment Act, 2000 would speed up recovery. As a result of the amendment carried out, banks are now able to seek injunction against the borrowers/seizures and sale of assets. Also the provision relating to counter claim by borrowers, has curtailed the delay and simplified the process of recovery.

Asked about the views of the Ministry with regard to expediting the process of settlement of pending cases, the Ministry in their written reply furnished in April,2004 had stated that on a review, it is observed that the arrangement needs to be further strengthened to expedite the resolution of larger number of cases referred to by Banks/Financial Institutions. In view of this, Government of India had

decided to set up a Working Group to examine the structural and other legal measures to strengthen the arrangement.

On being asked as to when the the Working Group on restructuring of DRTs was constituted and the factors that necessitated its constitution, the Ministry of Finance in their Post Evidence Reply furnished in December, 2004 have stated that after obtaining the performance review conducted by the RBI, the Government of India set up a Working Group in February 2001 under the Chairmanship of Shri S. N. Aggarwal, Presiding Officer of Debt Recovery Tribunal (DRT) II, Delhi to review the existing provisions of the Recovery of Debts due to Banks and Financial Institutions Act, 1993 and the Rules framed hereunder in the light of the suggestions received from various quarters such as banks, financial institutions, DRTs and individuals and to examine the adequacy of the infrastructure available to DRTs. While recognising the need for speedy and effective recovery of bad loans of the banking sector is a sine qua non for survival of the banking industry, the Working Group had suggested amendments to the Act and Rules framed thereunder. The Working Group submitted its report in August 2001. RBI examined the Report of the S.N. Aggarwal Group and communicated their views to Government in February, 2002. In their comments furnished to the Government, RBI supported the recommendations made by the Working Group for strengthening the infrastructure of DRTs in totality. As regards amendments to the DRT Act and the Rules framed thereunder, the RBI stated that they have no objection to the amendments proposed by the Working Group, barring six amendments on which RBI differed with the Working Group. Apart from their views on the Working Group recommendations RBI had

also made the following suggestions for consideration of the Government at the time of amendment of the DRT Act:-

i) Jurisdiction of DRTs over the cases pending/subsequently filed before BIFR.

ii) Provisions for more than one Presiding officer in a DRT.

iii) Penal provisions to cover obstruction by the borrower to receiver appointed by the DRT to take possession of his properties.

iv) Presiding Officers to have knowledge of banking law.

v) Empowerment of DRT to order disclosure of assets/property by the borrower by way of affidavit.

vi) DRT to notify borrowers defaulting to honour its decree.

vii) Recovery certificate to cover details of secured assets.

viii) Deletion of Rule 10 to enable banks to file one application for all facilities granted to borrowers.

Recently on the recommendations of Reserve Bank of India the Government had constituted a Working Group headed by Shri Vinod Rai, AS(FS) to examine afresh the issues related to DRT's role in recovery of NPAs for enhancing their effectiveness and to review the functioning of Debts Recovery Tribunals. The Working Group will examine the following issues and recommend appropriate measures:

i) The need to extend the provisions of the Recovery of Debts Due to Banks and Financial Institutions Act(RDDB Act) for less than Rs 10 lakhs under section 1(4) of the Act.

ii) Redistribution of the jurisdiction of the various DRTs.

iii) Modification in the existing strength of the DRTs/DRATs. Strengthening the scope of the Act to include other financial institutions under section 2 (h)(ii) of the Act.

iv) Desirability of enabling the Chairperson of a DRT to conduct an enquiry against the Presiding Officer and consequential changes in the criteria for eligibility for being appointed as a Chairperson, DRAT.

v) Desirability of appointing more than one Presiding Officer for a DRT to ensure speedy disposal of cases.

vi) The need to strengthen the supervisory role of Chairperson of DRATs over the DRTs.

vii) Any other matter considered relevant for improving the efficiency of DRTs.

Asked whether the Working Group would consider the issue of prioritisation of the cases so that high-value cases can be taken up first, the Secretary, Ministry of Finance (Department of Economic Affairs – Banking Division) during evidence held on 2.12.2004, stated as under:-

> "Since I am not privy to the Committee's deliberations, I would not be able to say whether we can recommend this, but this is an extremely important point…….we will certainly take this up. I quite agree that in ensuring effective management, we have to follow eighty-twenty principle. The more important cases must be taken up first. The fact is that the banks themselves have to do it. We have to have some fast track procedure within the DRTs also. Sir, your suggestion is very well taken."

Asked to furnish the details regarding long pending cases along with the period of pendency, age-wise, of each case, in each of the DRT, the Ministry in their reply stated that case-wise and DRT-wise

information is not available. However RBI obtains quarterly statements from the banks advising RBI about the number of DRT cases filed/decided/pending as also the amount involved/amount recovered.

Asked whether there is any proposal under consideration of the Government to set up more DRTs in the country the Ministry stated that there is no such proposal at present.

Staff strength and vacancies in DRTs

The Ministry of Finance (Department of Economic Affairs – Banking Division) in a written reply furnished on 9th May, 2003 had stated that each of the 29 DRTs has one post each of Presiding Officer, Registrar and Assistant Registrar and two posts of Recovery Officers and all these posts are deputation posts. The issue of manning DRTs had been continuously reviewed to ensure that adequate staff is posted and timely arrangements are made for replacement and also in meeting contingencies. The staff strength of DRTs which was originally 16, was subsequently increased, and now it stands at 30 including the Presiding Officer. The present strength is considered adequate to meet the current workload of DRTs. Banking Division appoints Presiding Officers, Registrars, Recovery Officers and Assistant Registrars. Recruitment for the remaining staff is done by the DRTs as per the Recruitment Rules notified. There are instances of vacancies in these positions on account of premature repatriation of existing staff for various reasons, as well as time taken for completing the selection procedure. Since delays are taking place in regular posting of staff, nodal banks have been asked to come forward to provide support to DRTs as a

temporary or ad-hoc measure as it is in the larger interest of the Banks to improve the efficiency of DRT system.

While pointing out that shortage of manpower had led to delay in the process of settlement of cases, the Committee suggested that vacant posts may be filled up in coordination with the concerned agencies including State Governments. In response, the Secretary, Ministry of Finance, (Department of Economic Affairs Banking Division) during evidence held on 10.12. 2003, deposed as under :-

> "I think, this is very valid. We shall take an immediate review and early corrective action and see that the sanctioned staff is provided and whatever staff strength is necessary or any improvement is necessary we take that".

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) Act, which came into force on June 21, 2002, and received President's asset on December 17, 2002 provides a platform to banks and financial institutions for resolving their problems of non-performing/distressed assets by financial restructuring or by expeditiously disposing of financial assets.

The salient features of the SARFAESI Act, 2002 are as follows:-

(i)Registration

A securitisation or reconstruction company, with owned fund of not less than Rs.2 crore or not exceeding 15 per cent of total financial assets acquired or to be acquired as specified by the RBI, can commence or carry on business after obtaining a certificate of registration (CoR). Existing securitisation or reconstruction companies would have to apply for registration to the RBI within six months from the commencement of the Ordinance. For grant of CoR to a company, the conditions to be satisfied include: (a) not incurred loss in any of the three preceding financial years. (b) made adequate arrangements for realisation of financial assets for securitisation or asset reconstruction, (c) pays periodical returns, and (d) complies with the prudential norms of the RBI. In addition, the Directors of the company should have adequate professional expertise and not have been convicted of any moral turpitude/offence. Not more than half the Board members should be associated in any manner with the sponsor, and should not otherwise hold any controlling interest in such securitisation or reconstruction company.

(ii)Operations/functions

The acquisition of financial assets by the securitisation/reconstruction company would be through the issuance of debentures/bonds or agreements with banks/FIs. The notice of acquisition may be sent by banks/FIs to the concerned obligor, who, in turn, is to make payment to the concerned securitisation or reconstruction company. In case no notice of acquisition is given, then money/properties received subsequently by banks/FIs would be held in trust on behalf of the securitisation or reconstruction company. Other functions of such company would include acting as agent for banks/FIs to recover their dues from borrowers, acting as

manager and receiver if appointed by court or tribunal. The disputes will be settled by conciliation or arbitration as provided in the Arbitration and Conciliation Act, 1996.

(iii)Prudential Norms

The RBI, in public interest and to regulate the financial system of the country to its advantage would, determine policy and give directions to such companies on income recognition, accounting standards, provision for bad and doubtful debt, capital adequacy and deployment of funds.

(iv)Enforcement of Security Interest

The Act empowers secured creditors to enforce any security interest credited in its favor without any intervention of court or tribunal. The secured creditor may require the borrower to discharge his liabilities within 60 days from the date of notice, failing which the secured creditor is entitled to take possession or management of the secured assets including the right to transfer by way of lease, assignment or sale or appoint any person to manage the secured asset. The borrowers are allowed to seek protection by filing an appeal in the Debt Recovery Tribunal (DRTs) along with a deposit of 75 per cent of the amount claimed with the DRT in order to prevent misuse of appeal provisions.

(v)Offences and Penalties

There are strict provisions of penalties for offences or default by the securitisation or reconstruction company. In case of default in registration of transactions, modification of security interest or in reporting satisfaction of security interest, every company or officer would be fined upto Rs.5,000/- per day. In case of non-compliance with directions by the RBI, the company could be fined upto Rs.5 lakh

and in case of continuing offence, an additional fine of Rs.10,000 per day may be imposed.

The provisions of this Act will override other laws. The application of other laws such as the Company's Act 1956, Securities Contract (Regulation) Act, 1956 and Securities and Exchange Board of India Act, 1993, however are not barred.

Securitisation and Reconstruction Companies (SC & RC)

The Ministry of Finance (Department of Economic Affairs - Banking Division) in a written reply furnished in April,2004 had stated that two Working Groups were constituted by the Reserve Bank to formulate guidelines for SCs and RCs. Based on the recommendations of these Working Groups, guidelines and directions were issued vide Notification No.DNBS.2/CGM(CSM)-2003, dated April 23, 2003 on aspects relating to registration, owned funds, permissible business, operational structure for giving effect to the business of securitisation and asset reconstruction, deployment of surplus funds, internal control system, prudential norms and disclosure requirements. Department of Banking Operation and Development had also issued guidelines on sale of financial assets to securitisation and asset reconstruction companies by banks and financial institutions and related issues on April 23, 2003. An External Advisory Committee chaired by Shri R.H. Patil, Chairman, Clearing Corporation of India and consisting of experts from the field of banking, law and accountancy was constituted for screening the applications for registration of Securitisation Companies and Reconstruction Companies. The members of the Committee were:

1. Shri H.R. Ranina, Advocate
2. Shri Y.H. Malegam, Chartered Accountant

3. Shri K.B.L. Mathur, Economic Advisor and Joint Secretary, Ministry of Finance and

4. Smt. Shyamla Gopinath, Executive Director, RBI.

The Committee decided the methodology to be adopted in scrutinising the applications vis-à-vis the conditions contained in Section 3 (3) of the Securitisation Act. On the recommendations of the Committee, Reserve Bank had granted registration to Asset Reconstruction Company (India) Limited (sponsored by SBI, ICICI Bank and IDBI and having its Registered Office in Mumbai) and Assets Care Enterprise Limited (sponsored by IFCI, PNB, TFCI, LIC, BOB and UBI and having its Registered Office in New Delhi) on August 29,2003 and October 17, 2003 respectively. Two applications were returned as the companies were yet to be incorporated and one company had requested to keep its application in abeyance as it is contemplating changes in the management. The remaining applications are at various stages of processing, as there are certain information gaps, which are awaited from the companies. The status position of the applications had been stated to be as under:-

Total applications received	15
Applications approved	2
Applications pending	11
Applications returned	2

Asked to state the total number of Asset Reconstruction Companies established as on date and whether the number of companies set up is adequate to meet the demands of Banks and Financial Institutions for Securitisation and Reconstruction of their impaired/bad assets, the Secretary, Ministry of Finance (Department

of Economic Affairs – Banking Division) during evidence held on 2.12.2004, had deposed as under:-

> "So far, three asset reconstruction companies have been set up. They are all very new. One is ACE, the second is ARCIL and the third has recently been promoted by the Unit Trust of India. Now, all of these companies are very new because the law itself is very new and the entire business of asset reconstruction for our country is also very new.
>
> These asset reconstruction companies are just in the process of starting to do business and unless they can operate successfully and show to other prospective investors that it is a good and viable business, it is unlikely that other asset reconstruction companies would come in the field. Elsewhere in the world also, the experience of asset reconstruction companies has not been altogether uniform. In some places, they have been somewhat successful and in some others they have not been so successful. In some places, asset reconstruction companies are primarily the holding of the Government and in others they are in the private sector. In India also, they are in the private sector and private sector capital is likely to come into the business of asset reconstruction only when it sees that these asset reconstruction companies are functioning effectively.
>
> So, doubtless, considering our total NPAs, perhaps, there might be business for three or four companies. There are already three companies operating, but these are at a very nascent stage and we need to do more to create enabling environment so that they function effectively. They are yet to prove that they would be effective instruments of the process of asset reconstruction."

