

**PHASES AND DIMENSIONS OF NON-PERFORMING ASSETS IN INDIAN
BANKING SYSTEM: LEGAL RESPONSE**

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The linchpin of any country's economy is its banking system. For an economic system to sustain, it is of utmost significance that the growth of the banking system is fast and at the same time, stable. The banking system of India, on the other hand, has been rendered to a lot of susceptibilities in the recent years owing to the globalised economic environment. One of the prime issues pertaining to the stability of the Indian banking system is the Non-Performing Assets (NPAs). A loan is characterized as a Non-Performing Asset if the borrower does not repay its principal along with interest payments for 90 days. It tends to block capital, thus reducing the earning capacity of the assets. As a consequence of such reduction, return on assets tends to get affected.

Non-Performing Assets: An Introduction

An asset, including a leased asset, becomes a non-performing asset when it ceases to generate income for the bank¹, i.e. Non-Performing Asset is any asset of a financial institution that does not produce any income. Investopedia defines it as “a debt obligation where the borrower has not paid any previously agreed upon interest and principal repayments to the designated lender for an extended period of time. The non-performing asset is therefore not yielding any income to the lender in the form of principal and interest payments.”² The loan would be called a Non-Performing Asset if the borrower does not repay its stated principal along with interest payments for 90 days. Section 2(1)(o)(a) of the The Securitisation and

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¹ *Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances*, Circular Number DBOD No. BP.BC/ 20 /21.04.048 /2001-2002 dated August 30, 2001, RESERVE BANK OF INDIA, (Mar. 7, 2016), http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?Id=449&Mode=09 (last updated Mar 7, 2016).

² *Non-Performing Asset*, INVESTOPEDIA, <http://www.investopedia.com/terms/n/nonperformingasset.asp> (last updated Feb 14, 2016).

Reconstruction of Financial Assets And Enforcement of Security Interest Act, 2002, describes Non-Performing Asset as:

“an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset-

(a) in case such bank or financial institution is administered or regulated by any authority or body established, constituted or appointed by any law for the time being in force, in accordance with the directions or guidelines relating to assets classifications issued by such authority or body;

(b) in any other case, in accordance with the directions or guidelines relating to assets classifications issued by the Reserve Bank”

The earnings of the banks lay in the amount that they earn from the difference between the interest they receive from borrowers and the interest they pay to the savers. The balance sheet of a bank lists loans given to its customers as assets but in fact Non-Performing Assets are a huge liability for the banks as their profit and income remains at risk which worsens even the situation for the payment of interest to the savers and causes the economic value of the loan assets to fall as well.

The loans given to the customers do not turn out to be bad debts at once. A customer in the case of most of the loans is provided a certain duration known as grace period, after which the debts are identified to be delinquent. Further, after a definite number of days, the concerned loan is categorized as a Non-Performing Loan. The number of days may range between 90 days to 180 days. The standard practice by banks is to categorize a commercial loan that is overdue for more than 90 days and a consumer loan which is overdue from more than 180 days as an NPA.³

³ *Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances*, Circular Number DBOD.No.BP.BC.9/21.04.048/2012-13, RESERVE BANK OF INDIA, http://rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=7357 (last updated July 2, 2012).

For an agricultural loan to be declared as a non-performing asset, the criterion is that the amount of interest and/or installment or the principal amount should remain overdue for two harvest seasons. But, the stipulated period should not be more than two years and any unpaid loan will be considered as non-performing asset after two years.⁴

Classification of Non-Performing Assets

Till mid of 1980s, management of non-performing assets was the responsibility of the auditors and the banks. The first framework of classification of assets for the Indian banking system was set up on the recommendations of A. Ghosh Committee on Final Accounts in 1985⁵. This system was known as the 'Health Code System' (HCS) and it included classification of bank advances into eight categories ranging from 1 (satisfactory) to 8 (bad and doubtful debt).⁶ In 1991, the Narasimhan Committee on the financial system said that the classification of assets according to the HCS was not in accord with global standards and suggested that for the purpose of stipulation, banks should classify their loans into the following four broad groups⁷:

- I. Standard Assets: The assets which do not reveal any trouble and do not carry more than normal risk connected to the business are known as Standard Assets. These assets are considered to be performing assets.
- II. A sub-standard asset is an asset that has been a non-performing asset for a duration less than or equal to 1 year. Another occasion where an asset class or a loan account of the bank is classified as a sub-standard asset is when the terms and conditions concerning to the loan account are revised

⁴*Ibid.*

⁵ Non-Performing Assets of Indian Banks, ACADEMIA.EDU, https://www.academia.edu/4497122/Non_Performing_Assets_ofbanks (last updated Feb 15, 2016).

⁶ Two decades of Credit Management in Indian Banks: looking back and moving ahead; address by Dr. K. C. Chakraborty, Deputy Governor, RBI at BANCON, (Mar. 1, 2016).

