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**MINISTRY OF FINANCE
(DEPARTMENT OF ECONOMIC
AFFAIRS—BANKING DIVISION)**

PUBLIC SECTOR BANKS—BAD DEBTS

ESTIMATES COMMITTEE

1998-99

THIRD REPORT

TWELFTH LOK SABHA



**LOK SABHA SECRETARIAT
NEW DELHI**

**THIRD REPORT
COMMITTEE ON ESTIMATES
(1998-99)**

(TWELFTH LOK SABHA)

**MINISTRY OF FINANCE
(DEPARTMENT OF ECONOMIC AFFAIRS—BANKING
DIVISION)**

PUBLIC SECTOR BANKS—BAD DEBTS



Presented to Lok Sabha on 15 December, 1998

**LOK SABHA SECRETARIAT
NEW DELHI**

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Corrigenda to Third Report of Estimates Committee
on Public Sector Banks - Bad Debts.

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**COMPOSITION OF THE ESTIMATES COMMITTEE
(1998-99)**

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30. Shri Sushil Chandra Verma

SECRETARIAT

1. Dr. A.K. Pandey — *Additional Secretary*
2. Shri K.L. Narang — *Director*

INTRODUCTION

1. I, the Chairman of the Estimates Committee having been authorised by the Committee to submit the report on their behalf present this Third Report on the Ministry of Finance (Department of Economic Affairs—Banking Division)—Public Sector Banks—Bad Debts.

2. The subject was selected for detailed examination by the Estimates Committee (1994-95). The Estimates Committee (1995-96, 1996-97, 1997-98 and 1998-99) continued with the examination of the Bad Debts of the Public Sector Banks. The Committee considered the replies furnished by the Ministry of Finance (Department of Economic Affairs) to the questionnaires issued on the subject from time to time and other material received from the Public Sector Banks during study tours. The Estimates Committee took evidence of the representatives of the Ministry of Finance (Department of Economic Affairs) and Reserve Bank of India on the 15th October, 1996. The Committee wish to express their thanks to the officers of the Government of India, RBI and Public Sector Banks and Indian Banks' Association for placing before them their considered views and perception and for furnishing the written replies and information desired in connection with the examination of the subject.

3. The Committee would also like to express their gratitude to the Estimates Committee (1994-95, 1995-96, 1996-97 and 1997-98) for able guidance and right direction provided by them in obtaining information and taking evidence for in-depth and comprehensive study of the subject.

4. The report was considered and adopted by the Committee at their sitting held on the 25th September, 1998.

5. The Report is divided into four chapters each devoted to specific aspects of the subject. The Committee have made the following important observations/recommendations:

- (i) In pursuance of the recommendations of the Committee on Financial System under the Chairmanship of Shri M. Narasimham, RBI introduced prudential norms on income recognition, asset classification and provisioning in all scheduled commercial banks in April, 1992. Based on record recovery of interest/principal the assets have been divided into four categories depending upon the period in which interest/instalments of principal had remained past due namely standard assets, sub-standard assets, doubtful assets and loss assets. The assets classified under sub-standard and loss assets are called non-performing assets (NPAs). A bad and doubtful debt will be a non-performing asset.
- (ii) With the introduction of the new system of income recognition, asset classification and provisioning norms for bad debts on a prudential basis, the concept and treatment of non-performing assets have brought about a complete transformation in the Banks in India as they have now to assess their profitability on more realistic basis and reflect the true state of their financial health.

(vi)

- (iii) In case of large divergence of classification of assets by bank auditors and RBI inspectors, a serious note should be taken and these auditors should be debarred from auditing for their sheer blantancy of misclassification.
- (iv) At present, 17 banks have non-performing assets in the range of 10 per cent to 20 per cent and 8 banks hold NPAs above the level of 20 per cent. It is shocking to find that one bank has NPAs at the level of 36.20 per cent and another has as high as 39.12 per cent. That none of the Public Sector Banks has been able to contain NPAs as per international standards where the tolerable levels of NPAs are around 3 to 4 per cent.
- (v) Failure to render honest, dedicated and dilligent service in the discharge of responsibility to the borrowers, poor motivation and inadequacy of professional skills for assessment of business risks, corporate failures both in the public and private sectors, scandalous siphoning off of funds by corporate racketeers and no fear of legal action initiated for recovery of problem loans from recalcitrant borrowers under the present slow and complex legal system, are the major factors causing hike in NPAs.
- (vi) RBI's Annual Financial Inspections (AFIs) for the last several years have been revealing a gradual deterioration of the Indian Bank's financial position. RBI had to scrutinise some accounts more than once as the bank continued to increase its exposure to some borrower groups despite the disquieting features observed by RBI and brought to bank's notice. In 1996, a scrutiny into the exercise of delegated lending powers by the then CMD and other top executive was carried out and the matter is under RBI's consideration. RBI has also conducted some scrutinies regarding administrative lapses/irregularities. CBI has registered some cases in this connection. The bank's losses accumulated to Rs. 2101.87 crore.
- (vii) A detailed review of the regulatory and supervisory functions of RBI preferably by a Committee of Experts well versed in banking matters to enhance its effectiveness and to check the laxity and complicity of RBI officials, if any, for not initiating action for effective timely measures, may be made.
- (viii) The increase in the Capital Adequacy Ratio for public sector banks as proposed in the budget for 1998-99 in pursuance of recently submitted Narasimham Committee Report may not be considered adequate in the light of a very high percentage of non-performing assets which is around 18 per cent at present, *vis-a-vis*, the international standard of tolerable levels of NPAs around 3 to 4 per cent for which ratio prescribed as per BIS norms is 8 per cent.
- (ix) In case of wilful default, recovery suits should be filed without any delay and names of wilful defaulter whether suits filed or not, should also be published for guidance of the other banks who should be instructed to exercise utmost caution in extending credit facilities to such borrowers.
- (x) Adverse comments made by RBI in their Annual Financial Inspection Reports on the CMD and other functionaries of the Public Sector Banks cannot be considered as small issues for which letter of displeasure are

issued. Government should take serious action on these adverse observations so as to achieve the laid down objectives of such inspections and also to set an example for other functionaries in the banks in order to deter them from indulging in any type of irregularities.

- (xi) If the top functionary violates the rules, he should be punished with the same severity as the other officers of the bank.
- (xii) Training system for bank officers need revamping.
- (xiii) Ministry of Finance should undertake a detailed review whether the performance of the Vigilance Departments of the banks was of requisite standard and should also consider the need for their revamping.
- (xiv) RBI/banks should examine the necessity of constituting Settlement Advisory Committee consisting of renowned bankers under the Chairmanship of retired High Court Judge to consider proposals of compromise/write offs as per laid down norms for speedy recovery of assets in cases of large default with a view to bringing down their non-performing assets.
- (xv) There should be legislative changes to ensure quick recovery of NPAs and to enable the banks to perform their assigned role of lending for socio-economic development of the people.
- (xvi) There is need for Government support both at the Centre and at the State level for extending help of the Revenue Departments in effective recovery in different cases and rendering required assistance in executing decrees obtained from the courts.
- (xvii) Banks should lay down specific guidelines duly approved by their Board of Directors for filing recovery suits and that should be made a part of their Loan Recovery Policy.
- (xviii) Government should also set up DRTs at more places for example at Chandigarh to cover States of Haryana, Punjab and Himachal Pradesh and Appellate Tribunals at Delhi, Calcutta and Chennai.

6. For facility of reference, the observations/recommendations of the Committee have been sideline in thick type of the body of the Report.

NEW DELHI;
December 7, 1998

Agrahayana 16, 1920 (Saka)

MADHUKAR SIRPOTDAR
Chairman,
Committee on Estimates.

CHAPTER I

CLASSIFICATION OF ASSETS

Introductory

1.1 Under the provisions of Section 6 of the Banking Regulation Act, 1949, in addition to the business of banking, a banking company may, *inter alia* engage in the business of borrowing, raising or taking up of money and lending or advancing of money either upon or without security. Traditionally, the banks have always been depended on their prime activity of deposit mobilisation/borrowing resources and deployment thereof in various assets including high risk portfolios for higher yields to cover all their expenses as also to earn profits. During the last two and a half decades, the banking sector has witnessed a phenomenal expansion of its network to remote rural areas in the country, and also growth the deposits and advances.

Introduction of Health Code System

1.2 With a view to having a uniform credit monitoring system in banks to monitor health of the advances portfolio and the extent to advances portfolio causing concern in relating to total advances and also to improve the quality of assets to achieve the ultimate objectives of improving recovery performance, all banks (excluding foreign banks, most of which already had similar Health Code System in their organisation) were advised by RBI on November 7, 1985 to introduce a comprehensive and uniform grading system (Health Code System) indicating the quality (or health) of individual advances into the following eight categories, with a health code assigned to each borrowal account:

Health Code No.	1	—	Satisfactory
-do-	2	—	Irregular
-do-	3	—	Sick: Viable under nursing
-do-	4	—	Sick: Non-viable/sticky
-do-	5	—	Advances recalled
-do-	6	—	Suit-filed accounts
-do-	7	—	Decreed Debts
-do-	8	—	Bad and Doubtful Debts

Detailed guidelines were also issued to the banks for classifying advances as per the above Health Code System.

1.3 The classification of a borrowal account under the Health Code System was subjective and was not based on record of recovery/servicing of interest.

Recommendations of Committee on Financial System

1.4 The Committee on Financial System under the Chairmanship of Shri M. Narasimham (also known as Narasimham Committee) had among other things examined the system for recognition of income, classification of assets and provisioning for bad debts on a prudential basis. This Committee had recommended *inter alia*, that in order to ensure that financial reports of banks reflect their real

financial health, a proper system for recognition of income, classification of assets and provisioning for bad debts on prudential basis is necessary. Further the classification of assets is to be made on the basis of objective criteria and uniform and consistent application of norms by all banks. The policy of income recognition should be objective and based on record of recovery rather than on any subjective consideration.

1.5 As regards provisioning requirement, the Committee has recommended that the provision should be made on the basis of classification of assets into four different categories; viz, standard, sub-standard, doubtful and loss assets. The above issues were examined by the Reserve Bank of India and it was decided to implement the prudential norms on income recognition, asset classification and provisioning in a phased manner over a period of three years commencing from the accounting year beginning 1 April, 1992. Accordingly RBI has issued guidelines on 27 April, 1992 for implementation of the above norms by the banks. Accordingly, all Scheduled Commercial Banks have implemented the prudential norms from the prescribed date. These guidelines are in line with international banking and supervisory standards.

As per the new system of prudential norms, the loan assets have to be classified into four categories, viz. standard, sub-standard, doubtful and loss assets, depending on the period the account has remained a non-performing asset.

Definition—Non-Performing Asset (NPA)

1.6 An asset becomes non-performing when it ceases to generate income for a bank. The Narasimham Committee has defined NPA as advances where, as on the date of the Balance Sheet, (a) in regard to term loans, interest remains "past due" for period of more than 180 days; (b) in respect of overdrafts and cash credit accounts, debt remains out of order for a period of more than 180 days; (c) in respect of bills purchased and discounted, the bills remain overdue and unpaid for more than 180 days; and (d) in respect of the other accounts, any amount to be received remains past due for a period of more than 180 days. According to the Committee, an amount is considered past due when it remains outstanding for 30 days beyond the due date.

Thus, an account will have to be treated as non-performing if interest or instalment of principal remains past due for two quarters at the year end.

Prudential Norms on Asset Classification

1.7 As per the prudential norms on asset classification, advances will have to be classified as under, depending upon the period the account has remained a non-performing asset (NPA):

Standard Asset

Standard asset is one which does not disclose any problem and which does not carry more than normal risk attached to the business.

Sub-Standard Asset

Sub-standard Asset is one which has been classified as non-performing asset (NPA) for a period not exceeding two years. Such an asset will have well defined credit weaknesses that jeopardise the liquidation of debt and

are characterised by the distinct possibility that the bank will sustain some loss if deficiencies are not corrected.

Doubtful Asset

Doubtful asset is one which has remained NPA for a period exceeding two years.

Loss Asset

A loss asset is one where loss has been identified by the bank or internal or external auditor or the RBI but the amount has not been written off, wholly or partly. In other words, such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.

The assets classified under Sub-standard, Doubtful and Loss assets are called NPAs. A bad and doubtful debt will be a non-performing asset; however, all non-performing assets need not be bad and doubtful debts.

The new system has introduced uniformity in the method of classification of loan assets by the banks.

1.8 The Ministry informed that these guidelines (on prudential norms) are in line with international banking and supervisory standards. Enquired whether "supervisory standards" were also as per international norms, the Ministry stated as follows:—

"Supervisory and Regulatory standards have been designed by RBI according to international standards. Improvement of the supervision process is an area that is being given continued attention by Reserve Bank of India."

Provisioning for Sub-standard Assets

1.9 As regards provisioning requirements, based on recommendations of the Narasimham Committee the RBI in its Circular dated 27th April, 1992 to all Scheduled Commercial Banks has directed that 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 banks, the banks should make provision against sub-standard assets, doubtful assets and loss assets as per detailed instructions in this regard furnished below:—

- (i) **Loss Assets:** The entire assets should be written off. If the assets are permitted to remain in the books for any reason, 100% of the outstandings should be provided for.
- (ii) **Doubtful Assets:**
 - (a) 100% 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.
 - (b) Over and above item (a) above, depending upon the period for which the asset has remained doubtful, 20% portion (*i.e.*, estimated realisable value the outstandings) on the following basis.

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

(iii) Sub-standard assets: A general provision of 10% of total outstandings.

1.10 During the oral evidence, while elaborating upon provisioning for loss assets, Deputy Governor, Reserve Bank of India stated as follows:—

“From 1992-93 onwards, we really came to know the extent and the degree of the exact state of health of the advances in the banks. When we implemented these norms, then we stated that as per the Bank for International Settlement norms, there was no provision required for standard advances because that was a standard by itself and there was no doubt about their recovery. On sub-standard assets 10 per cent provisioning was required to be made. On doubtful assets on the secured portion, it was to be applied for 20 per cent to 50 per cent each year. And on unsecured advances, it was hundred per cent. Similarly, on loss assets and loss advances, hundred per cent provisioning was to be made”.

1.11 The Committee enquired whether views of the banks were ascertained before introduction of prudential norms of income recognition, assets classification and provisioning and whether they had expressed any reservation in this regard. In reply, the Ministry of Finance stated as follows:—

“One of the recommendations of the Committee on Financial System was the introduction of prudential norms on income recognition, asset classification and provisioning. Before actually implementing the above recommendations, the matter was discussed with Chairmen of major banks and members of the accounting profession. The bankers did not have any reservations about the asset classification system being introduced.”

1.12 The introduction of the new system of asset classification combined with prudential norms on income recognition and provisioning has resulted in bringing out the true state of affairs of the health of the banks as may be observed from the working results of the public sector banks from the year ended 31st March, 1993. The number of banks incurring net loss increased to 13 as on 31st March, 1993 as against 2 banks in the previous year. For the year ended 31st March, 1994, the number of banks incurring net loss was 12 while as on 31st March, 1995, the loss making banks came down to 8. The increase in the number of loss making banks for the year ended 31st March, 1993 and 1994 was mainly due to the implementation of prudential norms on income recognition, asset classification and provisioning.

1.13 The Committee enquired whether there was any guidelines to decide when a debt became irrecoverable. In response, the Deputy Governor, RBI informed that “banks have their own guidelines.... It has to be decided on a case to case basis”. On being pointed out when banks take their own decisions, there is no uniformity, the

Deputy Governor submitted that "we have given them broad guidelines." In this connection, the Finance Secretary added:

"It is not the job of the Reserve Bank to micro-manage the banks. Bank has autonomous power to determine about the State of the assets. It is not necessary that all banks would follow it in the same way. Different banks may take different views on this matter."

1.14 There are generally some variations in the quantum of NPAs and the provisioning thereof as per banks estimates and RBI inspectors' assessments due to incorrect classification of assets, etc.

1.15 Reserve Bank of India advised all commercial banks vide circular BP. BC. 59/21.04 048/97 dated May 21, 1997 to make certain additional disclosures in the Notes on Account attached to the Balance Sheet for the year ended March 31, 1997. Among these (a) percentage of the non-performing assets to net advances and (b) the amount of provision made towards non-performing assets are the disclosures required to be made by banks in respect of non-performing assets. These guidelines make it compulsory for banks to make disclosures about non-performing assets.

1.16 The Committee enquired whether banks which had reported losses for the year ended 31st March, 1996 were taking recourse to a different interpretation of prudential norms and whether different banks were using different methods to calculate NPAs and declaring NPAs as favourable to them: Explaining the position, the Ministry have stated as follows:

"Reserve Bank of India had introduced the prudential norms for income recognition, asset classification and provisioning, from the accounting year 1992-93. These have been progressively tightened from time to time with regard to the non payment period of interest and principal instalments for being classified as non-performing and the quantum of provisions to be made against the non-performing assets. Detailed valuation norms have also been introduced with effect from 1992-93 in respect of the investment portfolio of the banks. Subsequently, a number of clarifications have been issued by RBI in order to minimise/eliminate the scope for interpretation in implementing the prudential norms. These have brought uniformity in the application of the norms. In the course of Annual Financial Inspection of banks by RBI, the adherence to the prudential norms is critically examined. It has been observed during the inspections that there have been divergences between the asset classification/provisioning for NPAs made by banks and the assessment made by RBI Inspections. Non-adherence to the guidelines issued by RBI and not taking into account certain qualitative factors were observed to be the main reasons for the divergence in asset evaluation. In order to narrow down the divergence and ensure adequate provisioning by banks, RBI in terms of circular dated October 31, 1996 advised that the banks will be furnished with a list of the accounts contributing to the divergence with all details above a certain level, in the inspection report and that the bank's statutory auditors can have a dialogue with the RBI in regard to the divergence in asset valuation as also the provision required for NPAs, as

spelt out in the inspection reports of banks for reconciling the differences while finalising the accounts for the ensuing year. This matter has been further reviewed by the Board for Financial Supervision and it has been decided that banks should, before finalising the accounts for the year ended 31st March, 1997 (as also for subsequent years) take into account the assessment made by the RBI Inspecting Officer and subsequent development, if any, and provide for the shortfall in provisioning for NPAs etc."

1.17 On being asked to furnish details of instances during RBI's inspections where commercial bank auditors had not properly classified assets under prudential norms, the Ministry of Finance furnished a statement based on NPAs as reported by the banks and NPAs as assessed by the RBI inspectors showing, additional provision recommended by the inspector during the last three years bank-wise are as follows:—

(Rupees in crores)

Sl.No.	Name of the Bank	31.3.95	31.3.96	31.3.97
1.	State Bank of Bikaner and Jaipur	5.13	17.33	22.29
2.	State Bank of Hyderabad	—	34.43	05.11
3.	State Bank of Indore	2.42	06.08	32.43
4.	State Bank of Mysore	16.36	17.07	13.62
5.	State Bank of Patiala	04.30	—	40.75
6.	State Bank of Saurashtra	20.26	15.45	05.53
7.	State Bank of Travancore	54.62	125.94	44.19
8.	*State Bank of India	—	—	217.98
9.	Allahabad Bank	12.47	02.16	*
10.	Andhra Bank	04.76	06.96	07.03
11.	Bank of Maharashtra	39.10	39.39	08.84
12.	Central Bank of India	50.90	23.36	07.22
13.	Corporation Bank	16.63	02.33	07.03
14.	Dena Bank	21.19	03.49	19.30
15.	Oriental Bank of Commerce	nil	nil	nil
16.	Punjab National Bank	107.24	21.52	21.90
17.	Punjab & Sind Bank	08.95	01.90	04.25
18.	Union Bank of India	24.76	13.70	26.30
19.	United Bank of India	89.73	36.22	27.16
20.	Vijaya Bank	135.02	28.33	25.45
21.	Bank of Baroda	100.52	33.72	04.19
22.	Bank of India	**	**	103.49
23.	Canara Bank	150.11	88.54	80.38
24.	Indian Bank	298.14	161.57	47.78
25.	Indian Overseas Bank	63.83	55.48	07.81
26.	Syndicate Bank	56.96	42.18	20.92
27.	UCO Bank	94.91	114.14	97.38

*AFI 1995, 1996 has not been conducted and the 1997 AFI report of the bank has not yet been received.

**The bank was holding excess provision for NPAs and hence additional provisioning was not recommended by the PIO.

Observations/Recommendations

1.18 The Committee note that in pursuance of the recommendations of the Committee on the Financial System under the Chairmanship of Shri M. Narasimham, RBI introduced prudential norms on income recognition, asset classification and provisioning in all scheduled commercial banks in April, 1992. Reporting under the Health Code System for classification of borrowal accounts which was in vogue, was withdrawn with effect from 1st April, 1994 by RBI. But the banks could continue to retain the system or any alternate loan grading system as might be advised by them for purposes of gradation of the quality of their loans and advances. However, for the purpose of reporting to RBI, the quality of the credit portfolio of banks was to be based on new norms for income recognition, asset classification and provisioning from that date i.e. 1st April, 1994.

1.19 Following the recommendations of the Narasimham Committee on the Financial System, the RBI issued a detailed circular in April, 1992 to all scheduled commercial banks (excluding RRBs). The circular contained specific guidelines for prudential norms to be adopted for:

- Income recognition,
- Asset classification, and
- Provisioning for assets of 'loss' or 'doubtful' nature.

An asset becomes non-performing when it ceases to generate income for the bank. For the purpose of income recognition, the Narasimham Committee recommended that no income should be recognised and taken into account on accrual basis with respect to non-performing assets (NPAs) and that such income should be accounted for only on the basis of actual receipt.

For the purpose of provisioning for 'loss' and 'doubtful' assets, RBI guidelines provide for classification of assets into four categories depending upon the period for which interest/instalments of principal had remained 'past due' namely—

- (i) Standard assets
- (ii) Substandard assets
- (iii) Doubtful assets and
- (iv) Loss assets.

1.20 The Committee further note that the introduction of new norms on asset classification into four categories viz. standard/sub-standard/doubtful/ loss asset, is for facilitating identification of an account as a non-performing asset depending on the period on an objective basis. In terms of the instructions, classification of an account into the four categories is based on record of recovery of interest/principal and is not based on any subjective consideration. These guidelines on asset classification and provisioning are in line with international banking and supervisory standards as per norms of the Banks for International Settlement.

1.21 There were no NPA norms earlier in India. Income from NPA is not internationally recognised on accrual basis but is booked as income only when it is actually received. Such reforms in the banking sector throughout the world were

introduced in 1987 with the implementation of Basle Committee recommendations. In India, the same were introduced in 1992 with the implementation of recommendations of the Narasimham Committee that similar practice should be followed by banks in India.

1.22 The Committee feel that with the introduction of the new system of income recognition, asset classification and provisioning norms for bad debts on a prudential basis, the concept and treatment of non-performing assets have brought about a complete transformation in the Banks in India as they have now to assess their profitability on more realistic basis and reflect the true state of their financial health.

1.23 The Committee note that there is considerable misclassification by banks of their non-performing assets and consequent under-provisioning of loan losses in disregard of RBI guidelines relating to income recognition, asset classification and provisioning. The Committee expect the RBI to ensure better adherence by the banks to the prudential norms to achieve the desired objectives of their introduction.

1.24 In case of large divergence of classification of assets by bank auditors and RBI inspectors, the Committee desire that a serious note should be taken and these auditors should be debarred from auditing for their sheer blantancy of misclassification.

CHAPTER II

NON-PERFORMING ASSETS

Basic Pre-requisites for Sanction of a Loan

2.1 To maintain the status of loan sanctioned as a standard asset the following basic pre-requisites are inter-alia to be considered before sanction of a loan/advance:

- (i) Proper assessment of the credit needs of the borrower.
- (ii) Purpose of the loan/advance.
- (iii) Adequacy of the security offered by the borrower.
- (iv) Repaying capacity of the borrower.
- (v) Technical feasibility and economic viability of a project in the case of project financing.
- (vi) Whether the activity financed is capable of generating sufficient surplus to service/liquidate the loan/advance.
- (vii) Proper documentation.
- (viii) Resources position and lending policy.

Guidelines for Lending

2.2 The Committee desired to know the prescribed/standardised norms laid down by RBI/Banking Division or by the Banks themselves regarding sanction of loans/advances, finance for various categories of borrowers e.g. corporate borrowers, SSI Units, small trade/business etc. In response the Ministry of Finance furnished a detailed account of the guidelines issued by RBI from time to time in the matter of bank loan policies, procedure for sanction of loans, credit limits, security norms, margin money time frame for sanction of loans, etc. for each category of borrowers—medium and large scale units, small scale industries, artisans, village and cottage industries, small borrowers in the Priority Sector and advances for Government sponsored schemes for poverty alleviation and self-employment schemes.

2.3 When asked how do the banks ensure recovery of loans where primary security is sold/missing, the Ministry in a written reply stated that:

"If the primary security is missing/sold, banks may take the usual action for recovery which may include legal action as a last resort."

2.4 On being asked why proposals otherwise viable in respect of advances over Rs. 25,000/- should be turned down merely for want of such collateral security or third party guarantees, the Ministry explained:

"In order to ensure that bankable proposals are not rejected merely for want of collateral/third party guarantee. RBI has always been exhorting the banks to exercise their prudence and commercial judgement in the interest of genuine borrowers."

2.5 When enquired how viability of project was ensured and whether any guidelines had been laid down for determining the viability of the project the Ministry of Finance stated:

"The viability of loan proposals is assessed based on important factors such as cash generating potential of the project, availability of backward and forward linkages, economic/technical feasibility, etc., among others."

2.6 Asked if the banks gave loan without collateral security or third party guarantee on otherwise viable proposals', how they ensured recovery in case of wilful default, who bore the responsibility for such bad debts and in case the project did not turn viable as assessed and the borrowal account became NPAs, whether any punitive action was taken against officials approving viability of the project, the Ministry stated that:

"In case of wilful defaults, banks have to adhere to the instructions/ guidelines issued by their head offices. In case the borrowal account becomes NPA due to extraneous circumstances or reasons beyond the control of borrowers and banks, these cases will have to be viewed and reviewed case by case depending on merits and appropriate action as deemed necessary will have to be taken by the Branch Managers in consultation with controlling offices/Head Office."