In their post evidence reply, the Ministry have further stated that three companies have been granted Certificate of Registration to commence the business of Securitisation/Reconstruction and few more companies may be considered for granting Certificate of Registration depending upon their suitability. The establishment of

these companies are expected to meet the immediate demand from banks for transfer of impaired assets.

Recovery of NPAs under SARFAESI Act

The Committee learnt that as per the interim order passed by Supreme Court, secured creditors cannot part with the assets of the borrowers by way of lease agreement or sale and that many banks were not even seizing the assets since it will not be possible for them to sell. Asked how the problem would be dealt with by the Ministry of Finance, the Secretary, Ministry of Finance (Department of Economic Affairs - Banking Division) during evidence held on 10.12.2003, deposed as under:-

> "…. But what has happened in this case is that as soon as this legislation was promulgated, a large number of petitions were filed in various courts, including the High Courts, and the matter has also come up before the Supreme Court. Many interim orders have also been passed and this has, unfortunately, for us, diluted the impact of this Act itself. This matter is still under consideration at the level of the hon. Supreme Court. The hearing is going on. It appears to us that the Court will perhaps uphold the validity of the Act. That is the impression we get. I cannot really predict what will happen. They have found that perhaps the debtors or borrowers are not getting proper opportunities to explain their own side of the case. Perhaps the principle of natural justice is not being properly adhered to. So, a suggestion has come up that we should lay down a procedure whereby they have adequate opportunity of hearing and they can present their own case. The Attorney-General himself is appearing in this case. The major case is Mardia Chemicals which is being discussed at present. Our hope is that perhaps the validity of this law will be upheld. But there might be certain instructions in regard to the procedure which is to be followed. The confirmation by the hon. Supreme Court

about the validity of this Act will greatly strengthen the hands of our banks…."

The Supreme Court of India in its Judgement dated 18.04.2004 in Mardia Chemicals Ltd. vs. Union of India and others, had upheld the validity of provisions of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 except the provision of sub-section (2) of Section 17 which had been held to be ultra vires of Article 14 of the Constitution.

The Finance Minister in his speech on the Budget for 2004-2005 had stated that in the wake of Supreme Court judgement, many banks have pointed out practical difficulties likely to arise in speeding up the recovery of non-performing assets. It is proposed to amend the relevant provisions of the Act to appropriately address the Supreme Court's concerns regarding a fair deal to borrowers while at the same time, ensuring that the recovery process is not delayed or hampered. Related amendments to the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, if necessary, will also be made.

Pursuant to Finance Minister's statement in the Budget : 2004-05, the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act, 2004 seeking to amend the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and the Companies Act, 1956 was passed by both Houses of Parliament and assented to by the President on 29th December, 2004. Amendments made to the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 are as follows:-

(a) The secured creditor is required to consider, in response to the notice issued by the secured creditor under sub-section (2) of Section 13 of the said Act, any representation made or objection raised by the borrower and cast an obligation upon the secured creditor to communicate within one week of receipt of such representation or objection the reasons for non-acceptance of the representation or objection to the borrower and take possession of the secured asset only after reasons for not accepting the objections of the borrower have been communicated to him in writing;

(b) enable the borrower to make an application before the Debts Recovery Tribunal without making any deposit (instead of filing an appeal before the Debts Recovery Tribunal after depositing seventy-five per cent of the amount claimed with the notice by the secured creditor);

(c) provides that the Debts Recovery Tribunal shall dispose of the application as expeditiously as possible and dispose of such application within sixty days from the date of such applications so that the total period of pendency of the application with such Tribunal shall not exceed four months;

(d) make provision for transfer of pending applications to any one of the Debts Recovery Tribunal in certain cases;

(e) enables any person aggrieved by any order made by the Debts Recovery Tribunal to file an appeal to the Debts Recovery Appellate Tribunal after depositing with the Appellate Tribunal fifty per cent of amount of debt due from

him, as claimed by the secured creditor or determined by the Debts Recovery Tribunal, whichever is less.

Besides above the Act also amended the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 so as to enable the bank or financial institution to withdraw, with the permission of the Debts Recovery Tribunal, the application made to it and thereafter take action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. The Companies Act, 1956 was also amended so as to provide that any reference made under section 424A of that Act shall abate if the secured creditors representing three-fourth in value of the amount outstanding against financial assistance disbursed to the borrower have taken measures to recover their secured debt under sub-section (4) of Section 13 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

Asked about the experience of the Government with regard to Securitisation Act, the Secretary, Ministry of Finance (Department of Economic Affairs – Banking Division) during evidence held on 2.12.2004 stated as under:-

> "Upto 30th September, 2004, which is the latest, the total number of notices issued was 70,254, and these only relate to public sector banks. Private sector banks would have also taken action under it. The total amount involved was Rs. 21,988 crore. The number of cases in which recoveries could be made was also around 29,301 but the total amount recovered was Rs. 22,238 crore. Then, the number of compromise proposals was 16,150 and the amount received through compromise proposals was Rs. 1369.87 crore, to be exact. Nearly two years have elapsed since the law was passed. For a major part of this period, this law was under judicial challenge. The hon. Supreme Court passed its Order only recently. Pursuant to the Supreme Court's Orders,

because of the urgency required in this matter, the Government has also brought in an Ordinance to comply with the Supreme Court Order and to see that the recovery process is not delayed. I would say that the experience so far has been quite satisfactory. With the loopholes that are proposed to be plugged by bringing out amendments in this Act, we will be able to address this problem further. The amendments proposed are already before the Parliament and are to be taken up for consideration whenever the Business Advisory Committee decides. According to this amendment, we have to give a reasonable opportunity to the borrower to state his case. The allegation in the judiciary was that sometimes you can make arbitrary claims against a borrower. If the due is only Rs. 10 crore, you can issue a notice for Rs. 100 crore and the borrower has no opportunity to explain whether the calculation is right or wrong. Also sometimes very arbitrary view can be taken. So, the hon. Supreme Court has taken a view that once that notice is issued, then the bank has to adjudicate. It has to issue a reasoned order responding to the objections of the borrower, and only thereafter the bank can proceed to attach the assets of the party. Against that order issued by the bank, which will be a reasoned order, the borrower will also have a right to go in for appeal.

Earlier, even to challenge the initial notice, the borrower had to deposit 75 per cent of the amounts due. That will no longer be necessary. He can state the case without depositing any amount. But when he goes in appeal, he has to deposit at least 50 per cent of the amount due and the appellate court in its discretion can reduce that amount from 50 per cent to 25 per cent. So it is fair to the borrower and it is fair to the lender also so that the recovery process is not delayed. We, in the Government, are confident that this will be not only a fair law, it will also be a very effective law against wilful defaulters."

Recovery of Loans/Dues through Compromise/One Time Settlement System

As per directions of Reserve Bank of India, compromise settlement system for recovery of loans has been evolved by

banks. The details of various schemes and amount recovered thereunder are as follows:-

1. **Settlement Advisory Committees:**

   RBI had issued specific guidelines to Public Sector Banks in May 1999 for constitution of Settlement Advisory Committees for compromise settlement of NPAs of small sector by PSBs in order to reduce pendencies and enable banks to vigorously pursue other relatively large cases. Some banks have set up independent Settlement Advisory Committees (SACs) headed by a retired Judge of the Higher Court to scrutinize and recommend compromise proposals. The function of the Committee is advisory in nature. While the Committee could give its views on the proposals involving compromise/write off referred specifically to it, a final decision thereon would have to be taken by the competent officials as prescribed under the system of delegation of powers in the bank independently.

2. **One Time Settlement Scheme for small sector**

   The guidelines issued by RBI in relation to Settlement Advisory Committees will apply to borrowers in the small business including trading and personal segment and Agricultural Sector. All NPAs which are chronic and at least three years old as on March 31, 1999 were eligible under the scheme which was in operation till September 30, 2000.

3. **Recoveries under OTS upto Rs. 5 crore :**

The One Time Settlement Scheme for NPAs upto Rs. 5 crore, which was offered upto 30th June, 2001 as per the guidelines of RBI had resulted in settlement of 887 lakh NPA accounts involving Rs. 4,649 crore.

4. **One Time Settlement Scheme for Small Loans limit upto Rs. 25,000/- :**

Following the meeting of Finance Minister with Chief Executives of public sector banks held on 12th November, 2001, RBI issued guidelines for compromise settlement of NPAs and small loan amount with sanctioned limits upto Rs. 25,000/- on 22nd December, 2001. The guidelines cover all NPAs as on 31st March, 1998 and were operative upto June, 2002. Under the scheme the amount to be recovered towards settlement was fixed at the balance outstanding towards principal in the loan account as on 31st March, 1998. All banks had implemented the scheme. An estimated 30.95 lakh accounts involving NPAs of Rs. 2,522 crore were eligible for settlement under the scheme. 2.33 lakh applications were received for settlement upto 31st March, 2002 out of which approvals were given in respect of 1.79 lakh cases involving an amount of Rs. 149 crore. As on 31st March, 2002, total recoveries reported under the scheme amounted to Rs. 90 crore.

5. **One time Settlement for NPAs in respect of loans to Small and Marginal Farmers upto Rs. 50,000/-:**

RBI issued guidelines under the scheme for recovery of NPAs in respect of loans to Small and Marginal

farmers upto Rs. 50,000/- on 22nd March, 2002. These guidelines were applicable for NPAs as on 31st March, 1998. The features of the scheme are similar to those in the scheme for small borrowers with limit upto Rs. 25,000/-. The scheme which was in operation until 31st December, 2002, was extended upto 31st March, 2003. As the scheme was announced towards the end of the financial year 2001-02, banks did not have any performance to report, as on 31st March, 2002. Most banks however, reported that their Boards have adopted the scheme and advised the branches for implementation. With a view to reducing the level of NPAs, all scheduled commercial banks and financial institutions were advised vide Circular dated 2nd May, 2001 to make increasing use of forum of Lok Adalats to settle banking disputes involving amount upto Rs. 5 lakh.

One-time settlement scheme for NPAs upto Rs.10 crore

The One Time Settlement Scheme for NPAs was reviewed by Reserve Bank of India and revised guidelines were issued to all Public Sector Banks on January 29, 2003. The coverage had been raised to chronic NPAs upto Rs. 10 crore.

Data in respect of the OTS scheme of Rs. 10 crore and below of the Public Sector Banks is given in Annexure V.

Asked to state the estimated total loss to banks, per year, on account of One Time Settlement Scheme (OTS), the Ministry in their written reply stated that the guidelines for OTS Scheme finalised by RBI in consultation with Government of India provides for settlement of dues in respect of NPAs which are classified as doubtful on a given date. They do not provide for any waiver of principal amount, but permit the Banks to waive only interest accruing after the amount had already turned NPA where interest payable cannot be booked as income of the Bank. In other words, the sacrifice in such settlements would cover amounts not actually accounted as income and hence the concept of "loss" in arriving at the settlement, as per the OTS guidelines of RBI, is not proper. However, the Banks have been entering into compromise settlements beyond the RBI guidelines in cases where the value of the collateral or other security has grossly eroded and the borrower, in the judgment of the Bank, is not in a position to cough-up adequate funds for payment as per the OTS Scheme circulated by RBI. For such settlements, the Banks have framed their own recovery policies with the approval of their respective Boards. Hence, there have been instances where the Banks, with the approval of their Board, have waived off principal amount also. The principal amount so waived can be treated a loss to the Bank, though this reduction in NPA helps the Bank in improving the quality of its financial status and asset portfolio. As principal amounts have been waived in exceptional cases by Banks as per their recovery policy adopted by the Board, such information is not being maintained centrally either by RBI or the Government.

Statements giving details of suit filed cases filed by Public Sector banks in Courts of Law and DRTs which are pending between

5 to 10 years and 10 years and above as on 31.3.2002 and 31.3.2003, are given in Annexure - VI.

Asked whether any target is set for recovery of bad loans the Secretary, Ministry of Finance (Dept. of Economic Affairs – Banking Division) during evidence held on 2.12.2004 deposed as under :-

> "Now, we have moved to an entirely different system. Most banks are listed in the stock markets, and their balance-sheets and their accounts are known; their NPAs are known. They are themselves very conscious of this fact. Therefore, for reducing their NPAs, there is no longer any need to set any targets. They will lose business, if they have high NPAs."