⁷ Evolution of Banking in India: First Phase of Reforms, RESERVE BANK OF INDIA, <http://rbi.org.in/scripts/publicationsview.aspx?id=10487> (last updated Mar 7, 2016).

or re-negotiated. And counting on the acceptable functioning basis of the reviewed terms, the account has to be assorted within the sub-standard asset class for at least 12 months. Therefore, mere alteration of terms of the account with no proper conformity does not result in the upgradation of the asset category.

- III. An asset would fall under the category of doubtful asset if it has continued to remain in the category of sub-standard asset for a period of twelve months. A loan categorized as doubtful has all the inherent disadvantages as were in the assets classified as sub-standard, with an additional feature that the limitations make liquidation or collection in full- on the basis of presently known facts, circumstances and values- highly questionable and implausible.⁸
- IV. A non-performing asset is considered to be a loss asset when the loss is recognized by the bank or internal or external auditors or the RBI inspection but the amount in question has not been written off entirely.⁹ To put it simply, such an asset is considered uncollectible and of such inconsequential value that its continuance as a bankable asset is not reasonable although there may be some reclaim or recovery value.

However, the Non-Performing Assets, according to a RBI circular¹⁰, requires banks to categorize them into sub-standard asset, doubtful asset and loss asset, on the basis of the duration that has elapsed since the time of such assets being declared as non-performing assets.¹¹ Following the analogy, prudential norms relating to income acknowledgment, asset categorization and provisioning were

⁸*Ibid.*

⁹ M/S Holystar Natural Resources Pvt. Ltd. & Anr. v. Union Of India & Anr., AIR 2014 Delhi 60.

¹⁰ *Master Circular- Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances*, Circular Number DBOD.No.BP.BC.9/21.04.048/2014-15 dated July 1, 2014, RESERVE BANK OF INDIA, http://rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=8128#412 (last updated July 1, 2014).

¹¹ *Master Circular- Income Recognition, Asset Classification, Provisioning & Other Related Matters*, Circular Number UBD.PCB.MC.No.3/09.14.000/2010-11, RESERVE BANK OF INDIA, http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=5761 (last updated Feb 15, 2016).

introduced in 1992 in a phased way. In 1998, the Narasimham Committee on Banking Sector Reforms recommended a further contraction of prudential standards in order to strengthen the current norms and bring them on par with evolving India.¹² With the introduction of 90-days norms for classification of NPAs in 2001, the NPA guidelines were brought as par with international standards.¹³

Importance of the Issue of Non-Performing Assets

The greater the amount of non-performing assets, the weaker will be the bank's revenue system in the economy. Most of the banks are capable to manage an increase in non-performing assets in the short run due to huge reserves or capital in various forms that can be employed to countervail the losses. But after the reserved capital has been exhausted, non-performing loans will begin to jeopardize a bank's growth.¹⁴ Net NPAs (% to Net Advances) which were 1.0% in 2007-08, increased to 1.7% in 2012-13.¹⁵ On examining the percent of Gross NPAs to Gross Advances for the Scheduled Commercial Banks as a whole, NPAs have increased from the level of 2.95% in 2012 to 4.27% in 2015.¹⁶

It is important to look into the issue of NPA as it results in harmful impacts on the return on assets. The interest income of banks will fall as it is accounted only on receipt basis. The profitability of banks will be adversely affected because of the provision of doubtful debts and consequent write off as bad debts. Further,

¹² Pandey, Shruti J. and others, *Non-Performing Assets of Indian Banks– Phases and Dimensions*, 48 Economic and Political Weekly (EPW), No.24, (Mar 5, 2016), http://www.epw.in/system/files/pdf/2013_48/24/NonPerforming_Assets_of_Indian_Banks.pdf.

¹³ K.C. Chakrabarty, *Two decades of credit management in banks: Looking back and moving ahead*, BANCON (2013).

¹⁴ Khaoula Hosni, *Early Warning Indicators for Systemic Banking Crises*, 5 JBSQ, Number 4, 2 (2014).

¹⁵ Suresh Kumar, *Non-Performing Assets: An Indian Perspective*, 3 IJ-AREMS, No. 2, (2014).

¹⁶ Standing Committee On Finance (2015-16), Ministry of Finance, http://164.100.47.134/lsscommittee/Finance/16_Finance_27.pdf [Hereinafter as 'standing committee'].

the Return on Investment (ROI) will reduce and the cost of capital or interest on loan will go up.

The non-performing assets affect the economic system so as to make it unstable and thus hamper its growth. A rise in the non-performing assets of the banks will lead to a scarcity of finances in the Indian security markets. Also, if the banks are not assured of the recovery of their lent money, only a few banks will then be willing to lend.

