

# To Analysis the Process of Recovery by Banks

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## *Abstract*

**Banks plays an important role in economy. They help in development of economy. Banks lends loan to the individuals, companies and other institutions as per their requirements. When loan not repayable from 90 days after expiration of maturity date, then it becomes NPA. All developing nations struggle with debt servicing, therefore it's critical that they have a reliable system in place to manage their overall debt and that their procedures for collecting unpaid debt are up to the task. A number of laws have been passed in India to address these needs, including the DRT Act and the SARFAESI Act. The remaining questions are whether these reforms were successful in meeting their goals, if they were enough to calm concerns, and what modifications, if any, are required. Industry players and RBI believe they are deficient, hence a reassessment of the system is necessary. This essay describes the difficulties with debt recovery in India.**

**Keywords: DRT, SARFAESI, Finance, Non-Performing Asset, Courts.**

## **Introduction**

Techniques for recovering debt are a crucial part of how well banking institutions perform because they help to ensure that the bank's main objective is to make loans that lead to the desired outcome of creating a profit margin above the loans given. It is clear that the use of debt collection tactics makes sure that debtors who live alone pay their bills. The debt collection unit's day-to-day responsibility is to see to it that the loans given to bank clients are repaid in accordance with the terms of the agreement that the client and the bank have signed. This essay tries to provide a general overview of India's rising debt problem and the measures being taken to achieve a prompt and effective debt recovery in India. In this sense, there are 2 fundamental laws:

- (1) The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act), and
- (2) The Recovery of Debts Due to Banks and Financial Institutions, 1993 (RDDB & FI Act).

## **Research Methodology**

The Methodology have been used in this study is Doctrinal method of research methodology. The Researcher has taken the data from Books, Reports of RBI, magazines, Newspapers etc.

## **Objectives**

- To study the problems faces by Banks in India.
- To study the process of recovery of Debts by banks.
- To analyse the major legislations for recovery process.

## **India's debt crisis and the banking sector**

The Indian banking system has been clogged by bad debts. India has been referred to as "Asia's other headache with bad debt." Business tycoons and politicians have been using their clout for years to get 'cheap' loans from banks and financial organisations, which has led to the disaster that has so far been created. The most crucial clause of the Agreement is the loan agreement's terms and conditions, which many parties rarely read or discuss. They accept these terms and conditions without question, as if they were a typical contract. The agreements that banks and other financial institutions frequently enter into with their clients are void from the start, cancelling the entire transaction and leaving the banks with little to no recourse.

The following act was put into effect to help banks recoup their obligations for this reason.

## **Debt Recovery Laws**

### **Debt Recovery Laws**

The Recovery of Debts and Bankruptcy (RDB Act) of 1993 establishes tribunals for the swift adjudication and recovery of debts owed to banks and financial institutions, as well as for matters related to or incidental to those concerns.

The Securitization & Reconstruction of Financial Assets & Enforcement of Security Interest (SARFAESI) Act of 2002 is a law that governs these processes as well as any issues that may arise in their course or as a result of them.

### **Debts Recovery Tribunals and Debts Recovery Appellate Tribunals**

The RDB Act, passed in 1993, established the Debt Recovery Tribunals (DRTs) and Debt Recovery Appellate Tribunals (DRATs) with the particular purpose of ensuring quick adjudication and recovery of debts owed to banks and financial institutions.

39 DRTs and 5 DRATs are currently operational around the nation. A Presiding Officer and a Chairperson, respectively, lead each DRT and DRAT.

### **SARFAESI Act**

The SARFAESI Act offers three different ways to recover funds:

- (1) Securitization,
- (2) Asset reconstruction, and
- (3) security enforcement without a court's or a tribunal's help.

In a nutshell, the SARFAESI Act gives banks and financial institutions (FIs) the authority to send demand notices to both the defaulting borrower and the guarantor of the debt, requiring each of them to pay the full amount owed to them within 60 days of the day the notification was served. Banks have the authority to seize the security used to secure the loan and sell, assign, manage, or appoint anyone to manage the right to the security in the event that the notice is not followed. However, if the secured asset is an agricultural property, no legal action can be taken under the Act.

