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SARFAESI ACT, 2002 - AN EFFECTIVE TOOL FOR NPA RECOVERY

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Abstract
Banking is considered to be one of the most important factors supporting the growth of an economy. The increased level of Non Performing Asset (NPA) is the main problem faced by the banks now. In India the level of level of NPA is increased every year and the performance of the banks is getting affected due to this problem. If the level of NPA is not controlled the existence of the banks will be in trouble. So it is the need of the hour to recover the NPA and save the banks to support our economy. The enactment of The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 made a lot of changes in the area of recovery of NPA. This made the NPA recovery more effective and fast. The most important feature of SARAFESI Act is that it enables the banks and financial institutions to sell the secured asset under auction without intervention of the curt. Though the SARFAESI Act helps for speedy recovery of NPA, some provisions of the Act create various problems to genuine borrowers. Many of the borrowers allege that the banks are misusing the provisions of the Act. The genuine borrowers are to be given some considerations before initiating action under SARAFESI Act for recovery.

Objective of the study
The objective of this study is to get an idea about NPA and the role of SARFAESI Act as a tool for recovery of NPA.

Key words: SARFAESI Act, Non Performing Asset, NPA Recovery, Provisioning.

Introduction
In present banking scenario in India, one of the main problems faced by banks is recovery of Non Performing Assets (NPA). Every year the level of NPA is increasing. The increased level of NPA affects the profitability and performance of the banks. Due to NPA banks are facing lack of liquidity of funds, loss of confidence of share holders and public, etc. It is the need of the hour to control and reduce the level of NPA to save the banks. Now banks have various tools to recover the dues from the customers. But the action under SARFAESI Act, 2002 is very effective and different tool from other tools. It enables banks to recover the unpaid dues without intervention of the court. So the recovery of NPA under SARFAESI Act is very fast and effective.

Meaning of NPA and Its Classification
This paper is mainly concentrated on SARFAESI Act and action under SARFAESI Act, 2002. But it is very essential and interesting to understand about Non Performing Asset (NPA) before discussing about SARAFESI Act. The basic function of a bank is accepting deposits for the purpose of lending. Banks are accepting deposits at a lower rate of interest and lending the same as loans and advances at a higher rate of interest. The margin between these two rates of interest is the main source of income of a bank. The deposits accepted by a bank are considered as its liabilities and the loans advanced by a bank are considered as its assets. If the payment of interest and repayment of principal is not made as and when it fall due, the asset is called as Non Performing Asset (NPA). NPA means an asset of bank which does not produce any income for the bank.

According to Reserve Bank of India a Non Performing Asset (NPA) is a loan or an advance where;

1. Interest and/ or installment of principal remain overdue for a period of more than 90 days in respect of a term loan,
2. The account remains 'out of order' as indicated at paragraph 2.2 below, in respect of an Overdraft/Cash Credit (OD/CC),
3. The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
4. The installment of principal or interest there on remains overdue for two crop seasons for short duration crops,
5. The installment of principal or interest there on remains overdue for one crop season for long duration crops,
6. The amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitization transaction undertaken in terms of guidelines on securitization dated February 1, 2006.
7. In respect of derivative transactions, the overdue receivables representing positive mark-to-market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment.

NPA Classification
The NPA accounts are classified into three categories on the basis of the period for which the asset has remained non performing and reliability of the dues. The three categories of NPA are Substandard Assets, Doubtful Assets and Loss Assets.

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1. **Substandard Assets**
   A substandard asset is an asset which has remained NPA for a period less than or equal to 12 months. In such cases the current net worth of the borrower or the guarantor or the current market value of the security charged is not enough to ensure the recovery of the dues to the bank in full.
2. **Doubtful Assets**
   An asset is classified as Doubtful if it has remained as substandard category for a period of 12 months.
3. **Loss Assets**
   A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. In other words, such an asset is considered 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.

Provisioning for NPA Accounts
The banks are responsible for proper asset classification and making adequate provision for any diminution in the value of loan assets, investment, or other assets. The banks are required to make adequate and necessary provisions in terms of prudential guidelines. As per the norms provisions should be made on NPA on the basis of classification of assets into prescribed categories such as substandard, doubtful and loss. The provisioning for each category is given below.

Substandard Assets
In case of substandard assets a general provision of 15% on total outstanding should be made. The unsecured exposures which are identified as ‘Substandard’ would attract additional provision of 10% i.e. a total of 25% on the outstanding balance. However in view of certain safeguards such as escrow accounts available in respect of infrastructure lending, infrastructure loan accounts which are classified as Substandard will attract a provisioning of 20% instead of aforesaid prescription of 25%. To avail of this benefit of lower provisioning, the banks should have in place an appropriate mechanism to escrow the cash flows and also have a clear and legal first claim on these cash flows.