Asked about the suggestions for effective recovery of NPAs by the Banks and measures taken/proposed to be taken by Government, RBI and Banks for reducing and preventing recurrence of bad loans, NPAs, the Ministry of Finance in a written reply have stated that Government of India and RBI have advised the banks to take the following measures for recovery of loans:-

i) Formulate Loan Policy and Loan Recovery Policy with the approval of Board of Directors and implementation thereof.

ii) Establish Recovery Cells at Head Office, fixing of recovery targets for various levels and close monitoring of recovery performance.

iii) Review NPA accounts of Rs. 1 crore and above by Board of Directors with special reference to fixing of staff accountability and review of top 300 NPA accounts by Management Committee of the Board.

iv) Strengthen the risk management systems by putting in place institutional framework for identifying, monitoring and management of credit risk.

v) Implement Non-discretionary and non-discriminatory One Time Settlement Scheme announced by RBI.

vi) Recovery of loans by way of compromise settlement through Settlement Advisory Committees and Lok Adalats; and

vii) Filing of cases in Debt Recovery Tribunals.

Besides above, the Ministry had also stated that a Credit Information Bureau had been set up to disseminate information on borrowers to the banks and Corporate Debt Restructuring (CDR) mechanism had been put in place to provide a transparent mechanism for restructuring of corporate debts of viable entities. The Securitisation & Reconstruction of Financial Assets and Enforcement of Security Interest Act,. 2002, had been enacted to facilitate foreclosure and enforcement of securities in cases of default and to enable the bank and financial institutions to realize their dues and the Asset Reconstruction Company (India) Ltd. had been incorporated under the Companies Act, 1956. RBI had issued a fresh one-time settlement scheme on 29th January, 2003 for compromise settlement of chronic NPAs upto Rs. 10 crore.

CHAPTER _V
WRITING OFF LOANS/ADVANCES

According to Ministry of Finance (Department of Economic Affairs – Banking Division), write off is permitted as a last resort when all other means to recover the loans are exhausted and where no security is available. Banks may write off advances at Head Office level, even though the relative advances are still outstanding in the branch books. However, it is necessary that provision is made as per the classification accorded to the respective accounts. In other words, if an advance is a loss asset, 100 per cent provision will have to be made therefor. The total amount which is written off finds a mention in the Balance Sheet/Annual Report of the respective banks.

The cases of compromise proposals of bad debts, losses, etc. written off by the Chairman and other functionaries are required to be put up to the Management Committee/Board of Directors, on a quarterly basis with all relevant information, such as, the sanctioning authority, causes for the account turning bad, efforts made for the recovery of dues and staff accountability.

The Ministry has further stated that technical write off is resorted to by banks to cleanse the balance sheet of bad debts. The borrowers, however, continue to be liable for payment of the dues to the bank. It is learnt that borrowers are not kept informed of such decisions, particularly when the branches continue to pursue the borrowers' obligations to repay the dues except where compromise settlements are entered into.

As per RBI instructions, Board of Directors of individual banks are required to delegate appropriate powers for write off of bad debts/ losses and compromise proposals to the various functionaries subject to such safe-guards/conditions and reporting, as the Board may prescribe. The proposals for write off should be examined covering, inter alia, the following aspects :-

(a) The sanctioning authority in the case of advances had exercised his powers judiciously and adhered to the guidelines issued by the banks in the matter of grant of advances and that normal terms and conditions were stipulated.

(b) There was no laxity in the conduct and post-disbursement supervision of advances.

(c) There was no act of commission or omission on the part of the staff leading to the debt proving irrecoverable.

(d) All steps possible to recover the dues had been taken and that there was no further prospect of recovering the debts and writing off/compromise was in the larger interest of the bank, and

(e) The authority approving write off proposal did not sanction the advance in question in his individual capacity.

The Committee liked to be apprised of the legality of the loan amount written off and whether Banks have the legal authority to recover the amount. The Secretary, Ministry of Finance (Department of Economic Affairs-Banking Division), during evidence held on 10.12.2003, clarified the matter as under :-

> "The other issue that you have kindly raised is in regard to the legal position of loans which are written off. Our own understanding is that irrespective of provisions made for bad loans or writing off of those loans, the banks retain the right to

recover the loans completely. The writing off is done only at the Head Office level and not at branch level. At the branch level, the loans remain recoverable and the bank itself should take all possible action to recover the loan from whatever asset is available for security or from personal guarantees or whatever means are available. So, writing off or making a provision in regard to a certain bad loan does not permit the bank or the branch from not recovering it. It is possible that somebody might challenge it in a court of law and so far I am not aware of court having passed any adverse judgement from our point of view. Of course, the courts will take a legal view in this regard, but our understanding so far has been this and this is the presumption and premise on the basis of which banks are presently operating."

The Deputy Governor, RBI further clarified during evidence as under:-

"Now, I come to the other comment which you made. Where write off has taken place, technically, after provisions have been made out of the bank profits, the loan goes out of the bank books, but it remains in another set of books where it is called 'advance under collection'. After the recoveries are made, the amounts are directly credited to Profit and Loss Account. This accounting procedure has been approved. It has stood the test of time. I cannot recollect the case laws, but a few people have challenged this in the court also, but my understanding is that courts have upheld the action that the legal rights do not get extinguished just after the asset is taken out of the books and that the lender has a right to pursue his request to the securities. That has stood the test of time on that part of it."

The total amount written off by Banks during the last five years is as under:-

Year	2000	2001	2002	2003	2004
Amount(Rs	4500	6446	8711	11620	13490

in crore)					

The statement showing details of amount recovered by Public Sector Banks through compromise/write-off during financial years 2003 and 2004 is furnished at Annexure-VII.

The details of borrowers whose NPA accounts involving more than Rs. 50 crore have been written off and the action taken against these borrowers by the respective banks is given in Annexure-VIII.

CHAPTER-VI

WILFUL DEFAULT AND DIVERSION OF FUNDS

1. Wilful Default of Loans

In the wake of concern expressed over the persistence of wilful default in the financial system by the Parliament's Standing Committee on Finance in their 8th Report (13 LS) on "Financial Institutions", the Reserve Bank of India had, in consultation with the Government of India, constituted in May 2001 a Working Group on Wilful Defaulters (WGWD) under the Chairmanship of Shri S.S. Kohli, the then Chairman of the Indian Banks' Association, for examining some of the recommendations of the Committee. The Group submitted its report in November 2001. The recommendations of the WGWD were further examined by an In-house Working Group constituted by the Reserve Bank. The RBI vide their Circular dated 30.05.2002 advised all the Banks/FIs about the revised definition of the term `wilful default' and other related

matters as recommended by Kohli Committee. The details contained in the circular are given below:-

"A. <u>Definitions</u>

"A wilful default would be deemed to have occurred if any of the following events is noted:

(i) the unit has defaulted in meeting its payment/repayment obligations to the lender even when it has the capacity to honour the said obligations.

(ii) The unit has defaulted in meeting its payment/repayment obligations to the lender and has not utilised the finance from the lender for the specific purposes for which finance was availed of but has diverted the funds for other purposes.

(iii) The unit has defaulted in meeting its payment/repayment obligations to the lender and has siphoned off the funds so that the funds have not been utilised for the specific purpose for which finance was availed of, nor are the funds available with the unit in the form of other assets.

B. <u>Diversion and Siphoning of Funds</u>

It has also been decided that the terms "diversion of funds" and "siphoning of funds" should be construed to mean the following:-

Diversion of Funds, referred to at para above, would be construed to include any one of the undernoted occurrences:

(a) utilisation of short-term working capital funds for long-term purposes not in conformity with the terms of sanction;

(b) deploying borrowed funds for purposes/activities or creation of assets other than those for which the loan was sanctioned.

(c) transferring funds to the subsidiaries/Group companies or other corporates by whatever modalities;

(d) routing of funds through any bank other than the lender bank or members of consortium without prior permission of the lender;

(e) investment in other companies by way of acquiring equities/debt instruments without approval of lenders;

(f) shortfall in deployment of funds vis-à-vis the amounts disbursed /drawn and the difference not being accounted for.

Siphoning of funds, referred to at para above, should be construed to occur if any funds borrowed from

banks/FIs are utilised for purposes un-related to the operations of the borrower, to the detriment of the financial health of the entity or of the lender. The decision as to whether a particular instance amounts to siphoning of funds would have to be a judgement of the lender based on objective facts and circumstances of the case.

C. Cut-off limits

While the penal measures indicated at para D below would normally be attracted by all the borrowers identified as wilful defaulters or the promoters involved in diversion/siphoning of funds, keeping in view the present limit of Rs.25 lakh fixed by the Central Vigilance Commission for reporting of cases of wilful default by the banks/FIs to RBI, any wilful defaulter with an outstanding balance of Rs.25 lakh or more, as on the date of this circular, would attract the penal measures stipulated at para 7 below. This limit of Rs.25 lakh may also be applied for the purpose of taking cognisance of the instances of `siphoning'/ `diversion' of funds.

D. Penal measures

In order to prevent the access to the capital markets by the wilful defaulters, a copy of the list of wilful defaulters would henceforth be forwarded by RBI to SEBI as well. It has also been decided that the following

measures should be initiated by the banks and FIs against the wilful defaulters identified as per the definition indicated at paragraph A above:

(i) No additional facilities should be granted by any bank/FI to the listed wilful defaulters. In addition, the entrepreneurs/promoters of companies where banks/FIs have identified siphoning/diversion of funds, misrepresentation, falsification of accounts and fraudulent transactions should be debarred from institutional finance from the scheduled commercial banks, Development Financial Institutions, Government owned NBFCs, investment institutions, etc. for floating new ventures for a period of 5 years from the date the name of the wilful defaulter is published in the list of wilful defaulters by the RBI.

(ii) The legal process, wherever warranted, against the borrowers/guarantors and foreclosure of recovery of dues should be initiated expeditiously. The lender may initiate criminal proceedings against wilful defaulters, wherever necessary.

(iii) Wherever possible, the banks and FIs should adopt a proactive approach for a change of management of the wilfully defaulting borrower unit.

(iv) A covenant in the loan agreements, with the companies in which the notified FIs have significant stake, should be incorporated by the FIs to the effect that the borrowing company should not induct a person who is a director on the Board of a company which has been identified as a wilful defaulter as per the definition and that in case, such a person is found to be on the Board of the borrower company, it would take expeditious and effective steps for removal of the person from its Board.

It would be imperative on the part of the banks and FIs to put in place a transparent mechanism for the entire process so that the penal provisions are not misused and the scope of such discretionary powers is kept to the barest minimum. It should also be ensured that a solitary or isolated instance is not made the basis for imposing the penal action.

While dealing with wilful default of a single borrowing company in a Group, the banks/FIs should consider the track record of the individual company, with reference to its repayment performance to its lenders. However, in cases where a letter of comfort and/or the guarantees furnished by the companies within the Group on behalf of the wilfully defaulting units are not honoured when invoked by the banks/FIs, such Group companies should also be reckoned as wilful defaulters."

On being asked whether covenant in the loan agreement has been incorporated by all the banks to the effect that the borrowing company should not induct a person who is a Director on the Board of Company which has been identified as a wilful defaulter, the Ministry in its reply has stated that financial institutions have incorporated a suitable covenant in the loan agreement entered into by the borrower company at the time of availment of the facility to ensure that the borrowing companies comply with this condition.

E. End-Use of Funds

With regard to end-use of funds, the RBI vide its circular dated 30.05.2002, had issued guidelines to banks on the basis of recommendations of Kohli Committee.

The guidelines inter alia state that in cases of project financing, the banks/FIs seek to ensure end use of funds by, inter alia, obtaining certification from the Chartered Accountants for the purpose. In case of short-term corporate/clean loans, such an approach ought to be supplemented by `due diligence' on the part of lenders themselves, and to the extent possible, such loans should be limited to only those borrowers whose integrity and reliability were above board. The banks and FIs, therefore, should not depend entirely on the certificates issued by the Chartered Accountants but strengthen their internal controls and the credit risk management system to enhance the quality of their loan portfolio. Needless to say, ensuring end-use of funds by the banks and the FIs should form a part of their loan policy document for which appropriate measures should be put in place. Following are some of the **illustrative measures** that could be taken by the lenders for monitoring and ensuring end-use of funds:-

(a) Meaningful scrutiny of quarterly progress reports/

operating statements/balance sheets of the borrowers;

(b) Regular inspection of borrowers' assets charged to the lenders as security;

(c) Periodical scrutiny of borrowers' books of accounts and the non-lien accounts maintained with other banks;

(d) Periodical visits to the assisted units;

(e) System of periodical stock audit, in case of working capital finance;

(f) Periodical comprehensive management audit of the `credit' function of the lenders, so as to identify the systemic-weaknesses in the credit-administration.

Asked to state whether the illustrative measures enumerated by RBI for ensuring proper end-use of funds are being followed by the banks, the Ministry of Finance in their reply stated that banks have a well-defined procedure for post-disbursement supervision of loan accounts and monitoring of end-use of funds. Aspects relating to diversion of funds by borrowers/companies are looked into and adherence or otherwise of guidelines of RBI for verifying end use of funds lent by banks are commented upon at the time of inspection of branches/controlling offices by bank's own inspectors, statutory auditors and also at the time of Annual Financial Inspection conducted by RBI. Serious deficiencies and lapses are discussed during Annual Financial Inspection/audit, etc.