2.7 Under the extant instructions it was stipulated that Branch Managers might reject applications provided the cases of rejection were verified subsequently by Divisional/Regional Managers. Asked about the actual practice in this regard, the Ministry stated that:

"It is observed that in actual practice the banks are by and large, adhering to prescribed procedure for rejection of applications barring exceptional cases. If such cases are reported to RBI, they are pursued vigorously with the concerned banks."

2.8 On being asked about the views of the Government on the suggestion that Divisional/Regional Managers review cases of rejection made by the Branch Manager in the light of other applications accepted by the Branch Manager for sanction of loans in order to ensure objectivity in consideration of loan application, it was stated that RBI guidelines did not preclude the banks from any such action and/or review of the decisions of their branch managers at their higher levels should they deem it necessary.

Magnitude of NPA

2.9 The Ministry of Finance have furnished the position of non-performing assets (gross) of Public Sector Banks during the last five years as follows:

Name of the Bank	1992-93		1993-94		1994-95		1995-96		1996-97*	
	Amount	% to total advances	Amount	% to total advances	Amount	% to total advances	Amount	% to total advances	Amount	% to total advances
STATE BANK OF INDIA	11171.38	20.25	11604.80	24.36	10926.15	19.98	10553.53	15.96	10961.54	16.02
STATE BANK OF BIKANER & JAIPUR	372.21	19.14	365.92	18.19	400.25	17.21	337.95	12.45	454.99	13.83
STATE BANK OF HYDERABAD	457.00	19.03	565.00	21.90	554.23	15.75	759.74	17.89	849.42	19.19
STATE BANK OF INDORE	206.19	21.43	232.65	21.41	199.01	15.28	218.84	14.20	266.76	15.81
STATE BANK OF MYSORE	257.87	17.73	332.47	21.46	284.48	14.44	328.93	14.54	467.96	16.92
STATE BANK OF PATIALA	283.38	13.08	305.38	13.09	330.98	11.42	399.71	11.49	454.80	11.32
STATE BANK OF SAURASHTRA	184.79	16.61	231.44	18.92	197.70	12.22	265.98	13.50	326.40	14.79
STATE BANK OF TRAVANCORE	282.00	13.63	339.29	13.57	377.88	11.10	430.22	11.74	586.85	14.49
TOTAL FOR STATE BANK GROUP	13214.82	19.64	13976.95	22.94	13270.68	18.50	13294.90	15.46	14367.82	15.81
ALLAHABAD BANK	1207.00	28.78	1025.03	24.74	1235.11	26.88	1255.00	23.93	1302.89	23.93
ANDHRA BANK	398.00	19.22	520.78	23.35	377.65	14.30	332.20	11.61	385.63	11.81
BANK OF BARODA	2409.27	18.97	2630.16	18.77	2689.68	16.58	2840.09	16.16	3116.00	17.15
BANK OF INDIA	4262.00	34.66	3772.00	29.96	2961.00	20.66	2434.00	14.49	2275.00	11.76
BANK OF MAHARASHTRA	753.99	34.20	847.67	36.23	734.59	25.71	694.26	21.87	749.43	20.67
CANARA BANK	1947.09	22.10	1653.00	18.22	1523.00	12.93	2647.32	17.93	3323.72	20.26
CENTRAL BANK OF INDIA	2173.00	29.88	2443.00	35.29	2154.78	24.98	2420.00	23.91	2520.00	25.00
CORPORATION BANK	176.00	14.26	299.01	16.41	260.01	11.69	251.83	9.67	316.78	9.92
DENA BANK	620.00	27.85	564.00	22.51	557.00	17.34	541.00	14.70	674.21	15.10
INDIAN BANK	1881.00	23.03	2040.51	26.79	2102.41	24.09	3140.00	34.15	3303.00	39.12
INDIAN OVERSEAS BANK	2272.00	40.43	2175.18	37.75	2001.41	26.85	2020.00	22.99	1317.00	15.50
ORIENTAL BANK OF COMMERCE	293.00	12.65	210.95	8.00	221.94	6.14	271.30	5.65	367.56	7.36
PUNJAB & SIND BANK	648.50	37.13	637.28	31.63	619.32	22.53	957.53	27.70	1089.70	30.71
PUNJAB NATIONAL BANK	1634.47	15.71	2179.03	21.41	2033.00	17.01	2518.00	18.74	2426.14	15.31
SYNDICATE BANK	1558.00	32.67	1409.60	29.40	1452.97	27.48	1311.75	20.97	1291.78	19.32
UCO BANK	1625.00	24.94	1961.81	34.61	1745.60	29.40	1839.52	24.54	1872.62	28.35
UNION BANK OF INDIA	780.00	16.82	693.49	12.87	695.95	9.41	945.86	10.38	987.80	10.38
UNITED BANK OF INDIA	949.00	30.83	1509.00	45.95	1309.68	36.90	1401.00	38.00	1398.00	36.20
VJAYA BANK	451.00	25.37	532.88	26.96	439.40	17.47	545.38	20.36	511.96	18.73
TOTAL FOR NAT. BANKS	26038.32	26.62	27064.38	26.84	25114.60	19.98	28366.04	19.52	29209.27	19.05
TOTAL FOR PSBs	39253.14	23.18	41041.33	24.78	38365.18	19.45	41660.94	18.01	43577.09	17.84

* PROVISIONAL

Factors responsible of NPAs.

2.10 Banks being credit institutions, certain amounts of bad debts do arise despite all systems and procedures to ensure safety of funds lent. Banking Division of the Ministry of Finance has informed that no study has been conducted to go into the causes of bad debts.

The Chairman, IBA, during study tour has pointed out that loans are given by banks for industrial production. Under the prevalent economic and industrial development scenario, five to ten per cent fault in loans as occupational hazard was expected.

A study has been conducted by the Committee headed by Shri Pannir Selvam, Chairman Indian Bank's Association (IBA) and Chairman and Managing Director, Union Bank of India to look into the problems of Non-Performing Assets (NPAs) of the Public Sector Banks and to suggest measures to bring down the NPAs in the banks to the acceptable level.

2.11 Advances of banks turn non-performing due to a variety of factors for which banks and borrowers are responsible as also due to external circumstances as explained by the Ministry of Finance as also emerged during discussion during study tours. These can be summarised as under:

Banks

Deficiencies in credit appraisal, non-observance of norms for sanction of loans and laxity in post disbursement supervision. Deficiencies in credit appraisal such as not assessing the need based requirements of borrowers without proper verification/assessment, granting excess over sanctioned limit, oral and ad-hoc sanctions, etc., non-obtention of credit reports from borrowers, excess over exposure limit, etc.

Borrowers

Wilful defaults by the borrowers and diversion of funds with a view to defrauding the banking system, managerial inefficiency/deficiency, family disputes/disputes among partners and promoters.

External Circumstances

Circumstances beyond the control of the bank and borrower such as non-availability of raw material, closure or suspension of work of business due to strike, natural calamities such as flood, droughts, and cyclones, recession in the industry due to which the borrower fails to produce or market his goods as originally stipulated, power failure, technological obsolescence, change of market/economic scenario, and change in tax structure/Government policy, etc.

2.12 Explaining the reasons for the advance going bad, the Deputy Governor, RBI stated as follows:

"There are various reasons for the advances going bad. It may be due to wrong skill of the person who is appraising. Banking in India has expanded very fast. The persons are not trained. There are instances where wrong people have taken the loans. But in future banks will be careful in lending

operations, in their training systems, formation of committee system for lending, etc."

2.13 Here it will be relevant to quote a letter claiming to be based on ground realities to the Editor of the Economic Times published on 31st March, 1998 wherein it has been *inter alia* observed as follows:

"(i) The sickness in the industry is not only due to inefficient management and therefore the axe should not fall on the management only. (ii) The detailed analysis of most of the cases will reveal that the sickness in the industry is caused by the indifferent, inefficient and corrupt approach of the officials of the banks and financial institutions. In most of the cases the industries get sick in the beginning itself due to delay in sanction and disbursement of the loan by financial institutions resulting in time and cost overruns. (iii) Bankers fail to provide, invariably, need-based working capital to the industries especially belonging to the new entrepreneurs having no push or pulls. The higher rate of interest and non-developmental approach of the financial institutions have made the going more tough. Corruption at various levels, starting from the loan sanction, disbursal of loan, getting power connection and no objection certificate from the Pollution Control Board eats away quite a lot of money for which no provision can be made in the project."

2.14 According to the Indian Banks Association, wilful default to a large extent emerges from lack of effective supervision of credit and frequent interference from local influence system, inadequate powers banks possess to execute recovery and long drawn legal process involved in executing decrees obtained from courts.

2.15 The Committee enquired about the reasons for the high percentage of Non-Performing Assets (NPAs) in regard to

Indian Overseas Bank
Punjab and Sind Bank
Bank of Maharashtra
United Bank of India
and
Syndicate Bank

as mentioned in the Table at para 2.9 above.

In reply, the Ministry stated as under:

"The prudential norms on income recognition, asset classification and provisioning were first introduced from the accounting year' ended March, 1993. In the absence of an objective system of classification of assets with reference to record of recovery, till the year ended March, 1992 banks were classifying accounts on the basis of a system of health code classification, and was based on the individual bank's perception of the prospects of recoverability. With the introduction of uniform prudential norms w.e.f. 1992-93 banks were required to classify an asset as non-performing if the payment of interest or instalment remains overdue for two quarters. Statutory Auditors of banks are also required to verify bank's compliance with RBI's

instructions. The banks therefore had to evaluate their credit portfolio in the light of the above instructions commencing from the accounting year ended 31st March, 1993. The higher level of NPAs as at 31st March, 1993 to a major extent is due to the emergence of a clearer picture on account of the introduction of the above prudential norms."

2.16 In regard to programme for reduction in NPA, the Deputy Governor, RBI informed as follows:

"Recovery of bad debts could be done by compromise or by upgradation or through cash recoveries. The future NPAs are being monitored very closely from year to year. So far as the old ones are concerned, we are emphasising the need for recovery because that is the only way through which this could be reduced. Through discussions with the bank managements, we expect that by March, 1998 the banking system will come to a level of about 10 per cent of the NPAs which, looking from where we started, should be a good level. Of course, it may not still meet the international standards, but it will be a good performance."

NPAs of Indian Bank

2.17 About the losses and NPAs of the Indian Bank, the Ministry of Finance in a note have stated as follows:

"Indian Bank, Madras, published its audited financial accounts for the year ended March 1996 in the last week of July 1996. The bank's operations for the financial year 1995-96 resulted in a loss of Rs. 1336.40 crore as against a net profit of Rs. 14.26 crore which it had disclosed for the previous year. Together with the carry forward loss of Rs. 376.39 crore of earlier years, the bank's accumulated losses topped Rs. 1706 crore which have wiped out its shareholders equity of Rs. 411.90 crore.

RBI's Annual Financial Inspections in the last several years have been revealing gradual deteriorations of the bank's financial position; this was largely due to imprudent lending policies pursued by the bank. Advances were granted to several high risk areas and such credit extension was also partly funded by costly market borrowings. Such lending has a two-fold impact on the bank's profitability, advances turned non-performing within a short period and funding losses were also involved. The findings of RBI's successive inspections revealed that the bank's credit and funds management functions were areas of serious concern.

The bank's asset-liability structure continued to be characterised by huge mismatches resulting from large expansion of long term credit on the one hand, and huge, volatile call money borrowings on the other. RBI's AFIs were followed up with special scrutinies/investigations of advances accounts wherever weaknesses such as irregular/injudicious loan sanctions, poor credit supervision and inadequate security were mentioned in the reports. RBI had to scrutinise some accounts more than once, as the bank continued to increase its exposure to these groups despite the disquieting features observed by RBI and brought to its notice. As recently as in 1996, a scrutiny into the exercise of delegated lending powers by the ex-CMD and other top executives was carried out and the matter is under RBI's consideration. In the discussions

held periodically with the top management of the bank after each inspection, the need to curtail the exposure to some of the above borrower groups was emphasised by the Reserve Bank. RBI's AFI's also revealed huge variations in the quantum of NPAs and consequent provisioning requirements as assessed by RBI Inspecting officers *vis-a-vis* the bank's own figures in this regard indicating non-adherence to the prudential norms introduced by RBI in 1992.

The bank was specifically advised to strictly adhere to the prudential norms and accounting standards when it came to light that it had reckoned unearned income on advances and investments for the years ended March 1992 and March 1993.

The bank's non-adherence to these norms was seen to be more pronounced in 1994-95, as RBI's AFI revealed large-scale omissions/ misclassifications by the bank of its non-performing assets and consequent under-provisioning of a huge magnitude (Rs. 419.00 crore).

As against non-performing assets of Rs. 2949 crore identified by the inspectors, the bank had reported NPAs of Rs. 2102.43 crore. It had also reported having maintained adequate provisions for depreciation on investments, certain contingent items of expenditure (such as for increased wages, etc.) and other losses. The inspectors pointed out that had all these been properly taken into account, the net result would have been a loss of Rs. 400.04 crore for the year 1994-95 as against the published profit of Rs. 14.26 crore. The bank was directed to recast its Balance Sheet. However, as the bank represented that the Balance Sheet was already published and to recast it would severely affect its image, it was directed by RBI, in consultation with Government, to make suitable adjustments for the shortfall in provisioning for 1994-95 in the following year i.e. 1995-96, and furnish explanatory remarks to this effect in the notes accompanying the Balance sheet."

2.18 In response to a query, the Ministry have informed as under:

(i) Erosion of Capital and Reserves

The book value of owned funds of the bank were at Rs. 792 crore which included capital at Rs. 654 crore and reserves at Rs. 138 crore. The accumulated losses of the bank aggregated to Rs. 1713 crore as on 31.3.1996. The reserves excluding those on account of revaluation (Rs. 121.07 crore) aggregated Rs. 138 crore. The entire capital and net worth has been lost as a result of the loss of Rs. 1336.40 crore.

(ii) NPAs in Balance Sheet, 1995-96

As per the format prescribed under the Banking Regulation Act, 1949 banks are not required to specifically disclose NPAs and provision made there against. The bank reported its NPAs at Rs. 3141 crore and had made additional provisions of Rs. 980.62 crore so as to comply with RBI norms. The adequacy of the provisions will be verified during the course of the Annual Financial Inspection of the bank which is under progress.

(iii) Losses

The bank published a loss of Rs. 390.65 crore during the year 1993-94 on account of better adherence to the provisioning norms based on RBI's advice

issued to it on the final accounts for the year ended March 1993. Thus, the bank had a carry forward loss of Rs. 376.39 crore for the year 1994-95. RBI's AFI for the year ended March 1995 revealed that there was massive under provisioning for loan losses and contingencies. The Government of India and the bank were kept apprised of RBI's findings in this regard.

2.19 The Committee desired to know whether the Government had inquired into irregularities committed in granting loans to certain firms by Indian Bank and making the bank to suffer a staggering loss of Rs. 1336.40 crore and whether these irregularities required launching criminal proceedings against the former CMD of the bank. The Ministry in their reply have stated as follows:

RBI have conducted some scrutinies and is in the process of conducting some more covering various aspects including administrative lapses/irregularities including recovery of overdues from their inception. Further, CBI has registered some cases in this connection.

2.20 Enquired whether the management had formulated any strategy for recovery of their assets from the defaulters, targets set for the current year for recovery of bank dues and upgrading assets into performing assets, and how much recovery had been effected so far, the Ministry stated as under:

"The present CMO of the bank was advised to spell out an action plan involving sustained recovery on non-performing advances, containment of credit, and reduction of call money borrowings, apart from streamlining procedures for appraisal and supervision of credit.

The bank was advised to fix staff accountability at all level for serious transgressions in lending by exceeding discretionary powers and indiscriminate/extensive resort to high cost borrowing.

It was also advised to carry out a diagnostic study. ICRA which was designated for the purpose has since submitted the report. The bank has also reported having set up a top management council to oversee its functions in all areas, a special recovery committee to monitor NPAs and the funds and an investment committee for deployment of resources.

RBI have also set up a system of monthly monitoring of the bank's performance in certain key parameters such as deposit growth expansion of credit, borrowing levels, repayment of high cost CDs, recoveries made during the month from the NPA accounts, etc. RBI have also appointed one of their senior officials to closely monitor the bank's performance on the basis of the monthly reporting.

During 1995-96 the bank reported a recovery of Rs. 254 crore of NPAs at Indian Branches. Between April and December 1996, recovery of Rs. 210.40 crore has been reported. The bank has been advised to target for a recovery of Rs. 500 crore of its NPAs."

2.21 The Committee sought the views of the Ministry on the role of auditors in not pointing out a true and fair picture of the banks' financial position and observing

prudential norms. In this connection, the Ministry stated that "the statutory auditors are certifying the true and fair picture of the balance sheet of the banks.

Besides RBI have also been asking the auditors to issue a certificate to the effect that (a) the treasury operations of the bank have been conducted in accordance with the instructions issued by the RBI from time to time, and (b) the income recognition, asset classification and provisioning have been made as per the guidelines issued by RBI from time to time."

2.22 In the case of Indian Bank large divergences were noticed during the financial inspection with reference to the bank's position as on 31st March 1995. RBI had called for the details of the divergence in different zones/branches and also the names of the concerned audit firms, RBI and the Chairman & Managing Director of Indian Bank debarred two of its SCAs and 10 statutory branch auditors for two years as the divergences in their cases were on the high side. Further, for taking up appropriate disciplinary action against these audit firms, RBI had advised Indian Bank to take up the matter with the ICAI which is the competent authority for taking disciplinary action against the auditors. It is now understood that Indian Bank has already taken up the matter with the ICAI.

Loans sanctioned by CMDs and other top Executives

2.23 The Ministry of Finance informed that only in five cases—4 cases in respect of former CMD, Vijay Bank and one case in respect of former CMD, UCO Bank in which amount of loan sanctioned was Rs. 1 crore and above at the level of CMD which turned 'bad debts' during the service period of these functionaries during the last three years. The Ministry also furnished the position regarding action for prosecution initiated against these ex-CMD and others as also action taken by Government for recovery of bank dues.

2.24 The Ministry also informed that in 62 cases loan amounts of Rs. 10 lakh and above sanctioned at the level of CMD/MD/FD turned 'bad debts' after retirement of these senior functionaries of the banks by whom these loans were sanctioned. The Ministry also furnished the position regarding departmental internal investigation, disciplinary action for procedural lapses on the part of existing staff members as also CBI investigation against the former CMDs/EDs who ceased to be in the service of the banks.

Observations/Recommendations

2.25 The Committee note that in accordance with the guidelines/directives of the Reserve Bank of India as also policy guidelines drawn up every year and duly approved by the Board of Directors, banks are sanctioning loans and advances for various categories of borrowers of medium and large scale industries, small scale industries, artisans, village and cottage industries, and other small scale industries as also for creation/modernisation/expansion of infrastructural facilities for productive purposes. It has also been the policy of the banks to provide credit facilities under the priority sector for development of agriculture, export and Government sponsored poverty alleviation and self-employment schemes. The Committee appreciate the pivotal role of the Public Sector banks for channelling the flow of funds for industrial

development, agricultural growth, employment generation, poverty alleviation and for other productive purposes.

2.26 The Committee note from information furnished by the Ministry of Finance that in percentage terms, NPAs came down significantly from 23.18 per cent as on March, 1992 (when prudential norms were introduced) to 17.84 per cent (provisional) as on 31 March, 1997 i.e. a reduction of 5.34% in a period of four years. Another notable feature is that banks have been able to avert further growth in NPAs in absolute terms *vis-a-vis* growth in lending. In absolute term these NPAs have accumulated from Rs. 39,253 crore as on March, 1993 to an amount of Rs. 43,577 crore as on March, 1997. At present, 17 banks have non-performing assets in the range of 10 per cent to 20 per cent and 8 banks hold NPAs above the level of 20 per cent. It is shocking to find that one bank has NPAs at the level of 36.20 per cent and another one has as high as 39.12 per cent. Only two banks have NPAs in the range of 5 to 10 per cent which, according to Chairman, IBA, is tolerable level under the prevalent economic and industrial development scenario. However, the Committee is extremely unhappy to observe that none of the Public Sector banks has been able to contain NPAs as per international standards where the tolerable levels of NPAs are around 3 to 4 per cent.

2.27 The Committee note that several factors mostly on the part of banks and also on the part of borrowers contribute to bad loans. Factors external to the banks and the borrowers such as changes in Government policies to some extent also could cause default in loans. Failure to render honest, dedicated and diligent service in the discharge of responsibility to the borrowers, poor motivation and inadequacy of professional skills for assessment of business risks, corporate failures both in the public and private sectors, scandalous siphoning off of funds by corporate racketeers and no fear of legal action initiated for recovery of problem loans from recalcitrant borrowers under the present slow and complex legal system, are the major factors causing hike in NPAs.

2.28 It is distressing for the Committee to find that Indian Bank's operations for the financial year 1995-96 resulted in a loss of Rs. 1336.40 crore. Together with the carry forward loss of Rs. 376.39 crore of earlier years, the bank's losses accumulated to Rs. 1713 crore as on 31.03.1996 wiping out the entire capital and net worth. RBI's Annual Financial Inspections (AFIs) into the last several years have been revealing the gradual deterioration of the Indian Bank's financial position. According to RBI, this was largely due to the imprudent lending policies pursued by the bank management. Findings of RBI's successive inspections revealed that the bank's credit and fund management functions were areas of serious concern. The Committee are further informed that RBI had to scrutinise some accounts more than once as the bank continued to increase its exposure to some borrower groups despite the disquieting features observed by RBI and brought to bank's notice. In 1996, a scrutiny into the exercise of delegated lending powers by the then CMD and other top executive was carried out and the matter is under RBI's consideration. RBI has also conducted some scrutinies regarding administrative lapses/irregularities. CBI has registered some cases in this connection.

The net loss of the bank for the year ended 31 March, 1997 is Rs. 389.09 crore as reported in the Annual Report 1996-97. The bank's losses have thus accumulated to Rs. 2101.87 crore.

The Committee are deeply perturbed at this state of affairs in the Indian Bank which has continued for the past few years. They are disappointed that the bank did not pay any heed to the repeated revelations of RBI relating to the imprudent policies being pursued by the management for corrective measures.

2.29 It is really surprising to find that the procedure adopted by RBI of only "bringing to the notice" of management of the Indian Bank their findings contained in AFIs revealing gradual deterioration of the bank financial position year after year and holding discussion with the bank management subsequently for the follow-up of corrective measures have proved totally ineffective. The bank management under the then CMD defiantly continued to pursue imprudent lending policies and exposure to some borrower groups despite the RBI's disquieting revelations. In the light of the experience gained in the dubious role of the ex-Chief Executives not only of the Indian Bank but also the Bank of Maharashtra or Vijaya Bank for losses to their banks, the Committee consider it imperative that some safeguards are put in place for swift and timely action for stopping imprudent policies being pursued by the management and other administrative lapses/irregularities to prevent any further damage and loss to the banks. The Committee, therefore, desire that a detailed review of the regulatory and supervisory functions of RBI preferably by a Committee of Experts well versed in banking matters to enhance its effectiveness and the laxity and complicity of RBI officials, if any, for not initiating action for effective timely measures, may be made.

2.30 The Committee also desire that the cases against the ex-CMD of the Indian Bank and other top executives should be pursued vigorously for meting out severe punishment to the guilty.

The Committee would like to be apprised of the action taken on their recommendations in this regard.

2.31 On perusal of the information furnished by the Ministry of Finance relating to big loans sanctioned by the top functionaries of the level of CMD/MD/ED of the Public Sector banks including the Indian Bank which turned into 'bad debts' during their service period as also which turned 'bad debts' after retirement of those functionaries, the Committee are distressed to find that the dubious role of the Chief Executives of the banks whether it is of Bank of Maharashtra or Vijaya Bank or Indian Bank in granting advances in utter disregard of laid down system and procedure has been the major contributing factor for turning these huge advances into bad loans. In the opinion of the Committee such things could be possible only with a motive of corruption and complicity in siphoning off of bank funds.

2.32 Apart from revamping the present procedure and system for awarding deterrent punishment for such serious irregularities and wrongdoings, the laid down system for selection and appointment of senior Executives including top Executives

of the banks should be reviewed so that officers of integrity, proven sense of duty and responsibility are appointed to these positions.

2.33 It has been observed that the loan amounts never reach the poor borrowers in full. The illiterate and gullible borrowers have to grease the palms of middlemen/block development officers and other Government intermediaries in forwarding/sponsoring loan applications. They have even to bribe the bank officials for sanctioning and disbursement of loan. That is why some of the borrowers wilfully refuse to pay the full loan amount as they are only paid less than half of the loan amount.

The Chairman, IBA has also opined that loan recovery becomes difficult if the entire loan sanctioned does not reach the borrower. The Committee desire that procedures and systems laid down for selection of beneficiaries and sponsoring the loan applications may be given a fresh look so that the involvement of various intermediaries is brought down considerably. Banks should also initiate effective measures to check malpractices on the part of bank officials in sanction and disbursement of loans to the borrowers. The Committee would like to be apprised of the concrete and effective measures taken in this matter also.

2.34 The Committee have been informed by BRA that there are no well defined safe limits as far as non-performing assets of the banks are concerned. But as per international standards the tolerable levels of NPAs are around 3 to 4 per cent. The Basle Committee on Banking Regulations and Supervisory Practices functioning in the Bank for International Settlements (BIS) has prescribed certain capital adequacy standards for banks which are being implemented in a large number of countries. The BIS standards seeks to measure capital adequacy as a ratio of capital to risk weighted assets and the ratio prescribed thereunder is 8 per cent. The Committee on the Financial System (Narasimham Committee) *inter alia* suggested that banks should, under a phased programme, move towards meeting the BIS norms on capital adequacy of 8 per cent which should be achieved by March, 1996. The Minister of Finance in his Budget Speech on 1st June, 1998 has stated that to strengthen the underlying health of banks, RBI is raising the minimum required Capital Adequacy Ratio for banks from the present 8 per cent to 9 per cent by March 31, 2000 and to 10 per cent by as early as possible thereafter. The Committee, however, feel that the increase in the Capital Adequacy Ratio for public sector banks as proposed in the Budget for 1998-99 in pursuance of recently submitted Narasimham Committee Report may not be considered adequate in the light of a very high percentage of non-performing assets which is around 18 per cent at present, *vis-a-vis*, the international standard of tolerable levels of NPAs around 3 to 4 per cent for which ratio prescribed as per BIS norms is 8 per cent.