The impact of the non-performing assets will ultimately lead to a huge amount of losses to the shareholders of the banks as banks themselves will find it difficult to last in the market. This will further result in a crisis of confidence and assurance in the market. The value of loans, i.e. the interest rates on the provided loans will increase drastically. A rise in the interest rates will directly affect the investors who wish to take loans for setting up various projects like infrastructural, industrial projects etc.

The common man will equally be affected as now, the retail consumers will have to dispense a larger interest rate for a loan like home loan, car loan etc. All of this will lead to a chain of low take off of funds from the security market which will impair the overall demand in the Indian economy. And, eventually it will result in lower growth rates and higher inflation rate on account of the higher capital cost.

Factors responsible for rising NPAs in the country

In 2012-13 financial year, the worsening quality of asset in the banking sector came out as a key concern, with total NPAs of banks recording a sharp rise. The unrecovered loans were at 4.4 per cent in March 2014 for public sector banks while it stood at 2.09 per cent in 2008-09, i.e. the gross NPA increased by almost four times from March 2010 to March 2014.¹⁷ The Reserve Bank of India, in response

¹⁷ “Economic Survey 2014: Growth of non-performing assets a cause for concern”, THE ECONOMIC TIMES, http://articles.economictimes.indiatimes.com/2014-07-09/news/51247902_1_npas-psbs-asset-quality (last updated Feb 14, 2016). [hereinafter ‘Economic Survey’].

to an RTI filed by The Indian Express, disclosed that 29 public sector banks wrote off as much as Rs. 1.14 lakh crore of bad debt in the past two years (2013-2015).¹⁸

Increase in non-performing assets of banks is chiefly accounted for by switching to system-based recognition of NPAs by public sector banks, deceleration of economic growth, and excessive lending of credit by banks in the past, especially during times of economic boom. Thus NPAs or bad loans of the banks, including private sector lenders, increased from 2.36 per cent to 3.90 per cent in March 2014. Increase was sharp in case of infrastructure with NPAs rising from 3.23 per cent to 8.22 per cent.¹⁹

It is considered that the slowing down of the economic growth shoots up the rate of interest sharply and thus the corporate sector finds it difficult to pay back loans, which leads to the addition to the increasing non-performing assets. However, the rise in the count of the non-performing assets cannot be attributed entirely to the reversal of economic cycles. There are many other reasons for this which can be sub-categorized into external problems and internal problems that are being faced by the banks.

iii. External Factors

d) REASONS ASSOCIATED WITH THE CORPORATE SECTOR

- I. The slowdown has not only been observed in the Indian economy but also on the global platform. This has unfavorably struck the corporate sector in India. The continuity of uncertainty in the global markets has resulted in the decline of exports of various products such as engineering goods (exports declined 9.36 per cent to \$5.03 billion in

¹⁸ *Net bad assets of govt banks a third of their net worth*, THE INDIAN EXPRESS, <http://indianexpress.com/article/india/india-news-india/bad-debt-loan-financila-crisis-rbi-net-bad-assets-of-govt-banks-a-third-of-their-net-worth/> (last updated Apr. 12, 2016).

¹⁹*Ibid.*

October 2014²⁰), gems (2014 witnessed 3 percent fall²¹), petroleum products (October 2014 witnessed 0.16 percent fall²²) etc. Hence the adversely affected corporate sector is finding it tough to repay the loans advanced to them by the banks.

- II. Various other factors such as the ban on mining undertakings²³ and delay in the permits related to the environment affecting iron and steel sector²⁴ etc. have had a great impact on the performance of the corporate sector which has further lessened their capability to pay back the loans lent to them.

e) REASONS ASSOCIATED WITH THE PRIORITY SECTOR

The banks in India are extremely regulated. One of the regulations upon the banks is the Priority Sector Lending (PSL) which necessitates the banks to give a fixed percent of their loans to certain sections of the society. These includes farmers, Scheduled Castes (SCs), Scheduled Tribes (STs), IT parks, Micro, Small and Medium Enterprises (MSMEs) etc.²⁵

Naturally one would presume that the weaker sections which fall under priority sector lending are the ones to be held responsible for such a situation. However,

²⁰ *Engineering exports to China decline by 9.36% in October*, THE HINDU, (Mar. 3, 2016), <http://www.thehindu.com/news/national/engineering-exports-decline-by-936-percent/article6670953.ece> (last updated Mar 3, 2016).

²¹ Dilip Kumar Jha, *Gems, jewellery export to decline this season*, Business Standard, (Mar 3, 2016), http://www.business-standard.com/article/markets/geery-export-to-decline-this-season-114120900860_1.html (last updated Mar 3, 2016).

²² *After sluggish 2014, India awaits 'promising' 2015 for exports*, INDIAN TRADE PORTAL, <http://www.indiantradeportal.in/vs.jsp?lang=0&id=0,10,577> (last updated Mar 4, 2016).