Doubtful Assets
In case of doubtful assets 100% of the extent to which the advance is not covered by the realizable value of the security to which the bank has valid record and the realizable value is estimated on realistic basis.

In regard to the secured portion, provision may be made on the following basis, at the rate ranging from 25% to 100% of the secured portion depending upon the period for which the asset has remained doubtful.

Period for which the advance has remained in doubtful status	Provision required
Up to one year	25%
One to three year	40%
More than three years	100%

Loss Assets
Loss assts should be written off. If loss assets are permitted to remain in the books for any reason, 100% of the outstanding should be provided for provision.

Effects of NPA
The level of Non Performing Assets is very important as far as profitability of a bank is concerned. The effects of NPA are discussed below.

1. **Impact on Balance Sheet of banks**
   In present scenario NPA management is one of the foremost and formidable problems faced by the banks in India. Every year the level of NPA is increased. The increasing level of NPA is caused for reducing the confidence of share holders, depositors, lenders, etc. It causes for poor recycling of funds which in turn will have deleterious effect on the deployment of credit. It affects the financial soundness of the bank.

2. **Impact on Profitability**
   As far as bank’s profitability is concerned, NPA is considered as double edged sword. Due to NPA the bank stops to earn income on one hand and attract higher provisioning on the other hand. On an average, banks are providing around 25% to 30% additional provision on incremental NPA which has direct bearing on the profitability of the banks.

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3. **Impact on Capacity for lending**
   The increased level of NPA causes for reduction in bank's capacity for lending more and thus results in lesser interest income.

4. **Impact on Liability Management**
   Because of increased level of NPA banks are forced to reduce the rate of interest on deposits on one hand and likely to levy higher rate of interest on advances. This affects bank's business and economic growth.

5. **Impact on Capital Adequacy**
   As per Basel Norms, banks are required to maintain adequate capital on risk-weighted assets on an ongoing basis. Every increase in NPA level adds to risk weighted assets which warrant the bank to shore up their capital base further.

6. **Impact on Confidence of Share Holders and Public**
7. The increased level of NPA has an adverse effect on profitability of the bank and the share holders do not get a market return on their capital. The confidence of public on bank is getting reduced due to NPA.

8. **Impact on Financial Ratios**
   The high level of NPA has an impact on all important financial ratios of a bank. The important ratios are Net Interest Margin, Return on Assets, Profitability , Dividend payout ratio, Provision Coverage ratio, Credit Contraction, etc. which may likely to erode the value of Share holders, depositors, borrowers, employees and public at large.

9. **Impact on Goodwill**
   If the level of NPA is very high the value of the goodwill of banks is getting reduced. The facts such as level of NPA, profitability, liquidity, goodwill, etc. are related with each other.

SARFAESI Act, 2002

Now we have discussed about NPA and the importance of the recovery of NPA. There are different tools in the hands of banks and financial institutions for recovery of NPA. Among these tools action under SARFAESI Act, 2002 is very important, popular and effective.

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 is a powerful instrument in the hands of the banks and financial institutions as secured creditors. As per the provisions of this act, the banks and financial institutions are given power to sell the properties, kept as securities against the loan availed, under auction to recover the bank dues. This act enables the banks and financial institutions to auction properties, whether it is residential or commercial, movable or immovable, if the borrower fails to repay the loans and accounts turn into NPA. The main benefit of this recovery method is that it avoids intervention of court to sell the secured property. This makes for easy and fast recovery of NPA.

If the loan repayment is not made in term and the accounts become NPA, the bank can take possession of the property (except agricultural property) without intervention of the court. SARFAESI is effective only for secured loans. Banks are getting charge over securities though hypothecation, pledge and mortgage. In such cases, court intervention is not necessary, unless the security is invalid or fraudulent. However if the asset in question is an unsecured asset, the bank has to approach the court to file civil case against the defaulters.

Background of the Act

By the late 1990s rising level of NPA raised concerns and Committees like Narasimham Committee II and Andhyarujina Committee which were constituted for examining banking sector reforms considered the need for changes in the legal system to address the issue of NPAs. These committees suggested a new legislation for securitization and empowering banks and financial institutions to take possession of the securities and sell them under auction without intervention of the court and without allowing borrowers to take shelter under provisions of Sick Industrial Companies Act (SICA) 1985 or Board for Industrial Financial Reconstruction. Acting on these suggestions, the SARFAESI Act was passed in 2002 to legalise securitization and reconstruction of financial assets and enforcement of security interest. The Act envisaged the formation of asset reconstruction companies and securitization companies.