CHAPTER III

CREDIT MANAGEMENT

3.1 Drawing up of plans/programmes/schemes for recovery or liquidation of bad/doubtful debts is essentially a management function of the banks concerned (especially credit management) and the effective performance of this was being looked into by the RBI primarily during the inspections of banks carried out at periodic intervals. With a view to reducing the accumulation of bad/doubtful debts in banks *vis-a-vis* improving the recovery performance of the banks, drawing/initiating of various plans/programmes/schemes by banks is encouraged/induced by the Reserve Bank of India.

Measures for Containment of NPAs

3.2 Apart from advising the banks from time to time to strengthen the credit appraisal system and skills of their officials (by imparting them necessary training, etc.) and also to ensure effective post-disbursement supervision and control, etc., a number of steps have been advised/ initiated to prevent recurrence of the factors contributing to increase in bad debts and to reduce NPAs as follows:—

(i) Formulation of policy framework

RBI has advised banks in the last couple of years to have documents of investment policy, loan policy, loan recovery policy, etc., prepared and duly vetted by their Board of Directors.

(ii) Prudential Norms

(1) Capital adequacy

In terms of instructions issued by RBI in April, 1992 banks are required to achieve ratio of capital to risk assets of 8% by March, 1996.

(2) Income recognition, assets classification and provisioning

Banks were advised by RBI on April 27, 1992 not to charge and take to income unrealised interest on all non-performing assets.

Banks are also advised to classify all advances under 4 heads *i.e.* Standard, Sub-standard, Doubtful or Loss on the basis of prescribed norms and make provisions as corresponding to the prescribed classification.

(3) Inspection System

On August 24, 1992 banks were instructed to undertake an immediate review of the adequacy of the internal audit system. Banks were further advised on September 8, 1993 regarding the following:—

(a) There should be some officials in the banks who could be treated as a nodal agency to co-ordinate and ensure that certain important instructions from the Reserve Bank of India/Government of India had been complied with and irregularities observed in the functioning of the banks had been rectified, by all the banks.

(b) The inspection manual/manual of instructions of the bank should be duly up-dated.

(c) Attention should be paid to the selection of personnel for the Inspection Department.

(d) Serious lapses on the part of the staff attached to the Inspection Department should be examined from the point of view of accountability.

(iii) Memorandum of Understanding

Government have released an amount of Rs. 5700 crore to various public sector banks during 1993-1994 as equity contribution to the banks executing with RBI, a document containing performance obligations and commitments required on their part for 1993-94. The main thrust of such obligations/commitments, was on recovery and reduction of NPAs and also to set up recovery cell at H.O. under the charge of a G.M. to monitor the recovery of NPAs by the respective banks. The recovery targets would equally cover the debts of Government/Public Sector Undertakings/Units to banks.

(iv) Discussion with the CMD of banks

After the issue of Annual Financial Inspection Report of a bank its CMD is called for a discussion on the findings of the reports, with the top management of RBI. During the course of discussion, the position of recovery performance *inter-alia* is also discussed and measures to improve the efficiency of recovery performance are reviewed.

(v) Monitoring of sticky accounts.

All the sticky accounts, commented upon in the AFI reports are closely monitored by Reserve Bank of India.

(vi) Dissemination of information on Defaulters

Reserve Bank of India have prepared a scheme to collect and disseminate information on defaulting borrowers and suit filed accounts of Rs. 1 crore and above. The objective of the scheme is to alert banks and financial institutions and to put them on guard against borrowers who have defaulted in repayment of their dues to lending institutions. Reserve Bank of India has also started publishing information on suit filed accounts in a booklet from annually. These booklets are available to all eligible institutions, association of industry and trade, press and general public. Thus, there is a mechanism in place to guard the banks from lending to defaulting borrowers and also proprietors/partners/directors etc. named in the list.

(vii) Recovery Management

The stipulations in this regard are:—

- (1) The bank shall constitute a separate Recovery Cell at the Head Office, which shall be under the charge of one of the General Managers.
- (2) Branch-wise targets shall be fixed for recovery and reduction in NPAs.
- (3) Performance of different branches in recovery shall be monitored at Head Office level on a monthly basis by the Chairman and Managing Director.

- (4) The Board of Directors shall be kept informed about the progress of recovery at quarterly intervals.

Compliance of the above stipulations are monitored by Reserve Bank of India.

(viii) Reduction of NPAs through sustained efforts for recovery and also through compromise/write-off of proposals on merits

Reserve Bank have issued guidelines with the requisite safeguards to banks to make all endeavours to eliminate or reduce the NPAs through persuasion by way of compromises or negotiated settlements with the borrowers to ensure recovery of its dues to the maximum extent possible at minimum expense.

RBI have only laid down the precautions to be observed by banks while considering and writing off bad debts. The systems and procedures for recovery of bad debts are left to be decided by the Managements of individual banks.

RBI have also requested the Indian Banks Association to encourage its member banks to bring an increasing number of loan recovery cases to Lok Adalat Nyayalayas and settle them through fair compromises.

(ix) Setting up of 'Debt Recovery Tribunals'

The Recovery of Debts due to Banks and Financial Institutions Act, 1993 has been enacted for expeditious adjudication and recovery of debts due to banks/financial institutions. Debt Recovery Tribunals have been established at Calcutta, Delhi and Jaipur, etc. under the Act. The Appellate Tribunal has also been established in Bombay. The provisions of this Act shall not apply where the amount of debts due to any bank or financial institution or to a consortium banks or financial institutions is less than ten lakh rupees or such other amount, being not less than one lakh rupees as the Central Government may by notification specify.

(x) Group Approach

RBI have evolved a concept known as 'Group Approach' in consultation with Government of India. The task of identification of the 'Group' is left to the perception bank/financial institutions, the guiding principle being commonality of management and effective control.

(xi) Board for Financial Supervision

A Board of Financial Supervision has been set up to ensure effective supervision over banks and financial institutions.

(xii) Off-site Surveillance

Apart from conducting Annual Financial inspection, RBI have introduced a system of 'off site' surveillance, through periodical returns to be submitted by banks on various aspects, including the position of NPAs.

(xiii) Reconstitution of Boards

The board of banks have been reconstituted by including Chartered Accountants and other professionals.

(xiv) Concurrent Audit

As advised by RBI, all the public sector banks have introduced a system of concurrent audit with a set target of 50% coverage of its total business.

(xv) Audit Committee of Board

All the public sector banks have been advised to reconstitute the 'Audit Committee of Board' organisationally and functionally to, *inter-alia* provide direction and oversee operation of the total audit function in the bank.

(xvi) Computerisation

More functional areas of the banks are being computerised which will enable them to have prompt and effective supervision/ monitoring of borrowal accounts.

(xvii) Modernisation

Six public sector banks have been given a World Bank loan for modernisation technological upgradation and human resources development.

(xviii) Turn Around Strategy

RBI had entrusted the study of weak nationalised banks to specialists for suggesting turn around strategies. The reports have been received and the same are under consideration of RBI in consultation with the concerned banks.

Effective Credit Monitoring Techniques

3.3 According to Indian Banks' Association (IBA) the health of the assets of the banking system largely depends on the overall health of the economy. Any deficiencies in the tempo of economic growth would also affect the health of the banking assets. While we cannot evolve a particular design which could totally do away with bad debts, with affective credit monitoring techniques in place, banks could detect any signs of distress in any loan account in time and take suitable corrective steps.

Appraisal and Supervision

3.4 The following guidelines issued by RBI for realistic assesement of credit requirements also take care of deployment of loan funds:—

(a) Banks are to make their own assessment of credit requirements of borrowers based on a total study of borrowers' business operations, i.e., taking into account the production/processing cycle of the industry as well as the financial and other relevant parameters of the borrowers. Accordingly, banks can decide the levels of holding of each item of inventory as also of receivables, which in their view would represent a reasonable build up of current assets for being supported by bank finance. Thus realistic assessment of maximum permissible bank finance (MPBF) depends on the existence of a system for credit appraisal and monitoring in a bank and efficacy of the same.

(b) Further, banks are required, in terms of extant guidelines, to periodically (at least once in a year) review the MPBF as well as to review operations of sanctioned credit limits (normally equal to MPBF) every quarter through Quar-

terly Information System (QIS) to be furnished by the borrowers. Under the QIS, banks can fix effective operative limits for each month/quarter.

(c) Banks have also been advised to use "cash flow" statements and projections, in addition to "Credit Monitoring Arrangements—Data Base", where statements are fund-based. Proper adoption of the above will enable banks to monitor inflow and outflow of cash and hence be able to detect early any use of funds for purposes other than normal business operations and hence be able to take effective steps to prevent the same.

(d) In accordance with their own lending discipline and the guidelines issued by RBI, banks are required to exercise supervision over deployment/end-use of funds lent, by obtaining stock statements and conducting inspection of the security/finances periodically.

(e) Reserve Bank of India has been advising banks from time to time to ensure end-use of funds lent. However, RBI does not prescribe any detailed guidelines for ensuring end-use of funds, though RBI have, suggested to banks from time to time various ways of ensuring end-use of funds. For illustration, direct payment to supplier of goods is one such way. However, if banks are regular in monitoring the borrowal accounts as well as in analysing various returns required to be submitted by a borrower, the banks should not have any difficulty in ensuring end-use of funds.

3.5 Enquired what measures were being adopted by RBI/banks to ensure effective post-disbursement supervision, the Ministry of Finance Stated as under:—

"NPA occur on account of a combination of factors which included diversion of funds also. During the course of AFI, RBI inspectors examine whether proper post sanction supervision is being exercised by the bank/branches. Deficiencies in this area are brought out in the report for compliance by the banks. Banks are required to ensure proper end-use of funds, proper monitoring of stocks, receivables and other securities."

"Banks have put in place systems for reporting to their top managements whenever advances, particularly large advances, develop any problems affecting recovery. These may cover deficiencies in credit appraisal or any external factors affecting the borrowal unit lapses in monitoring/supervision etc. Notes are again put up to top management at the time of filing suits, or when there are proposals for compromise with borrowers involving waiver of interest and remission of part loan amount."

3.6 IBA'S view is that banks have become extremely careful in selection of assets and are keen in putting in place risk-management practices to reduce incidence of bad debts. Many banks are even considering organisational restructuring with the help of management consultants to install efficient and effective credit monitoring systems, which is essential to ensure streamlined credit supervision. Simultaneously, officers in the banks are given training in risk management products and practices to inculcate in them the techniques of better management of assets.

3.7 During study tour of the Estimates Committee, the State Bank of Hyderabad

informed that the present audit system provided for elaborate guidelines and directions for closely monitoring the sanction of loan with the following salient features:—

- (i) If any serious deviations/violations are observed in sanction of advances, the inspecting official has to send a special report to the Controller and Head Office for corrective action.
- (ii) 54 Branches located in Metropolitan areas and far flung areas are subject to short audit at quarterly intervals to verify the credit management area.
- (iii) Concurrent audit is arranged at branches where the turnover of business exceeds Rs. 30 crore. The concurrent auditor verifies and scrutinises the credit portfolio at the branch in regard to compliance with systems and procedures of credit management on day to day basis.
- (iv) The inspecting official also verifies the following areas:—
 - (a) Proper appraisal/assessment of the credit requirements on reasonable and realistic assumptions.
 - (b) Scrutiny of loan applications for their completeness and correctness.
 - (c) Compilation of credit reports on borrowers and guarantors.
 - (d) Strict compliance with the terms and conditions of sanction accorded by the Zonal Office/Head Office.
 - (e) Submission of compliance certificate to Credit Department, Head Office having complied with all the terms and conditions of sanction.
 - (f) whether discretionary powers by the Branch/Divisional Manager are exercised judiciously and wherever excesses permitted are reported to the Controller.
 - (g) Compliance with Reserve Bank of India norms while assessing the limits.

3.8 Enquired whether there was a system for audit of cases of loan sanction before disbursement with a view to ensuring that the case was processed in accordance with laid down norms/guidelines for a particular type of borrower and that proper care was exercised in credit assessment as well as recovery of bank dues, the Ministry have stated as follows:—

"What is intended by the above question is a system in banks to preclude the incidence of serious errors and fraudulent manipulations. This has been achieved by intensifying the system of concurrent audit in banks particularly public sector banks. The concurrent auditor will necessarily have to see whether the transactions or decisions are within the policy parameters laid down by the Head Office of the bank or by the RBI and they are within the delegated authority. Banks have been given detailed instructions regarding introduction of the system of concurrent audit in October 1993 so as to cover atleast 50% of the business operations. As on date most of the public sector banks have achieved this target and all have covered atleast 50% of the lending operations. With this coverage all extra large branches i.e. those having business of Rs. 100 crore and above, all very large branches

i.e. those having business of Rs. 15 crore and above upto Rs. 100 crore, poorly rated branches and a fair cross section of other branches have been covered by concurrent audit. The coverage is expected to be increased taking into account the cost and benefit. It may be added that concurrent audit will cover, among other things pre-sanction appraisal, post-disbursement supervision and recovery of advances."

3.9 Apart from the system of concurrent audit banks have a system of internal inspection of branches/offices once a year which also looks into the sanction of loans and whether such sanctions were exercised with the discretionary powers of the line functionaries in accordance with the laid down instructions. Banks have been advised to regularly update their manual of instructions for ongoing as well as new activities. Instructions have also been issued by RBI in April, 1994 that banks should set up an Audit Committee of the Board to oversee the internal audit function in banks.

3.10 Enquired whether RBI scrutinised credit appraisal made by the banks, especially whether the norms were followed by them while sanctioning credit limits and high value loans sanctioned by the top executives, the Ministry stated as under:—

"On a random basis RBI inspectors look into the credit appraisal system obtaining in the banks and comment upon deficiencies in assessment of credit requirements, violation of RBI/banking norms, etc.

The credit appraisal deficiencies as brought out in the inspection reports are followed up with the banks for compliance, fixing staff accountability, if any, on the part of erring officials."

3.11 In another note the Ministry informed as under:

"The AFI reports on banks have a comprehensive chapter on credit portfolio assessment which enumerates the several deficiencies that inspectors may have noticed in banks' credit appraisal and credit supervision systems. Besides, comments on top 50 NPAs are made available to Chairman/Chief Executive Officer separately and these are to be placed before the Board/Audit Committee alongwith the AFI Report.

During the past two years inspectors from Department of Supervision (DOS) were asked to look into the top 10 cases of loan write-off/ compromise proposals in banks. They were asked to clearly bring out whether banks showed unwarranted concessions or relaxations in cases of wilful defaults, whether banks took every measure possible to safeguard banks' interests, etc.

Thus, RBI does look into the cases of NPAs and write-offs/ compromise proposals every year during the inspection of banks and the outcome of such studies are duly taken up with the banks. In the case of public sector banks, the AFI reports are also forwarded to Government of India."

3.12 In regard to remedial measures taken by banks to prevent/reduce to minimum the diversion of funds by borrowers, the Ministry of Finance have stated as follows:—

"NPAs arise on account of a combination of various factors which also includes on some occasions diversion of funds. It is extremely difficult to

quantify which portion of the NPA is on account of diversion of funds. However, the Department of Supervision in RBI during the course of its inspection of commercial banks found certain instances of diversion of funds by borrowers to other than the purposes for which the loans are sanctioned and in these cases the concerned banks have been cautioned against cases of misapplication of funds.

Banks have been advised *vide* RBI circular DBOD No. BP.BC. 60/21.01.23/92 dated 21.12.1992 to ensure that there is no diversion of working capital finance. RBI's recent scrutiny of certain large borrowal accounts conducted in a few banks has revealed some diversion of bank finance for investment in finance companies, associate companies/subsidiaries, inter-corporate deposits, etc.

RBI has recently advised banks that in future if a borrower is found to have diverted finance granted for working capital purposes to other activities, banks must recall the amounts so diverted. In addition, banks should charge penal interest of not less than 2 per cent over and above the lending rate on the amounts, where borrowers fail to repay the amounts diverted from cash credit accounts for other uses than for which working capital limits have been allowed."

3.13 In regard to end-use of funds lent, the Deputy Governor, RBI during evidence admitted that "the end-use in case of large borrowers is generally not ensured. We have been seized of this problem and have given very strong instructions to the banks that in case of large borrowers, they must ensure the end-use. We have also sent instructions relating to end-use of large credits. After the instructions are sent the banks are now very careful about large advances and end-use thereof."

3.14 Enquired whether officers in the public sector banks were well equipped with sufficient technical expertise to scrutinise applications for all categories of loans and advances, the Ministry have stated as follows:—

"In order to train the officials for proper scrutiny of applications for all categories of loans and advances, almost all public sector banks have their own training establishments where members of their staff are trained/equipped with techniques of appraisal and post-sanction supervision and follow-up of advances.

Besides, banks also depute their officers to the Bankers Training College, College of Agricultural Banking of RBI and the National Institute of Bank Management to attend specific training programmes slated for pre-sanction appraisal techniques and post-sanction supervision and follow-up of advances."

Prudential Norms

3.15 According to the Ministry of Finance the non-performing assets, including sticky advances, were in existence in all the banks even before 1992-93. However, in the absence of a standardised system for identifying such assets as non-performing assets (NPAs), they were not fully reflected in their balance-sheets until 1991-92. With the introduction of prudential norms for asset classification, income recognition

and provisioning as also for accounting standards, the NPAs of the banks accumulated over the period but not fully reflected earlier started getting so reflected in their balance sheets for 1992-93 and 1993-94.

In the wake of financial sector reforms, and following the introduction of income recognition, assets classification and capital adequacy norms, banks are becoming increasingly sensitive to credit risks and there is a growing awareness of the need to keep NPAs at the minimum.

As per the prudential norms advised by RBI, banks should not take to income interest not realised. The NPAs of the banks do not therefore generate income for the bank. Besides, the banks are also required to make provisions out of their operating profits towards NPAs which varies from 10% in the case of sub-standard NPAs to 100% in the case of loss NPAs. Hence, profitability of banks largely depends on the management of NPAs. Banks have realised that higher level of NPAs erode their profitability and therefore address themselves to the reduction of NPAs through well defined policies and strategies.

3.16 The Committee enquired how much had been achieved by implementation of prudential norms. In reply, the Finance Secretary stated as follows:—

“After implementation of the new norms it was discovered that there were some high levels of non-performing assets in the banking sector. As a result of the application of norms, as a result of proper management, as a result of better supervision, we have been able to reduce the non-performing assets in the system..... I do not say a perfect change has been brought up but a much better situation exists than we had in 1992.”

3.17 Enquired further whether there was transparency and accountability in the system than in the pre-1992 system, the Finance Secretary replied:—

“Yes, it is there. We are also trying to improve the accountability and transparency. That is one of the given objectives of these changes.”

3.18 In response to a query, Finance Secretary clarified:—

“Today we have a system where the bank managements have a very strong incentive to run the bank in a manner in which the percentage of non-performing assets is reduced. It should be reduced in the small loans, it should be reduced in the loans of weaker sections and also big loans. It is certainly true that a large part of non-performing assets comes from the medium and large industry also. There is no presumption here that big loans do not generate non-performing assets. One of the major gains of this system is that it shows up whether the borrower, small or big, is actually delivering payment of interest and re-payment as scheduled or not.”

3.19 In a subsequent post-evidence note the Ministry have stated as follows:—

“The total NPAs of PSBs which was about Rs. 41,041 crore as on 31 March, 1994 had gone up marginally to Rs. 41,660 crore as on 31 March, 1996, while during the same period the loans and advances granted by PSBs increased by about Rs. 61,000 crore. The percentage of NPA to total advances which was 24.78% as on 31 March, 1994 has come down to 18.01% as on

31 March, 1996. The incidence of NPAs among credit facilities sanctioned since 1993 also is between 3 to 4% for the public sector banks evidencing greater awareness of the need to reduce addition of NPAs.”

Memorandum of Understanding

3.20 During MoU discussions with CMDs of nationalised banks held annually the performance of the banks in various areas including reduction of NPAs is reviewed by RBI and banks with higher level of NPAs are instructed to bring the level down. Commitments made by banks to bring the level of NPAs to certain agreed levels are indicative targets towards which the banks strive to progress.

3.21 The data pertaining to commitments made by the nationalised banks in respect of NPAs vis-a-viz actual NPAs for the last years are given below:—

(Rs. in crores)

	1994-95		1995-96	
	Targets	Actual	Targets	Actual
1. Allahabad Bank	.835.00	1235.11	.1129.00	1255.00
2. Andhra Bank	.342.00	.377.65	.315.00	.332.20
3. Bank of Baroda	2382.00	2689.68	.2500.00	2840.09
4. Bank of India	2968.00	*2961.00	.2395.00	2434.00
5. Bank of Maharashtra	725.00	734.59	584.59	694.26
6. Canara Bank	1576.67	*1523.00	2066.83	*2647.32
7. Central Bank of India	2153.00	*2154.00	2175.00	2420.00
8. Corporation Bank	90.00	260.01	285.00	251.83
9. Dena Bank	450.00	557.00	475.00	541.00
10. Indian Bank	1815.00	2102.00	2967.00	3140.00
11. Indian Overseas Bank	2017.00	*2001.40	1811.00	*2020.00
12. Oriental Bank of Commerce	185.00	221.90	231.00	271.30
13. Punjab National Bank	1450.00	2033.00	1903.00	2518.00
14. Punjab & Sind Bank	577.28	*619.32	633.15	*957.53
15. Syndicate bank	1211.25	1452.97	1342.37	1311.75
16. Union Bank of India	488.00	695.95	600.00	945.86
17. United Bank of India	977.00	1310.00	1105.00	1401.00
18. UCO Bank	1562.00	*1745.60	1265.00	*1839.52
19. Vijaya Bank	440.00	439.40	401.00	545.38

*As per the figures furnished by the Ministry of Finance regarding NPAs (gross) of the Public Sector Banks during the last five years vide O.M. No. 19/24/94-BOA dated 18.11.1997.

Dissemination of Information on Defaulters

3.22 In pursuance of the FM's announcement in his Budget Speech in February, 1984, RBI introduced a scheme to collect and disseminate information on the defaulters in order to alert the banks and financial institutions and caution them so that the banks and financial institutions can be better informed while taking credit decisions. The information so collected and circulated by the RBI pertains to borrowal accounts whose outstandings (both in funded and nonfunded facilities) to banks/financial institutions aggregate Rs. 1 crore and above and whose accounts have been classified by banks/FIs as 'doubtful' or 'loss'. Under the current secrecy laws the names of the defaulting borrowers cannot be disclosed.

However, Reserve Bank of India publishes yearly a list of borrowers with aggregate out standing of Rs. 1 crore and above as on 31st March against whom suits have been filed. Based on the information furnished by banks and financial institutions, RBI have published the list of borrowal accounts against which banks and financial institutions have filed suits for recovery of funds (position as on 31st March, 1995)

While circulating the list of persons associated with such companies/firms, RBI have instructed the banks FIs that they may make use of the information while considering on merits, the request for new or additional credit limits by the defaulting borrowing units and also proprietors/partners/directors, etc. named in the list, either in their own names or in the names of other units with which they are associated. It may be mentioned that advances falling under sub-standard category are not being collected by RBI for the purpose of this scheme.

3.23 Instead of cautioning the banks about the defaulters, the Committee enquired why these defaulters should not be debarred from taking loans from other banks and FIs. Explaining the views of the Government in this regard, the Ministry have stated as follow:—

"Lists of defaulters circulated by RBI are intended to provide pooled information as well as serve as a guide to banks and Financial Institutions for exercising caution against those whose names were figuring therein. As the credit decisions are purely business decisions, it is left to the discretion of each bank/FI to take its own decision. It may be mentioned that each bank works under the overall guidance of its Board of Directors which, under instructions from RBI have formulated, *inter alia*, the lending policy for the concerned bank. Once the accounts are classified as 'doubtful' or 'loss' or where suits are filed banks/FIs themselves are cautious while sanctioning fresh additional limits to the defaulters/Group companies excepting in the case of sick units under Rehabilitation Programme. Further, once a borrower is a defaulter to one bank, it is difficult for that borrower to obtain loan from other banks and FIs as those banks/FIs also make detailed enquiries about the borrower before sanctioning advances and take credit decision based on their commercial judgement. As such, there is no ground for RBI/Government to issue a general direction to banks/FIs debaring financing of the defaulters."

3.24 The Committee during evidence referred to the recommendation of the Joint Parliamentary Committee for review of the secrecy clause in the Banking Regulation Act, 1949 and enquired whether for classification of assets, a new format of balance Sheet without necessary provision of transparency in the financial system with removal of secrecy clause would be helpful in any way. In response the Deputy Governor, RBI stated as follows:—

"Section 45 E (2) of the RBI Act says that disclosures can be made in very specific circumstances. They have mentioned the circumstances. Barring that, we have been examining also the practice in other countries and we have to abide by the regulations which are prevalent in the Central Banks of other countries with regard to secrecy clauses."

3.25 The Committee pointed out that in the course of inspection, RBI discovers that a borrower had taken money from a group of banks and siphoned off the money. As a result of that, the banks had suffered, so cases had been initiated. The Committee enquired whether there was any difficulty to disclose details of the defaulter to make others aware of people dealing/connected with or related to that borrower. The representative of RBI stated as under:—

"As per the legal provision, as they stand now, we cannot disclose the names of defaulters unless a suit is filed and it becomes public knowledge."

3.26 Clarifying the position further, the Finance Secretary stated as follows:—

"An account holder may be in arrears or in default but it does not mean that this person is guilty. In any business practice, the account holder may go into default of payment of interest. It is a correct thing to classify such an account as default account. It is not a correct thing to immediately reveal to the rest of the world that he has not paid the interest. It is a grey area. It is an area where the bank should put pressure on the borrower that he must pay the dues. Definitely, the bank should not lend to such a borrower. But at the same time it is not a think to publish to the rest of the world. This is the position. We are aware of the concern within the banking system as also in the public. I am only trying to explain what the law says. When the bank finally says that so and so has gone beyond the pale and it is filing a suit to recover the money, at that point, there is no secrecy because the bank is going to the court and those names can be revealed. The concern of some of the Hon'ble Members was that big people who are defaulters should not be able to get loans. It is very valid point. In the banking system, we have introduced so many systems to try and proceed against them. First is, names of defaulters are being circulated to banks. So, the banks know what is the credit performance and credit behaviour of different borrowers. This is designed to prevent banks from lending money."