²³ Krishna N Das and Jatindra Dash, *Supreme Court orders temporary closure of some Odisha iron ore mines*, REUTERS, New Delhi/Bhubaneswar, <http://in.reuters.com/article/2014/05/16/uk-india-iron-mining-idINKBN0DW0HU20140516> (last updated May 16, 2014).

²⁴ Amit Bhandari, *Huge, Growing Crisis in Public-Sector Banks*, INDIA SPEND, <http://www.indiaspend.com/cover-story/huge-growing-crisis-in-public-sector-banks-39870> (last updated Feb 17, 2015).

²⁵ *Priority Sector Lending – Targets and Classification*, Circular Number RPCD.CO.Plan.BC 13/04.09.01/2012-13 RESERVE BANK OF INDIA, <http://www.rbi.org.in/scripts/NotificationUser.aspx?Id=7460&Mode=0> (last updated July 20, 2012).

such presupposition is not true. As per the news reports, the Standing Committee on Finance²⁶ will examine the causes for high non-performing assets in Public Sector Banks (PSBs). The record, shared with the Standing Committee, reflects that non-performing assets in the corporate sector are far higher in number than those in the priority sector. On the other hand, within the priority sector, rise in the non-performing assets were more in respect to micro, small and medium enterprises followed by agriculture. However, the priority lending sector has added considerably to the non-performing assets.

Furthermore, the lethargic legal system in India and lack of efficient and continuous efforts by the banks makes it more difficult to recover these loans from corporate sector as well as non-corporate sector.

iv. Internal Factors

- I. There is lack of a system which is rigorous in nature at state-owned banks which weakens the loan appraisal systems and monitoring of warning signals at the required time. This specifically holds true in the case of infrastructural projects, which continue for a time span of 20 to 30 years, out of which many are struggling to pay back the loans. The Gross NPAs and restructured standard advances²⁷ for the infrastructure sector, together as a percentage of total advances to the sector, has increased considerably from 4.66% as at the end of March 2009 to 17.43% as at the end of March 2013.²⁸
- II. The poor and inefficient means of recovery used by the banks in recovering loans are also an impediment in the stability of the banking

²⁶ *Banking System in India – Non Performing Assets*, INSIGHTS, <http://www.insightsonindia.com/2014/07/05/banking-system-india-non-performing-assets/> (last updated Feb 14, 2016).

²⁷ When a project loan classified as 'standard asset' is restructured within a period of two years from the original date of commencement of commercial operations, then the loan is known as restructured standard advances.

²⁸ K.C. Chakrabarty, *Infrastructure Financing By Banks In India: Myths and Realities*, RESERVE BANK OF INDIA, http://www.rbi.org.in/scripts/BS_SpeechesView.aspx?Id=831 (last updated Mar 8, 2016).

sector in the country. The wait and watch method used by the banks have often been blamed as the cause for the rising non-performing assets as banks let the deteriorating assets to go from bad to worse in the expectation of revival and sometimes offers restructuring option to the corporates.²⁹

A Parliamentary panel on examining the rising incidents of non-performing assets has remarked that the state-owned banks should stop “ever-greening³⁰” or repeated restructuring of corporate debt to check the continuous bulging of their non-performing assets. The members of the panel were of the opinion that non-performing assets are the outcome of terrible economic situation, but there are also organizational issues of ever-greening of loans, which could be averted by “not renewing loans, particularly of corporate”.

Legal Mechanism

The simplest measure to decrease the count of non-performing assets is to recover the bad loans. Viewing the financial reforms being undertaken by the Government of India on the basis of the Narasimham Committee report I and II, prudential norms were brought in by Reserve Bank of India to address the credit monitoring process being adopted and followed by the banks and financial institutions.³¹ To further strengthen the recovery of dues by banks and financial institutions, Government of India promulgated The Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002:

²⁹ *Ibid.*

³⁰ *Ibid.*

³¹ T.R.Radhakrishnan, *Non-Performing Assets or NPA - An Overview*, ALL BANKING SOLUTIONS, <http://www.allbankingsolutions.com/Banking-Tutor/NPA-overview.htm> (last updated Mar 6, 2016).

The Recovery of Debts Due to Banks and Financial Institutions Act, 1993:

The Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDB Act) came into force more than two decades before. The motivation behind the enactment of the Act is held in the report of the Tiwari Committee: “The civil courts are burdened with diverse types of cases. Recovery of dues due to banks and financial institutions is not given any priority by the civil courts. The banks and financial institutions like any other litigants have to go through a process of pursuing the cases for recovery through civil courts for unduly long periods.”³²