The Ministry of Finance has further stated that it has been observed from the loan policy documents of the banks that

they have incorporated measures such as visits to the assisted units, calling for documentary evidence, verification of stock acquired out of bank funds etc. for ensuring end use of funds.

2. <u>Role of Auditors</u>

The Ministry of Finance has stated that in case of project financing, banks/FIs obtain certificate from Chartered Accountants on end use of funds by the borrowers. The Working Group on wilful defaulters set up under the Chairmanship of Shri S.S. Kohli had recommended that in case any falsification of account on the part of the borrowers is observed by the banks/FIs, they should lodge a formal complaint against the auditors of the borrowers with the Institute of Chartered Accountants of India (ICAI), if it is observed that the auditors were negligent or deficient in conducting the audit to enable the ICAI to examine and fix accountability of the auditors. With a view to monitoring the end-use of funds, if the lenders desire a specific certification from the borrowers' auditors regarding diversion/siphoning of funds by the borrower, the lender should award a separate mandate to the auditors for the purpose. To facilitate such certification by the auditors the banks and FIs will also need to ensure that appropriate covenants in the loan agreements are incorporated to enable award of such a mandate by the lenders to the borrowers/auditors.

RBI has formulated the following policy for taking action against audit firms on account of irregularities reported against them:-

(i) Anonymous complaints received against audit firms are not entertained;

(ii) In case of complaints received from any Government Department, any regulating authorities, or in case serious

irregularities are observed by Inspector of RBI during AFI of the bank or where delay in accepting, commenting/completing statutory audit work assignment by RBI or refusal of statutory audit by concerned audit firms, they are denied audit by RBI after examining their responses and in consultation with the Sub-Committee (Audit) of the BFS.

(iii) Where complaint is received from Government of India, Ministry of Finance, Banking Division, necessary penal action is taken by RBI against the concerned audit firm and full facts are reported to Sub-Committee (Audit) of BFS.

(iv) Where complaint has already been filed with ICAI no action is taken unless it is advised by the ICAI about either filing the case by its Council at its on prima facie stage or referring the case to its disciplinary committee.

(v) Audit firm denied audit by the office of C&AG are also denied audit by RBI. In case statutory audit is denied to any audit firm its name is not considered for any private sector bank/foreign bank/local area bank/state financial corporation.

It has further been stated that presently, firms having been found guilty of professional mis-conduct by ICAI firms against which the cases are pending with the institute (including those involved in audit of banks/financial institutes involved in the irregular secured transactions of 90-91, 91-92) and those denied audit by the office of C&AG, are denied statutory audit by RBI.

Asked to state the number of cases where banks have lodged

complaints against the auditors of the borrowers for falsification of accounts with the Institute of Chartered Accountants of India (ICAI) for being negligent or deficient in conducting the audit, the Ministry in a written reply have stated that at present there is no system in place to compile information on such complaints made by banks to ICAI.

3.Criminal Liability/action against diversion/ siphoning of funds

Expressing serious concern over diversion/siphoning of funds by borrowers, the Joint Parliamentary Committee on Stock Market Scam and Matters relating thereto in their Report have inter alia recommended (para no. 10.84) as under:-

> "…….. the Committee find that the activity of diversion of funds is not culpable either under Banking Regulation Act or under the Indian Penal Code……..the Committee are however constrained to note that even this circular (circular dated 30.5.2002 issued by RBI pursuant to recommendation of Working Group on Willful Default –Kohli Committee) is silent with respect to fixing criminal liability against those who siphon of funds deliberately, resort to mis-representation, falsification of accounts and indulge of fraudulent transactions. In view of the fact that as regards judicial interpretation of Sections 405 and 415 no offence of breach of trust or cheating is construed to have been committed in the case of loans, it is essential that such offences are clearly defined under the existing statutes governing the banks, providing for criminal action in all such cases where the borrowers divert the funds with malafide intention. Though the Committee agree that such penal provisions should be used sparingly and after due diligence and caution, at the same time it is also essential that banks closely monitor the end use of the funds and obtain certificates from the borrowers certifying that the funds have been used for the purpose for which these were obtained. Wrong certification, should attract criminal action against the borrowers."

RBI constituted a Working Group under the chairmanship of Shri D.T. Pai, Banking Ombudsman, Uttar Pradesh with representatives of SBI, ICICI Bank, Canara Bank, IDBI, IFCI and RBI as its members to examine the JPC recommendation (para No. 10.84). The terms of the reference of the Working Group amongst others were to review sections 405 & 415 of Indian Penal Code in order to spell out clearly that breach of trust or cheating is construed to have been committed in the case of loans of banks/financial institutions. The Working Group had submitted its Report on 25th April, 2003. The Working Group deliberated all relevant issues and recommended amendment to Section 405 and incorporation of new Sections 415A, 424A and 465A to the IPC to provide for criminal action against those indulging in diversion/siphoning of funds, resorting to misrepresentation, falsification of accounts and indulging in fraudulent transactions. The recommendations made by the

Working Group are detailed as under :-

Proposed amendments to Indian Penal Code, 1860

I. Section 405 – Number the present provision as sub section (1) and add new sub sections (2) and (3) to the section

Section 405(2) – whoever, has availed any financial assistance from a bank or financial institution, shall be deemed to have been entrusted with the amount involved in the financial assistance and if he makes mis-utilisation of such money or disposes any portion or whole of such amount not in accordance

with the terms of the contract, express or implied with the bank or financial institution shall be deemed to have dishonestly used such amount in violation of legal contract as aforesaid.

405(3)- Who ever has acquired any specific property with the financial assistance availed, from a bank or financial institution and a security interest has been created in favour of such bank or financial institution shall be deemed to have been entrusted with such property and if he misutilises or disposes such property, wholly or partly, not in accordance with the terms of the contract, express or implied with the bank or financial institution shall be deemed to have dishonestly misappropriated such property in violation of legal contract as aforesaid.

Explanation (1) for the purpose of sub sections (2) and (3) above and Sections 415A, 424A, 465A, the words 'bank', 'financial institution', 'financial assistance', 'security interest' shall have the same meaning as assigned in the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

II. In the Indian Penal Code after Section 415 the following sub-section may be inserted namely,

Section 415 – After the present provision <u>insert</u> a new Section 415A

Who ever, with the intention of availing financial assistance from a bank or financial institution or to

prevent the bank or financial institution from recovering the financial assistance availed or which may be availed, makes any statement which is false in material particulars or does any act or omits from doing any act, causing wrongful loss to the bank or financial institution shall be deemed to have deceived the bank or financial institution with an intention to cheat.

Provided that whoever knowingly takes part in the preparation or provides information which is false in material particulars for such preparation or certifies or authorizes the veracity of any statement submitted to the bank or financial institution for availing the aforesaid financial assistance or preventing its recovery shall be deemed to have intentionally aided cheating.

III. In the Indian Penal Code, after Section 424 the following section may be inserted, namely:

Section 424A Punishment for Removal of Assets etc.

Who ever

(a) removes or conceals, or transfers or causes to be transferred any property in his custody or control which is subject to any form of security interest created in favour of any bank without the express or implied consent or concurrence of such bank; or

(b) furnishes any statement which is false in any material particulars, to any bank concerning any property which is in his custody or control and which is either subject to any form or security interest in favour of any bank/FI or which is offered by him to any bank/FI to be made subject to any security interest in favour of that bank

shall be punished with imprisonment of either description which may extend to two years, or with fine or with both.

IV. Add new section numbering as 465A in IPC

After the present Section 465 the following new Section may be inserted namely:

465A – Penalty for falsification of books;

If with intent to defraud or deceive a bank or a financial institution from whom a financial facility is availed, any borrower or employee or his agent.

a) destroys, mutilates, alters, falsifies or secrets, or is privy to the destruction, mutilation, alteration, falsification or secreting of any books, papers or securities; or

b) makes or is privy to the making of any false or fraudulent entry in any register/books of accounts or document belonging to the company;

He shall be punishable with imprisonment for a term which may extend to seven years and shall also be liable to fine.

Amendment to Indian Evidence Act, 1872

V. Amendment to the Indian Evidence Act, 1872 by incorporating Section 114A has been recommended as detailed under. This would provide statutory presumption in favour of prosecution in connection with the offences dealt under Section 424A of IPC and reduce burden of banks/financial institution in proving the offence.

After Section 114A of the Indian Evidence Act, 1872, the following section may be inserted, namely:-

"114B In a prosecution for dishonest or fraudulent removal, concealment or transfer of any form of security interest, created in favour of any bank/ or FI, furnishing of any statement which is false in any material particulars with respect of such security interest under Section 424A of the Indian Penal Code, the Court shall presume that -

a) any act of removal, concealment of transfer of such security interest or the furnishing or any such statement by any person, was dishonestly or fraudulently made unless a contrary is shown:

b) any such transfer was dishonestly or fraudulently made when –

i) such transfer was made without the consent or concurrence of the bank/FI and

ii) the proceeds of such transfer were not utilized to discharge the security interest subject to which such property is held."

VI. The amendments recommended by Mitra Committee with regard to the provisions of Indian Penal Code, Indian Evidence Act and Criminal Procedure Code be implemented expeditiously.

VII. The Banking Regulation Act primarily deals with the banks and do not directly deal with relation between the borrower and the bank. The issue involved is fixing criminal liability on borrower, the group was of the strong view that certain additions to Section 405 and 415 of IPC will serve the purpose. It is not out of place to mention here that the Banking Regulation Act does not have any trial procedure. Group therefore do not recommend any amendment to the Banking Regulation Act.

Asked to state whether the recommendations made by D.T. Pai Working Group have been accepted and implemented, the Deputy Governor, RBI during evidence held on 2.12.2004 deposed as under:-

> "Sir, you have mentioned about the JPC's recommendation about taking criminal action against those who have siphoned off funds or have diverted bank credit or other uses. It is true, the JPC had recommended that we should consider taking criminal action. We had had this examined by the legal

department. Then, we have set up, what is called, a Standing Technical Advisory Committee for financial regulation. It comprises select bankers and financial institutions. We considered this subject matter as one of the agenda items for discussion also. The members include select foreign bankers, the private bankers, the public sector banks. We wanted a debate on the subject as to how and whether it would be appropriate to take criminal action. After having considered the Standing Technical Advisory Committee's views and the legal views in the matter, we have proceeded to issue a circular to all banks in July 2004 advising the banks that they should take criminal action wherever they find that borrowers have diverted funds."

On perusal of guidelines advised by RBI to all banks/AFIs on on 23rd July,2004 regarding measures to be taken by banks against wilful defaulters (Annexure-IX), the Committee found that under the extant guidelines Banks were to seriously and promptly consider initiating criminal action against wilful defaulters, wherever considered necessary, based on the facts and circumstances of each case under the provisions of Section 403 and 415 of IPC, 1860.

Asked about the reasons for not accepting the specific recommendations proposing amendments to IPC made by D. T. Pai Committee, the Ministry in their post-evidence reply have stated as under:-

"The D.T. Pai Committee recommendations were examined by RBI in the background of the steps already initiated by Reserve Bank in May 2002 to effectively address the issue of diversion/siphoning of funds. The D.T. Pai Committee had recommended legal amendments necessary to facilitate criminal action against borrowers who divert/siphon off bank funds, but it was felt that 'presumptive guilt' in breach of contracts with borrowers for initiating criminal proceedings implicit in the recommendation could post difficulties as had happened in the case of FERA violations. The experience of

banks in regard to vigilance proceedings based on similar presumption was also no better. It was also observed that the recommendation could lead to asymmetry between Banks and borrowers in the context of the ability of banks to appropriate all types of cash flows in the borrowers' accounts in its favour. In this context, there was also the need to distinguish genuine exogenous causes affecting the borrowers' ability to service the dues from deliberate attempts to divert banks assistance. Thus when certain defaults may not be due to diversion, also sometimes even diversion may not lead to default. It was also important to know whether the banks can have systems to identify and check attempts for diversion at some stage and to initiate appropriate action based on loan covenants rather than relying on criminal action to recover the dues. While there was certainly a need to check the abuse of the financial system, it was felt that as lending and borrowing are commercial transactions between consenting/contracting parties, presumption of criminality may not be proper. Further, such stipulation if applied only to banks and not to other intermediaries may lead to asymmetrical treatment and could be questioned in Courts of law. Considering the implications implicit in the legislative amendments, D.T. Pai Committee recommendations were taken up for wider discussions with the Standing Technical Advisory Committee on Financial Regulation (STACFR), an advisory body comprising of bankers, legal experts and academicians set up by RBI. The issue was examined by the STACFR with specific reference to the following :

(i) Implications of adopting the changes suggested by the D.T. Pai Committee.
(ii) Exploring all possible options available to achieve the objectives governing the recommendations of the JPC.
(iii) Need for checking diversion of banks funds through the NBFC route :
(iv) Mechanism for redressal of grievances of borrowers declared as willful defaulter.