3.27 The Finance Secretary added:

"Many units in this country are sick. I am sure, Hon'ble Members also want banks to try and help sick units recover from their sickness. We frequently receive suggestions that banks should not stop helping units when they go temporarily in difficulty. It is a controversial area of judgment where the line is drawn. There are always rules to disagree. I would really

request the Committee to consider and hopefully to agree with our assessment that merely because there is a default in terminology of the banking supervision, that is not a reason for revealing the facts."

3.28 In a subsequent note, the Ministry of Finance have submitted as under:—

"As per the recommendation of Joint Parliamentary Committee, provisions regarding secrecy laws were examined. Keeping in view the fact that the relationship of a bank and its customer is one of utmost trust and it is a well established concept prevailing all over the world, it is not considered appropriate to delete these provisions."

Group Approach

3.29 Companies belonging to prosperous industrial houses are turning sick but promoters are not. They just go on to new projects. It had been suggested that in such cases banks should stop lending to all companies, firms and business houses controlled by such industrial houses in whose companies or firms loans and advances had become NPAs. When asked to give considered views on the suggestion in all its ramifications, the Ministry of Finance and Indian Bank' Association stated as follows:

Ministry of Finance (Department of Economic Affairs)

"Total stoppage of credit flow to Units or Industrial Houses on account of NPA which may be due to factors beyond the control of borrowers, may have far reaching adverse effects on the industrial activities of the country. Such an extreme measure will deprive good and healthy companies belonging to various industrial houses, of the necessary funds to run their units resulting in production loss and sickness. In order to discipline such defaulting houses and at the same time not to disturb the on-going industrial activities, RBI have evolved the concept of Group Approach in consultation with Government of India, which envisages restrictive-cum-selective flow of additional credit to groups or borrowers, committing wilful defaults and/or not co-operating with the banks/FIs in setting their dues for expansion/diversification/modernisation as well as for new projects Under this concept the legitimate need-based working capital requirements of existing units of recalcitrant groups are not to be disturbed on account of wilful defaults of one or more companies of the groups concerned. The task of identification of a Group is left to the perception of banks/FIs, the guiding principle being commonalty of management and effective control. The concept is only expected to operate as a tool to put indirect pressure on the erring promoters of groups/Industrial Houses to cooperate with financing banks/FIs in regularising defaulting accounts by moderating flow of credit for further expansion of existing companies and those of new units. Further, restriction/moderation of credit flow to various companies belonging to defaulting groups come into picture only when group approach is applied/invoked by the banks/FIs within the stipulated guidelines of RBI. This concept if applied effectively will go a long way in disciplining erring groups.

Indian Banks' Association

"The Reserve Bank of India has publishing and circulating to a limited

extent, the list of top defaulters of banks as a deterrent for the defaulters and their associate companies to obtain fresh loans from banks. In addition to this, banks also have exposure limits to individual corporate and Group. The risk management practice procedures that are being put in place by banks would greatly discourage and credit flows to accounts which have shown disappointing performance either on its own or through any of its associates. Banks are of the view not to entertain any fresh loans if the existing loans of the company are impaired."

Adverse Comments against Top Management

3.30 During the course of Annual Financial Inspection by RBI, the performance of top management of the bank is looked into and adverse features, if any, commented in the Inspection Report. The Committee enquired in how many banks during the last 3 years the inspection by RBI invited adverse comments against top management of the banks in respect of sanction of loans and recovery of debts and whether such adverse comments contained in the Annual Finance Inspection of the Banks, were reviewed by the Banking Division in the Ministry of Finance. In reply, the Ministry stated as follows:—

"The AFI reports of RBI pertaining to the last three years, viz. 1991-92, 1992-93 and 1993-94, contain certain adverse comments against the top management (i.e. Executive Director/Chairman and Managing Director and above) of 11 banks in the area of sanction of loans/recovery of debts the details of which are indicated, in brief, in the Annexure.

Following AFI and during the course of discussion held by Deputy Governor/ Executive Director of RBI with top management of individual banks, the deficiencies contained in the AFI reports, including those indicated in the proceeding sub-paragraph(s), are brought to the notice of the latter who are also advised to ensure that such lapses/deficiencies do not recur of late, specific time frame is also prescribed for individual banks for rectification of deficiencies brought out in the AFI reports. During the course of subsequent AFI, the RBI examines *see, inter alia* whether the said deficiencies have been rectified by the concerned banks.

Now, the important features of AFIs are also being reviewed by the Ministry of Finance (Banking Division)."

3.31 The RBI in their Annual Financial Inspection Reports had made adverse comments against the CMD of the Bank of India for the three consecutive years. The Committee enquired why the Ministry of Finance was sitting quiet on them and why no action had been taken against CMD. Explaining the position, Deputy Governor, RBI stated as followed:

"Whenever the Reserve Bank inspects the banks they come across certain discrepancies or aberrations in the functioning of the Chairman and other functionaries. They point out those things in their inspection reports. Copies of those reports are sent to the Government also. Generally, if there is a very serious issue involved, then it is a different matter. Otherwise generally we advise the Government that he should be issued a letter of displeasure."

Annexure (Para 3.30)

Statement regarding Adverse comments against top management of banks contained in the Annual Financial Inspection (AFI) Reports of RBI

Sr. No.	Name of the bank	AFI report for the year	Functionary etc. of the bank against whom adverse comments made	Details of adverse comments		
				Number of cases covered by the comments	Adverse comments, in brief	
1	2	3	4	5	6	
1.	State Bank of India	1993-94	Executive Committee of the Central Board	1	Ad hoc limits (Rs. 4.50 crore) sanctioned in July 1993 to a party whose borrower account was already irregular since 1987.	
2.	Bank of Baroda	1992-93	Former CMD (Dr. A.C. Shah)	Few (exact number not available)	Sanctioned credit facilities far in excess of his lending powers (Rs. 10 crores for fund based and Rs. 5.00 crores for non-fund based facilities)	
		-do-	Board of Directors	-do-	The above sanctions were ratified by the Board without ascertaining the reasons therefor.	
3.	Bank of India	1991-92	C.M.D.	1	An LC limit (Rs. 0.93 crore) was sanctioned by CMD in May 1991 despite the fact that (i) the borrower company had not raised additional capital as undertaken, (ii) the EPC a/c was overdue for Rs. 1.41 crore, (iii) the borrower had defaulted in honouring L.C./fulfilling guarantee stipulations on earlier occasions. Eventually, the account turned into sticky.	

1	2	3	4	5	6
		1992-93	C.M.D.	1	The enhancement granted by the CMD to a company in working capital (from Rs. 75 lakhs to Rs. 1.38 crore) appeared to be for repayment of overdues in its term loan account.
		1993-94	C.M.D.	1	With a view not to losing leadership of a consortium, the CMD has sanctioned an ad hoc limit of Rs. 14 crore to a party whose audited balance sheets, CMA data etc. were not available with the bank.
4.	Bank of Maharashtra	1992-93	C.M.D.	2	In one case, a project loan (Rs. 1.50 crore) was sanctioned by the CMD to a company for development of real estate, without ascertaining whether the borrower company would be in a position to execute the project work. The company had a low capital base and did not submit the proposed plan duly approved by competent authorities. In the other case (the same party), cash credit/guarantee limit was enhanced from Rs. 0.05 crore/Rs. 0.45 crore to Rs. 0.08 crore/Rs. 0.75 crore even though operations in the account were not satisfactory and certain clarifications, as sought for, had not been received from the branch.
5.	Canara Bank	1991-92	C.M.D.	—	Most of the advances sanctioned at London branch with the approval of CMD turned into sticky.

1993-94	C.M.D.	34	While 33 credit proposals falling under the powers of Management Committee/Board were sanctioned by the CMD, one proposal was sanctioned by him without obtaining 'No objection certificate'/opinion letters from the existing bankers.
6. Canara Bank of India	C.M.D.	12	Fund and non-fund based credit facilities (regular as also ad hoc) involving more than Rs. 60.00 crore were sanctioned/confirmed/enhanced by the CMD—some of them orally/telephonically—in excess of his discretionary powers/without accessing the need based requirement or taking into account the borrowers' financial position/post performance, fulfilment or otherwise of stipulations, submission of financial statements, etc. resulting in adverse comments by the Board in certain cases.
1992-93	C.M.D.	9	Fund/non-fund based facilities, regular as also ad-hoc—some of which orally—involving more than Rs. 45.00 crore were sanctioned/confirmed/enhanced/terms of sanction waived by the then CMD in contravention of the Board's instructions/without getting them ratified by the Board/without having appraisal of the proposal or taking into account the status of the existing accounts/observing normal lending discipline and safeguards.

1	2	3	4	5	6
1992-93	Board of Directors	1			A bridge loan (Rs. 1.00 crore) was sanctioned to a sugar factory without proper credit appraisal.
-do-	Management Committee	4			In the case of the above bridge loan, the condition for release of the amount was waived by the Committee. In the other two instances, a short term additional loan (Rs. 5.00 crore) sanctioned and subsequently enhanced (Rs. 8.90 crore) by the CMD without appraisal of the proposal was ratified by the Committee. In the fourth instance, a proposal for grant of an enhanced working capital limit was sanctioned by the Committee despite adverse features in regard to eligibility of the borrower, compliance with the terms of existing sanction, financial position of the borrower etc.
7. Indian Bank	C.M.D.	1991-92		11	Credit facilities (Rs. 85.46 crore) of various types were sanctioned/confirmed by the CMD without obtaining essential information/taking into account the necessity, adverse financial features, repaying capacity, status of the earlier advance and other relevant factors. Further certain sanctions/confirmations were in excess of his lending powers/in violation of the Board's instructions/lending discipline/RBI instructions etc.

1992-93	C.M.D.	25	Advances (Rs. 158.75 crore) were sanctioned before receipt of applications/in haste to accommodate parties/for development of real estates to parties not in that business etc. While many of the advances sanctioned in this manner turned into sticky, in a few cases, the action of the CMD was not ratified by the Board.
1993-94	C.M.D.	4	Credit facilities (Rs. 15.74 crore) were sanctioned by CMD without obtaining collateral/ conducting appraisal or viability study/even after refinance was declined by Exim Bank.
1991-92	C.M.D.	40	Limits were sanctioned by the CMD in excess of his powers, though the same were subsequently ratified by the Board.
1993-94	C.M.D.	3	In one case, the proposal for waiver/write off of the bank's dues earlier rejected by the Board was cleared by the CMD under his enhanced powers of the other two cases, in one case, 'in principle' sanction of advance for Rs. 25 crore was given by the CMD without getting the proposal assessed by the bank/consortium. In the other case, fund-based limits were enhanced from Rs. 2.80 crore to Rs. 6.00 crore by the CMD as against the MPBF at Rs. 1.95 crore and despite inflated projections for receivables and 90% of sales being to sister concerns.

1	2	3	4	5	6
10.	UCO Bank	1991-92	C.M.D.	8	In all the cases (Rs. 117.86 crore), oral sanctions were given by the CMD.
		1992-93	-do-	2	In one case, oral sanction (Rs. 10 crore) was given by CMD while in the other case, limit (Rs. 1 crore) was enhanced by him without having the appraisal done.
11.	Vijaya Bank	1991-92	C.M.D.	4	In one case, a bill discounting limit (Rs. 5.00 crore) was sanctioned by CMD in violation of prudential norms and the Board's decision in that regard and this invited Board's displeasure. In another case, a limit (Rs. 2.15 crore) falling under the powers of the Board was sanctioned by the CMD. In the third case, a bank guarantee (Rs. 1.02 crore) was issued on behalf of a company against the guarantee limit sanctioned to a different company and without having the details of the project for which the guarantee was required. In the fourth case, a guarantee (Rs. 2.35 crore) was sanctioned by CMD over telephone although the party had no regular borrowing arrangements with the bank, its financial position was far from satisfactory and credit reports from its bankers were not obtained and this invited the Board's displeasure.

Delegation of Financial Powers

3.32 The delegation of financial powers at different levels of hierarchy in banks is not uniform but differs from bank to bank.

The delegation of financial (lending) powers is not uniform because of various factors such as organisational structure, historical background, size, class of clientele, culture, main area of operation, resource base, the level of expertise of the delegates etc. of an individual bank. The lending powers at different levels right from the officials at the branch to functionaries at top level are fixed by individual banks taking into account these factors.

3.33 When asked whether delegation of credit sanctioning powers is properly exercised while taking credit decision, the Ministry of Finance stated as follows:—

"Delegation of credit sanctioning powers are, by and large, properly utilised by the sanctioning authorities of banks. In a few cases, however, sanctioning authorities are observed to be exceeding their delegated powers; in such cases the loans/advances are required to be ratified thereafter by the proper sanctioning authority. Where frequent transgressions are found to be taking place and/or transgressions are not subsequently ratified by the proper sanctioning authority, we consider the bank's management control as poor and impress upon banks to rectify the position. Further, the banks have been advised *inter alia* to scrupulously adhere to the following aspects:—

- that there was no laxity in the conduct and post-disbursement supervision of the advances; and
- that there was no act of commission or omission on the part of the staff leading to the debt proving irrecoverable."

3.34 On being enquired about the instructions to the banks issued by RBI and the time limit prescribed for ratification of sanction by the proper sanctioning authority, the Ministry have explained as follows:

"In its efforts towards better regulation of banking industry through transparency and prudence, RBI have advised banks in the last couple of years to have policy documents on the important areas of its activities, including loan policy. Keeping this in view, the credit sanctioning powers of bank functionaries are fixed and revised from time to time by individual bank boards. The instructions issued by the banks in this regard also lay down that transgression of the delegated powers, if exercised in emergencies, should be got ratified by the competent authority within the prescribed time limit which varies from bank to bank. While the present reporting system does not require banks to report the case of transgression of powers to RBI, there may be some instances of transgression in all the banks mainly by way of ad-hoc sanctions, temporary overdrafts, excess drawals, etc. to business/manufacturing concerns for meeting their urgent requirements."

3.35 Enquired as to how the cases of transgression come to the notice of the management/Government, the Ministry in a reply stated that:

"The cases of transgression come to the notice of the management/RBI through periodical returns, requests for ratification of transgression, internal audit/inspection, concurrent/statutory audit, RBI inspection, etc."

3.36 When asked whether there had been instances of accounts turning into NPAs on account of transgression of delegated powers and whether such cases had ever been reported in the AFI of banks, the Ministry stated as under:

"Transgression of delegated powers may be only one of the contributing factors for certain accounts turning into NPAs. While no separate record is maintained by banks in regard to advances turning into NPAs on account of transgression of delegated powers, along with other reasons, if any, the number of instances of accounts turning into NPAs for this reason is negligible."

"During the course of Annual Financial Inspections, the aspects relating to exercise/transgression of lending power is looked into by the inspectors on a sample basis. On the basis of this random scrutiny, instances of transgression of lending powers which might have led to the accounts becoming NPAs are also commented by the inspectors and the findings are communicated to the banks and followed up for compliance."

3.37 On being asked whether there was any system for initiating action against officers who sanctioned credit exceeding their delegated powers, the Ministry of Finance stated:

"As regards the action against the functionaries who commit such excess, the intensity of punishment varies depending upon the amount of excess, frequency of such excesses as also existence of malafide intention on the part of the official concerned."

3.38 The Deputy Governor, RBI during evidence in response to a query replied:

"There was a judgement of the Supreme Court in one case wherein, in the case of Central Bank of India, the hon. Supreme Court passed orders and strictures against the Branch Manager that he had no right to exceed his discretionary powers and disburse and create his own little empire..... We studied that judgement and we advised the banks that a management culture has got to be developed within the bank where one should know how to work within the framework. Supposing a Branch Manager or a Regional Manager or a Deputy General Manager or a General Manager or an Executive Director has been given certain powers, he must work within that framework and if the bank feels that they want to give him more powers, nobody stops them. But the only thing we said was that when the lines were drawn, those lines should be honoured..... But the idea and the intentions are that they should work within the framework."

Accountability of Staff

3.39 There are specific instructions from RBI to banks that they should invariably go into the question of staff lapses or staff accountability, before considering any write off or negotiated settlement. Banks are also required to look into staff lapses. Whenever a borrowal accounts status changes for the worse *i.e.* from satisfactory to irregular or from the standard to sub-standard (*i.e.* the erstwhile health code 1 to 2).

Banks do take punitive action against their staff, when they find evidence that the bank suffered significant losses in the credit portfolio because of the acts of omission/commission by any official.

3.40 On the basis of the findings of its inspection of banks RBI advises banks wherever necessary to fix staff accountability for lapses/negligence in sanction/recovery of loans/advances.

3.41 According to the Ministry of Finance, RBI have specifically called for the requisite information and the information received so from 16 banks is furnished in tabular form in regard to the action taken against officials found responsible for advances resulting into bad debts and for laxity in post-disbursement supervision of advances causing bad debts in the following statements I and II:

Statement I

Sl. No.	Name of Bank	Year	No. of officials found responsible for advances turning into	No. of the officials indicated in col. (4)		
				No. of officials prosecuted in court of Law	No. of officials punished	No. of officials dismissed
1	2	3	4	5	6	7
1.	State Bank of Indore	1992-93	10	Nil	10	—
		1993-94	20	Nil	20	—
		1994-95	19	Nil	19	—
2.	State Bank of Bikaner & Jaipur	1992-93	20	—	15	1
		1993-94	14	—	09	—
		1994-95	25	—	12	—
3.	Oriental Bank of Commerce	1992-93	08	0	07	1
		1993-94	08	2	06	—
		1994-95	06	1	05	—
4.	Allahabad Bank	1992-93	20	—	20	1
		1993-94	16	—	16	—
		1994-95	25	—	25	—
5.	Canara Bank	1992-93	170	02	168	04
		1993-94	170	02	143	02
		1994-95	134	—	094	01
6.	Indian Overseas Bank	1992-93	30	02	20	01
		1993-94	53	—	25	—
		1994-95	54	—	27	—
7.	United Bank of India	1992-93	13	—	3(4)*	01
		1993-94	39	2	11(24)*	02
		1994-95	24	—	-(6)*	—
8.	Bank of Baroda	1992-93	15	2	3*	—
		1993-94	37	1	7	—
		1994-95	38	2	1	—
9.	Bank of Maharashtra	1992-93	27	1	18	—
		1993-94	20	0	16	—
		1994-95	33	1	17	—
10.	Andhra Bank	1992-93	18	—	17	1
		1993-94	44	—	43	1
11.	State Bank of Saurashtra	1992-93	05	—	03	—
		1993-94	07	—	04	—
		1994-95	12	2	07	—
12.	State Bank of Hyderabad	1992-93	24	—	24	1
		1993-94	17	—	13	—
		1994-95	11	—	04	1

1	2	3	4	5	6	7
13.	State Bank of Mysore	1992-93	—	—	—	—
		1993-94	—	—	—	—
		1994-95	—	—	—	—
14.	Corporation Bank	1992-93	2	—	2	1
		1993-94	19	—	19	3
		1994-95	2	—	2	—
15.	State Bank of Patiala	1992-93	4	—	3	1 (Removed)
		1993-94	19	—	15	1
		1994-95	14	—	14	—
16.	Indian Bank	1992-93	62	10	58	5*
		1993-94	70	7	64	—*
		1994-95	63	5	14	—*

*Figures in brackets indicate disciplinary/departmental proceedings in progress.

*For the remaining cases, the Trial/Disciplinary proceedings is in progress.

Statement—II

Sl. No.	Name of Bank	Year	No. of cases of laxity in post-disbursement supervision of advances resulting in bad debts	No. of cases where departmental enquiries conducted	No. of officials	Action taken	
						Major	Minor
1	2	3	4	5	6	7	8
1.	Canara Bank	1992-93	93	93	93	52	41
		1993-94	91	91	91	49	33
		1994-95	86	86	86	16	45
Disciplinary proceedings in progress							
2.	Indian Overseas Bank	1992-93	25	25	14	8	6
		1993-94	35	35	24	12	12
		1994-95	45	45	48	23	25
3.	Allahabad Bank	1992-93	2	2	2	2	—
		1993-94	4	3	4	3	1
		1994-95	5	4	5	3	2
4.	Oriental Bank of Commerce	1992-93	8	1	7	2	5
		1993-94	8	—	3	—	6
		1994-95	6	—	5	1	4
5.	State Bank of Bikaner & Jaipur	1992-93	8	8	7	2	6
		1993-94	5	5	4	2	2
		1994-95	5	5	4	3	1
6.	State Bank of Indore	1992-93	5	3	8	1	7
		1993-94	12	—	12	2	10
		1994-95	10	5	10	5	5
7.	Bank of Baroda	1992-93	15	15	3	2	1
		1993-94	37	37	7	6	1
		1994-95	38	38	1	1	—
8.	Bank of Maharashtra	1992-93	16	16	10	2	8
		1993-94	15	15	12	1	11
		1994-95	23	23	10	1	9
9.	Andhra Bank	1992-93	10	9	18	4	14
		1993-94	44	19	44	9	35
		1994-95	20	14	20	5	15
10.	State Bank of Saurashtra	1992-93	5	5	3	3	—
		1993-94	7	7	4	3	—
		1994-95	12	12	7	5	2
11.	United Bank of India	1992-93	2	1*	—	—	—
		1993-94	5	4*	—	—	—
		1994-95	5	3*	—	—	—
12.	State Bank of Hyderabad	1992-93	3	3	3	3	—
		1993-94	3	3	3	—	1*
		1994-95	3	3	3	1**	—
13.	Corporation Bank	1992-93	1	1	1	—	1
		1993-94	14	14	14	8	6
		1994-95	2	2	2	1	1
14.	State Bank of Patiala	1992-93	4	4	3	2	1
		1993-94	19	19	15	3	12
		1994-95	14	14	14	6	8

*Disciplinary proceedings in progress.

**1. Major cases of 1993-94 are still pending for disposal.

**2. Major cases of 1994-95 are still pending for disposal.

1	2	3	4	5	6	7	8
15.	Indian Bank	1992-93	52	52	52	14	38
		1993-94	63	63	63	13	50
		1994-95	58	58	58	1*	13*
16.	State Bank of Mysore	1992-93	11	11	10	8	2
		1993-94	22	22	7	5	2
		1994-95	22	22	5	2	3

*For the remaining cases, Departmental proceedings are in progress.

3.42 The Committee pointed out that in United Bank of India, in case of four out of 13 officials pertaining to 1992-93 and 24 out of 39 officials pertaining to 1993-94, disciplinary/departmental proceedings were still in progress and enquired why there was delay in finalising the disciplinary/departmental proceedings and when these proceedings expected to be finalised. In reply, the Ministry stated as follows:

"The present stage of finalisation of the disciplinary/departmental proceedings of the pending cases, as reported by United Bank of India, is as under:

- (a) Out of 4 cases pertaining to the year 1992-93, 3 cases have already been disposed of. The remaining one case pertaining to the said period is at the concluding stage and is likely to be disposed of shortly. The delay in disposing this case is due to the fact that the competent authority is required to pursue as many as 3,455 management documents which are in the process of being collected from a remote branch located in the State of Assam.
- (b) Out of 24 cases relating to the period 1993-94, 5 cases have already been disposed of and in respect of 9 cases, the same are at the final stage of disposal. Out of the remaining 10 cases pertaining to the year 1993-94, in respect of 3 cases, Enquiry Officers have submitted reports to the Disciplinary Authority and the same are under examination. The enquiries in respect of the remaining 7 cases are in progress and constant follow-up is being made by the appropriate department of the bank for early conclusion of those enquiries."

3.43 Enquired what follow up action was taken by RBI/Government for recurring lapses on accounts becoming N&As, the Ministry of Finance stated as follows:

"The banks are required to examine staff accountability aspect whenever there is a deterioration in the asset quality. In the cases of recurring lapses/accounts becoming NPAs, which come to the notice of RBI, it impresses upon banks to fix staff accountability, if any.

Recently RBI have advised all banks to review and fix staff accountability in respect of 300 NPAs and place a review note before their Boards and advise RBI. Besides, banks have been advised to frame a policy on staff accountability with the approval of their Boards."

Action against Retired Officers

3.44 During study tour, the Central Bank of India pointed out:

The rules do not provide to initiate action against retired officers. In case any irregularities have been noticed before release of terminal benefits and in case the disciplinary proceedings were started before the date of retirement, necessary actions continue.

However, recently, the Government has revised the guidelines for taking action against the retired officers, which reads as follows:

No departmental or judicial proceedings shall be instituted after the employee's retirement in respect of the acts/cause of action/fraud which took place more than 4 years before such institutions.

3.45 The Committee pointed out that if an offence was detected after retirement no punishment was given to the officers. The Committee enquired whether Government would consider attachment of property obviously the wealth accumulated on account of malpractice or corrupt practices on the part of concerned officers, as a result of which the bank suffered. In response the Deputy Governor stated as follows:—

"In case of those officers who already retired and the irregularity has come to notice subsequently and it becomes a criminal offence, then we always advise the bank to go to CBI."

3.46 The Finance Secretary added:

"If it is something criminal, it would not be appropriate to take legal action before the establishment of guilt. It is not something that can be done administratively. The present position is that a bank officer is liable, just as a Government officer, to criminal action. It does not stop just because he retires. If he has committed a mistake in good faith and there is no presumption of *mala fide* intention, and if it is only a question of incompetence or error, then the question of attachment of property normally does not come in. There is no question of misuse of power involved there.

If the truth is that he has misused his powers and accumulated wealth, it is quite clearly a criminal matter. If it is a criminal matter, criminal proceedings have to be initiated. It is not something that there would be an administrative decision regarding attachment of property."