The Tiwari Committee recommended three ways to recover outstanding dues; most important among them was to establish quasi-judicial bodies to address only those issues which involve the recovery procedure of the fiscal sector. The chairman of the financial system Committee, Shri Narasimham supported and advanced in the report submitted to the Ministry of Finance in November 1991, the opinions of the Tiwari Committee for the institution of particular statute law and special tribunals to hasten the recovery process in the concerned domain.³³

v. Development of the RDB Act

The development of the RDB Act resulted from some of the concerns like under section 537 of the Companies Act, 1956, there was a demand for the leave of the Company court prior to an order of winding up or previous to the appointment of an interim liquidator under section 446 of the stated Act and whether the orders for the stay of proceedings can be passed by the Company court preceding such an order by the Debt Recovery Tribunal constituted under the Act. Further, the stance of the non-obstante clauses within the concerned Act and the Companies Act as well. The jurisdiction of the Recovery and the Tribunal Officer was equally

³²Sabjeet Singh Jabbal, *Recovery of dues by banks*, LEGAL INDIA, <http://www.legalindia.in/recovery-of-dues-by-banks/> (last updated Mar 5, 2016).

³³Meenakshi Rajeev & H P Mahesh, *Banking Sector Reforms and NPA: A study of Indian Commercial Banks*, THE INSTITUTE FOR SOCIAL AND ECONOMIC CHANGE, (Mar 5, 2016), <http://www.isec.ac.in/WP%20252%20-%20Meenakshi%20Rajeev%20and%20H%20P%20Mahesh.pdf>

a disputable matter. It became imperative to determine the status of the secured creditor who is not involved in the provisions relating to the winding up in the Companies Act and the determination of the constitutional legality of the concerned Act.

vi. Need for the leave of the Company court for shifting of cases

The first case wherein the clauses of the superseding implication of the Act were observed was, *Industrial Credit & Investment Corporation of India Ltd v. Srinivasa Agencies*³⁴. This case considered the question whether the Company court be allowed to grant leave to carry on legal proceedings in any other civil court.

Section 18 of the RDB Act has debarred the jurisdiction of any other court, with an exception of the writ power that has been accorded to the superior courts, with respect to the subjects mentioned under section 17, which relate to the recovery of due debts to the concerned institutions. The Hon'ble Court opined that the method to be followed up by the Company court need not to be confined by defining its limits. The Company court should be given complete discretion to decide according the varying facts and conditions of individual case. However, when such authority is being exercised by the Company court, it is pertinent that the court observes the underlying principle that resulted in the passage of the Act.

vii. The stance of the non-obstante clauses within the concerned Act and the Companies Act as well

The non obstante clause contained in the RDB Act and the non obstante clauses of the Companies Act, 1956 are conflicting in nature. On one hand, the RDB Act provides Tribunal with the jurisdiction, powers and authority to entertain and decide applications from the banks and financial institutions for recovery of debts due to such banks and financial institutions³⁵ and bars the jurisdiction of other

³⁴ *Industrial Credit & Investment Corporation of India Ltd v. Srinivasa Agencies* (1996) 86 Comp Case 255 (SC)

³⁵ RDB Act, §17 (1993).

courts except HC and SC³⁶ while on the other hand, the Companies Act bestows the jurisdiction on the Court which is winding up the company to entertain, or dispose of the matters by or against the company³⁷.

This conflict was, first, observed in *Industrial Credit and Investment Corporation of India Ltd. v. Vanjinad Leathers*³⁸. In this case, the court reckoned that section 18 of the Act prevents the other courts and authorities except the High Courts and Supreme Court from exercising jurisdiction. Further the court opined that the concerned Act as well as the Companies Act are special legislations. Nevertheless, as the RDB Act came into force after the Companies Act, 1956 was enacted, it will not be wrong to say that the law makers would have had the provisions of the latter Act into consideration while drafting the former Act. Thus the latter legislation will override the former one due to the fact that the RDB Act reflects, to some extent, the same principles as by the Companies Act.

The various courts have been considering the consequence of a special act ordained following another special or for that matter a general act. The Supreme Court in *Life Insurance Corporation of India v. DJ Bahadur & Ors.*³⁹ adjudged that the

³⁶ Section 18- On and from the appointed day, no court or other authority shall have, or be entitled to exercise, any jurisdiction, powers or authority (except the Supreme Court, and a High Court exercising jurisdiction under articles 226 and 227 of the Constitution) in relation to the matters specified in section 17.

³⁷ Section 446- The Court which is winding up the company shall, notwithstanding anything contained in any other law for the time being, in force, have jurisdiction to entertain, or dispose of-

- (a) any suit or proceeding by or against the company;
 - (b) any claim made by or against the company (including claims by or against any of its branches in India);
 - (c) any application made under section 391 by or in respect of the company;
 - (d) any question of priorities or any other question whatsoever, whether of law or fact, which may relate to or arise in course of the winding up of the company;
- whether such suit or proceeding has been instituted or is instituted, or such claim or question has arisen or arises or such application has been made or is made before or after the order for the winding up of the company, or before or after the commencement of the Companies (Amendment) Act, 1960.]