While entirely agreeing with the observations of the JPC on the need for strong action against willful defaulters, in a demonstrable way, STACFR observed that :

(a) The recommendations of the Pai Group for amendments to Indian Penal Code has an implicit element of presumptive guilt on the part of the borrower. Implementation of the recommendation is fraught with constraints particularly in view of the general banker-customer relationship and the aspect of natural justice.

(b) Banks can initiate criminal action against defaulting borrowers even in the present environment. Diversion of funds often takes place through new accounts opened in banks other than the lending banks. While it is difficult to prevent a customer from borrowing from any other bank in the present environment, banker should be prudent while financing a borrower of another bank.

(c) Banks are generally interested in recovering the moneys lent by them and option for recall of a loan is exercised after exhausting all other methods of recovery. Initiating criminal action against the borrower is unlikely to help banks in recovering the money lent by them.

After further examination of the views of the STACFR and the legal position, RBI has noted that even the existing legal provisions in Cr. P. C. facilitate initiation of desired actions without legal amendments as was originally contemplated.

In view of the above, banks/FIs have been advised by RBI on 23rd July 2004 to formulate a transparent policy with the approval of the Board in order to initiate criminal action against willful defaulters on a case by case basis, under the provisions of Sections 403 and 415 of the Indian Penal Code(IPC), 1860 depending upon the facts and circumstances of the case."

It had also been stated in the said circular that the mechanism put in place by the banks for initiating criminal action

against wilful defaulters would be reviewed after one year with a view to improve the same.

The number of criminal proceedings initiated by banks/FIs against the wilful defaulters, as on November 30, 2004 pursuant to RBI circular dated 23.7.2004 is as follows:-

Category	Information received from No. of banks/Fis	No. of banks/FIs filed criminal proceedings	No. of criminal complaints lodged
Public Sector Banks	22	18	138
Private Sector Banks	12	10	36
Foreign Banks	15	9	21
Total of banks	**49**	**37**	**195**
Financial Institutions	4	3	27
Grand Total	**53**	**40**	**222**

Classification of borrowers as Wilful Defaulters

According to the RBI's circular dated 29th July, 2003 all Banks are required to –

(a) form a Committee of higher functionaries headed by the Executive Director for classification of borrowal accounts as willful defaulters, and

(b) create a redressal mechanism in the form of Committee headed by Chairman and Managing Director for giving a hearing to borrowers who represent that they have been wrongly classified as willful defaulters.

On representation by the borrowers who were classified as 'Willful Defaulters', that the redressal mechanism should precede the classification as Willful Defaulter, the RBI vide its circular dated 17th June, 2004 had clarified that the classification of the defaulter as willful and the mechanism for redressal of the grievance of the borrower concerned are to be carried out thoroughly through two distinct processes, viz.

(a) The first stage would be the identification of default as 'willful' based on the prescribed norms (vide circular dated May 30, 2002) through a Committee approach as stipulated in paragraph 1(a) of the circular dated July 29, 2003 referred to above.

(b) The borrower should thereafter be suitably advised about the proposal to classify him as willful defaulter along with the reasons therefor. The concerned borrower should be provided reasonable time (say 15 days) for making representation against such decision, if he so desires, to the Committee headed by the Chairman and Managing Director.

A final declaration as 'willful defaulter' should be made after a view is taken by the Committee on the representation and the borrower should be suitably advised.

The Ministry of Finance (Department of Economic Affairs – Banking Division) in a written reply have stated that out of 55 banks (including 23 public sector banks) and 4 financial institutions (FIs), from whom the information has been received, all the banks/FIs except 2 foreign banks have set up the Committee for Grievance Redressal. As regards number of cases of wilful defaulters referred to the Grievance Redressal Committee, it has been stated that from

the information received from 55 banks (including 23 public sector banks), 33 cases have been referred to the Grievances Redressal Committee by banks and in 31 cases, it has been established that the default was wilful. Remaining 2 cases are pending with the Committees for consideration.

Asked to state whether any efforts have been made to track down the money siphoned off by Wilful Defaulters and to retrieve the same, the Secretary Ministry of Finance (Department of Economic Affairs – Banking Division) during evidence held on 2.12.2004 deposed as under:-

> "…in regard to siphoning off of money and how this money trail being pursued let me say that there are bodies within the Ministry of Finance, I would not be able to describe functions properly because I am not personally aware; but there is, for instance, the Directorate of Revenue Intelligence and the income-tax authorities themselves. There are intelligent wings who will track movements of money.
>
> But in regard to banks and financial institutions, perhaps the focus is more on credit and development and, of course, recovery of their own dues. Perhaps, there is not so much attention in pursuing any loss of money of other sources, other channels because they are essentially not in business of doing it. I am not saying that it is not important and it should not be attempted. But that has been the case so far…. But what we need to do is to establish a mechanism where these agencies can share that information with banks because it is all in public interest to do so. Even in countries abroad, as far as I understand, if such a thing were to happen in the United States, it is IRS which will actually track. But the point is very well taken that there must be a system in place within the financial sector where this information can be collected and shared. This is insofar as tracking the money trail is concerned."

Statement showing number of cases of wilful defaulters (suit-

filed accounts) involving Rs. 25 lakh and above as on 31st March, 2003 and 2004 in respect of all the Public Sector Banks is given in Annexure-X. The number of cases of wilful default (non-suit filed accounts) of Rs. 25 lakh and above as on 31st March, 2003 and 2004 in respect of Public Sector Banks is shown in the Statements given at Annexure-XI.

On perusal of figures in respect of cases of wilful default (non-suit filed accounts) obtained as on 31st March, 2004, the Committee noticed that State Bank of India had 160 number of non-suit filed accounts of cases of wilful default involving an amount of Rs. 790.33 crore, Bank of India had 53 non-suit filed accounts involving Rs. 131.27 crore, and Punjab National Bank had 46 accounts involving Rs. 124.47 crore.

Asked to furnish the names of the defaulting individuals/companies and the action taken against them by the above banks, the Ministry of Finance (Department of Economic Affairs – Banking Division) in a written reply have stated that the information under the schemes of defaulters of Rs. 1 crore and above and wilful defaulters of Rs. 25 lakh and above is being collected and disseminated under the provisions of Chapter IIIA of the RBI Act. Sub-Section (1) of Section 45E of the RBI Act stipulates that any credit information contained in any statement submitted by a banking company under Section 45C or furnished by the Reserve Bank to any banking company under Section 45D shall be treated as confidential and shall not, except for the purposes of this Chapter, be published or otherwise disclosed. Clause (b) of sub-section(2) of Section 45E of the RBI Act enables the Reserve Bank to publish the information collected by it under Section 45C in such consolidated

form as it think fit without disclosing the name of any banking company or its borrowers. Moreover, such publication is permissible only if the same is considered necessary by the Reserve Bank in the public interest. In view of the specific statutory prohibition contained in Section 45E of the RBI Act, it is not open to the Reserve Bank to publish/publicise the list of all defaulting borrowers. However, as the names of defaulters against whom suits have been filed are ready in public domain, the information is placed on the web site of CIBIL.

CHAPTER-VII

CORPORATE DEBT RESTRUCTURING

Corporate Debt Restructuring (CDR) is one of the methods suggested for reduction of Non-Performing Assets. The process is primarily rescheduling the debt portfolio of the borrowers among its creditors to help the borrowers in the revival of projects and continue operations through reductions in existing debt burden and establishment of new credit lines with implied assumption that the lender would prefer reduction in risk to optimization of returns. The objective of the CDR is to ensure a timely and transparent mechanism for restructuring of the corporate debts of viable corporate entities affected by internal and external factors, outside the purview of BIFR, DRT or other legal proceedings, for the benefit of all concerned. In particular, the framework was intended to preserve viable corporates affected by certain internal/external factors and minimise losses to creditors/other stakeholders through an orderly and coordinated restructuring programme.

The guidelines on CDR put forth by the Reserve Bank indicate that the CDR is to have a three tier structure : (a) CDR Standing Forum; (b) CDR Empowered Group and (c) CDR Cell.The CDR Standing Forum would be a self-empowered body which would lay down policies and guidelines and guide and monitor the progress of corporate debt restructuring. The CDR Empowered Group on the other hand, will decide on individual cases of corporate debt

restructuring, which will consider preliminary report of all cases of requests of restructuring submitted to it by the CDR Cell. The Empowered Group would be mandated to look into each case of debt restructuring and examine the viability and rehabilitation potential of the company and approve the restructuring package within a specified time of 90 days or at best 180 days of reference to the Empowered Group. The lowest of the three tiers would be the CDR Cell, which would make the initial scrutiny of all proposals received from borrowers/lenders by calling for proposed rehabilitation plan and other information and put up the matter before CDR Empowered Group within one month to decide whether rehabilitation is *prima facie* feasible.

Pursuant to the announcement made in the Union Budget -2002-2003, a High Level Group (under the Chairmanship of Shri Vepa Kamesam) was constituted to revamp the CDR Scheme. Based on the recommendations made by the High Level Group and in consultation with the Government, a revised scheme of CDR was finalised and forwarded to banks in February, 2003.

The salient features of the revised CDR scheme issued in February 2003 are as follows:-

(i) It will cover multiple banking accounts/syndication/consortium accounts with outstanding exposure of Rs.20 crore and above.

(ii) It will be a voluntary system based on Debtor-Creditor Agreement (DCA) and Inter-Creditor Agreement (ICA).

(iii) The revised guidelines provide exit options for lenders who do not wish to commit additional financing or wish to sell their existing stake.

(iv) `Stand-still' agreement binding for 90 days or 180 days by debtors and creditors respectively, under which both sides commit themselves not to take recourse to any legal action during the `stand-still' period.

In a written reply, the Ministry of Finance have stated that the following parameters were laid down for approval of the cases under CDR system :-

(a) The Category 1 CDR system will be applicable only to accounts classified as `standard' and `sub-standard'. There may be a situation where a small portion of debt by a bank might be classified as doubtful. In that situation, if the account has been classified as `standard'/`substandard' in the books of at least 90% of

lenders (by value), the same would be treated as standard/sub-standard, only for the purpose of judging the account as eligible for CDR, in the books of the remaining 10% of lenders. There would be no requirement of the account/company being sick, NPA, or being in default for a specified period before reference to the CDR system. However, potentially viable cases of NPAs will get priority. This approach would provide the necessary flexibility and facilitate timely intervention for debt restructuring. Prescribing any milestone(s) may not be necessary, since the debt restructuring exercise is being triggered by banks and financial institutions or with their consent.

(b) In no case, the requests of any corporate indulging in wilful default, fraud or malfeasance, even in a single bank, will be considered for restructuring under CDR system.

(c) The accounts where recovery suits have been filed by the lenders against the company, may be eligible for consideration under the CDR system provided, the initiative to resolve the case under the CDR system is taken by at least 75% of the lenders (by value). However, for restructuring of such accounts under the CDR system, it should be ensured that the accounts meet the basic criteria for becoming eligible under the CDR mechanism.

(d) BIFR cases are not eligible for restructuring under the CDR system. However, large value BIFR cases, may be eligible for restructuring under the CDR system if specifically recommended by the CDR Core Group. The Core Group shall recommend exceptional BIFR cases on a case-to-case basis for consideration under the CDR system. It should be ensured that the lending institutions complete all the formalities in seeking the approval from BIFR before implementing the package.

(e) Details of restructuring packages approved by Corporate Debt Restructuring (CDR) empowered Group under CDR mechanism are as under :-

Sr No.	Status	No. of restructuring packages approved	Amount
1	Fully implemented cases	42	36587
2	Sanctioned, but not implemented/partly implemented	22	15648
3	Sanction/implementation in progress	18	9531
	Total	82	61766

A list of corporate entities whose accounts have been restructured under the Corporate Debt Restructuring System, is given in Annexure-XII. .Asked to furnish the information regarding the date from which each of these companies had been referred for debt restructuring under CDR mechanism, the time schedule fixed for repayment of debt, both principal and interest; and the amount of debt including interest repaid by each company and the outstanding debt pending, the Ministry of Finance (Department of Economic Affairs – Banking Division) in a written reply have stated that as the information sought is lender-specific and is not in the public domain, RBI would not be in a position to furnish them in the light of statutory restrictions.