Setting up of Advisory Committee for Compromise/Write offs

3.47 Public Sector banks reduce NPAs through upgradation and compromise settlements/write offs apart from recovery. The Committee pointed out that one of the suggestions was to set up a Settlement Advisory Committee with a retired High Court Justice as Chairman, and top level bankers and Senior Executives of the Bank as its members to examine large compromise proposals from the defaulting borrowers and recommend one time settlement. Another suggestion made was for setting up of a Lok Adalat where decisions were made quickly on the basis of compromise. The Committee requested IBA to furnish their views on these suggestions and also their

opinion as to which mechanism would be more fair and effective. In their considered opinion IBA stated as under:

"Loan recovery process should comprise of a mix of policies containing effective supervision, rescheduling of loan installments, compromise and write-offs in genuine cases. Mechanisms such as Lok Adalat could supplement the existing measures in strengthening loan recovery. The setting up of Advisory Committees with high ex-judicial offices and top officials of banks will ensure transparency in the process and is therefore considered a useful help to banks. For recovery to be effective there is a genuine need, at least in a short run, to focus on several measures implemented in various dimensions to effect loan recovery".

Asset Reconstruction Fund

3.48 The setting up of Asset Reconstruction Fund (ARF) has been recommended by the Narasimham Committee. As per the recommendations of the Committee, ARF will take over the bad and doubtful debts from banks and financial institutions and subsequently follow up on the recovery of the dues owned to them from the primary borrowers. The ARF would acquire the debts at a discount which will be determined by an independent auditor. The transfer of asset to the ARF by banks/DFIs would be accompanied by the primary lenders renouncing in favour of ARF claims on the collateral pledged in respect of the loans inclusive of any guarantees by Central or State Governments or any other bodies.

The Fund would pay for the acquisition of these assets from banks/DFIs at a discounted price in the form of rates. The bonds would be guaranteed by Government and hence will qualify for inclusion as SLR assets. The advantage to the banks of this arrangement would be that a portion of their bad and doubtful debts would be off their books though at a price, but they would have in substitution of these advances bonds upto the discounted value with a certainty of interest income which would be an obviously important aspect from the point of view of income recognition. Further, by making these bonds eligible for SLR purposes, fresh resource could become available for normal lending purposes.

To enable ARF to collect the dues and invoke the guarantees for expeditious clearance, ARF will be vested with full authority. The Committee recommended that powers would be much broader than those contained in Section 29 to 32 of the State Financial Corporations Act, 1991. Once the dues are collected by the ARF they will be in a position to redeem the bonds issued to Banks/DFIs. After the bonds are redeemed, ARF would be wound up.

This recommendation was examined in detail and setting up of a nation wide Asset Reconstruction Fund was not accepted.

3.49 The Indian Banks Association in a note furnished in October, 1997 stated as follows:

"The current level of NPAs of public sector banks are accumulated over a long period of time. Hence, the huge size of the NPAs cannot be drastically reduced within a short time without any major institutional measures. To reduce the level of NPAs and free the public sector banks from their burden,

the Committee on the Financial System headed by Shri M. Narasimham, recommended creation of a separate Asset Reconstruction Fund into which all NPAs of public sector banks could be transferred and effective strategies evolved to recover them.

3.50 During his Budget Speech while presenting Central Governments Budget for 1998-99 on 1st of June, 1998 in Lok Sabha the Minister of Finance announced the decision taken on one of the recommendations of the recently submitted Narasimham Committee report as follows:—

"A few banks have particularly high NPAs. These banks will be encouraged, on an experimental basis, to establish Asset Reconstruction Companies, which will take over the NPAs of the bank at their realisable value and swap them with special bonds to be held by the bank. The Asset Reconstruction Companies will concentrate on recovery of dues to realise the maximum value for the assets transferred to them."

Observations/Recommendations

3.51 The Committee note that the RBI had advised banks from time to time to improve upon deficiencies in credit appraisal, non-observance of terms of sanction, laxity in post disbursement supervision and poor internal control which are some of the factors responsible for NPA, and to strengthen their credit appraisal systems and skills of their officials by imparting the requisite training and also to ensure effective post disbursement supervision to prevent recurrence of the factors contributing to increase in NPAs. Other measures to contain NPAs inter alia include close monitoring of sticky advances of banks commented in the inspection reports by way of receiving Quarterly Progress Reports from banks in respect of commented accounts, strengthening of inspection system, emphasising, among others, the need for better recovery performance during the time of discussion on the inspection reports of banks, with the CMD of the concerned banks by the top management of the RBI, prescription by RBI prudential norms regarding capital adequacy, income recognition, asset classification and provisioning so as to improve the asset quality of banks, provision of a clause regarding the need to set up a recovery cell at Head Office in the MoU signed by the banks, before their share of capital provided by the Government is released to them, dissemination of information on defaulters of Rs. one crore and above and suit filed accounts to alert other banks and financial institutions to guard them from lending to defaulting borrowers, setting up of recovery tribunals, etc.

3.52 The Committee note that as per RBI guidelines the banks are required to make their own assessment of credit requirements of borrowers on reasonable and realistic assumption in compliance with laid down systems, procedures and policy parameters for sanction. The banks are also required to comply with RBI norms while assessing the credit limits. In accordance with their own lending discipline and guidelines issued by RBI, banks are also required to exercise supervision over the deployment/end use of funds lent by proper monitoring of stocks, receivables and other securities. Further concurrent audit covering at least 50 per cent of the lending operations to ensure that the transactions/decisions

were taken within the policy parameters laid down and annual internal inspection of branches ensures that credit appraisal and post-disbursement supervisions were carried out in accordance with laid down instructions by the bank/RBI. The deficiencies in banks' credit appraisal and credit supervision systems as brought out in the RBI inspections are followed up with the banks for compliance, fixing staff accountability, etc. The Committee do recognise that norms and care exercised in selection of assets, effective post-sanction credit supervision, concurrent audit of lending operations, annual internal inspection of branches and deficiencies highlighted in RBI's AFI reports and their follow-up with banks for compliance are no doubt salient features of prudent credit management necessary to reduce the incidence of problem loans.

3.53 The Committee note the position stated by the Ministry of Finance that with the introduction of the prudential norms, banks are becoming increasingly sensitive to credit risks and there is a growing awareness of the need to keep NPAs to the minimum. As the banks are required to make provisions out of their operating profits towards NPAs, the profitability of the banks largely depends on the management of NPAs. Banks have realised that higher level of NPAs erode their profitability and therefore address themselves to the reduction of NPAs through well defined policies and strategies.

3.54 According to the Ministry of Finance, with the prudential norms on income recognition, asset classification and provisioning for bad debts from April, 1992, the Public Sector banks have become sensitive to non-performing assets. The dud loans that came about are loans which had accumulated over the period before 1992-93. The incidence of NPAs on the fresh credit facilities sanctioned since the introduction of prudential norms in 1992-93 ranges from 3 and 4 per cent in the case of the Public Sector banks. The Committee would have been much happier had this been the correct position. But, facts are otherwise. Apart from considerable growth in deposits, the investible resources of the banks had substantially increased (by more than Rs. 61,000 crore) through successive cuts in CRR which had been brought down from 15 per cent to 10 per cent. The banks, though being flush with funds and can take on considerable lending activities, are reluctant to perform their legitimate function of lending to corporate sector. One wonders what would be the NPA ratio if the banks expand their credit to corporate sector instead of investing to zero-risk low yield Government securities. According to media reports, nearly 60 per cent of the banks' funds are being invested in Government securities and in the debt market. What is further surprising is that with vast network of branches even in remote and inaccessible areas of the country and where need for bank credit is the most acute, the Public Sector banks like foreign banks for meeting their targets for priority sector have taken recourse to the option of deployment of their priority sector funds with SIDBI and NABARD to avoid non-performing assets that may accrue in case of defaults.

3.55 The Committee note that during the MoU discussions with CMDs of the nationalised banks, which are held annually, the performance of the banks in various areas including reduction of NPAs is reviewed by RBI and the banks with higher

level of NPAs are advised to bring NPAs to a lower level. The commitments made by the banks to bring the level of NPAs to certain agreed levels are the targets towards which these banks strive to achieve. The Committee, however, find that the data pertaining to commitments made by the nationalised banks in respect of targets for reduction of NPAs vis-a-vis actual NPAs for the past two years indicate a very dismal picture. Only four out of nineteen nationalised banks during each year of 1994-95 and 1995-96 have been able to contain the actual NPAs within the budgeted targets. All other nationalised banks showed that the actual gross non-performing assets are much higher than those of the targets set by them for the two years. The Committee also find that the actual gross NPAs in some of the banks are much higher by Rs. 100 to 600 crore than the targeted level. The Committee feel that the matter needs to be closely monitored for achievement of agreed levels of NPAs target.

3.56 The Committee note that RBI compiles and circulates information on defaulting borrowers of Rs. 1 crore and above in order to alert the banks and financial institutions and caution them so that banks/FIs are better informed while taking credit decisions. The information so circulated pertains to borrowal accounts whose outstandings to banks/financial institutions aggregate to Rs. 1 crore and above and whose accounts have been classified by banks as 'doubtful', 'loss' or 'suit filed'. While circulating the list, RBI has advised banks and FIs that they may make use of the information while considering on merits the request for new or additional credit limits of defaulting borrowing units and also proprietors/partners/directors, etc. named in the list.

3.57 The Committee further note that the Government does not consider it appropriate to delete provisions regarding secrecy laws in the Banking Regulation Act, 1949, as according to them the relationship of a bank and its customer is one of utmost trust and is a well established concept prevailing all over the world. The Committee feel that banks should file suits against the borrowing units within two years of their default and compile list of such cases region-wise and share such information with other banks in order to caution them while taking credit decisions for new or additional credit limits by the defaulting borrowers and also proprietors/partners/directors named in the list.

3.58 The Committee note that at present RBI publishes yearly list of defaulting borrowers in whose cases suits have been filed and the amounts are Rs. one crore and above. List of these defaulters are circulated to caution the other banks in extending credit facilities to such defaulters. In other categories, in small loans, and in medium loans, even though those persons are defaulters of one bank, they are taking loan from some other banks. The Committee feel that in case of wilful default recovery suits should be filed without any delay and names of wilful defaulter whether suits filed or not should also be published for guidance of the other banks who should be instructed to exercise utmost caution in extending credit facilities to such borrowers. The Committee also desire that their recommendation may be brought before the Board of Directors of each Public Sector Bank for making it a part of credit policy.

In case of weaker section loans, list of names of wilful defaulters should be compiled

for guidance of sponsoring authorities and the banks for making them ineligible from further loan facilities.

3.59 The Committee note from the views expressed by the Ministry on extending loans and advances to units of an industrial group in the event of the defaulting borrower being a member of such group stating inter alia that in order to discipline such defaulting industrial house and at the same time not to disturb the ongoing industrial activities, RBI in consultation with Government of India has evolved the concept of Group Approach which envisages restrictive-cum-selective flow of additional credit for expansion/diversification/modernisation/new projects to groups or borrowers committing wilful defaults and/or not cooperating with the bank in settling their dues. According to the Ministry, under this concept the legitimate need-based working capital requirements of existing units of recalcitrant groups are not to be disturbed on account of wilful defaults of one or more companies of the group. According to IBA, risk management practice procedures that are being put in place by banks would greatly discourage any credit flows to accounts which have shown disappointing performance either on its own or through any of its associates. The argument advanced by the Government that the default by one member of the group does not necessarily imply denying further credit facilities to other members of the group appears sound but is not pertinent. The Committee, however feel that at the same time the bank should adopt a more cautious approach in its dealing with such group and discourage credit flow to other units of the group for unjustly putting banks to suffer loss for their wilful default.

3.60 It may also happen that such a group may have availed of loan facilities from more than one bank. The other banks from who the group (borrower) has availed of loan facilities may not be aware of the deterioration of the credentials of the borrower by virtue of the default. Such a borrower will be source of potential risk for the other banks. As such to overcome such situation, the Committee desire that an appropriate mechanism may be evolved whereby there should be adequate disclosure of information among banks regarding defaulting borrowers. This would enable the banks to take adequate precautions while extending credit facilities to such borrowers or otherwise dealing with them.

3.61 The Committee note that during the course of inspection by RBI, the performance of the top management i.e. CMD and other functionaries of the bank is looked into and adverse features, if any, commented upon in the Inspection Reports. Copies of these Reports are also sent to the Government. In case of small issues, RBI advises the Government that he should be issued a letter of displeasure. The Committee, however, feel that adverse comments made by RBI in their Annual Financial Inspection Reports against CMD and other functionaries of the Public Sector banks cannot be considered as small issues for which letter of displeasure are issued. The Committee desire the Government to take serious action on these adverse observations so as to achieve the laid down objectives of such inspections and also to set an example for other functionaries in the banks in order to deter them from indulging in any type of irregularities.

The Committee also like to be apprised of the follow up action taken by Government/RBI on the adverse comments contained in the Annual Financial

Inspection Reports against CMD and other top functionaries of Public Sector banks during the last three years.

3.62 On perusal of the statement furnished by the Ministry of Finance on adverse comments against the management of banks contained in the Annual Financial Inspection (AFI) Reports of RBI for the year 1991-92, 1992-93 and 1993-94, the Committee find that top functionaries/Executive Committee of the Central Board/Board of Directors/CMDs of certain banks sanctioned credit facilities to parties without obtaining essential information/taking in account the necessity, status of earlier advances, repayment capacity and other relevant factors for sanction of loans. Further, certain sanctions/confirmations were far in excess of their lending powers in violation of the Board's instructions/lending discipline/RBI guidelines, etc. In certain cases credit facilities were sanctioned/confirmed/enhanced by the CMDs orally/telephonically in excess of their discretionary powers without assessing the need based requirement or taking into account the borrower's financial position/past performance. In one case, a loan was sanctioned by CMD of a bank to a company for development of real estate without ascertaining whether the borrower company would be in a position to execute the project work. The company had a low capital base and did not submit the proposed plan duly approved by competent authority.

All the above cases of gross abuse of official position by the top functionaries of the banks, might have resulted in losses of crores of rupees to the banks.

3.63 The Committee are unhappy to note that despite the fact that AFI reports of RBI pointed out their adverse comments against top management of the banks, no serious action was taken except an advice made by Deputy Governor/Executive Director of RBI to the Banks to ensure that such lapses/deficiencies should not recur. Of late, specific timeframe has also been prescribed to individual banks for rectification of deficiencies brought out in AFI reports.

3.64 The Committee, however, feel that such adverse comments against top management of the banks made in RBI AFI without any follow up purposeful action would send wrong signals to other functionaries of banks for abusing their official position in total disregard of laid down norms for sanction of credit facilities to the detriment of the banks. Further any credit management without accountability will lack substance. The Committee, therefore, recommend that there should be a system in which all such cases of adverse comments against top management of the banks contained in the AFI reports regarding sanction of loans/recovery of debts where heavy losses occur to the banks should be investigated with a view to fixing responsibility against the erring top functionaries and also to find out any nexus between the top functionaries and the companies in the matter of sanction of credit facilities/recovery of loans for causing wrongful loss to the banks for launching prosecution.

3.65 Now the Ministry of Finance (Department of Economic Affairs Banking Division) also reviews the important features of the Annual Financial Inspection Reports of RBI. The Committee expect the Ministry of Finance not to allow the Chief Executives to regard the banks as their personal fiefdom so long as they are at

the helm of affairs and indulge in any violation of norms laid down for sanction of credit facilities/recovery of debts. The Committee feel that if the top functionary violates the rules, he should be punished with the same severity as the other officers of the bank. The Committee, therefore, desire the Ministry of Finance to initiate action against the chiefs of the banks for violation of lending norms/discipline/RBI guidelines, etc. and for causing pecuniary loss to the banks as is done in the case of other officials in the lower rung of the hierarchy.

3.66 The Committee note that delegation of lending powers at different levels of hierarchy, differs from bank to bank depending, inter alia upon organisational structure, scale of operation, resource base, level of expertise of the delegates, etc. The lending powers at different levels right from the Branch level officials to functionaries at top level are fixed by individual banks taking into account the above factors. Under the extant guidelines loans/advances sanctioned transgressing delegated powers are required to be ratified thereafter by the competent authority. According to the Ministry of Finance, number of accounts turning into NPAs on account of transgression of delegated powers is reported to be negligible. What is worrisome to the Committee is the very fact that apart from requests for ratification of transgression, cases of transgression of powers by the officials come to the notice of bank management/RBI through internal audit/inspection, concurrent/statutory audit, RBI inspection, etc. clearly indicates that transgression of powers by bank officials are not being regularly ratified as per extant guidelines but are being suppressed which only come to light subsequently through audit/inspection. The Committee feel that cases of transgression of powers are not fully reported for ratification as per extant guidelines and that is why the number of accounts turning into NPAs on account of transgression of powers coming to the notice of bank management/RBI appears to be negligible. The Committee expect that in the light of the judgement of the Supreme Court, the Bank Officers would function within the parameters of their sanctioning powers for lending so that the chance of an account turning into NPA on this ground is reduced to the minimum.

3.67 One of the reasons cited by Deputy Governor, RBI for advances going bad is that "it may be due to wrong skill of the person who is appraising.... in future the banks will be careful in their training system". The Committee have been informed that almost all banks have their own training establishments where members of their staff are trained in proper appraisal, supervision and follow up of advances. Besides, banks also depute their officers to the Banker's Training College, College of Agricultural Banking of the Reserve Bank of India and the National Institute of Bank Management where they are, inter alia imparted training in the above aspects. However, in regard to factors for which banks are responsible for advances turning non-performing, the Ministry have cited deficiencies in credit appraisal, non-observance of norms for sanction of loans and laxity in post-disbursement supervision. The Committee feel that training system for bank officers need revamping. The Committee recommend as follows:

- (i) The syllabus in the institutes/colleges imparting training in the various programmes relating to different schemes/sectors for appraisal, supervision and follow up of advances may be reviewed by a Committee of

Senior Bankers to improve the quality of specialised training in risk management, project appraisal skill and resource management as also qualifying and trainers, standards upgraded to skillfully groom the bank officers for improved professional capabilities to enable them to face various types of business risks in the present age of competition and changing economic scenario.

- (ii) There is also a need for upgrading the professional skills among the senior management in banks. To upgrade their project appraisal skill and to equip them with adequate awareness of technological developments in various sectors of the economy, there should be a regular outflow of senior bank officers from all Public Sector Banks as also officers of the level of Directors in the Banking Division of the Ministry for specialised training in training institutes abroad to equip them with latest procedures and the system of banking prevalent in those countries. Salient features of the systems prevalent in other countries in the world may be incorporated in the training system in India and updated from time to time and tuned to the issues confronting the Banking Sector in India to meet the emerging challenges on the basis of the experience and knowledge of these officers.
- (iii) Some training institutes may be identified for development as Centres of Excellence within the Banking Sector for sharing training facilities and providing state-of-the-art training.

3.68 The Committee note that performance of various recovery plans is being looked into by the RBI during inspection of banks carried out at regular intervals. As per RBI guidelines banks have been asked to formulate a loan recovery policy with the approval of the Board of Directors. They have also constituted a Recovery Cell at their Head Office under the charge of a G.M. Further branchwise targets are required to be fixed by banks for recovery of NPAs, and their performance is to be monitored at Head Office level on monthly basis. The Committee hope that these measures put in place to improve recovery will work and prove to be effective. Further those measures will facilitate banks to increase the tempo of recovery, enable them to reach their recovery targets. The Committee desire that the RBI closely monitor the utility of these measures by banks in improving recovery of the existing problem loans.

3.69 The Committee feel that the IBA suggestion that banks should strengthen the recovery mechanism not only from the point of view of establishing special recovery branches but also by training people and creating systems for close supervisions of the loan accounts to detect immediately any signs of deficiencies, deserves consideration.

3.70 The Committee note that recommendation made by the Narasimham Committee in its Report on the Financial System for setting up of a separate Asset Reconstruction Fund to take over the bad and doubtful debts from banks and financial institutions and subsequently follow up on recovery of dues owed to them from the primary borrowers was examined by the Government of India and not found acceptable.

The Committee also note the IBA view that huge size of NPAs, accumulated over a long period of time, cannot be drastically reduced within a short time without any major institutional measures. This can be achieved by creation of Asset Reconstruction Fund as recommended by Narasimham Committee. However, Hon'ble Minister of Finance has announced in his Budget Speech 1998-99 the decision to establish Asset Reconstruction Companies. According to the decision a few banks having particularly high NPAs will be encouraged to establish Asset Reconstruction Companies, which will take over the NPAs of the bank at their realisable value and swap them with special bonds to be held by the bank. The Asset Reconstruction Companies will concentrate on recovery of dues to realise the maximum value for the assets transferred to them.

3.71 The Committee note that the RBI's recent scrutiny of certain large borrowal accounts conducted in a few banks has revealed diversion of bank finances for investment in finance companies, associate companies/subsidiaries, inter-corporate deposits, etc. In this connection, RBI has advised banks that if a borrower is found to have diverted finance granted for working capital purposes for other activities, banks must recall the amount so diverted. In order to gauge the magnitude of diversion of funds by borrowers as also whether the diversion of bank finance was for activities not permissible under the extant norms of investment/credit policy of the banks, the Committee would like to be informed of the number of instances of diversion of funds by borrowers to other than the purposes (including breakup of non-permissible activities) for which the loans were sanctioned, the amount involved and the recall of the amount so directed bank-wise for the last year only.

3.72 The Committee note that under the extant guidelines banks are required to examine staff accountability whenever there is a deterioration in the asset quality. In this connection, the Ministry of Finance have furnished statements giving details of (i) officials found responsible for advances turning into bad debts and (ii) cases of laxity in post disbursement supervision of advances resulting in bad debts in respect of certain banks and punitive action taken against these officials during the year 1992-93, 1993-94 and 1994-95. On perusal of these statements, it is observed that in some cases disciplinary/Departmental proceedings are still pending. The Committee desire that pending proceedings should be expeditiously finalised.

3.73 Further, on perusal of the statements it is also felt that year-wise disciplinary proceedings initiated bank-wise via-a-vis. quantum of loans/advances turning into NPAs are minimal just an eye-wash. The Committee expect the Ministry of Finance to impress upon the banks to take a serious view of the lapses in sanction of loans/advances and laxity in post disbursement supervision for fixing staff accountability.

3.74 The Committee also note that banks have been advised to frame a policy on staff accountability with the approval of their Boards. The Committee would like to be apprised of the present position on finalisation of policy on staff accountability and the time frame fixed for its finalisation bank-wise. One of the important measures which could be considered for stopping wilful defaults is, according to IBA, swift and effective penal action on the erring bank officials

connected with irregularities. The Committee desire that this aspect should form a part of a policy on staff accountability.

3.75 All Public Sector banks have their Vigilance Departments at Head Office/Controlling Office level to look into any sort of malpractice/irregularities against bank officials in sanction/disbursement of loans. As there has been considerable deterioration in the quality of assets of the banks and ineffectiveness of departmental action either due to administrative sleaze and laxity or pervasive attitude of pessimism on the part of Chief Vigilance Officer (CVO) or possible collusion among personnel of the Vigilance Department, unscrupulous bank officers and private parties to siphon off bank funds, the Committee desire the Ministry of Finance to undertake a detailed review whether the performance of the Vigilance Departments of the banks was of requisite standard and as also of the need for their revamping.

3.76 The Committee also make the following recommendations to recover/reduce/contain NPAs in the Public Sector Banks:

- (i) With a view to reducing the Non-Performing Assets (NPAs) and at the same time avoiding lengthy and time consuming legal action, banks have been advised to recover their dues by entering into settlement/compromise proposals with borrowers on mutually acceptable terms. The Committee feel that banks should be very careful in considering settlement/compromise proposals. Instead RBI banks should examine the necessity of constituting Settlement Advisory Committee consisting of renowned bankers under the Chairmanship of retired High Court Judge to consider proposals of compromise/write offs as per laid down norms for speedy recovery of assets in cases of large default with a view to bringing down their non-performing assets.
- (ii) Public Sector Banks should also share information on loan sanction and loan write off/compromise proposals in cases of borrowal accounts of Rs. 10 lakh and above to caution the other banks from lending to such defaulting borrowers.
- (iii) Suits should be filed immediately where promoters have guaranteed the advance and there is a default.
- (iv) Banks should introduce the system of obtaining an audit certificate from the borrowers to ensure proper end use of funds lent.
- (v) Banks should also consider the feasibility of introducing a system for internal audit of sanction of loans before disbursement for larger advances.
- (vi) It may not be difficult for the banks to place the right people for the work of credit portfolio management who have training and greater awareness at operational level for credit risk assessment and can render honest and diligent service in the discharge of their responsibilities.
- (vii) Non-performance by lenders in not making timely sanction/disbursement of loans sometimes convert potentially profitable enterprises to loss making ones. Many industries suffer decline because

of delays in disbursement of loans by banks. This may contribute to NPAs. This aspect also needs to be closely monitored.

- (viii) A doubtful asset normally takes a minimum of two years to surface. It would, therefore, be prudent on the part of the management not to post bank officers for credit portfolio work during the three years preceding their retirement so as to enable them to retire honourably and gracefully.
- (ix) A review of the performance of the officer, belonging to credit portfolio management should be made regularly and necessarily at least one year before his retirement to assess whether he had not acted prudently while sanctioning of advances, whether he had not observed the normal procedure followed in the bank in sanctioning the applications and whether any serious irregularities in the conduct of credit portfolio or in other accounts had been observed.

CHAPTER IV

RECOVERY

4.1 For the banking sector to perform, it is essential to ensure that the parties to whom loans or advances have been given by the banks are regularly repaying the principal amounts as stipulated and the banks have to take reasonable steps to ensure recovery of principal and interest whenever due. The Ministry of Finance explained that it facilitates identification of an account as a NPA on objective basis. In the context of release of additional share capital contribution by Government of India to restore and maintain their financial soundness the banks were, *inter alia* advised during August, 1993, as part of MOU, to formulate Loan Recovery Policy duly vetted by their Boards of Directors. The salient objectives of the policy are (i) effecting maximum recoveries particularly out of NPA accounts by fixing recovery targets and bringing down the level of NPA, (ii) close monitoring of large borrowal accounts in order to avoid their slippage into NPAs and (iii) entering into compromise proposals for expeditious recovery based on RBI guidelines and close follow-up of cases under litigation.