The main distinction between the two Acts is that the DRT Act allows banks and financial institutions to recover debts exceeding ten lakhs through DRTs and is entitled to the doctrine of election, i.e., it doesn't limit itself to secured or unsecured debts. In contrast, the SARFAESI Act only permits the recovery of

secured debts and permits recovery without the involvement of judicial process. As stated in the Deshpande Committee Report, the ideal number of cases to be handled by any DRT at any given time was supposed to be 30, but even in the initial stages, this number was around 4000 in major cities. The creation of DRTs and DRATs was intended to reduce the burden on the judiciary and to provide for an effective measure, but the problem has only been transferred to the DRTs. Additionally, DRTs were burdened with problems relating to state dues, worker dues, and claims concerning unsecured assets. Borrowers often slowed down the legal process by filing lawsuits against lenders in civil courts. DRT success rates have been estimated at under 25%, which is worrying. Another issue that has emerged is the issue of DRTs losing their jurisdiction by bringing lawsuits in civil courts. The Supreme Court has ruled that consent is not required for case transfers, while another decision has reached the opposite conclusion. Subsequent cases have not clarified the position. The DRTs' summary proceedings and lack of capacity to deal with difficult legal issues, as well as questions of fraud and misrepresentation, prompted concerns. Even while the parliament recognised this problem and suggested the establishment of new DRTs, little has happened. The 33 DRTs currently operating throughout India are also understaffed, with numerous positions lying vacant. Credit Information Bureaus were established in accordance with the Credit Information Bureau Act of 2005, and significant improvements have recently been made to modernise the debt management process. Credit information on credit worthiness and credit rating is important in every industry that deals with debt. There are now numerous credit rating companies, and the practise of granting credit based on rating is gradually becoming more widespread.

### **The Bankruptcy Code 2016: Unlocking the Locked Money**

The Parliament approved the Bankruptcy Code in May 2016. It aims to regulate insolvency for companies, people, and businesses under a single comprehensive code. There is a two-step process when it comes to corporate insolvency.

#### **I. Insolvency Resolution Process**

#### **II. Liquidation**

In accordance with the IRP, the corporate lender may begin legal action under the NCLT, following which a moratorium or "quiet time" is declared. In addition, a Resolution Professional is hired, after which the administration is changed from that of the debtors to that of the creditors. Additionally, a creditor committee is established, and decisions are made by a vote of 75% of the committee members; a revival plan is therefore formed in 180 days. If 75% of the debtors opt for liquidation, a revival plan isn't developed within 180 days, or the NCLT rejects the plan, the debtor's assets will be liquidated to pay off the debt.

For individuals, the threshold is set at 1000, and if a repayment plan is not chosen freely by both parties, a bankruptcy order will be sent.

If 75% of the debtors opt for liquidation, a revival plan isn't developed within 180 days, or the NCLT rejects the plan, the debtor's assets will be liquidated to pay off the debt.

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### **Impact of The Debt Recovery System on Banks and the RBI's Stand**

Banks were required to file a civil lawsuit in accordance with the Civil Procedural Code prior to the passage of the RDDB & FI legislation and the subsequent establishment of DRTs and DRATs. The first creditor-friendly legislation or mechanism was put in place when banks were given the authority to seize secured assets through DRTs, making the job of the banks much easier. Failure of DRTs would result in all

issues associated with NPAs, including cash being blocked, which would reduce bank liquidity, bad debts reflecting poorly on banks, which would result in the loss of goodwill and further investments, banks losing out on returns on investment, as well as a negative opportunity cost as they would miss out on potential future profits and good debts. After advertising, the banks hold an auction for the assets, setting a reserve price and collecting a non-refundable earnest money deposit from the winning bidder. This method has several quirks and has been found to be ineffective. The RBI has taken notice of the rising bad debts of significant PSUs in recent years, and the former governor, Raghuram Rajan, had launched a campaign to reduce NPAs in these institutions. First, the RBI established standards for dividing problematic debts or NPAs into three categories. Then, it established instructions for how to deal with this scenario through ARC (Asset Reconstruction Companies). Banks are unable to lower rates because of the 13% recovery volume; instead, they must charge firms a 6% credit risk premium, which drives up overall interest rates. Furthermore, it should be highlighted that DRTs frequently violate the established deadlines, which depreciates assets and renders them unprofitable for banks. The DRTs are diverging from their intended purpose by concentrating on other factors rather than debt collection from a commercial interest point of view. The Strategic Debt Restructuring Scheme and the 5/25 are just two of the latest measures made by the RBI. These programmes exempt banks from provisioning and restructuring as long as certain requirements are met, and non-performing assets of banks may be converted to equity under specific conditions. In order to address the NPSs in major banks, the RBI recently undertook a cleanup process. In this regard, a periodic and thorough analysis of the books of major banks was conducted. As anticipated, it was discovered that the amount of bad debts was undervalued. As a result, RBI has taken steps to obtain an accurate estimate. Recently, the RBI discovered that the major public sector banks' leverage ratios were unacceptable, their gross non-performing assets were at 4.6% of advances, and their overall stressed assets were at 11% of advances.