However, as per the information furnished by the Ministry, the frequency distribution of tenure of packages approved under CDR mechanism as on 30th June, 2004 is as under:

Sr.	Tenure of package	No. of cases	Percentage
1	Less than 7 years	17	18
2	7 to 10 years	42	44
3	10 to 15 years	29	31
4	15 years and more	6	7
	Total	94	100

The Ministry have also stated that the post-restructuring performance of the 61 fully implemented cases of CDR shows that in case of 66% of these cases, payment is being received regularly. Payment is not yet due in respect of 16 cases. The details given are as under:

(Rs. Crore)

Performance	No.	Amount	Performance	No.	Amount
Better than projection	22	36,229	Regular in payment of dues	40	35,498
In line with projections	25	10,233	Debt service is yet to commence/ moratorium	16	5,939
Inferior to projections	14	3,695	Delay in payment	5	8,720
	61	**50,157**		**61**	**50,157**

The Committee came to know that there has been a tendency amongst banks to go in for restructuring of debts of corporate bodies with a view to reduce the provisioning in respect of NPAs. By restructuring the loans of corporate bodies, which are usually of high value, the banks are able to bring down the NPAs on paper.

Asked whether it is not desirable for RBI to issue new guidelines asking the banks to classify the loans being restructured under CDR scheme as NPAs and make graded provisioning according to an approved formula and reclassify them only after these loans have turned into standard assets, the Secretary Ministry of Finance (Department of Economic Affairs – Banking Division) during evidence held on 2.12.2004 deposed as under:-

> "But there was a small point, which you mentioned, about Corporate Debt Restructuring (CDR) mechanism. In that you said that should it not be classified as NPA? Absolutely on the dot, right. It should be classified as NPA, and we have issued instructions that for one year, it should continue to be classified as per its existing classification. That means, even after restructuring, they cannot change the classification for one year. The account would be watched and only on the basis of the recovery made, can the classification change thereafter."

In their post evidence reply, the Ministry of Finance (Department of Economic Affairs – Banking Division) have supplemented that CDR mechanism accepts only those corporate debts for restructuring, which are facing temporary problems but are viable. The CDR Standing Forum has put in place well defined viability parameters for various industry categories. RBI also has issued guidelines on provisioning requirement and asset classification methodology to be followed by banks in respect of accounts taken up for restructuring. These guidelines do not leave any scope for banks to misrepresent the status of their assets restructured under the CDR mechanism. Further RBI has prescribed detailed guidelines on upgradation of an asset into standard category, which has undergone restructuring. Banks are also required to disclose on an aggregate

basis in the balance sheet the details of advances restructured under CDR mechanism.

A copy of the instructions issued by RBI to banks with regard to applicability of the asset classification norms in respect of NPA loans, which have been restructured under CDR is given in Annexure .

Asked to state whether the afore-stated instructions are being followed by banks in letter and spirit and whether instances of violation of these instructions have come to notice of RBI during their Annual Financial Inspection (AFI), the Ministry in their reply stated that instances of non-observance have not come to notice of RBI, during the AFI of the banks.

The Ministry have further stated that as the CDR mechanism had completed 3 years, RBI had set up a Special Group under Deputy Governor (Smt. Gopinath) to review the CDR mechanism and suggest improvements.

CHATPER-VIII

CREDIT INFORMATION BUREAU

Banks and lending institutions have a traditional resistance, because of the confidential nature of banker-customer relationship, to share credit information on the client, not only with each other, but also across sectors. There has been a widely felt need to establish a Credit Information Bureau (CIB) designed to obtain and share data on borrowers in a systematic manner for sound credit decisions, thereby helping to facilitate avoidance of adverse selection. This would also facilitate reduction in NPAs. Based on the recommendations of the Working Group constituted to explore the possibilities of setting up a CIB in India and realising the importance of developing better institutional mechanisms for sharing of credit-

related information, the Union Budget 2000-01, announced the establishment of a Credit Information Bureau. Pursuant to Finance Minister's announcement in his Budget proposals for 2000-01, Credit Information Bureau (India) Ltd. (CIBIL). CIBIL was set up by State Bank of India in association with HDFC in January, 2001 with an unauthorized capital of Rs.50.00 crore and paid-up capital of Rs.25.00 crore, with equity participation of 40 per cent each and two foreign technology partners viz. M/s Dun & Bradstreet Information Services (India) Ltd. and Trans Union International Inc., USA sharing the remaining 20 per cent equity stake. CIBIL will serve as an effective mechanism for exchange of information between banks and FIs for curbing growth of NPAs and for cater to dissemination of credit information in respect of commercial and consumer segment. CIBIL is also required to collect credit related positive and negative information on borrowers from various credit institutions and process and disseminate the information on a regular basis.

The Ministry had further stated that as a first step towards activating the Bureau, RBI constituted a Working Group in December 2001 to examine the possibility of the CIB performing the role of collecting and disseminating information on the suit-filed accounts and the list of defaulters, presently being reported to RBI by banks and notified financial institutions. The Report of the Working Group was submitted in January, 2002 and some of its recommendations which satisfied the existing legal framework had been implemented by the Reserve Bank of India. Accordingly, banks and FIs had been directed under Section 35A of the Banking Regulation Act, 1949 that they should submit the list of suit-filed accounts of Rs.1 crore and above as on March 31, 2002 and quarterly updates thereof till

December 2002 and suit-filed accounts of wilful defaulters of Rs.25 lakh and above as at end-March, June, September and December 2002 to RBI as well as to CIBIL for a period of 1 year till 31st March, 2003. Thereafter, aforesaid information should be submitted to CIBIL only and not to RBI. However, banks and notified FIs would continue to submit the data relating to non-suit filed accounts of Rs.1 crore and above, classified as doubtful or loss, as on March 31, and September 30 and also quarterly list of wilful defaulters (Rs.25 lakh and above) where suits have not been filed only to RBI as hitherto. Thus, the statement on non-suit filed account need not be sent by banks/FIs to CIBIL. Once fully operationalised, CIBIL would be able to share its comprehensive database of credit information on all borrowal accounts (performing and non-performing) with its members, which is likely to improve the quality of their credit appraisal and decisions.

On being asked about the non-operationalisation of CIBIL, Secretary, Ministry of Finance (Deptt. of Economic Affairs - Banking Division) during evidence held on 10.12. 2003 stated as under:-

> "As far as CIBIL is concerned, it is a private company and certain type of information has been made available to them. That is above one crore willful defaulters, and suit filed cases that information is being collected. Now, in so far as CIBIL infrastructure is concerned, it is state of the art. It has all the modern software and hardware, and it is quite capable of collecting, analyzing, generating and disseminating that information. The problem, however, is that there is a certain degree of doubt whether secrecy laws should prevent some types of information being shared with this company.

Now, in many countries this is being done on the basis of the law prevailing there. There is no special law for this kind of company, excepting in the Sri Lankan case. In Sri Lanka they have special law for Credit Information Bureau and in other countries, there are no laws, but under the existing laws, they have created this. But CIBIL type of organisations are functioning in many other countries. This is only at a consideration stage. The decision at the political leadership level is yet to be taken, but we have framed a draft law and sent it to the Ministry of Law so that we get a legal foundation for this company and impediments that already exist in its becoming fully operational can be removed. The Ministry of Law has been having some doubts about it. If the hon.Committee considers it appropriate to make a recommendation, it will greatly strengthen our hands. Our intention really is that the information which is not privileged, which is in public domain or which impacts on the functioning of banks, which are trustees of depositors' money, must be available to this Credit Information Bureau and it must be shared with other bankers for a public purpose. We should have that capacity and ability. That is what the proposed law seeks to do. It is also just sharing of that information. There is no public disclosure in this."

In their post-evidence reply furnished in April, 2004, the Ministry of Finance had stated that Reserve Bank of India had advised banks/notified All India Financial Institutions and State Financial

Corporations on June 4, 2002 to submit periodical information on suit-filed accounts of Rs.1.00 crore and above and suit-filed accounts of wilful defaulters of Rs.25.00 lakh and above to RBI and CIBIL from March 31, 2002 for a period of one year till March 31,2003 and thereafter to CIBIL only. Statements showing summary as well as detailed list of suit filed accounts of Rs.1 crore & above and suit filed accounts (wilful defaulters) of Rs.25 lakhs & above compiled by CIBIL as on 30.9. 2004 are given in Annexure - XIII.

CIBIL had become operational in 2002 and had since taken over the work of collating the lists of suit-filed accounts of Rs.1 crore and of suit-filed accounts of wilful defaulters of Rs.25 lakh and above as on 31.03.2003 and onwards. However, CIBIL would be fully operational once banks/FIs furnish credit information on non-suit filed accounts also. In this regard, RBI had advised banks/FIs on October 1, 2002 to obtain consent clause from existing and new borrowers to enable CIBIL to take over credit dissemination function in its entirety. In November 2002, CIBIL had advised operating rules to banks/FIs with the approval of its Standing Advisory Committee.

The Ministry had further stated that with a view to strengthening the legal mechanism and facilitating the Bureau to collect, process and share credit information on the borrowers of banks/FIs, and also to overcome the constraints of banks' obligation of maintaining secrecy with regard to borrowal accounts,. a draft Credit Information Companies (Regulation) Bill covering registration, responsibilities of the Company, rights and obligations of the credit institutions and safeguarding privacy rights was prepared by Reserve Bank and submitted to Government in October 2001. The Ministry of Finance discussed the draft bill with Reserve Bank officials in March

2003 and certain changes were made in the bill. Subsequently various aspects relating to enactment of the Bill, were discussed in a meeting held in November, 2003 in the Ministry of Law. Certain clarifications sought by Ministry of Law were provided by RBI. The draft bill had been discussed by the officials of Ministry of Law, Ministry of Finance and RBI and further refinements had been made in the proposed bill in the year 2004.

The Credit Information Companies Regulation Bill, 2004 seeking to provide regulation of credit information companies and to facilitate efficient distribution of credit and matters connected therewith or incidental thereto had since been introduced in Rajya Sabha on 6th December, 2004. The bill inter alia covers the following broad areas :-

i) Registration of credit information companies. Grant of Registration Certificate by RBI.
ii) Requirement as to minimum capital.
iii) Management of credit information companies.
iv) Power of RBI to determine policy in relation to functioning of credit information companies. Power of RBI to give directions.
v) Powers and duties of Auditors.
vi) Functions of credit information companies.
vii) Settlement of disputes.
viii) Information privacy principles.
ix) Offences and penalties.
x) Power of RBI to impose penalty.
xi) Power of Central Government to make rules.
xii) Power of Central Government to exempt in certain cases.

The bill also empowers CIBIL to collect information relating to

all borrowers including non-suit-filed accounts of wilful defaulters.

Besides above, the credit information company may:-

- Collect, process and collate information on trade, credit and financial standing of the borrowers of the credit institutions which is a member of the credit information company.
- May provide credit scoring to its specified users or to other credit information company.
- No credit information received by the credit information company be disclosed to any person other than specified user or for any other purpose other than permitted by any law.

Observations/Recommendations of the Committee

9.1 The initiatives taken by RBI starting from 1992 to tackle the problem of Non Performing Assets (NPAs) in the financial system by way of prescribing prudential norms/regulations in line with the international standards for recognition of income accrued on impaired loans, asset classification and loan loss provisioning, followed by further tightening of these prudential norms at periodical intervals, had led to gradual decline in the NPAs in the financial system in general and Public Sector Banks in particular. As per Economic Survey – 2004-05, Gross NPAs in Public Sector Banks in absolute terms have decreased from Rs. 56473 crore in 2001-02 to Rs. 51538 crore in 2003-04. During the same period Gross

NPAs to Gross Advances in Public Sector Banks declined from 11.1% in 2001-02 to 7.8% in 2003-04 and Gross NPAs to Total Assets declined from 4.9% to 3.5%. Net NPAs to Net Advances also reduced from 5.8 % in 2001-02 to 3.0% in 2003-04 and the Net NPAs to Total Assets reduced from 2.4% to 1.3% during the same period. The decline in percentage of NPAs should not give any room for comfort or make the banks and RBI complacent because when compared to international standards of 2%, the level of gross NPAs in Public Sector Banks at 3.5% is still high. Especially the level of gross NPAs in some of the Public Sector Banks like Punjab & Sind Bank and Dena Bank which is still as high as 8% and 6.7%respectively, is a matter of grave concern.

9.2 The decline in gross and net NPAs and improvement in the Capital Adequacy Ratio (CAR) of Public Sector Banks in the recent years was largely aided by sharp reduction in interest rates, which brought windfall profits to the banks, as they had parked their funds in Government securities far above the statutory limits. The profits earned had been sensibly used to make provisions, write off NPAs and to improve their CAR. The new RBI norms for reckoning assets as non-performing and for

non-recognition of income from such assets (by reducing the minimum period of debt-servicing default from 180 days to 90 days) which came into effect from the quarter ended March, 2004, would presumably have resulted in significant additions to NPAs during the financial year 2003-2004 and 2004-2005. Added to this the RBI's advice to banks in its Annual Policy Statement for 2004-05 to introduce graded higher provisioning according to the age of NPAs included under "doubtful for more than three years' category" would have further increased the burden of banks in relation to provisioning and put severe strain on their profits as well as on their Capital Adequacy Ratio (CAR).