³⁸ *Industrial Credit and Investment Corporation of India Ltd. v. Vanjinad Leathers* AIR 1997 Kerala 273.

³⁹ *Life Insurance Corporation of India v. DJ Bahadur & Ors* (1981) 1 SCC 315.

legislators exercise the undisputed authority that they possess to alter a legislation which has already been proclaimed with the help of a succeeding law. In order to modify, abolish or repeal the special law enacted earlier by a general law, an express provision has to be provided in that regard. Furthermore, it was stated that for a general law to supersede a previously enacted special law an express provision in that respect has to be provided, if the two laws are so repugnant to each other that their co-existence cannot be affected. Therefore, a former special law can remain completely untouched by the enactment of a latter law only when no explicit provision is *contra* to the provisions of the earlier act.

In the case of a contradiction between two laws the common rule to be abided by is that the statute which has been passed later abrogates the earlier passed act (*leges posterior espriores contrarias abrogant*) and the well-established exception that has been observed is that a general statute does not derogate special statutes (*generalia specialibus non derogant*).

The High Court of Patna in the case of *Bihar Solex (P.) Ltd.*⁴⁰, opined in the context of the judgment delivered in *Maharashtra Steel Tubes* case⁴¹. According to its judgment, the authority and jurisdiction of the DRT to hear the proceedings and adjudge the filed suits is exclusive with the exceptions of the High Courts and Supreme Court under Article 226 and 227 of the Constitution of India.

The SC in *Industrial Credit and Investment Corporation of India Ltd. v. Grapco Industries Ltd. & Ors.*⁴² opined that for a party to continue with the legal proceedings in the DRT, a leave of the Company court was not required and that the proceedings have to be heard in the specific apparatus provided under the concerned Act.

⁴⁰ *In re*(1999) 20 Comp Cas 235 (Bihar).

⁴¹ *Maharashtra Tubes Ltd. v. State Industrial and Investment Corporation of Maharashtra Ltd.*, 1993 SCR (1) 340.

⁴² *Industrial Credit and Investment Corporation of India Ltd.v. Grapco Industries Ltd. & Ors* 1999 (3) SCR 759.

Therefore, consequently the conflict and the contradiction between the clauses of two different statutes came to an end.

viii. The disputed jurisdiction of the Recovery and the Tribunal Officer

In the case of *Allahabad v. Canara Bank*⁴³, the Hon'ble Court had deliberated over various issues that it was confronted with. The issues covered, *inter alia*, included jurisdiction of the tribunal and the Recovery Officer under the Act. In this case the jurisdiction of the tribunal related to the judgment of the case was decided to be exclusive. The Court mentioned that the primary duty of the tribunal is to judge the legal responsibility of the defendant in the concerned case and then grant a certificate under section 19(22) of the RDB Act. Likewise, in the case of execution the jurisdiction solely lies with the recovery officer.

ix. Constitutional validity of the Act

After the completion of nine years of its enactment, the Act faced a major challenge with respect to its constitutional validity. The basis for challenging the Act was unreasonableness & its nature which violates Article 14 of the Constitution, which is *ultra vires* and thus outside the legislative authority of the Parliament. Firstly, the validity of the Act was challenged before the High Court of Delhi in *Delhi Bar Association & Ors. v. UOI & Anr.*⁴⁴ The Delhi High Court opined that the DRT could be instituted by the Parliament despite the fact that it is not within the purview of Articles 323A and 323B of the Constitution of India and that the expression 'administration of justice' as it appears in Entry 11A of List III of the Seventh Schedule to the Constitution includes Tribunals. The impugned Act was, however, declared unconstitutional as it erodes the independence of the judiciary and was irrational, discriminatory, unreasonable, arbitrary and hit by Article 14 of the Constitution. It also quashed the appointment of the Presiding Officer of the Tribunal. The aforesaid conclusions were drawn on the basis that the Act, section 17 in particular, did not have a provision for counter

⁴³Allahabad v. Canara Bank [2000] INSC 180 (4 April 2000).

⁴⁴Delhi Bar Association & Ors. v. UOI & Anr AIR 1995 Del 323.

claim as provided in the Civil Procedure Code and was irrational and arbitrary. The Act lowered the authority of the HC on the basis of the pecuniary jurisdiction and eroded the independence of the judiciary since the jurisdiction of the civil courts had been truncated and vested in the Tribunal.