### **Effect of DRT**

The effectiveness of DRTs has been the topic of intense discussion. There has been a lot of uproar regarding whether it is genuinely advancing the cause of prompt and effective debt recovery. Some even claim they fall under the category of non-performing assets (NPA). Industry perspectives show that the recovery procedure is ineffective and that properties auctioned off under DRTs frequently have weak participation. While the DRTs first succeeded in achieving their goal, they were unable to continue when the large and powerful borrowers started employing their evasive strategies. A jurisdictional clash between DRTs and civil courts was the root of this issue. The Apex Court, however, held that "such a borrower-filed independent suit could not be transferred to the DRT without his agreement since his right to approach a civil court cannot be taken away." This ruling caused concern among the banks and FIs since the borrower could simply circumvent the DRT's jurisdiction by bringing a separate lawsuit in civil court asking for the exact reverse of what the bank or FI was requesting in the DRT.

However, just a year later in 2007, in the case *State Bank of India v. Ranjan Chemicals Ltd.*, the Apex Court reviewed the identical issue and determined that it had the "authority to transfer a suit without the parties' assent." Given that the Court ordered the transfer of a separate lawsuit on the grounds that "it would avoid the duplication of evidence, lawyers, and expenses," among other things, there is some difficulty reconciling this decision with that of *ABS Marine*.

In addition to this, there are some small flaws. For example, the debts owed by employees to the corporation, the Government, and other unsecured creditors would all come to a standstill before DRTs, adding to the current backlog of cases before the DRT.

The conflicting jurisdiction between the Recovery Officers of the DRTs and the Official Liquidators appointed by the High Court in winding up cases is another drawback.

In this case, the Official Liquidator would take ownership of all the assets belonging to secured creditors who are in front of the DRTs because they have been designated by a higher authority. The activities of recovery officers, who would recover the entire sum to pay back the banks while giving the other claimants, including credits like the company's workers, peanuts in return, also irritate the High Courts. Due to these issues, the Act was amended in 2000. Despite some degree of rationality brought forth by the 2000 amendment, it was inadequate to persuade large debtors to accede to the DRTs' jurisdiction. Lenders were subsequently burdened by the NPA problem. The illiquidity of the asset pledged as security and its specificity in value provide another issue, albeit a small one that is less frequent and universal to the recovery process. In the typical recovery process, the bank sells the asset at a public auction in order to pay off its debts.

In order to attract buyers for the asset, the bank must also publicise the auction in the top newspapers after setting a reserve price. The earnest money deposit (EMD), which could be 15% of the reserve price, is required of all bidders prior to the opening of the bidding process.

After winning the auction, the winning bidder is required to pay the remaining sum within the time frame set by the bank. The EMD wouldn't be refunded if the bidder wasn't willing to pay the amount he requested. After the bidding has concluded, the owner of the asset has 30 days to request a halt to the sale on the grounds that the price was lower than anticipated or that the asset hadn't been properly advertised at the auction. The asset that is pledged as security is typically illiquid and has a highly definite value, making it challenging to sell to anyone. Now, presuming the bank does receive a lower price for it, it might decide to accept that price due to the illiquidity and peculiarity of the asset. Although the item may be worth the most to the owner, it might mean little to the other potential buyers. Furthermore, DRTs are envisioned as the adjudicating body for individuals and partnership firms under the Insolvency and Bankruptcy Code, which was adopted by the Lok Sabha in May 2016. DRTs were initially designed to resolve cases in a maximum of 180 days. However, judicial lag is a problem in the DRTs just as much as it is in other courts, according to statistics and experience. The DRTs will struggle to handle the added obligation of handling insolvencies and liquidations in addition to making decisions on routine banking issues.

## CONCLUSION

The system of credit risk management used by banks is where the issue of rising NPAs first emerged. In order to fix pre-sanctioning appraisal responsibility and implement post-disbursement supervision, banks must take suitable preventive measures. Loans should be regularly monitored by banks in order to spot accounts that could eventually stop performing. To guarantee that funds are used to their full potential, banks must use their inspectional capabilities. Additionally, banks may be given the authority to recoup loans from the borrower's guarantor. The results of statistical research clearly show that the average amount recovered through different channels differs significantly from one another. This demonstrates that the available tools are inadequate to handle the situation. The amount collected through SARFAESI is significantly less than anticipated. DRTs take substantially longer, and the recovery procedure becomes drawn out because the tribunal's ruling might be contested in a higher court. On the other hand, Lok Adalat is crucial in streamlining the recovery process, and its judgement cannot be contested in a higher court. The quantity of recovery through this channel is however the lowest and its usefulness in the enforcement of recovery is limited because NPAs exceeding 10 lakh cannot be recovered through it.

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