9.3 The interest rates seem to have been bottomed out and stabilized at the current levels. As a result Public Sector Banks, of late, have been paying more attention to lending, rather than relying on treasury income to increase their bottom line. As the banks register strong asset growth through disbursal of loans, their capital base is expected to decline and will need to be augmented. The new Basel II norms which will come into effect from 2006 would require banks to set aside larger capital depending on the risk of loan assets. It is, therefore, imperative

and also incumbent upon the banks to tighten their control in relation to credit risk management, credit supervision and monitoring of post disbursement of loans, etc. so that the assets of the banks are not impaired and turn bad. Besides this further integration of the Indian economy with the global economy is expected to subject the competitiveness and performance of Indian enterprises to increased pressures. All these factors point towards the need for constant vigilance aimed at containing fresh accretions to NPAs. The Committee, therefore, recommend that the following measures may be taken by the Ministry of Finance/RBI to further improve the performance of the public sector banks in relation to their control and containment of NPAs in order to develop a healthy and sound financial system in the country:-

1. **The RBI may require to impress upon banks about the need to set up/strengthen their corporate research capabilities and to furnish to credit evaluation officials updated information on macro-economic trends and the current state of global competitiveness; near-term prospects of various industries; and the likely shifts in relevant**

Government policies so that potential NPAs can be detected at the incipient stage and necessary corrective measures taken by the banks for recovery of the loans.

2. **It should be ensured that corporate governance is implemented by all the Public Sector Banks on priority basis over a time-bound period.**
3. **'Governance' audits should be conducted and penalties imposed through increased capital charge on non-compliant and errant banks.**
4. **Special training modules for staff in credit supervision and monitoring and recovery management be developed.**

9.4 The Committee note that despite the banks having well laid down loan and loan recovery policies inter alia covering the methodology for measurement, monitoring and control of credit risk and other prudential norms for credit exposure to various sectors/groups of borrowers coupled with onsite and offsite monitoring system and RBI's examination of these policies and identification of various risks in relation to credit exposure to

various sectors by banks during their Annual Financial Inspection (AFI), there has been a steady increase in incremental NPAs of Public Sector Banks. Gross NPAs in PSBs in absolute terms have been increasing steadily over the years. From Rs. 39253.14 crore in 1992-93, the year in which Prudential Regulations for Income Recognition, Asset Classification and Provisioning was introduced by RBI, the gross NPAs in absolute terms rose to Rs. 51541 crore in 2003-04. The Committee, therefore, desire that the banks should further streamline and strengthen their systems/procedures relating to credit assessment, supervision and monitoring of post-disbursal credit, etc. and ensure that bank functionaries strictly adhere to these systems/procedures, so that fresh NPAs are not accreted to the banks. RBI should also constantly monitor the various systems/procedures laid down by banks in relation to credit appraisal, supervision and management, post-disbursement credit monitoring, internal control, credit audit system and compliance with various prudential regulations so that banks may better manage their NPAs and no fresh NPAs are accreted to the balance sheet. The Committee also recommend that RBI should strengthen its supervision of the banks by progressively

increasing the coverage of maximum number of branches of each bank under Annual Financial Inspection, so as to ensure that various guidelines/instructions issued by it relating to identification of NPAs and recognition of interest accrued on them, are correctly interpreted and that there is no under-reporting of NPAs by the banks.

9.5 The Committee are concerned to note that 22 banks had sanctioned credit in excess of prudential exposure limits in 2000-2001 and the number of banks which have exceeded the credit limits went up to 25 in the years 2001-02 and 2002-03. It is astonishing that RBI had granted approval in all the cases after examination on merits and no punitive action was taken, despite the fact that the action on the part of the banks was in gross violation of prudential norms/measures prescribed by RBI. Needless to say condonation of such commissions of serious nature by RBI have the grave potential of loans leading to NPAs and also will encourage banks to commit such violations time and again. The failure of Global Trust Bank (GTB) and its subsequent merger with Oriental Bank of Commerce is a case in point. It is now evident that over-

exposure to capital market beyond prudential norms had led GTB to incur heavy losses resulting in mounting NPAs, erosion of capital and net worth turning negative resulting in collapse of the bank. The Committee expect that RBI would in future exercise more stringent supervision on the banks and would impose severe penalties for violating of prudential exposure limits.

9.6 The Committee note with satisfaction that pursuant to the recommendations of Joint Parliamentary Committee (Stock Market Scam) the system of compliance of banks to the findings of inspection by RBI had been streamlined. The RBI had also prescribed a new set of guidelines for strengthening compliance by banks. The Committee trust that there will not be any slackness in the follow-up of the Compliance Reports submitted by banks. The Committee also recommend that a separate 'Monitoring Cell' should be set up in RBI for continuous monitoring of compliance of RBI guidelines and observations made in its Inspection Reports.

9.7 The Committee have been informed that as per RBI

guidelines, staff accountability is required to be examined by the concerned bank in consultation with the CVC as soon as there is a shift in the asset classification of an advance from standard to sub-standard. A distinction is made between malafide acts and genuine action on the part of functionaries in respect of instances of transgression reported and action is taken accordingly against the erring officials. During evidence, the Deputy Governor, RBI informed the Committee that there is a judgment call taken by the management to see whether the transgression done has benefited the person who has sanctioned it and if that is the case, then it is manifestly irregular and will attract vigilance. If it is only a judgmental error, then the benefit of doubt is given in favour of the official who took the decision. The Committee, however note that there are no proper guidelines in regard to fixing of accountability in respect of transgression of delegated powers by the bank functionaries. The Committee note that recently Ministry of Finance had unveiled a package giving managerial autonomy to the Public Sector Banks, and advised them to take further action thereon. As part of the autonomy package, Ministry of Finance had suggested Banks to lay down a policy of accountability and

responsibility for Bank officials and take action against erring Bank officials in conformity with such policy. It has also been suggested that the policy framework should also provide for stringent punishment for all mala fide actions of bank officials but, at the same time, recognize that bona fide errors do occur while making decisions relating to commercial judgment. The Committee recommend that in the light of above broad policy frame work laid down by the Ministry of Finance, RBI should advise all the banks to formulate a transparent policy for fixing accountability and responsibility on erring bank officials for their mala fide actions and provide stringent speedy punishment depending on the degree and nature of offence.

9.8 As per the extant rules, bank officials of the rank of Scale III and above in the Public Sector Banks are covered under the ambit of Central Vigilance Commission. During interaction with representatives of various PSBs, the Committee learnt that bank officials, in general, are hesitant to take initiatives for mustering new accounts and giving loans for fear of the accounts turning into NPAs. As a result there is lack of initiative on the part of bank employees who are now more

concerned about avoiding vigilance cases and adverse entries in their ACRs. As a result of this, lending operations in the banks have been adversely affected. The Committee, therefore, recommend that the Ministry of Finance should take up the matter with the CVC to restrict the coverage of bank officials coming under the purview of CVC so that officials of the banks are able to concentrate better on the core banking activity of lending credit and recovery of loans without being under the grip of undue fear.

9.9 The Committee, are unhappy to note that even after 11 years since the enactment of Recovery of Debts due to Banks and Financial Institutions Act, 1993, the performance of DRTs set up under the said Act is not very satisfactory. As per information furnished by the Ministry of Finance, as on 30.6. 2004, 63,600 cases were filed before DRTs involving an amount of Rs. 91925.89 crore. Out of this, 27956 cases involving an amount of Rs. 26358 crore were decided and only an amount of Rs. 7845.31 crore had been recovered, which is around 30% of the amount settled. The Ministry have contended that subsequent to amendments made to the Act in 2000, the performance of DRTs has improved which has been reflected in the increase in percentage of cases decided by DRTs from 13% as on 31.12. 1997 to 37.26% as on 31.3. 2004, and in the percentage of recovery to total dues which also concurrently increased from 1.67% to 8.36% during the said period. As there

are still large number of cases pending before DRTs involving huge amount, the Committee do not fully share the perception of the Ministry of Finance that the performance of DRTs has improved subsequent to the amendments to the DRT Act in 2000, and feel that still there exists a lot of scope for further improvements.

9.10 In a written reply furnished to the Committee in December, 2004, the Ministry of Finance (Department of Economic Affairs – Banking Division) informed that after obtaining the performance review conducted by the RBI, the Government of India had set up a Working Group in February, 2001 under the Chairmanship of Shri S. N. Aggarwal, Presiding Officer of Debt Recovery Tribunal (DRT) II, Delhi to review the existing provisions of the Recovery of Debts due to Banks and Financial Institutions Act, 1993 and the Rules framed thereunder in the light of the suggestions received from various quarters such as banks, financial institutions, DRTs and individuals and to examine the adequacy of the infrastructure available with DRTs. The Working Group submitted its report in August, 2001 wherein it had suggested amendments to the Act and Rules framed thereunder. The report was examined by RBI and their views communicated to the Government in February, 2002. On the recommendations of Reserve Bank of India the Government had further constituted another Working Group headed by Shri Vinod Rai, AS(FS) to examine afresh the issues related to DRT's role in recovery

of NPAs for enhancing their effectiveness and to review the functioning of Debts Recovery Tribunals.

9.11 The Committee note that the Working Group headed by Shri S.N. Aggarwal had submitted its Report to the Government way back in August, 2001. In their comments/views, furnished to the Government on the recommendation of Working Group in February, 2002, the RBI supported the recommendations made by the Working Group for strengthening the infrastructure of DRTs in totality. As regards amendments to the DRT Act and the Rules framed thereunder, the RBI stated that they have no objection to the amendments proposed by the Working Group, barring six amendments on which RBI differed with the Working Group. Apart from their views on the Working Group recommendations RBI had also made some suggestions for consideration of the Government at the time of amendment of the DRT Act. The fate of the recommendations made by the Aggarwal Working Group are not known as the reply furnished by the Ministry is silent with regard to its implementation. It appears that the Ministry of Finance instead of examining the feasibility of implementing the recommendations of the Working Group headed by Shri

Aggarwal, had rather chosen to constitute another Working Group headed by Shri Vinod Rai and that too after passage of more than two years to examine afresh the issues related to DRT's role in recovery of NPAs and to review the functioning of DRTs. The Committee deplore the casual approach of the Ministry of Finance to such an important issue of functioning of DRT system especially when the entire process of recovery of bad debts of banks and FIs hinges on its effective functioning. The Committee hope that in future Government will act with greater promptness in plugging loopholes in the system for speedy recovery of bad debts.

9.12 The Committee hope that the Working Group headed by Shri Vinod Rai shall go into the entire gamut of functioning of DRTs and suggest comprehensive measures for complete overhaul of the DRT structure for speedy recovery of bad loans. They further expect that the Working Group would also examine the feasibility of streamlining the existing procedures so that DRTs can take up high value cases on a priority basis and also for their expeditious settlement so that it would have a bearing on the overall recovery position of NPAs by the banks/FIs. The

Committee expect that the Working Group would submit its Report expeditiously and the functioning of DRTs would be streamlined at the earliest.

9.13 The Committee note that lack of adequate staff at various levels, particularly at Recovery Officer/Inspector level had seriously jeopardized the working of DRTs. Key vacancies in the grade of Presiding Officer/Recovery Officer/ Recovery Inspectors lie unfilled for several months, leading to delay in settlement of cases. The Committee decry the half-hearted measures proposed to be taken by the Ministry, such as soliciting the cooperation of nodal banks to come forward for providing staff support to DRTs as a temporary or adhoc measure, etc. The Committee desire that the possibility of constituting a separate cadre for manning the DRTs should be explored and till the same is constituted, steps should be taken in the right earnest to fill up the existing vacancies expeditiously. The Committee also recommend that in view of ever-burgeoning of pending cases of NPAs in the DRTs, the Working Group headed by Shri Vinod Rai may also examine if there is a need of setting up more DRTs in the country. Besides this, proper

infrastructure and other amenities should be provided to the existing DRTs for their efficient functioning.

9.14 The Committee note that two Asset Reconstruction Companies viz. Asset Reconstruction Company (India) Ltd. (ARCIL) and Asset Care Enterprise Ltd. (ACE) sponsored by Banks (FIs) have been granted registration in August and October 2003 respectively. The third company promoted by UTI has been set up in 2004. The Secretary, Ministry of Finance (Department of Economic Affairs – Banking Division) in his deposition before the Committee on 2.12.2004 stated that all the three asset reconstruction companies are just in the process of starting to do business and unless they can operate successfully and show to other prospective investors that it is a good and viable proposition, it is unlikely that other asset reconstruction companies would come in the field. However, the Committee are given to understand that at present the Asset Reconstruction Company (India) Ltd., (ARCIL) is buying the bad assets of the Banks at 70 to 80% discount and besides banks have no guarantee that they will get any return from these assets, with the result that most banks are hesitant to transfer their assets to

ARCs. The Committee feel that setting up of more Asset Reconstruction Companies will lead to healthy competition which in turn will force the ARCs to acquire bad loans at better valuations.