4.2 In the documents containing performance obligations and commitments for 1993-94 and 1994-95 submitted to Reserve Bank of India by the nationalised banks in connection with the release of additional capital by Government of India it was indicated that a "Recovery Cell" has been constituted at their Head Office under the charge of a General Manager, branch-wise targets were fixed for recovery of NPAs and the performance of the branches in recovery was monitored at Head Office level on a monthly basis by the Chief Executives. The Board of Directors is kept informed of the progress in recovery at quarterly intervals. Targets for recovery/reduction of NPAs have been fixed by Reserve Bank of India. Banks have also been advised that, wherever possible, pragmatic action, including compromise on reasonable terms should be resorted to.

4.3 Central Bank of India in a note to the Committee during study tour stated that special emphasis was being laid on recovery from NPA. This would *inter alia* gain greater momentum if permission was granted for sale of surplus land in respect of accounts where huge funds were blocked up.

Compromise/Write-off

4.4 The figures of bad debts written off during the last three years and their percentage to total advances are given below:

(Rs. in crore)

	Nationalised Banks	SBI and its associates	Public Sector Banks
1992-93 [⊙]	1534.41 (1.50%)	739.32 (1.09%)	2273.73 (1.34%)
1993-94 [⊙]	2437.06 (2.33%)	581.11 (0.95%)	3018.17 (1.82%)
1994-95*	815.42 (0.65%)	291.17 (0.41%)	1106.58 (0.56%)

(Figures in brackets indicate percentage to total advances)

* (Figures for 1994-95 are only in respect of actual write-off).

⊙ (Figures for 1992-93 and 1993-94 include both actual and technical write-off).

4.5 When asked how much recovery could be made and what was the quantum which was involved in the process of compromise, a representative of RBI stated:

"During the last year 1995-96, the addition to the NPA in absolute terms was Rs. 5,700 crore, but the recovery in terms of upgradation of the accounts may be from sub-standard to standard category, or the amount recovered through compromise or the amount recovered through cash was Rs. 7,692 crore. That is about Rs. 2,000 crore more than the collection which means there was decrease in the NPA during 1995-96. Now, the balances are more or less secured because of the application of prudential norms and provision requirements."

4.6 In a subsequent note furnished to the Committee, the Ministry have furnished details of reduction in NPAs of all Public Sector Banks (PSBs) on account of upgradation, compromise/write-off and recovery for the years 1994-95 and 1995-96 as given below. The column compromise/write-off indicate reduction of non-performing assets due to compromise/write-off.

Reduction in NPAs of PSBs on account of upgradation, compromise/write-off and recovery

(Rupees in crore)

1994-95 (Actuals)						
NPAs at the beginning of year	Upgradation write	Compromise/ off	Recovery	Total of Reduction/ rec. in NPA	Additions during the year	NPAs at the end of Year
41041.33	1741.04	1889.25	4262.30	7892.59	5236.44	38385.18
1995-96 (Actuals)						
38385.18	868.18	2120.00	4762.56	7751.73	11027.49	41660.94

4.7 On perusal of details of write-off and negotiated settlement/compromise of loans exceeding Rs. 5 lakh and subsequent recovery since 1991-92, it was observed that in most of the cases the amount recovered was less than 50% and in certain cases it was as low as 5% of the total amount due. The Committee enquired:

- (i) What was the purpose of negotiating for these kinds of settlement/compromise of loans where the recovery was very low?
- (ii) Why these cases were not considered fit for referring to the Tribunals, when the Act came into being in 1993, for the recovery of these dues expeditiously before entering into settlement/compromise of proposals with borrowers?

The Ministry in their reply have explained as follows:

"In determining whether a settlement/compromise proposal ought to be accepted, the Bank is expected to consider the realisable value of the securities held by it as well as the time within which such recovery, as is possible, can be effected. This is a commercial decision to be taken by the bank concerned having regard to the need for quick realisation of as much dues as can be

realised and the possibility of redeploying such funds in order to generate income for the bank. While detailed reasons for not referring individual cases to the Tribunals by the banks are not available or expected to be maintained by the Banking Division, and are expected to be gone into by the Board of Directors of the Bank, RBI have intimated that in some cases the parties concerned have approached the bank with compromise proposals as soon as the cases have been filed before the Tribunal and taking into account the time likely to be taken in the disposal of the cases by the Tribunals and the chances of recovery the bank sometimes accepts settlement proposals in such cases in order to expedite the recovery of funds wherever realisable having regard to the securities held by the bank".

Cases under litigation

4.8 As at the end of 31 March, 1993, there was a total of 10.25 lakh accounts of public sector banks involving a total sum of Rs. 4071.60 crore in respect of which suits had been filed by banks. Further, decrees have been obtained in respect of 5.21 lakhs accounts, amounting for Rs. 984.94 crore as on 31.3.1993. Information in regard to the time since when these accounts are under litigation is not available with RBI.

4.9 The biggest handicap in quick recovery of the dues of the banks and financial institutions is the slow and dilatory process of recovering dues. The civil courts are burdened with diverse types of cases and they are not able to accord priority to the recovery of the dues of banks and financial institutions. It takes a very long time before it is possible to obtain a decree and even after a decree is obtained, the execution of decree is again a very time consuming process. Some advances given by the banks, especially those given to the rural sector have been included by some State Governments in their respective Recovery Acts and are, therefore, eligible for recovery as arrears of land revenue. But again, since the State recovery machinery is over burdened with recovery of a large number of public debts of the State, the recovery of the dues of the banks does not get the desired attention.

4.10 The Committee enquired whether there were any guidelines to decide when an indebt became irrecoverable. In reply the Deputy Governor stated as under:

"Banks have their own guidelines. We have told them about the asset that has been lost and whether it is recoverable or not whether there is security. It has to be studied on a case to case basis. We have given them broad guidelines."

4.11 The Finance Secretary added:

"The crux of the matter is, the moment a bank loses hope of recovery it should file a suit. The whole point is, when banks do not file suit, it is because they have a hope of recovery."

Strengthening Recovery Powers of Banks

4.12 For improving the position regarding recovery of bad debts in the bank, the State Bank of Hyderabad during study tour suggested *inter alia* as follows:

"(i) Although, the fixed assets/immovable properties of the borrowers are

charged with the Banks they have no power to seize and effect sale of the same for recovery of dues without intervention of the Court.

The Banks should be conferred with the power of seizure and sale of fixed assets of the borrowers charged with the Banks as these powers, conferred on Financial Institutions under Section 29 of the State Financial Corporation Act has proved to be very effective in recovery of dues by such Corporations.

(ii) Contrary to the expectations, the establishment of Debt Recovery Tribunals have not provided the expected reliefs to the Banks for various reasons. Therefore, the Government should take steps to remove the hurdles in the way of effective functioning of the Tribunals. Steps should also be taken to extend the jurisdiction of Tribunals to all matters of Rs. 5.00 lakh and above. To avoid piling up of cases with the existing Tribunals sufficient number of Tribunals should be established.

(iii) The present legal system is too technical and consumes more time for adjudication of suits. The Government should take steps through suitable amendments to the Civil Procedure Code, Indian Evidence Act and other relevant laws to provide for summary disposal of all bank suits within a stipulated period."

The Ministry in their latest reply dated 10 December, 1998 have added:

"In 1987 the Tiwari Committee set up by RBI had gone into various alternatives for recovery of banks dues including conferring on banks, powers similar to those of SFCs under Section 29 of SFCs Act, 1951. After examining the pros and cons of the alternatives, the Committee recommended setting up of Special Tribunals (which would adjudicate within a time bound schedule all matters relating to recovery of dues of banks) rather than conferring on banks powers similar to those of SFCs. In this connection, IDBI has advised us that invoking of sections 29, 30 and 31 of the SFCs Act, 1951 has generally involved SFCs in avoidable litigation and process of recovery has been time consuming and the success rate in recovery of dues by SFCs is negligible. The banks can now recover their dues by approaching Debts Recovery Tribunals established under Recovery Tribunals established under Recovery of Debts due to Banks and Financial Institutions Act, 1993."

4.13 According to IBA, to enable banks to put in place effective loan recovery processes, apart from the individual initiatives of the banks, it is also important to refine legal systems and strengthen recovery powers of banks akin to those available for revenue departments, co-operative banks and development financial institutions. There should not also be any political measures announcing loan waivers which would dampen motivation of the banks to put in place efficient recovery management practices.

4.14 During study tour, the bank representatives have highlighted that under Section 29 of SFC Act, the Financial Corporations also have the right to (a) transfer by way of lease, or (b) effect sale of the industrial concern, to realise the amounts due

from them. Financial Corporations are treated as Deemed Owners of the Industrial concerns on invocation of Section 29 of the SFC Act. Further under Section 31 of the SFC Act, the Financial Corporation can file a SFC OP (by paying a nominal court fee of Rs. 10/- before the District Court/High Court within whose jurisdiction the industrial concern carries on business) wholly or partly, in the event of not complying with the terms of the loan sanctioned or default in committed repayments, and pray for order for sale of the mortgaged hypothecated/pledged assets. The representative observed that such powers to bank officers would accelerate the recovery prospects.

4.15 During evidence the representatives of RBI responded as follows:

"Their recovery procedure is entirely different. They can just file an application and get the attachment and decree. They do not have to go through the process of law because they are covered under different Acts."

4.16 The Finance Secretary added:

"I think, on the specific issue of what practice SFCs are following and whether it can be applied to the banking system, we will give a separate note. We are not familiar with the practice that they are following. I think, the legal constraints relating to them are different."

4.17 During study tour of the Estimates Committee, a CMD of a nationalised bank suggested that for effective recovery, Banks should be empowered to enforce their right on the asset created out of bank finance without resorting to court of law. Similarly, powers vested with the Revenue authorities, for attachment of the properties and their auction, be given to the banks to instill a sense of seriousness in the minds of the borrowers. When asked to give its comments on the suggestion, the Ministry stated as under:

"The assets created out of the bank's finance would invariably be secured in favour of the lending bank. The question therefore, is really the right of private sale of the secured assets. The security on such assets is ordinarily in the form of hypothecation. The major problems in this regard were, highlighted in the Hedge Committee Report as under:

- (i) the difficulty in taking possession of the stocks/hypothecated properties by the officials of the bank;
- (ii) the banks having no control over the borrowers who may dispose of hypothecated properties without the knowledge of the bank;
- (iii) the risk of the stocks being deteriorated due to inaction of the borrowers; and
- (iv) the delay in the courts in obtaining orders for seizure, sale, etc.

However, according to the Committee, a few of these problems can be sorted out if adequate statutory support is provided to the rights and liabilities of the parties to the contract of hypothecation. In this connection, the Committee made the following recommendations:

- (i) codifying the law relating to the hypothecation;

- (ii) conferment of the right of seizure and or private sale of the hypothecation on the creditor in the event of borrower's default;
- (iii) dispensing with the necessity of giving notice to the borrower of the creditor's intention to seize hypothecated properties;
- (iv) conferring the right of sale in respect of any property of the borrower whether the creditor has secured possession thereof or not; and
- (v) giving priority to the hypothecation in favour of banks and financial institutions against subsequent transactions even if the subsequent parties do not have notice of prior hypothecation."

4.18 In regard to the suggestion to give to banks powers for attachment of properties and their auction as vested within the Revenue authorities, the Ministry stated that exercise of such powers requires adjudication as regards the debt owed by borrower. Without adequate support for enforcement of such right, no purpose will be served by merely conferring such a power on the banks. In view of this, empowering banks for enforcement of their rights, as suggested might not be necessary at this stage.

The Ministry have added that similar powers have been conferred on the Recovery Officer under Section 25 of the Recovery of Debts due to Banks and Financial Institutions Act, 1993. There is a provision in the above mentioned Act to appoint a Recovery Officer who has been empowered to recover the amount of debt specified in the certificates by one or more of the following modes, namely:—

- (a) attachment and sale of immovable or movable property of the defendant.
- (b) arrest of the defendant and his detention in prison.
- (c) appointing a receiver for the management of the movable or immovable properties of the defendant.

4.19 IBA has been representing to the Government to strengthen the legal system to facilitate banks with various options of speedy recovery such as foreclosure, speedy execution of decrees streamlining and strengthening of the debt recovery tribunals, etc.

4.20 In regard to the measures to improve recovery performance under various Government sponsored self-employment schemes and poverty alleviation programmes, IBA suggested as follows:

"In respect of financing of Government sponsored programmes there should be greater cohesion and co-ordination between the Government agencies which recommend the loans cases and bank branches which sanction the loan facilities. The relationship between these two agencies involved in financing developmental programmes should be strengthened so as to make them effective in all areas including recovery."

Debt Recovery Tribunals

4.21 Cumbersome procedure exists in the judicial system and rights to appeal entail inordinate delay in the ultimate recovery of the dues pursuant to legal proceedings initiated. To speed up recovery process, the Recovery of Debts due to

Banks and Financial Institutions Act, 1993 has been enacted to provide for the expeditious adjudication and recovery of debts due to banks and financial institutions and for matters connected therewith or incidental thereto.

4.22 The Delhi High Court in the matter of **Delhi High Court Bar Association Vs. G.O.I** had held that the **Recovery of Debts due to Banks and Financial Institutions Act, 1993** was unconstitutional. However, the Supreme Court has stayed the Delhi High Court Order and admitted Special Leave Petition filed on behalf of the Government.

4.23 On the current status of the present Special Leave Petition filed on behalf of the Government, the Ministry have informed as follows:

"The matter relating to Special Leave Petition filed on behalf of Union of India came up for hearing on 24th July, 1997 before the Division Bench of the Supreme Court. After hearing the argument of both the parties, the Division Bench decided to refer the matter to a three Judges Bench. The matter, therefore, will now come up again after constitution of the three Judges Bench. In this regard it is also stated that in addition to filing the Special Leave Petition (SLP) in the matter of Union of India Vs. Delhi High Court Bar Association, the Union of India has also filed a Transfer Petition (TP) before the Hon'ble Supreme Court requesting for transfer of all the cases pending before the various High Courts and to hear all these cases alongwith the SLP filed by the Union of India."

4.24 Salient features of the **Recovery of Debts due to Banks and Financial Institutions Act, 1993** are—

- (1) The Act provides for the establishment of Tribunals for expeditious adjudication and recovery of debts due to banks and financial institutions and for matters connected therewith or incidental thereto.
- (2) The provisions of this Act shall not apply where amount of debt due to any bank or financial institutions or to a consortium of banks or financial institutions is less than ten lakh rupees or such other amount being not less than one lakh rupees as the Central Government may by notification specify. In order to achieve the objective of expeditious disposal of cases that would go to them. While determining the cut-off limit basically two objectives were considered; first, the tribunals do not get overloaded with a large number of cases and second, substantial amounts are recovered with the help of the special machinery of the Tribunals.
- (3) Central Government shall, by notification establish one or more tribunals.
- (4) A Tribunal shall consist of one person only.
- (5) The Central Government shall by notification establish one or more Appellate Tribunals.
- (6) The application made to the Tribunals shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the application finally within six months from the date of receipt of the application.

(7) Where an appeal is referred by any person from whom the amount of debt is due to a bank or a financial institution or consortium of banks or financial institutions, such appeal shall not be entertained by the Appellate Tribunal unless such person has deposited with the Appellate Tribunal seventy-five per cent of the amount of debt so due from him as determined by the Tribunal. Appellate Tribunal may for reasons to be recorded in writing waive or reduce the amount to be deposited.

(8) The Tribunal and the Appellate Tribunal shall not be bound by the procedure laid down by the code of Civil Procedure, 1908 but shall be guided by the principle of natural justice and subject to other provision of this Act.

4.25 In terms of Section 31 of the Recovery of Debts due to Banks and Financial Institutions Act, 1993 every suit or other proceeding pending before any court immediately before the date of establishment of a Tribunal under the Act, shall stand transferred on that date to such Tribunal. Government vide its letter dated 24 August, 1993 have instructed all the nationalised banks to take immediate steps to identify the suit filed cases of Rs. 10 lakh and above which will have to be transferred from the civil courts to the Tribunals as per Section 31 of the Act.

4.26 In a note furnished during study tour in November, 1997, the IBA has given the latest jurisdiction of respective Debt Recovery Tribunals (DRTs) and also the problems being faced at these Tribunals:—

Place where Tribunal is established	Jurisdiction in States	Alternative Place where it functions	Experience and Problems
1	2	3	4
Appellate Tribunal (Mumbai)	All over India & over all Tribunals	There is need to arrange sitting at other places in India	No Recovery Officer appointed. Functioning is satisfactory.
Calcutta	West Bengal, Andaman & Nicobar Islands		Files from High Court not transferred. Functioning is satisfactory but saddled with large number of cases.
Delhi	Delhi		No Recovery Officer appointed. Functioning is satisfactory.

1	2	3	4
Jaipur	Rajasthan, Himachal Pradesh, Punjab and Haryana, Union Territory of Chandigarh		Functioning well. It has large geographical coverage.
Bangalore	Andhra Pradesh, Karnataka	Hyderabad	Saddled with more than 2500 cases. It is fully functional but existing man power not sufficient.
Ahmedabad	State of Gujarat & Union Territories of Dadra & Nagar Haveli, Daman & Diu		Functioning well.
Chennai	Tamil Nadu, Kerala & Union Territory of Pondicherry	Ernakulam under consideration	No Recovery Officer appointed. Functioning is satisfactory, has large geographical coverage.
Patna	Bihar & Orissa		Files from Civil Courts from Bihar & Orissa not transferred; has large geographical coverage.
Bhubaneswar		under consideration	
Guwahati	Assam, Meghalaya, Manipur, Mizoram, Arunachal Pradesh & Nagaland		Has large geographical coverage

4.27 In response to USQ No. 1516 answered in Lok Sabha on 5 June, 1998, the Minister of State in the Ministry of Finance has stated *inter alia* as follows:

"Nine Tribunals have already been set up at Ahmedabad, Bangalore, Calcutta, Delhi, Jaipur, Chennai, Guwahati, Jabalpur and Patna. The only Tribunal yet to be set up is at Mumbai. The Tribunal at Mumbai is also likely to be set up shortly.

An Appellate Tribunal has also been established in Mumbai."

4.28 In their general comments on DRTs, IBA has stated as follows:

- (i) Infrastructure at most DRTs is poor. More than one Recovery Officer is required to be appointed at each DRT. The Recovery Officers should be

provided with atleast three/four persons to assist him in the execution of recovery certificates.

- (ii) Work at DRTs comes to a standstill in case of leave and sickness of the Presiding Officer. It is suggested that where there are large number of cases pending and are likely to be transferred, more Presiding Officers may be appointed. Ultimately, for each State there should be one DRT.
- (iii) Writ Petitions by the borrowers and stay orders passed have impeded functioning of DRTs in all cases. In many cases, stay orders are obtained against orders passed by DRTs causing delays and legal battles at the execution stage.

4.29 In response to USQ No. 1516 answered in Lok Sabha on 5 June, 1998, the Minister of State in the Ministry of Finance has stated *inter alia* as follows:—

"RBI has recently constituted a Working Group which is going into various problems associated with Debts Recovery Tribunals including legislative amendments. After recommendations of the Working Group are available, a decision would be taken whether there is any need for amending of any provisions of the Act for making Debts Recovery Tribunals more effective and also about setting up of more DRTs in the country."

4.30 The Tribunals have started functioning and disposing of cases filed by the banks/Financial Institutions. However as regards recovery of dues banks are in the process of collecting, compiling and filing of cases for recovery before the Tribunals for assignment of the case to the Recovery Officer of the Debts Recovery Tribunals.

4.31 Enquired whether all the banks had compiled their lists of cases to be filed before the Tribunals for recovery of their debts and how many cases had been disposed off, the Ministry in their reply have informed as follows:

"Besides 9564 cases filed by different Public Sector banks/financial institutions upto 28th February, 1997 (including cases transferred from other courts to various DRTs) it has been reported by these banks (excluding PNB) and financial institutions that as on February 28, 1997, 7251 more cases became fit for filing before the Debts Recovery Tribunals.

As reported by the Debts Recovery Tribunals as on March 31st, 1997 an amount of Rs. 153.54 crore has been recovered in 1627 cases."

4.32 The Minister of State in the Ministry of Finance informed Lok Sabha *vide* USQ No. 1516 on 5 June, 1998 that the performance of these Tribunals for the last three years is as under:—

	April '94 to Mar. 95	April '95 to Mar. 96	April '96 to Dec. 97
1. No. of cases filed	2036	6768	5685
2. Amount involved (Rs. in crores)	1468.46	4526.58	5690
3. No. of cases settled	61	224	1556
4. Amount recovered	21.15	86.51	74.39

4.33 The Committee enquired what was the experience of the Government in the functioning of these Tribunals in disposal of the cases and whether there was any need for any amendment to be made in the Act for expediting the disposal of cases. In reply, the Ministry stated as under:

"It has been experienced that the disposal of the cases by the Tribunals is not to the desired extent as several court cases in the Supreme Court and various High Courts challenging the validity of the Act and the proceedings/decisions of the Tribunals have been filed. The greatest setback to the Act came when the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 was declared as unconstitutional and void by the Delhi High Court in the case of Delhi High Court Bar Association Vs. U.O.I. In addition to the SLP and TP pending in Supreme Court, presently about 750 cases in which proceedings/decisions of DRTs have been challenged are pending in various High Courts. Keeping in view the judgement of Delhi High Court on the validity of the Act, a need has been felt to carry out some amendments in the Act. However, on the advice of Ministry of Law the matter has been kept pending till the disposal of SLP by the Supreme Court."

Observations/Recommendations

4.34 The Committee note that Public Sector Banks reduce their NPAs and recover their dues through upgradation of accounts from sub-standard to standard category, compromise/write off of loans as per laid down guidelines and cash recoveries. It is indeed heartening to note that with the introduction of prudential norms, the Government/RBI has become extremely anxious to effect all round improvement in the working of the credit portfolio of the banks. To improve their performance in recovery of bad debts, PSBs as advised by RBI, have formulated their Investment Policies and Loan Recovery Policies duly approved by their Board of Directors. A General Manager at the Head Office has been assigned the exclusive portfolio of Recovery. Branchwise targets are fixed for recovery of dues and monitoring is done at Head Office level on a regular basis. The Board of Directors are to be informed about the progress of recovery at quarterly intervals. The progress of recovery and reduction in NPAs is also reviewed by RBI periodically. The Committee expect that with various measures in place coupled with a fair amount of dedication and involvement of the bank officers assigned with the responsibility of credit portfolio at the grass roots level in recovery in a big way, seeking assistance of the Government agencies when necessary, counselling of borrowers and also organising recovery campaigns in all branches to step up realisation of dues of the bank, the efforts will fructify.

4.35 On perusal of the details furnished by the Ministry for the years 1994-95 and 1995-96, the Committee find that banks have been able to achieve total reduction in NPAs on account of upgradation, compromise/write off and recovery of Rs. 7892 crore and Rs. 7751 crore respectively.

4.36 High level of non-performing assets (NPAs) in the banking sector at present is the most worrisome aspect of the financial sector. NPAs in Public Sector Banks (PSBs) at about 18 per cent of credit portfolio are much in excess

of international standards where the tolerable levels of NPAs are around 3 to 4 per cent. The Committee are satisfied to note that Banks are aware of the paramount need for containing NPAs. But despite taking various suitable corrective measures and putting in place credit monitoring systems by PSBs to bring the ratio down to a manageable level, they have been able to achieve relatively limited success.

4.37 The Committee feel that recovery of dues by the banks is one of the major concerns in view of the need for recycling the funds for socio-economic development and the very survival of the banking sector. For intensive recovery efforts the main hurdle has been the time consuming legal process because of which the borrowers do not feel compelled to come forward for settling their dues. With the introduction of prudential norms and concept of NPAs from the year 1992-93 and also requirement for provisioning, credit procedures will become a critical input in credit decisions. The time, cost and efforts in recovery of loans will determine whether banks are willing to grant loans to borrowers where they are sure that they can recover their dues quickly and not get bogged down in endless wrangling. That may spell disaster especially for small and medium borrowers. It is therefore imperative in the larger interest of the borrowers that their should be legislative changes to ensure quick recovery of NPAs and to enable the banks to perform their assigned role of lending for socio-economic development of the people.

4.38 The Committee note from the submissions made by the Banks during their study tours as also from the Ministry of Finance in their notes furnished to the Committee that the major handicap in quick recovery of dues of the banks is the slow and dilatory process of recovering dues. It takes a very long time before it is possible to obtain a decree and even after a decree is obtained, there are problems in execution of the decree for realisation of assets/decretal dues. The Committee are informed that as on March, 1993, there were a total of 10.25 lakh accounts of Public Sector Banks involving an amount of Rs. 4071.60 crore in respect of which suits have been filed by banks. Further, decrees have been obtained in respect of 5.21 lakh accounts. IBA in this connection has suggested that there was a need to refine the legal system and strengthen the recovery powers of banks akin to those available for the Revenue Department, Cooperative Banks and Developmental Financial Institutions.

The Committee feel that there is need for Government support both at the Centre and at the State level for extending help of the Revenue Departments in effective recovery in different case and rendering required assistance in executing decrees obtained from the courts. The Committee desire that the matter may be taken up at the highest level in the Ministry of Finance with other Departments of the Government of India and their PSUs where huge funds of banks are blocked up and also impress upon the State Governments for providing requisite assistance for execution of decrees granted by the Courts in favour of the banks for recovery of their dues as also the need for bringing about amendments in the Recovery Acts to effect improvement in the recovery of banks' dues, and strengthen recovery powers to the banks as available to Revenue Departments, Cooperative Banks and Developmental Financial Institutions as suggested by IBA and

introduction of a system whereby borrowers should be compelled for timely payment of bank dues thus obviating time consuming and costly civil court proceedings in the larger interest of borrowers.

4.39 At present no policy guidelines have been laid down either by RBI or by the banks themselves for filing of suits for recovery of their non-performing assets. Under the prudential norms, assets have been classified into four categories depending upon the periodicity of their non-performance i.e. standard, sub-standard, doubtful and loss assets. It is really surprising that no time frame has been prescribed for filing recovery suits in respect of doubtful/loss assets. According to the Finance Secretary banks should file recovery suits the moment they lose hope of recovery. The Committee feel that in the absence of a strict monitoring many unscrupulous borrowing units may simply vanish and there will neither be a promoter nor any property left against which the bank can make recovery. The reality is that in the absence of specific guidelines the functionaries of banks file recovery suits when it is virtually impossible to recover their money. As such banks need to act fast for timely action of filing recovery suits. The Committee therefore desire that banks should lay down specific guidelines duly approved by their Board of Directors for filing recovery suits and be made a part of their Loan Recovery Policy. The Committee would like to be apprised of the follow up action taken by Government in this regard.