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Preconditions for Initiating Action under SARFAESI Act

Whenever an account is declared as NPA as per the guidelines issued by Reserve Bank of India, the bank can initiate action under SARFAESI Act. For initiating action under SARFAESI Act there are some preconditions. They are:

- The loan should be secured.
- The loan account should be classified as NPA s per the guidelines of Reserve Bank of India.
- The outstanding dues should be Rs.1.00 lakh and above and it should be more than 20% of the principal loan amount and interest there on.
- The security enforced should not be an agricultural property.

Rights of the Borrowers

Even though SARFAESI Act provides the secured creditors power to sell the secured assets without intervention of the court, the borrowers are also getting some rights under the provisions of this act. They are as follows:

- The borrowers can at any time before the sale concluded, deposit the dues and avoid losing the secured asset.
- In case any unhealthy or illegal act is done by the Authorized Officer of the banks or financial institutions, he will be liable for penal consequences and the borrowers will be entitled to get compensation for such acts.
- For redressing the grievances, the borrowers can approach firstly the DRT and the DRAT in appeal. The limitation period is 45 days and 30 days respectively.

Recovery Methods

As per the provisions of SARAFESI Act, the recovery of NPA account can be done mainly in two methods. They are as follows:

Securitization Method

In this method marketable securities backed by a pool of existing assets are issued. After an asset is converted into a marketable security, it is sold. A securitization company or reconstruction company may raise funds only from the QIB (Qualified Institutional Buyers) by forming schemes for acquiring financial assets.

Asset Reconstruction Method

Enactment of SARFAESI Act caused for the formation of Asset Reconstruction Companies in India. It can be done by either proper management of the business of the borrower, or by taking over it or by selling a part or whole of the business or by rescheduling of payment of debts payable by the borrower.

Procedures under SARAFESI Act

When an account becomes NPA and if SARFAESI Act is applicable, the banks can issue Demand Notice to the defaulting borrower and the guarantor, demanding them to discharge the dues in full within 60 days from the receipt of the notice. If the notice is not delivered to the borrower the same should be published in minimum one English news paper and in one regional language news paper. Further the banks have power to issue notice to any person who has acquired any of the secured assets from the borrower to surrender the same to the bank. The bank can ask any debtor of the borrower to pay any sum due or becoming due to the borrower.

After receiving the Demand Notice, if the borrower or guarantor makes any representation or raises any objection, the Authorised Officer of the bank shall consider the same carefully and if he comes to the conclusion that such representation or objection is not acceptable or tenable, he can communicate the reason for non acceptance within one week of receipt of such representation or objection.

If the borrower or guarantor is aggrieved by the action of the bank, they can file an appeal with DRT and then with DRAT, but they cannot file any appeal with any Civil Court. The borrower or the guarantor has to deposit 50% of the dues before an appeal with DRAT.

After receiving Demand Notice, if the borrower or guarantor fails to discharge the dues, the bank can take possession of the security, sale or lease or assign the right over the security, manage the same or appoint any person to manage the same. After taking possession of the security, bank or financial institution can sell the security under auction. The bid price is fixed on the present value of the property. The valuation of security is done by the professional valuers or experts and on the basis of their valuation report, the reserve price of the security is fixed. The reserve price fixed will be the bid price. Usually the valuations tend to be on the conservative side as it is a distress sale. After fixing the reserve price, the sale notice is issued to the borrower and the guarantor and same is published in at least one English news paper and in one regional language news

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paper, 30 days prior to the auction. The interested bidders must submit their bids along with a certain percentage of the reserve price as earnest money deposit. On the auction day, the highest bid is announced. The winner has to pay 25% of the bid amount to confirm the purchase. The bank may allow the winner to pay the remaining amount in 10-15 days. If the price fetched exceeds bank's due, excess amount is given to the borrower.

Conclusion

In present banking scenario in India, the level of NPA is increasing and now it is at an alarming level. So action under SARAFESI Act is one of the most effective tools for speedy recovery of bank dues. When loan accounts become NPA the banks are facing many problems such as liquidity problems, provisioning, profitability problems, etc. So it is very important for banks to reduce the level of NPA and speedy and effective recovery of the same. Though the action under SARFAESI Act helps the bank for recovery of NPA, various provisions of the act have created many problems to genuine borrowers. The various provisions meant to balance the requirements of the borrowers and the banks, have their balance of favour titled towards banks. In most of the cases, the borrowers allege that banks are misusing the powers of the Act. The banks should try to understand the problems of genuine borrowers before initiating SARFAESI proceedings. If the provisions of the SARFAESI Act are used for recovery of NPA with a consideration to genuine borrowers, the level of NPA can be reduced considerably.

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