9.15 The Committee are distressed to note that over the years the recovery of NPAs has not shown any satisfactory progress. The total recoveries through upgradation and compromise write-off which stood at Rs. 18730 crore in March, 2003 had marginally increased to Rs. 20705 crore in March, 2004. As is evident, the efforts for recovery by banks is off-set by aggressive provisioning, which is the only viable method banks seem to have resorted to for reduction of NPAs. This shows the sordid state of affairs prevailing in banks in so far as recovery of bad loans is concerned. The Committee, therefore, recommend that banks should further streamline their Loan Recovery Policy and also evolve innovative methods such as setting up of Special Recovery Teams for recovery of bad loans and also explore the possibility of franchising the job of recovery of bad loans to an outside agency as has been done by some private banks such as ICICI Bank and HDFC Bank. The Committee note that some banks like SBI had roped in Detective Agencies which have expertise in financial investigation, fraud detection, etc. to recover NPAs. They recommend that other banks should emulate SBI in this regard and also explore the possibility of

deploying other Value Added Services that will aid banks in effective recovery of loans.

9.16 It is a disturbing trend that the amount of NPAs written off in respect of PSBs has been steadily increasing over the years. As against an amount of Rs. 4500 crore written off in the year 2000, the amount of NPAs written-off in 2004 rose to Rs. 13490 crore, which has more than trebled. The Committee recommend that due diligence should be exercised while writing off loans and the number of accounts as well as the amount written off should be kept to the barest minimum. As per the existing procedure, the loans are written off only at the Head Office level and remain recoverable at the branch level. The Committee, therefore, recommend that there should not be any let up on the part of banks with regard to loans written off and concerted efforts should be made for their recovery.

9.17 The Committee are deeply concerned about the growing number of suit filed and non-suit filed accounts of wilful defaulters in Public Sector Banks. The number of non-suit filed accounts of wilful defaulters which stood at 439 involving an amount of Rs. 1114.06 crore as on 31.3.2002 increased to 513

involving an amount of Rs. 1643.22 crore by 31.3. 2004. The non suit filed account of wilful defaulters of Rs. 25 lakh and above was 1421 as on 31.3.2003 involving an amount of Rs. 4140.61. The number increased to 1487 cases involving an amount of Rs. 4525.87 crore as on 31.3.2004. The Committee recommend that banks should make concerted efforts to strengthen their credit appraisal and sanctioning system and post-disbursement supervision so that the incidence of wilful default can be detected at the incipient stage and corrective measures taken to check it.

9.18 The Committee note that based on the recommendations of the Working Group on Wilful Defaulters (Kohli Committee), RBI had advised the banks in May, 2002 about the revised definition of the term 'Wilful Default' and also the meaning of terms such as "Diversion of Funds", "Siphoning of Funds", etc. and suggested the penal measures the banks should take against the wilful defaulters.

As the RBI circular dated 30.5.2002 issued pursuant to recommendations made by the Kohli Committee was silent with regard to fixing of criminal liability against those who siphon of

funds deliberately, resort to mis-representation, falsification transactions, etc., the JPC on Stock Market Scam (2002) in their Report recommended that such offences be clearly defined under the existing statutes governing the banks, providing for criminal action in all such cases where the borrowers divert the funds with malafide intention. Pursuant to recommendation made by JPC on Stock Market Scam, the Ministry of Finance constituted a Working Group under the chairmanship of Shri D.T. Pai, Banking Ombudsman, UP. The Working Group in their Report submitted in April, 2003 inter alia recommended for amendments to Sections 405 and incorporation of new Sections 415A, 424A and 465A in IPC stipulating for stringent penal action ranging from 2 to 7 years of imprisonment for those defaulters who indulge in diversion/siphoning of funds, resorting to misrepresentation, falsification of accounts indulging in fraudulent transactions, etc. Considering the implications implicit in the legislative amendments recommended by the D.T. Pai Committee, the same were discussed by the Standing Technical Advisory Committee on Financial Regulation (STACFR), an advisory body comprising of bankers, legal experts and academicians set up by RBI. After further

examination of the views of the STACFR and the legal position and having noted that even the existing legal provisions in Cr. P. C. would facilitate initiation of desired action without legal amendments as was originally contemplated, RBI advised banks/FIs on 23rd July 2004 to formulate a transparent policy with the approval of their Boards in order to initiate criminal action against willful defaulters, on a case by case basis, under the provisions of Sections 403 and 415 of the Indian Penal Code(IPC), 1860 depending upon the facts and circumstances of the case. It had also been stated in the said circular that the mechanism put in place by the banks for initiating criminal action against wilful defaulters would be reviewed after one year with a view to improve the same.

9.19 The Committee note that as on 30.11.2004, 138 criminal complaints have been lodged and in 18 cases criminal proceedings have been filed against the wilful defaulters by Public Sector Banks pursuant to the guidelines issued by RBI on 23.7. 2004 in this regard . The Committee urge upon the banks to adopt a proactive approach in filing criminal cases against the wilful defaulters and recommend that RBI should periodically

review the progress made by the banks in this regard. The Committee note that under the extant guidelines performance of banks will be reviewed by RBI after a period of 1 year. They recommend that the efficacy of the existing penal provisions under sections 403 and 415 of IPC in relation to action against willful defaulters by banks may also be got reviewed by the STAFCR set up by Ministry of Finance/RBI, and legal and other procedural changes, if any, that may be required may be made so that the menace of wilful default can be contained effectively.

9.20 Corporate Debt Restructuring (CDR) is one of the methods suggested for reduction of NPAs. The objective of CDR is to ensure timely and transparent mechanism for restructuring corporate debts of viable corporate entities affected by internal and external factors outside the purview of BIFR, DRT or other legal proceedings for the benefit of all concerned. The Committee were informed that out of 82 restructuring packages approved under CDR, 42 cases involving Rs. 36587 crore have been fully implemented, 22 cases involving Rs. 15648 crore were sanctioned but not implemented/partly implemented and in 18 cases involving Rs. 9531 crore sanction/implementation is in

progress. An analysis of post-restructuring performance of 61 fully implemented cases, show that in 40 cases involving an amount of Rs. 35,498 crore, payment is being received regularly, in 16 cases involving Rs. 5939 crore debt receiving is not yet due, and in 5 cases in which an amount of Rs. 8720 crore is involved there has been a delay in payment. It has further been stated that in 22 CDR cases, the performance is stated to be better than projections made and in 25 cases the performance has been in line with the projections. In 14 cases the performance has been stated to be below the projections made. The frequency distribution of tenure of packages approved under CDR mechanism reveals that out of 94 CDR packages approved as on 30th June, 2004, in 17 cases the tenure for repayment of loan is less than 7 years and in 42 cases the tenure is between 7 to 10 years. In 29 cases the tenure is between 10 to 15 years and in 6 cases the tenure is 15 years and more. The Committee are of the opinion that there is a need for rationalisation of tenure of packages approved under CDR mechanism, which is presently divided into four time slabs. The Committee recommend that the feasibility of reducing the time slabs from 4 to 3 should be examined, and also the possibility of

limiting the maximum tenure of package for repayment of loan to 15 years.

9.21 The Committee note that a Special Group headed by Smt. Gopinath, Deputy Governor, RBI had been set up to review the functioning of CDR mechanism. The Committee expects that the Special Group would examine the functioning of CDR scheme in its entirety and suggest suitable measures for streamlining the functioning of the CDR mechanism so that only such cases which are potentially viable for revival are selected in a non-partisan, non-discriminatory and transparent manner.

9.22 The Committee are happy to note that Credit Information Bureau (India) Limited (CIBIL) has become functional from January, 2001, with an authorised capital of Rs.50 crore and paid-up capital of Rs.25 crore. The Bureau will serve as an effective mechanism for exchange of information between banks and financial institutions for curbing growth of NPAs and for disseminating credit information in respect of commercial and consumer segment. CIBIL is also required to collect credit related positive and negative information on borrowers from various credit institutions and process and disseminate the same on a regular basis. CIBIL became operational in 2002 and had taken over the work of collating the

lists of suit filed accounts of Rs.1 crore and above and of suit-filed accounts of wilful defaulters of Rs.25 lakh and above from 31.03.2003 onwards.

9.23 With a view to provide necessary legislative support to the business of credit information and to regulate credit information companies so as to facilitate efficient distribution of credit, the Credit Information Companies (Regulation) Bill, 2004, had been introduced in the Rajya Sabha on 6.12.2004. The Bill inter alia, provides for registration and responsibilities of the credit information company, rights and obligations of the credit institutions, facilitating credit information companies to collect, process and share credit information on the borrowers of banks/FIs and safeguarding privacy rights, and also to overcome the constraints of bank's obligation of maintaining secrecy with regard to borrowal accounts etc. The Parliamentary Standing Committee on Finance, to which the Bill had been referred had since submitted its Report to Parliament. The Committee expect the Government to pursue the legislation so that its enactment would enable Credit Information Companies to play an effective role in maintaining comprehensive and efficient data base system of credit information on borrowers so

as to enable banks and FIs to facilitate management of their credit risk efficiently so that fresh accretion of NPAs are arrested.

NEW DELHI: **C.KUPPUSAMI**
April 5, 2005 **Chairman,**
Chaitra 15,1927(S) **Committee on Estimates**

MINUTES OF SITTING OF THE ESTIMATES COMMITTEE (2004-2005)

TENTH SITTING

The Committee sat on Thursday, the 2nd December, 2004 from 1500 to 1640 hours.

Present

Shri C. Kuppusami - Chairman

Members

2. Prof. Chander Kumar
3. Shri Anant Gudhe
4. Shri Jai Prakash
5. Shri Bhartruhari Mahatab
6. Shri Sunil Kumar Mahato
7. Shri Zora Singh Mann
8. Shri Prabodh Panda
9. Shri Mahendra Prasad Nishad
10. Shri Harikewal Prasad
11. Shri Laxman Singh
12. Shri M.A. Kharabela Swain
13. Shri V. Kishore Chandra S. Deo

Secretariat

1.	Smt. P.K. Sandhu	-	Joint Secretary
2.	Shri A.K. Singh	-	Principal Chief Parliamentary Interpreter
3.	Shri Cyril John	-	Under Secretary
4.	Shir M.K. Madhusudhan	-	Assistant Director

Witnesses

MINISTRY OF FINANCE (DEPARTMENT OF ECONOMIC AFFAIRS – BANKING DIVISION)

1.	Shri N.S. Sisodia	-	Secretary (FS)
2.	Shri Vinod Rai	-	Additional Secretary (FS)
3.	Shri Amitabh Verma	-	Joint Secretary (BO)
4.	Shri Ram Muivah	-	Director (BOA)

RESERVE BANK OF INDIA

1.	Mrs. K.J. Udeshi	-	Deputy Governor, RBI
2.	Shri C.R. Muralidharan	-	CGM, DBOD

2. The Committee took further evidence of the representatives of Ministry of Finance (Department of Economic Affairs-Banking Division) and RBI on the subject 'Ministry of Finance (Department of Economic Affairs-Banking Division) – Public Sector Banks - Non Performing Assets'. The evidence was concluded.

3. A verbatim record of the proceedings was kept.

(The witnesses then withdrew)

4. Thereafter, the Committee considered the explanation given by Dr. P.C. Keshavankutty Nayar, President, Medical Council of India(MCI) regarding his absence during the sitting of the Estimates Committee held on 16th November, 2004. In view of the regrets expressed by the President, MCI, the Committee condoned his absence during the said sitting and decided not to pursue the matter further.

5. The Committee also decided to undertake on the spot Study Tour in February, 2005.

The Committee then adjourned.

MINUTES OF SITTING OF THE ESTIMATES COMMITTEE (2004-2005)

THIRTEENTH SITTING

The Committee sat on Tuesday, the 22nd March, 2005 from 1500 to 1535 hours.

Present

Shri C. Kuppusami - Chairman

Members

2. Shri B. Vinod Kumar
3. Prof. Chander Kumar
4. Shri Adhir Ranjan Chowdhury
5. Shri Jai Prakash
6. Shri Bhartruhari Mahatab
7. Shri Prabodh Panda
8. Shri Harikewal Prasad
9. Shri K.S. Rao
10. Shri Iqbal Ahmed Saradgi

11. Shri Laxman Singh
12. Shri V. Kishore Chandra S. Deo
13. Shri Vijoy Krishna

Secretariat

1.	Shri A.K. Singh	-	Principal Chief Parliamentary Interpreter
2.	Shri B.D. Swan	-	Deputy Secretary
3.	Shri Cyril John	-	Under Secretary
4.	Shri M.K. Madhusudhan	-	Assistant Director

2. The Committee considered the draft Report on 'Ministry of Finance (Department of Economic Affairs-Banking Division) – Public Sector Banks - Non Performing Assets', and adopted the same without any modification.

3. The Committee authorised the Chairman to finalise the Report in the light of verbal and other consequential changes, if any, arising out of factual verification by the Ministry and present the same to the House.

The Committee then adjourned.