4.40 The Committee note that to fill up a major lacuna in the existing legal framework, the Recovery of Debts due to Banks and Financial Institutions Act, 1993 has been enacted to provide for expeditious adjudication and recovery of debts due to the Banks and Financial Institutions. One of the salient features of the Act is that the 'Tribunal and the Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908 but shall be guided by the principle of natural justice and subject to other provision of the Act.' The Committee further note that the Delhi High Court had held that the Recovery of Debts due to Banks and Financial Institutions Act, 1993 was unconstitutional. However, the Supreme Court has stayed the Delhi High Court order and admitted Special Leave Petition (SLP) filed on behalf of the Government. The matter came up for hearing in July, 1997. The Division Bench of the Supreme Court decided to refer the matter to a three Judge Bench. The Union of India had also filed a Transfer Petition (TP) before the Hon. Supreme Court requesting the transfer of all the cases pending before various High Courts and to hear all these cases alongwith the SLP filed by the Union of India.

4.41 The Act provides for establishment of Tribunals. So far, nine Debt Recovery Tribunals (DRTs) have been established having their jurisdiction over certain States. These are located at Calcutta, Delhi, Jaipur, Bangalore, Ahmedabad, Chennai, Patna, Jabalpur and Guwahati. There is one Appellate Tribunal at Mumbai having jurisdiction all over India and over all Tribunals. In their general comments on DRTs, IBA has pointed out that the infrastructure at most DRTs is poor. Some of the Tribunals have large geographical coverage. IBA has also suggested that DRTs may be expeditiously opened in unrepresented States like Maharashtra and Uttar Pradesh. Government should also set up DRTs at more places for example at Chandigarh to cover States of Haryana, Punjab and Himachal Pradesh and Appellate Tribunals at Delhi, Calcutta and Chennai.

4.42 Meanwhile the Tribunals have started functioning and disposing of the cases filed by the banks/financial institutions. In regard to the experience of the Government in the disposal of cases by the Tribunals and whether there was any need for amendment to be made in the Act for expediting disposal of cases, the Ministry have informed that the disposal of cases by the Tribunals is not to the desired extent because of the judgement of the Delhi High Court on the validity of the Act. Keeping in view the judgement of the Delhi High Court, the Government have felt the need to carry out some amendments in the Act. But the same has been kept pending till the disposal of SLP by the Supreme Court on the advices of the Ministry of Laws on the matter.

4.43 Provisions of the Recovery of Debts due to Banks and Financial Institutions Act, 1993, do not apply where the amount of debts due to any bank or financial institution or to a consortium of banks or financial institutions is less than ten lakh rupees or such other amount being not less than one lakh rupees as the Central Government by notification may specify. In order to achieve the objectives of expeditious disposal of cases of substantial amount and to ensure that DRTs do not get loaded with large number of cases, at present cut off limit of rupees ten lakh and above has been specified. The Committee desire that this cut off limit should be reduced to Rs. 5 lakh as soon as pendency of cases before the Tribunals falls considerably.

4.44 The Committee note that keeping in view the judgement of the Delhi High Court on the validity of the Act, the Government propose to carry out some amendments in the Act after the disposal of the Special Leave Petition by the Supreme Court. In this connection, IBA has pointed out that in many cases stay orders are being obtained against orders passed by DRTs causing delays and legal battles at the execution stage. The Committee desire that before initiating amendments in the Act, the Ministry of Finance in the light of recommendations of Working Group constituted by RBI should hold deep consultations with IBA and Financial Institutions on measures considered essential for making DRTs more effective for speedy recovery of bank dues and also the need for more Tribunals.

NEW DELHI;
December 7, 1998

Agrahayana 16, 1920 (saka)

MADHUKAR SIRPOTDAR,
Chairman,
Committee on Estimates.

APPENDIX I

MINUTES OF SITTING OF THE ESTIMATES COMMITTEE (1996-97)

Second Sitting

The Committee sat on Tuesday, the 15th October, 1996 from 1500 to 1715 hrs.

PRESENT

Shri Rupchand Pal—*Chairman*

MEMBERS

2. Shri G.M. Banatwalla
3. Shri Pradeep Bhattacharya
4. Shri Ram Tahal Chaudhary
5. Shri Chandu Bhai Deshmukh
6. Shri Jagat Vir Singh Drona
7. Shri Udaisingrao Gaikwad
8. Shri Bijoy Krishna Handique
9. Shri Bhupinder Singh Hooda
10. Dr. G.L. Kanaujia
11. Shri Harinder Singh Khalsa
12. Shri Sanat Kumar Mandal
13. Shri C. Narasimhan
14. Shri Vishambhar Prasad Nishad
15. Shri Nitish Kumar
16. Shri Sarat Pattanayak
17. Shri Ramendra Kumar
18. Shri Kashiram Rana
19. Prof. Rasa Singh Rawat
20. Shri Mahadeepak Singh Shakya
21. Shri Mangat Ram Sharma
22. Col. Rao Ram Singh
23. Shri Thota Gopala Krishna
24. Shri Chun Chun Prasad Yadav
25. Shri Dinesh Chandra Yadav

SECRETARIAT

- | | | |
|----------------------------|---|-------------------------|
| 1. Smt. Roli Srivastava | — | <i>Joint Secretary</i> |
| 2. Shri K.L. Narang | — | <i>Deputy Secretary</i> |
| 3. Shri Raj Shekhar Sharma | — | <i>Under Secretary</i> |

WITNESSES

Ministry of Finance (Department of Economic Affairs)

1. Shri Montek Singh Ahluwalia — Finance Secretary
2. Shri C.M. Vasudev,
Additional Secretary (Banking)
3. Shri A.K. Jain, Joint Secretary (IF) — Banking Division
4. Shri M. Damodaran, Joint Secretary (BO) — Banking Division
5. Shri D.R.S. Choudhary, Joint Secretary (PS) — Banking Division

Reserve Bank of India

1. Shri S.P. Talwar — Deputy Governor
2. Shri V. Rangarajan — Executive Director

2. The Committee took evidence of the representatives of the Ministry of Finance (Department of Economic Affairs—Banking Division) and Reserve Bank of India on the subject 'Bad Debts'.

3. The evidence was concluded.

4. A verbatim record of the proceedings was kept.

5. The Chairman desired the representatives of the Ministry to send notes on the points not covered during evidence and also on points on which Hon'ble Members wanted to have further information.

(The witnesses then withdrew).

The Committee then adjourned

APPENDIX II

MINUTES OF SITTING OF THE ESTIMATES COMMITTEE (1998-99)

Second Sitting

The Committee sat on Friday, the 25th September, 1998 from 1100 to 1315 hours

PRESENT

Shri Madhukar Sirpotdar — *Chairman*

MEMBERS

2. Shri Rajendra Agnihotri
3. Dr. Shakeel Ahmad
4. Shri G.M. Banatwala
5. Shri Narendra Bhudania
6. Prof. Prem Singh Chandumajra
7. Smt. Rama Devi
8. Shri A. Ganeshamurthi
9. Shri Satya Pal Jain
10. Shri Sanat Kumar Mandal
11. Shri Bhubaneswar Kalita
12. Shri Arvind Tulsiram Kamble
13. Shri Rama Chandra Mallick
14. Shri Abdul Fazal Golam Osmani
15. Shri Uttamsingh Pawar
16. Shri Ajay Kumar S. Sarnaik
17. Dr. Chhatrapal Singh
18. Dr. Mahadeepak Singh Shakya
19. Shri Maheshwar Singh
20. Dr. Ramesh Chand Tomar
21. Shri Ritlal Prasad Verma
22. Prof. (Smt.) Rita Verma

SECRETARIAT

1. Shri K.L. Narang — *Director*
2. Shri Raj Shekhar Sharma — *Under Secretary*
3. Smt. Neera Singh — *Assistant Director*

2. The Committee considered the draft Report on Ministry of Finance (Department of Economic Affairs — Banking Division) — Public Sector Banks— Bad Debts and adopted the same with some modifications/amendments as indicated in the Annexure.

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

4. The Committee then considered their future programme of work and decided to hold their next sitting on 6th October, 1998 at 1100 hrs. for consideration and adoption of the draft Report on Crude Oil—Indigenous Production and Imports.

The Committee then adjourned

*Amendments/modifications made by the Estimates Committee in the draft Report
on Public Sector Banks — Bad Debts*

Para	Amendments/Modifications
1.23	<i>For "debarred" Substitute "debarred from auditing"</i>
2.26	<i>For "One bank has" Substitute "It is shocking to find that one bank has"</i>
2.28	<i>For "The Committee note" Substitute "It is distressing for the Committee for the Committee to find"</i>
2.29 (Last Sentence)	<i>For "The Committeemay be made." Substitute "The Committee, therefore, desire that a detailed review of the regulatory and supervisory functions of RBI preferably by a Committee of Experts well versed in banking matters to enhance its effectiveness and the laxity and complicity of RBI officials, if any, for not initiating action for effective timely measures, may be made."</i>
3.76(i)	<i>For "Instead banks" Substitute "Instead RBI/banks"</i>
3.76(ii)	<i>For "on loan write off" Substitute "on loan sanction and loan write off"</i>
3.76(ix)	<i>For "may be made" Insert "should be made regularly and necessarily at least". Delete "so that there is no witch hunting and mindless enquiry after retirement."</i>
4.41	<i>Add at the end. "Government should also set up DRTs at more places for example at Chandigarh to cover States of Haryana, Punjab and Himachal Pradesh and Appellate Tribunals at Delhi, Calcutta and Chennai."</i>
4.45	<i>Delete Para 4.45.</i>

APPENDIX III

STATEMENT OF OBSERVATIONS/RECOMMENDATIONS

Sl. No.	Para No.	Observations/Recommendations
1	2	3
1.	1.18	<p>The Committee note that in pursuance of the recommendations of the Committee on the Financial System under the Chairmanship of Shri M. Narasimham, RBI introduced prudential norms on income recognition, asset classification and provisioning in all scheduled commercial banks in April, 1992. Reporting under the Health Code System for classification of borrowal accounts which was in vogue, was withdrawn with effect from 1st April, 1994 by RBI. But the banks could continue to retain the system or any alternate loan grading system as might be advised by them for purposes of gradation of the quality of their loans and advances. However, for the purpose of reporting to RBI, the quality of the credit portfolio of banks was to be based on new norms for income recognition, asset classification and provisioning from that date <i>i.e.</i> 1st April, 1994.</p>
2.	1.19	<p>Following the recommendations of the Narasimham Committee on the Financial System, the RBI issued a detailed circular in April, 1992 to all scheduled commercial banks (excluding RRBs). The circular contained specific guidelines for prudential norms to be adopted for:—</p> <ul style="list-style-type: none">— Income recognition,— Asset classification, and— Provisioning for assets of 'loss' or 'doubtful' nature. <p>An asset becomes non-performing when it ceases to generate income for the bank. For the purpose of income recognition, the Narasimham Committee recommended that no income should be recognised and taken into account on accrual basis with respect to non-performing assets (NPAs) and that such income should be accounted for only on the basis of actual receipt.</p> <p>For the purpose of provisioning for 'loss' and 'doubtful' assets, RBI guidelines provide for classification of assets into four categories depending upon the period for which interest/instalments of principle had remained 'past due' namely:—</p> <ul style="list-style-type: none">(i) Standard assets;(ii) Substandard assets;(iii) Doubtful assets; and(iv) Loss assets.

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3.	1.20	The Committee further note that the introduction of new norms on asset classification into four categories viz. standard/sub-standard/doubtful/loss asset, is for facilitating identification of an account as a non-performing asset depending on the period on an objective basis. In terms of the instructions, classification of an account into the four categories is based on record of recovery of interest/principle and is not based on any subjective consideration. These guidelines on asset classification and provisioning are in line with international banking and supervisory standards as per norms of the Banks for International Settlement.
4	1.21	There were no NPA norms earlier in India. Income from NPA is not internationally recognised on accrual basis but is booked as income only when it is actually received. Such reforms in the banking sector throughout the world were introduced in 1987 with the implementation of Basle Committee recommendations. In India, the same were introduced in 1992 with the implementation of recommendations of the Narasimham Committee that similar practice should be followed by banks in India.
5	1.22	The Committee feel that with the introduction of the new system of income recognition, asset classification and provisioning norms for bad debts on a prudential basis, the concept and treatment of non-performing assets have brought about a complete transformation in the Banks in India as they have now to assess their profitability on more realistic basis and reflect the true state of their financial health.
6	1.23	The Committee note that there is considerable misclassification by banks of their non-performing assets and consequent under-provisioning of loan losses in disregard of RBI guidelines relating to income recognition, asset classification and provisioning. The Committee expect the RBI to ensure better adherence by the banks to the prudential norms to achieve the desired objectives of their introduction.
7	1.24	In case of large divergence of classification of assets by bank auditors and RBI inspectors, the Committee desire that a serious note should be taken and these auditors should be debarred from auditing for their sheer blantancy of misclassification.
8	2.25	The Committee note that in accordance with the guidelines/directives of the Reserve Bank of India as also policy guidelines drawn up every year and duly approved by the Board of Directors, banks are sanctioning loans and advances

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for various categories of borrowers of medium and large scale industries, small scale industries, artisans, village and cottage industries, and other small scale industries as also for creation/modernisation/expansion of infrastructural facilities for productive purposes. It has also been the policy of the banks to provide credit facilities under the priority sector for development of agriculture, export and Government sponsored poverty alleviation and self-employment schemes. The Committee appreciate the pivotal role of the Public Sector banks for channelising the flow of funds for industrial development, agricultural growth, employment generation, poverty alleviation and for other productive purposes.

9 2.26 The Committee note from information furnished by the Ministry of Finance that in percentage terms, NPAs came down significantly from 23.18 per cent as on March, 1992 (when prudential norms were introduced) to 17.84 per cent (provisional) as on 31 March, 1997 i.e. a reduction of 5.34% in a period of four years. Another notable feature is that banks have been able to avert further growth in NPAs in absolute terms *vis-a-vis* growth in lending. In absolute terms these NPAs have accumulated from Rs. 39,253 crore as on March, 1993 to an amount of Rs. 43,577 crore as on March, 1997. At present, 17 banks have non-performing assets in the range of 10 per cent to 20 per cent and 8 banks hold NPAs above the level of 20 per cent. It is shocking to find that one bank has NPAs at the level of 36.20 per cent and another one has as high as 39.12 per cent. Only two banks have NPAs in the range of 5 to 10 per cent which, according to Chairman, IBA, is tolerable level under the prevalent economic and industrial development scenario. However, the Committee is extremely unhappy to observe that none of the Public Sector banks has been able to contain NPAs as per international standards where the tolerable levels of NPAs are around 3 to 4 per cent.

10 2.27 The Committee note that several factors mostly on the part of banks and also on the part of borrowers contribute to bad loans. Factors external to the banks and the borrowers such as changes in Government policies to some extent also could cause default in loans. Failure to render honest, dedicated and diligent service in the discharge of responsibility to the borrowers, poor motivation and inadequacy of professional skills for assessment of business risks, corporate failures both in the public and private sectors, scandalous siphoning off

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of funds by corporate racketeers and no fear of legal action initiated for recovery of problem loans from recalcitrant borrowers under the present slow and complex legal system, are the major factors causing hike in NPAs.

11. 2.28 It is distressing for the Committee to find that Indian Bank's operations for the financial year 1995-96 resulted in a loss of Rs. 1336.40 crore. Together with the carry forward loss of Rs. 376.39 crore of earlier years, the bank's losses accumulated to Rs. 1713 crore as on 31.03.1996 wiping out the entire capital and net worth. RBI's Annual Financial Inspections (AFIs) into the last several years have been revealing the gradual deterioration of the Indian Bank's financial position. According to RBI, this was largely due to the imprudent lending policies pursued by the bank management. Findings of RBI's successive inspections revealed that the bank's credit and fund management functions were areas of serious concern. The Committee are further informed that RBI had to scrutinise some accounts more than once as the bank continued to increase its exposure to some borrower groups despite the disquieting features observed by RBI and brought to bank's notice. In 1996, a scrutiny into the exercise delegated lending powers by the then CMD and other top executive was carried out and the matter is under RBI's consideration. RBI has also conducted some scrutinies regarding administrative lapses/irregularities. CBI has registered some cases in this connection.

The net loss of the bank for the year ended 31 March, 1997 is Rs. 389.09 crore as reported in the Annual Report 1996-97. The bank's losses have thus accumulated to Rs. 2101.87 crore.

The Committee are deeply perturbed at this state of affairs in the Indian Bank which has continued for the past few years. They are disappointed that the bank did not pay any heed to the repeated revelations of RBI relating to the imprudent policies being pursued by the management for corrective measures.

12. 2.29 It is really surprising to find that the procedure adopted by RBI of only "bringing to the notice" of management of the Indian Bank their findings contained in AFIs revealing gradual deterioration of the bank financial position year after year and holding discussion with the bank management subsequently for the follow up of corrective measures have

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		<p>proved totally ineffective. The bank management under the then CMD defiantly continued to pursue imprudent lending policies and exposure to some borrower groups despite the RBI's disquieting revelations. In the light of the experience gained in the dubious role of the ex-Chief Executives not only of the Indian Bank but also the Bank of Maharashtra or Vijaya Bank for losses to their banks, the Committee consider it imperative that some safeguards are put in place for swift and timely action for stopping imprudent policies being pursued by the management and the administrative lapses/irregularities to prevent any further damage and loss to the banks. The Committee, therefore, desire that a detailed review of the regulatory and supervisory functions of RBI preferably by a Committee of Experts well versed in banking matters to enhance its effectiveness and the laxity and complicity of RBI officials, if any, for not initiating action for effective timely measures, may be made.</p>
13.	2.30	<p>The Committee also desire that the cases against the ex-CMD of the Indian Bank and other top executives should be pursued vigorously for meting out severe punishment to the guilty.</p> <p>The Committee would like to be apprised of the action taken on their recommendations in this regard.</p>
14.	2.31	<p>On perusal of the information furnished by the Ministry of Finance relating to big loans sanctioned by the top functionaries of the level of CMD/MD/ED of the Public Sector banks including the Indian Bank which turned into 'bad debts' during their service period as also which turned 'bad debts' after retirement of those functionaries, the Committee are distressed to find that the dubious role of the Chief Executives of the banks whether it is of Bank of Maharashtra or Vijaya Bank or Indian Bank in granting advances in utter disregard of laid down system and procedure has been the major contributing factor for turning these huge advances into bad loans. In the opinion of the Committee such things could be possible only with a motive of corruption and complicity in siphoning off a bank funds.</p>
15.	2.32	<p>Apart from revamping the present procedure and system for awarding deterrent punishment for such serious irregularities and wrongdoings, the laid down system for selection and appointment of senior Executives including top Executives of the banks should be reviewed so that offices of integrity, proven sense of duty and responsibility are appointed to these positions.</p>

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16.	2.33	<p>It has been observed that the loan amounts never reach the poor borrowers in full. The illiterate and gullible borrowers have to grease the palms of middlemen/block development officers and other Government intermediaries in forwarding/ sponsoring loan applications. They have even to bribe the banks officials for sanctioning and disbursement of loan. That is why some of the borrowers wilfully refuse to pay the full loan amount as they are only paid less than half of the loan amount.</p> <p>The Chairman, IBA has also opined that loan recovery becomes difficult if the entire loan sanctioned does not reach the borrower. The Committee desire that procedures and systems laid down for selection of beneficiaries and sponsoring of loan applications may be given a fresh look so that the involvement of various intermediaries is brought down considerably. Banks should also initiate effective measures to check malpractices on the part of bank officials in sanction and disbursement of loans to the borrowers. The Committee would like to be apprised of the concrete and effective measures taken in this matter also.</p>
17.	2.34	<p>The Committee have been informed by IBA that there are no well defined safe limits as far as non-performing assets of the banks are concerned. But as per international standards the tolerable levels of NPAs are around 3 to 4 per cent. The Basle Committee on Banking Regulations and Supervisory Practices functioning in the Bank for International Settlements (BIS) has prescribed certain capital adequacy standards for banks which are being implemented in a large number of countries. The BIS standard seeks to measure capital adequacy as a ratio of capital to risk weighted assets and the ratio prescribed thereunder is 8 per cent. The Committee on the Financial System (Narasimham Committee) <i>inter alia</i> suggested that banks should, under a phased programme, move towards meeting the BIS norms on capital adequacy of 8 per cent which should be achieved by March 1996. The Minister of Finance in his Budget Speech on 1st June, 1998 has stated that to strengthen the underlying health of banks, RBI is raising the minimum required Capital Adequacy Ratio for banks from the present 8 per cent to 9 per cent by March 31, 2000 and to 10 per cent by as early as possible thereafter. The Committee, however, feel that the increase in the Capital Adequacy Ratio for public sector banks as proposed in the Budget for 1998-99 in pursuance of</p>

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		<p>recently submitted Narasimham Committee Report may not be considered adequate in the light of a very high percentage of non-performing assets which is around 18 per cent at present, <i>vis-a-vis</i>, the international standard of tolerable levels of NPAs around 3 to 4 per cent for which ratio prescribed as per BIS norms is 8 per cent.</p>
18.	3.51	<p>The Committee note that the RBI had advised banks from time to time to improve upon deficiencies in credit appraisal, non-observance of terms of sanction, laxity in post disbursement supervision and poor internal control which are some of the factors responsible for NPA, and to strengthen their credit appraisal systems and skills of their officials by imparting the requisite training and also to ensure effective post disbursement supervision to prevent recurrence of the factors contributing to increase in NPAs. Other measures to contain NPAs <i>inter alia</i> include close monitoring of sticky advances of banks commented in the inspection reports by way of receiving Quarterly Progress Reports from banks in respect of commented accounts, strengthening of inspection system, emphasising, among others, the need for better recovery performance during the time of discussion on the inspection reports of banks, with the CMD of the concerned banks by the top management of the RBI, prescription by RBI prudential norms regarding capital adequacy, income recognition, asset classification and provisioning so as to improve the asset quality of banks, provision of a clause regarding the need to set up a recovery cell at Head Office in the MOU signed by the banks, before their share of capital provided by the Government is released to them, dissemination of information on defaulters of Rs. one crore and above and suit filed accounts to alert other banks and financial institutions to guard them from lending to defaulting borrowers, setting up of recovery tribunals, etc.</p>
19.	3.52	<p>The Committee note that as per RBI guidelines the banks are required to make their own assessment of credit requirements of borrowers on reasonable and realistic assumption in compliance with laid down systems, procedures and policy parameters for sanction. The banks are also required to comply with RBI norms while assessing the credit limits. In accordance with their own lending discipline and guidelines issued by RBI, banks are also required to exercise supervision over the deployment/end use of funds lent by proper monitoring of stocks, receivables and</p>

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		<p>other securities. Further concurrent audit covering at least 50 per cent of the lending operations to ensure that the transactions/decisions were taken within the policy parameters laid down and annual internal inspection of branches ensures that credit appraisal and post-disbursement supervisions were carried out in accordance with laid down instructions by the bank/RBI. The deficiencies in banks' credit appraisal and credit supervision systems as brought out in the RBI inspections are followed up with the banks for compliance, fixing staff accountability, etc. The Committee do recognise that norms and care exercised in selection of assets, effective post-sanction credit supervision, concurrent audit of lending operations, annual internal inspection of branches and deficiencies highlighted in RBI's AFI reports and their follow-up with banks for compliance are no doubt salient features of prudent credit management necessary to reduce the incidence of problem loans.</p>
20	3.53	<p>The Committee note the position stated by the Ministry of Finance that with the introduction of the prudential norms, banks are becoming increasingly sensitive to credit risks and there is a growing awareness of the need to keep NPAs to the minimum. As the banks are required to make provisions out of their operating profits towards NPAs, the profitability of the banks largely depends on the management of NPAs. Banks have realised that higher level of NPAs erode their profitability and therefore address themselves to the reduction of NPAs through well defined policies and strategies.</p>
21	3.54	<p>According to the Ministry of Finance, with the prudential norms on income recognition, asset classification and provisioning for bad debts from April, 1992, the Public Sector banks have become sensitive to non-performing assets. The dud loans that came about are loans which had accumulated over the period before 1992-93. The incidence of NPAs on the fresh credit facilities sanctioned since the introduction of prudential norms in 1992-93 ranges from 3 and 4 per cent in the case of the Public Sector banks. The Committee would have been much happier had this been the correct position. But, facts are otherwise. Apart from considerable growth in deposits, the investible resources of the banks had substantially increased (by more than Rs. 61,000 crore) through successive cuts in CRR which had been brought down from 15 per cent to 10 per cent. The banks, though being flush with funds and can take on considerable lending</p>

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activities, are reluctant to perform their legitimate function of lending to corporate sector. One wonders what would be the NPA ratio if the banks expand their credit to corporate sector instead of investing to zero-risk low yield Government securities. According the media reports, nearly 60 per cent of the banks' funds are being invested in Government securities and in the debt market. What is further surprising is that with vast network of branches even in remote and inaccessible areas of the country and where need for bank credit is the most acute, the Public Sector banks like foreign banks for meeting their targets for priority sector have taken recourse to the option of deployment of their priority sector funds with SIDBI and NABARD to avoid non-performing assets that may accrue in case of defaults.