The Hon'ble SC, in appeal⁴⁵, dissented with the opinion given by the High Court of Delhi and asserted that the power accorded to Parliament under Articles 323A & 323B to constitute Tribunals does not intervene in the independence of the judiciary.

x. The Securitization Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002:

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) has been enacted to provide a prompt and summary remedy for the recovery of thousands of crores which are due to the financial institutions and banks. The Securitisation Act, as known popularly, targets to attain the twin objectives along with providing for an extensive legal framework for asset securitisation and asset restoration. The instant Act lets financial institutions or banks to recover their non-performing assets without the interference of the Court, by the way of gaining and disposing of the secured assets in the non-performing asset accounts with an outstanding amount of one lakh rupees or above. The banks have to follow a specific laid down procedure whereby the issuance of notice is the first action to be performed by the bank and then on the borrower's failure to pay back the loan, they can take the custody of security pledged and/or takes on the organization of the borrowing concern and then appoint a person to handle the concern.

f) INVOCATION OF PROVISIONS OF SARFAESI

The right of the banks or other financial institutions to avail the provisions of the SARFAESI arises only in the event where any borrower, who is under legal responsibility to a secured creditor under a security agreement, makes any default

⁴⁵ Appeal (civil) 4679 of 1995.

in payment of a secured debt or any installment thereof and his account in respect of such debt is categorized by the secured creditor as non-performing asset.⁴⁶Hence, classification of account as an NPA is inevitable and, the following eventualities can be harvested for recovery of credit under the provisions of SARFAESI: Existence of a debt by a borrower from a secured creditor under a security agreement; Default made in repayment of secured debt or any installment thereof by the borrower; In the case of default, borrower's account is classified by the secured creditor as 'non-performing asset'; Issuing a notice by the secured creditor to the borrower to discharge in full his liabilities within sixty days from the date of the notice; and as per Section 13(3), the notice shall also give details of the amount payable by the borrower and the secured assets intended to be enforced by the secured creditor.⁴⁷

The borrower is not permitted to approach the Civil Court because of the bar under section 34 of SARFAESI Act, 2002. Though there is a scope for the Civil Court to entertain the SARFAESI related matters in some cases in a restricted sense pursuant to the *Mardia Chemical's case*⁴⁸, it is very difficult to convince the Civil Court with regard to its jurisdiction in SARFAEI matters and this can be attributed to the lack of expertise on the part of the Civil Courts with the Securitisation Law.

xi. Lok Adalats:

Section 89 of the Civil Procedure Code, 1908 provides settlement of disputes outside the courts through Alternative Disputes Resolution (ADR) methods such as Conciliation, Arbitration, Mediation and Lok Adalats. The relevant section of the Code states that wherever the court finds that there can be a settlement acceptable to the parties, the court should formulate the terms of settlement and give the same to the concerned parties for their observations and after receiving the observation, it may reformulate the terms of a possible settlement.

⁴⁶ The Institute of Company Secretaries of India, (Mar 6, 2016), <https://www.icsi.edu/docsS%20JUNE22014.pdf>.

⁴⁷M/S Signal Apparels Pvt. Ltd v. Canara Bank, 2010 (5) CTC 337.

⁴⁸Mardia Chemicals Ltd. v. Union of India, 2004 136 TAXMAN 360 SC.

The system of Lok Adalats was statutorily recognised under the Legal Services Authorities Act, 1987. Lok Adalats function under the guidance of Central, State and District Legal Services Authority headed by judges from Supreme Court, High Court and District Court respectively, who have powers to settle both pending suit filed cases as well as pre litigation cases.⁴⁹ The presiding officers can grant awards, which are treated as decree and can be straight away executed in a court of law.⁵⁰ Lok Adalats are one of the most used forms of ADR because, the mechanism of Lok Adalat offers speedy, economical and mutually satisfactory way of resolution of disputes. Lok Adalats is an outcome of court apparatus to settle matters relating to payment of dues, summoned by Debt Recovery Tribunals or Debt Recovery Appellate Tribunals. It is a shared platform for the bank and the borrower to negotiate and reach a mutual settlement. At present, accounts in doubtful and loss category with outstanding above Rs. 20 lakhs can be referred to this forum.⁵¹ Lok Adalats have proved to be an effective and efficient mechanism for rendering quick justice and recovery of small loans. The Hon'ble Supreme Court has observed that loans, personal loans, credit card loans and housing loans with less than ten lakh rupees can be referred to Lok Adalats.⁵² The public sector banks have been advised by the Government to make use of this apparatus to its maximum potential for the recovery in non-performing assets cases.⁵³

xii. The Insolvency and Bankruptcy Code, 2015:

The Insolvency and Bankruptcy Code, 2015 was passed by the Lok Sabha on May 5, 2016 and by the Rajya Sabha on May 11, 2016, and shall come into force, once, it receives the Presidential assent. It is being considered to be one of the most progressive and innovative legislations in the contemporary times.

⁴⁹ *Recovery Policy- Financial Year 2012*, RBL BANK, (Mar 8, 2016), <http://www.rblbank.com/pdfs/bp/Recovery-%202012.pdf>

⁵⁰*Ibid.*

⁵¹STANDING COMMITTEE, *supra* note 15.

⁵²Chandan Karmakar v. UCO Bank & Ors., W.P. 31146 (W) of 2013.