22. 3.55 The Committee note that during the MOU discussions with CMDs of the nationalised banks, which are held annually, the performance of the banks in various areas including reduction of NPAs is reviewed by RBI and the banks with higher level of NPAs are advised to bring NPAs to a lower level. The commitments made by the banks to bring the level of NPAs to certain agreed levels are the targets towards which these banks strive to achieve. The Committee, however, find that the data pertaining to commitments made by the nationalised banks in respect of targets for reduction of NPAs *vis-a-vis* actual NPAs for the past two years indicate a very dismal picture. Only four out of nineteen nationalised banks during each year of 1994-95 and 1995-96 have been able to contain the actual NPAs within the budgeted targets. All other nationalised banks showed that the actual gross non-performing assets are much higher than those of the targets set by them for the two years. The Committee also find that the actual gross NPAs in some of the banks are much igher by Rs. 100 to 600 crore than the targeted level. The Committee feel that the matter needs to be closely monitored for achievement of agreed levels of NPAs target.
23. 3.56. The Committee note that RBI compiles and circulates information on defaulting borrowers of Rs. 1 crore and above in order to alert the banks and financial institutions and caution them so that banks/FIs are better informed while taking credit decisions. The information so circulated pertains to borrowal accounts whose outstandings to banks/financial institutions aggregate to Rs. 1 crore and above and whose accounts have been classified by banks as 'doubtful' 'loss' or

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		'suit filed'. While circulating the list, RBI has advised banks and FIs that they may make use of the information while considering on merits the request for new or additional credit limits of defaulting borrowing units and also proprietors/partners/directors, etc. named in the list.
24.	3.57	The Committee further note that the Government does not consider it appropriate to delete provisions regarding secrecy laws in the Banking Regulation Act, 1949, as according to them the relationship of a bank and its customer is one of utmost trust and is a well established concept prevailing all over the world. The Committee feel that banks should file suits against the borrowing units within two years of their default and compile list of such cases region-wise and share such information with other banks in order to caution them while taking credit decisions for new or additional credit limits by the defaulting borrowers and also proprietors/partners/directors named in the list.
25	3.58	The Committee note that at present RBI published yearly list of defaulting borrowers in whose cases suits have been filed and the amounts are Rs. one crore and above. List of these defaulters are circulated to caution the other banks in extending credit facilities to such defaulters. In other categories, in small loans, and in medium loans, even though those persons are defaulters of one bank, they are taking loan from some other banks. The Committee feel that in case of wilful default recovery suits should be filed without any delay and names of wilful defaulter whether suits filed or not should also be published for guidance of the other banks who should be instructed to exercise utmost caution in extending credit facilities to such borrowers. The Committee also desire that their recommendation may be brought before the Board of Directors of each Public Sector Bank for making it a part of credit policy. In case of weaker section loans, list of names of wilful defaulters should be compiled for guidance of sponsoring authorities and the banks for making them ineligible from further loan facilities.
26	3.59	The Committee note from the views expressed by the Ministry on extending loans and advances to units of an industrial group in the event of the defaulting borrower being a member of such group stating <i>inter alia</i> that in order to discipline such defaulting industrial house and at the same time not to disturb the ongoing industrial activities, RBI in

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consultation with Government of India has evolved the concept of Group Approach which envisages restrictive-cum-selective flow of additional credit for expansion/diversification/modernisation/new projects to groups or borrowers committing wilful defaults and/or not cooperating with the bank in settling their dues. According to the Ministry, under this concept the legitimate need-based working capital requirements of existing units of recalcitrant groups are not to be disturbed on account of wilful defaults of one or more companies of the group. According to IBA, risk management practice procedures that are being put in place by banks would greatly discourage any credit flows to accounts which have shown disappointing performance either on its own or through any its associates. The argument advanced by the Government that the default by one member of the group does not necessarily imply denying further credit facilities to other members of the group appears sound but is not pertinent. The Committee, however feel that at the same time the banks should adopt a more cautious approach in its dealing with such group and discourage credit flow to other units of the group for unjustly putting banks to suffer loss for their wilful default.

- 27 3.60 It may also happen that such a group may have availed of loan facilities from more than one bank. The other banks from whom the group (borrower) has availed of loan facilities may not be aware of the deterioration of the credentials of the borrower by virtue of the default. Such a borrower will be source of potential risk for the other banks. As such to overcome such situation, the committee desire that an appropriate mechanism may be evolved whereby there should be adequate disclosure of information among banks regarding defaulting borrowers. This would enable the banks to take adequate precautions while extending credit facilities to such borrowers or otherwise dealing with them.
- 28 3.61 The Committee note that during the course of inspection by RBI, the performance of the top management i.e. CMD and other functionaries of the bank is looked into and adverse features, if any, commented upon in the Inspection Reports. Copies of these Reports are also sent to the Government. In case of small issues, RBI advises the Government that he should be issued a letter of displeasure. The Committee, however, feel that adverse comments made by RBI in their Annual Financial Inspection Reports against CMD and other functionaries of the Public Sector banks cannot be considered

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as small issues for which letter of displeasure are issued. The Committee desire the Government to take serious action on these adverse observations so as to achieve the laid down objectives of such inspections and also to set an example for other functionaries in the banks in order to deter them from indulging in any type of irregularities.

The Committee also like to be apprised of the follow up action taken by Government/RBI on the adverse comments contained in the Annual Financial Inspection Reports against CMD and other top functionaries of public Sector banks during the last three years.

29 3.62

On perusal of the statement furnished by the Ministry of Finance on adverse comments against the management of banks contained in the Annual Financial Inspection (AFI) Reports of RBI for the years 1991-92, 1992-93 and 1993-94, the Committee find that top functionaries/Executive Committee of the Central Board Executive Committee of the Board of Directorss/CMDs of certain banks sanctioned credit facilities to parties without obtaining essential information/taking in account the necessity, status of earlier advances, repayment capacity and other relevant factors for sanction of loans. Further, certain sanction/confirmations were far in excess of their lending powers in violation of the Board's instructions/lending discipline/RBI guidelines, etc. In certain cases credit facilities were sanctioned/confirmed/enhanced by the CMDs orally/telephonically in excess of their discretionary powers without assessing the need based requirement or taking into account the borrower's financial position/past performance. In one case, a loan was sanctioned by CMD of a bank to a company for development of real estate without ascertaining whether the borrower company would be in a position to execute the project work. The company had a low capital base and did not submit the proposed plan duly approved by competent authority.

All the above cases of gross abuse of official position by the top functionaries of the banks, might have resulted in losses of crores of rupees to the banks.

30 3.63

The Committee are unhappy to note that despite the fact that AFI reports of RBI pointed out their adverse comments against top management of the banks, no serious action was taken except an advice made by Deputy Governor/Executive Director of RBI to the Banks to ensure that such lapses/deficiencies should not recur. Of late, specific timeframe has

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		also been prescribed to individual banks for rectification of deficiencies brought out in AFI reports.
31	3.64	The Committee, however, feel that such adverse comments against top management of the banks made in RBI AFI without any follow up purposeful action would send wrong signals to other functionaries of banks for abusing their official position in total disregard of laid down norms for sanction of credit facilities to the detriment of the banks. Further any credit management without accountability will lack substance. The Committee, therefore, recommend that there should be a system in which all such cases of adverse comments against top management of the banks contained in the AFI reports regarding sanction of loans/recovery of debts where heavy losses occur to the banks should be investigated with a view to fixing responsibility against the erring top functionaries and also to find out any nexus between the top functionaries and the companies in the matter of sanction of credit facilities/recovery of loans for causing wrongful loss to the banks for launching prosecution.
32.	3.65	Now the Ministry of Finance (Department of Economic Affairs—Banking Division) also reviews the important features of the Annual Financial Inspection Reports of RBI. The Committee expect the Ministry of Finance not to allow the Chief Executives to regard the banks as their personal fiefdom so long as they are at the helm of affairs and indulge in any violation of norms laid down for sanction of credit facilities/recovery of debts. The Committee feel that if the top functionary violates the rules, he should be punished with the same severity as the other officers of the bank. The Committee, therefore, desire the Ministry of Finance to initiate action against the chiefs of the banks for violation of lending norms/discipline/RBI guidelines, etc. and for causing pecuniary loss to the banks as is done in the case of other officials in the lower rung of the hierarchy.
33	3.66	The Committee note that delgation of lending powers at different levels of hierarchy, differs from bank to bank depending, <i>inter alia</i> upon organisational structure, scale of operation, resource base, level of expertise of the delegates, etc. The lending powers at the different levels right from the branch level officials to functionaries at top level are fixed by individual banks taking into account the above factors. Under the extant guideliens laons/advances sanctioned transgressing delegated powers are required to be ratified

thereafter by the competent authority. According to the Ministry of Finance, number of accounts turning into NPAs on account of transgression of delegated powers is reported to be negligible. What is worrisome to the Committee is the very fact that apart from requests for ratification of transgression, cases of transgression of powers by the officials come to the notice of bank management/RBI through internal audit/inspection, concurrent/statutory audit, RBI inspection, etc. clearly indicates that transgression of powers by bank officials are not being regularly ratified as per extant guidelines but are being suppressed which only come to light subsequently through audit/inspection. The Committee feel that cases of transgression of powers are not fully reported for ratification as per extant guidelines and that is why the number of account turning into NPAs on account of transgression of powers coming to the notice of bank management/RBI appears to be negligible. The Committee expect that in the light of the judgement of the Supreme Court, the Bank Officers would function within the parameters of their sanctioning powers for lending so that the chance of an account turning into NPA on this ground is reduced to the minimum.

34 3.67

One of the reasons cited by Deputy Governor, RBI for advances going bad is that "it may be due to wrong skill of the person who is appraising....in future the banks will be careful in their training system." The Committee have been informed that almost all banks have their own training establishments where members of their staff are trained in proper appraisal, supervision and follow up of advances. Besides, banks also depute their officers to the Banker's Training College, College of Agricultural Banking of the Reserve Bank of India and the national Institute of Bank Management where they are, *inter alia* imparted training in the above aspects. However, in regard to factors for which banks are responsible for advances turning non-performing, the Ministry have cited deficiencies in credit appraisal, non-observance of norms for sanction of loans and laxity in post-disbursement supervision. The Committee feel that training system for bank officers need revamping. The Committee recommend as follows:

- (i) The syllabus in the institutes/colleges imparting training in the various programmes relating to different schemes/sectors for appraisal, supervision and follow up of advances may be reviewed by a Committee of Senior bankers to improve the quality

of specialised training in risk management, project appraisal skill and resource management as also qualifying and trainers' standards upgraded to skillfully groom the bank officers for improved professional capabilities to enable them to face various types of business risks in the present age of competition and changing economic scenario.

- (ii) There is also a need for upgrading the professional skills among the senior management in banks. To upgrade their project appraisal skill and to equip them with adequate awareness of technological developments in various sectors of the economy, there should be a regular outflow of senior bank officers from all Public Sector Banks as also officers of the level of Directors in the Banking Division of the Ministry for specialised training in training institutes abroad to equip them with latest procedures and the system of banking prevalent in those countries. Salient features of the systems prevalent in other countries in the world may be incorporated in the training system in India and updated from time to time and tuned to the issues confronting the Banking Sector in India to meet the emerging challenges on the basis of the experience and knowledge of these officers.
- (iii) Some training institutes may be identified for development as Centres of Excellence within the Banking Sector for sharing training facilities and providing state-of-the-art training.

35 3.68 The Committee note that performance of various recovery plans is being looked into by the RBI during inspection of banks carried out at regular intervals. As per RBI guidelines banks have been asked to formulate a loan recovery policy with the approval of the Board of Directors. They have also constituted a Recovery Cell at their Head Office under the charge of a G.M. Further branchwise targets are required to be fixed by banks for recovery of NPAs, and their performance is to be monitored at Head Office level on monthly basis. The Committee hope that these measures put in place to improve recovery will work and prove to be effective. Further those measures will facilitate banks to increase the tempo of recovery, enable them to reach their recovery targets. The Committee desire that the RBI closely monitor the utility of

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		these measures by banks in improving recovery of the existing problem loans.
36	3.69	The Committee feel that the IBA suggestion that banks should strengthen the recovery mechanism not only from the point of view of establishing special recovery branches but also by training people and creating systems for close supervision of the loan accounts to detect immediately any signs of deficiencies, deserves consideration.
37	3.70	<p>The Committee note that recommendation made by the Narasimham Committee in its Report on the Financial System for setting up of a separate Asset Reconstruction Fund to take over the bad and doubtful debts from banks and financial institutions and subsequently follow up on recovery of dues owned to them from the primary borrowers was examined by the Government of India and not found acceptable.</p> <p>The Committee also note the IBA view that huge size of NPAs, accumulated over a long period of time, cannot be drastically reduced within a short time without any major institutional measures. This can be achieved by creation of Asset Reconstruction Fund as recommended by Narasimham Committee. However, Hon'ble Minister of Finance has announced in his Budget Speech 1998-99 the decision to establish Asset Reconstruction Companies. According to the decision a few banks having particularly high NPAs will be encouraged to establish Asset Reconstruction Companies, which will take over the NPAs of the bank at their realisable value and swap them with special bonds to be held by the bank. The Asset Reconstruction Companies will concentrate on recovery of dues to realise the maximum value for the assets transferred to them.</p>
38	3.71	The Committee note that the RBI's recent security of certain large borrowal accounts conducted in a few banks has revealed diversion of bank finances for investment in finance companies, associate companies/subsidiaries, inter-corporate deposits, etc. In this connection, RBI has advised banks that if a borrower is found to have diverted finance granted for working capital purposes for other activities, banks must recall the amount so diverted. In order to gauge the magnitude of diversion of funds by borrowers as also whether the diversion of banks finance was for activities not permissible under the extant norms of investment/credit policy of the banks, the Committee would like to be informed of the number of instances of diversion of funds by borrowers to

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		other than the purposes (including breakup of non-permissible activities) for which the loans were sanctioned, the amount involved and the recall of the amount so directed bank-wise for the last year only.
39	23.72	The Committee note that under the extant guidelines banks are required to examine staff accountability whenever there is a deterioration in the asset quality. In this connection, the Ministry of Finance have furnished statements giving details of (i) officials found responsible for advances turning into bad debts and (ii) cases of laxity in postdisbursement supervision of advances resulting in bad debts in respect of certain banks and punitive action taken against these officials during the year 1992-93, 1993-94 and 1994-95. On perusal of these statements, it is observed that in some cases disciplinary/Departmental proceedings are still pending. The Committee desire that pending proceedings should be expeditiously finalised.
40	3.73	Further, on perusal of the statements it is also felt that year-wise disciplinary proceedings initiated bank-wise via-a-vis. quantum of loans/advances turning into NPAs are minimal just an eye-wash. The Committee expect the Ministry of Finance to impress upon the banks to take a serious view of the lapses in sanction of loans/advances and laxity in post disbursement supervision for fixing staff accountability.
41	3.74	The Committee also note that banks have been advised to frame a policy on staff accountability with the approval of their Boards. The Committee would like to be apprised of the present position on finalisation of policy on staff accountability and the time frame fixed for its finalisation bank-wise. One of the important measures which could be considered for stopping wilful defaults is, according to IBA, swift and effective penal action on the erring bank officials connected with irregularities. The Committee desire that this aspect should form a part of a policy on staff accountability.
42	3.75	All Public Sector banks have their Vigilance Departments of head Office/Controlling Office level to look into any sort of malpractices/irregularities against bank officials in sanction/disbursement of loans. As there has been considerable deterioration in the quality of assets of the banks and ineffective departmental action either due to administrative sleaze and laxity or pervasive attitude of pessimism on the part of Chief Vigilance Officer (CVO) or possible collusion among personnel of the Vigilance Department, unscrupulous

bank officers and private parties to siphon off bank funds, the Committee desire the Ministry of Finance to undertake a detailed review whether the performance of the Vigilance Departments of the banks was of requisite standard and as also of the need for their revamping.

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The Committee also make the following recommendations to recover/reduce/contain NPAs in the Public Sector Banks:

- (i) With a view to reducing the Non-Performing Assets (NPAs) and at the same avoiding lengthy and time consuming legal action, banks have been advised to recover their dues by entering into settlement/compromise proposals with borrowers on mutually acceptable terms. The Committee feel that banks should be very careful in considering settlement/compromise proposals. Instead RBI banks should examine the necessity of constituting Settlement Advisory Committee consisting of renowned bankers under the Chairmanship of retired High Court Judge to consider proposals of compromise/write offs as per laid down norms for speedy recovery of assets in cases of large default with a view to bringing down their non-performing assets.
 - (ii) Public Sector Banks should also share information on loan sanction and loan write off/compromise proposals in cases of borrowal accounts of Rs. 10 lakh and above to caution the other banks from lending to such defaulting borrowers.
 - (iii) Suits should be filed immediately where promoters have guaranteed the advance and there is a default.
 - (iv) Banks should introduce the system of obtaining on audit certificate from the borrowers to ensure proper end use of funds lent.
 - (v) Banks should also consider the feasibility of introducing a system for internal audit of sanction of loans before disbursement for larger advances.
 - (vi) It may not be difficult for the banks to place the right people for the work of credit portfolio management who have training and greater awareness at operational level for credit risk assessment and can render honest and diligent service in the discharge of their responsibilities.
 - (vii) Non-performance by lenders in not making timely sanction/disbursement of loans sometimes convert
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potentially profitable enterprises to loss making ones. Many industries suffer decline because of delays in disbursement of loans by banks. This may contribute to NPAs. This aspect also needs to be closely monitored.

- (viii) A doubtful asset normally takes a minimum of two years to surface. It would, therefore, be prudent on the part of the management not to post bank officers for credit portfolio work during the three years preceding their retirement so as to enable them to retire honourably and gracefully.
- (ix) A review of the performance of the office belonging to credit portfolio management should be made regularly and necessarily at least one year before his retirement to assess whether he had not acted prudently while sanctioning of advances, whether he had not observed the normal procedure followed in the bank in sanctioning the applications and whether any serious irregularities in the conduct of credit portfolio or in other accounts had been observed.

44 4.34

The Committee note that Public Sector Banks reduce their NPAs and recover their dues through upgradation of accounts from sub-standard to standard category, compromise/write off of loans as per laid down guidelines and cash recoveries. It is indeed heartening to note that with the introduction of prudential norms, the Government/RBI has become extremely anxious to effect all round improvement in the working of the credit portfolio of the banks. To improve their performance in recovery of bad debts, PSBs as advised by RBI, have formulated their Investment Policies and Loan Recovery Policies duly approved by their Board of Directors. A General Manager at the Head Office has been assigned the exclusive portfolio of Recovery. Branchwise targets are fixed for recovery of dues and monitoring is done at Head Office level on a regular basis. The Board of Directors are to be informed about the progress of recovery at quarterly intervals. The progress of recovery and reduction in NPAs is also reviewed by RBI periodically. The Committee expect that with various measures in place coupled with a fair amount of dedication and involvement of the bank officers assigned with the responsibility of credit portfolio at the grass roots level in recovery in a big way, seeking assistance of the Government agencies when necessary, counselling of

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		borrowers and also organising recovery campaigns in all branches to step up realisation of dues of the bank, the efforts will fructify.
45	4.35	On perusal of the details furnished by the Ministry for the years 1994-95 and 1995-96, the Committee find that banks have been able to achieve total reduction in NPAs on account of upgradation, compromise/write off and recovery of Rs. 7892 crore and Rs. 7751 crore respectively.
46	4.36	High level of non-performing assets (NPAs) in the banking sector at present is the most worrisome aspect of the financial sector. NPAs in Public Sector Banks (PSBs) at about 18 per cent of credit portfolio are much in excess of international standards where the tolerable levels of NPAs are around 3 to 4 per cent. The Committee are satisfied to note that Banks are aware of the paramount need for containing NPAs. But despite taking various suitable corrective measures and putting in place credit monitoring systems by PSBs to bring the ratio down to a manageable level, they have been able to achieve relatively limited success.
47	4.37	The Committee feel that recovery of dues by the banks is one of the major concerns in view of the need for recycling the funds for socio-economic development and the very survival of the banking sector. For intensive recovery efforts the main hurdle has been the time consuming legal process because of which the borrowers do not feel compelled to come forward for settling their dues. With the introduction of prudential norms and concept of NPAs from the year 1992-93 and also requirement for provisioning, credit procedures will become a critical input in credit decisions. The time, cost and efforts in recovery of loans will determine whether banks are willing to grant loans to borrowers where they are sure that they can recover their dues quickly and not get bogged down in endless wrangling. That may spell disaster especially for small and medium borrowers. It is therefore imperative in the larger interest of the borrowers that there should be legislative changes to ensure quick recovery of NPAs and to enable the banks to perform their assigned role of lending for socio-economic development of the people.
48	4.38	The Committee note from the submissions made by the Banks during their study tours as also from the Ministry of Finance in their notes furnished to the Committee that the major handicap in quick recovery of dues of the banks is the slow and dilatory process of recovering dues. It takes a very long

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time before it is possible to obtain a decree and even after a decree is obtained, there are problems in execution of the decree for realisation of assets/decretal dues. The Committee are informed that as on March, 1993, there were a total of 10.25 lakh accounts of Public Sector Banks involving an amount of Rs. 4071.60 crore in respect of which suits have been filed by banks. Further, decrees have been obtained in respect of 5.21 lakh accounts. IBA in this connection has suggested that there was a need to refine the legal system and strengthen the recovery powers of banks akin to those available for the Revenue Department, Cooperative Banks and Development Financial Institutions.

The Committee feel that there is need for Government support both at the Centre and at the State level for extending help of the Revenue Departments in effective recovery in different cases and rendering required assistance in executing decrees obtained from the courts. The Committee desire that the matter may be taken up at the highest level in the Ministry of Finance with other Departments of the Government of India and their PSUs where huge funds of banks are blocked up and also impress upon the State Governments for providing requisite assistance for execution of decrees granted by the courts in favour of the banks for recovery of their dues as also the need for bringing about amendments in the Recovery Acts to effect improvement in the recovery of banks' dues, and strengthen recovery powers to the banks as available to Revenue Departments, Cooperative Banks and Developmental Financial Institutions as suggested by IBA and introduction of a system whereby borrowers should be compelled for timely payment of bank dues thus obviating time consuming and costly civil court proceedings in the larger interest of borrowers.

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At present no policy guidelines have been laid down either by RBI or by the banks themselves for filing of suits for recovery of their non-performing assets. Under the prudential norms, assets have been classified into four categories depending upon the periodicity of their non-performance i.e. standard, sub-standard, doubtful and loss assets. It is really surprising that no time frame has been prescribed for filing recovery suits in respect of doubtful/loss assets. According to the Finance Secretary banks should file recovery suits the moment they lose hope of recovery. The Committee feel that in the absence of a strict monitoring many unscrupulous

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borrowing units may simply vanish and there will neither be a promoter nor any property left against which the bank can make recovery. The reality is that in the absence of specific guidelines the functionaries of banks file recovery suits when it is virtually impossible to recover their money. As such banks need to act fast for timely action of filing recovery suits. The Committee therefore desire that banks should lay down specific guidelines duly approved by their Board of Directors for filing recovery suits and be made a part of their Loan Recovery Policy. The Committee would like to be apprised of the follow up action taken by Government in this regard.

50 4.40 The Committee note that to fill up a major lacuna in the existing legal framework, the Recovery of Debts due to Banks and Financial Institutions Act, 1993 has been enacted to provide for expeditious adjudication and recovery of debts due to the Banks and Financial Institutions. One of the salient features of the Act is that the "Tribunal and the Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908 but shall be guided by the principle of natural justice and subject to other provision of the Act." The Committee further note that the Delhi High Court had held that the Recovery of Debts due to Banks and Financial Insitutions Act, 1993 was unconstitutional. However, the Supreme Court has stayed the Delhi High Court order and admitted Special Leave Petition (SLP) filed on behalf of the Government. The matter came up for hearing in July, 1997. The Division Bench of the Supreme Court decided to refer the matter to a three Judge Bench. The Union of India had also filed a Transfer Petition (TP) before the Hon. Supreme Court requesting the transfer of all the cases pending before various High Courts and to hear all these cases alongwith the SLP filed by the Union of India.

51 4.41 The Act provides for establishment of Tribunals. So far, nine Debt Recovery Tribunals (DRTs) have been established having their jurisdiction over certain States. These are located at Calcutta, Delhi, Jaipur, Bangalore, Ahmedabad, Chennai, Patna, Jabalpur and Guwahati. There is one Appellate Tribunal at Mumbai having jurisdiction all over India and over all Tribunals. In their general comments on DRTs, IBA has pointed out that the infrastructure at most DRTs is poor. Some of the Tribunals have large geographical coverage. IBA has also suggested that DRTs may be expeditiously opened in unrepresented States like Maharashtra and Uttar Pradesh.

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		Government should also set up DRTs at more places for example at Chandigarh to cover States of Haryana, Punjab and Himachal Pradesh and Appellate Ttribunals at Delhi, Calcutta and Chennai.
52	4.42	Meanwhile the Tribunals have started functioning and disposing of the cases filed by the banks/financial institutions. In regard to the experience of the Government in the disposal of cases by the Tribunals and whether there was any need for amendment to be made in the Act for expediting disposal of cases, the Ministry have informed that the disposal of cases by the Tribunals is not to the desired extent because of the judgement of the Delhi High Court on the validity of the Act. Keeping in view the judgement of the Delhi High Court, the Government have felt the need to carry out some amendments in the Act. But the same has been kept pending till the disposal of SLP by the Supreme Court on the advice of the Ministry of Law on the matter.
53	4.43	Provisions of the Recovery of Debts due to Banks and Financial Institutions Act, 1993, do not apply where the amount of debts due to any bank of financial institution or to a consortium of banks or financial institutions is less than ten lakh rupees or such other amount being not less than one lakh rupees as the Central Government by notification may specify. In order to achieve the objectives of expeditious disposal of cases of substantial amount and to ensure that DRTs do not get loaded with large number of cases, at present cut off limit of rupees ten lakh and above has been specified. The Committee desire that this cut off limit should be reduced to Rs. 5 lakh as soon as pendency of cases before the Tribunals falls considerably.
54	4.44	The Committee note that keeping in view the judgement of the Delhi High Court on the validity of the Act, the Government propose to carry out some amendments in the Act after the disposal of the Special Leave Petition by the Supreme Court. In this connection, IBA has pointed out that in many cases stay orders are being obtained against orders passed by DRTs causing delays and legal battles at the execution stage. The Committee desire that before initiating amendments in the Act, the Ministry of Finance in the light of recommendations of Working Group constituted by RBI should hold deep consultations with IBA and Financial Institutions on measures considered essential for making DRTs more effective for speedy recovery of bank dues and also the need for more Tribunals.

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