⁵³ *Master Circular- Loans and Advances – Statutory and Other Restrictions*, Circular No. DBOD.No.Dir.BC.14/13.03.00/2013-14 dated Jul 01, 2013, RESERVE BANK OF INDIA, http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=8135 (last updated Mar 7, 2016).

The Code will provide for a speedy process of winding up for defaulting companies and thus a quick recovery of loans lent by the lenders. The Code provides time-bound process (within 180 days) for insolvency resolution of individuals and companies. Nonetheless, if insolvency could not be resolved, the assets of the borrowers can be sold to make repayment to creditors. The National Company Law Tribunal (NCLT) has been empowered by the Code to adjudicate insolvency resolution for companies whereas for individuals, the Debt Recovery Tribunal (DRT) has been given such jurisdiction. In addition to this, The Insolvency and Bankruptcy Board of India will be constituted to regulate functioning of various other bodies established under the Code.⁵⁴

An analysis of the Code, thus, reveals that it will act as a catalyst in curbing the ever-increasing amount of non-performing assets of the banks.

Efficacy of the laws governing NPA

During 2011-12, total NPAs recovered through these three channels (Lok Adalats, DRTs and SARFAESI) were Rs. 144 billion, and out these Rs. 101 billion were recovered through SARFAESI Act only, i.e. 70%. In 2012-13, the share of SARFAESI Act increased further. In 2012-13, out of the total NPAs recovered of Rs. 232 billion, Rs. 185 billion were recovered through SARFAESI Act alone, i.e. 80% of the NPAs recovered were contributed by this Act. In 2013-14, SARFAESI contributed to the recovery of as much as 25.56% of the total amount recovered whereas DRT and Lok Adalat led to the recovery of 9.83% and 8.31% respectively.⁵⁵ It, thus, shows that SARFAESI Act is the most important channel for NPA recovery for Indian banks.⁵⁶ Hence, it can be concluded that the laws enacted and measures taken for the purpose of tackling with the issue of NPAs have been working quite effectively. Further, the RBI provisioning law had come into force from April 1, 2015, according to which, all new restructured loans will

⁵⁴ The Insolvency and Bankruptcy Code, 2015, PRS LEGISLATIVE RESEARCH, <http://www.prsindia.org/billtrack/the-insolvency-and-bankruptcy-bill-2015-4100/> (last updated Mar 7, 2016).

⁵⁵ ECONOMIC SURVEY, *supra* note 16.

⁵⁶ *Operation and Performance of Commercial Banks*, RESERVE BANK OF INDIA, <http://www.rbi.org.in/scripts/PublicationsView.aspx?id=15440> (last updated Mar 8, 2016).

be classified as bad loans and thus, will disincentivize the banks from easily providing for restructured loans.⁵⁷

However, the legal framework governing recovery of secured loans can still be very fair and the Tribunals and Appellate Tribunals can be conferred with well drafted powers so as to give directions to the Bank, when needed.

Conclusion

The holistic performance of the banks is assessed by NPAs. Thus it has always been a cause of concern in the country. Currently Indian banking sector is encountering a critical situation in terms of NPA. A steep rise in the level of NPAs indicates a higher probability of a hefty number of credit defaults that would definitely have an effect on the liquidity and profitability of banks. The amount of NPAs is relatively high in public sectors banks. For an improvement in the efficiency and profitability, the NPAs have to be reasonably planned. The government, from time to time, has taken many steps to reduce NPAs. However it is very unfeasible to have zero percentage NPAs. The management of NPAs is the need of the hour. Every bank has to ensure that an asset does not become NPA and if it does, proper steps should be taken for early recovery, failing to which the profitability of the bank will be eroded. Thus, it is the responsibility of the banks to ensure that they give loans to trustworthy and more importantly creditworthy customers.

Looking at the gigantic size of the banking industry, there can be barely any doubt that the threat of NPAs needs to be cramped. It poses a huge risk to the macro-economic constancy of the Indian economy. An investigation of the current condition brings us to the point that the problem is many-sided and has roots in economic deceleration; worsening business climate in India; shortages in the legal system; and the operational deficiency of the banks. Therefore, it has to be dealt at numerous levels. The government can't be expected to save the state-run banks with tax-payer's money every time they fall into a crisis. But, the kind of attention with which this crisis has been received by policymakers and bankers alike is a big

⁵⁷ *RBI's new provisioning laws to help banks act at the earliest signs of stress*, ECONOMIC TIMES, http://articles.economictimes.indiatimes.com/2015-04-03/news/60787332_1_indian-banks-bankruptcy-law-restructured-loans (last updated Mar 8, 2016).

ray of hope. Right steps, well-timed and rigorous actions and a revitalization of the Indian economy will put a lid on NPAs. Prevention, however, has to become a priority than mere cure.