



# AN ACT WHICH REINED THE ARCH NEMESIS OF THE BANKING SECTOR: SARFAESI ACT (2002) - A NEW AGE STORY OF RESOLUTION OF STRESSED ASSETS IN THE INDIAN BANKING SECTOR

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**Abstract:** The catastrophic impact of stressed assets coupled with the obvious provisioning and hence a hit on the bottom line of the financial institutions has taken its toll on the banking sector in India making it reel under it. A healthy banking sector functioning smoothly and profitably is a sine qua non for any growing economy but for India it is the mythological “elixir”. Statistics show that credit growth is linked with the growth of economy and vice versa. The stressed assets hit the very nerve of it. Tougher BASEL norms vying for strict and upward provisioning against bad debts leave the banking sector in peril as they huff and puff for more capital. The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act 2002.) came as a breather at the early stage of the new millennium. It was touted as a go for all type of legislation for banking institutions given its objective of recovering bad debts without intervention of the courts in India. This paper makes an attempt to ascertain its impact viz a viz other modes of recovery mechanism in bringing down the quantity of stressed asset..

**Index Terms** - SARFAESI Act 2002, NPA, Resolution, Indian Banking Sector

## I. INTRODUCTION

Indian Banking Sector plays a stellar role in the growth of Indian economy. The interlinked activities of the sector acts as a catalyst in the economic system which fuels the flow of funds thus stimulating economic growth. The gap between the dynamic commercial practices, reforms and the legal framework of commercial transactions has led to alarming level of stressed assets in Financial Institutions.

## HISTORY

Narasimham Committee I and II and Andhyarujina Committee were formed to accelerate banking sector reforms. These Committees suggested ways to form new legislation for securitization and empowering banks and financial institutions to gain possession of the securities and to sell them without any intervention of the court here. The SARFAESI Act was passed on December 17, 2002, to serve this very purpose. It empowered banks and other financial institutions to directly auction securities pledged with them to recover loans from borrowers. Before this Act took effect, financial institutions had to take recourse to civil suits in the courts to recover their dues, which was a lengthy and time-consuming process.

## AN INTRODUCTION TO NON PERFORMING ASSETS (NPA)

In line with international practices, RBI introduced a system of income recognition, asset classification (IRAC) and provisioning norms from 1993 onwards based on the findings / recommendations of Narasimhan Committee. The IRAC norms and provision requirement on various categories of advances have undergone periodic changes since then. The gist of the said norms is reproduced below:

### NON PERFORMING ASSETS (NPA)

An asset becomes non-performing when it ceases to generate income to the Bank. A nonperforming asset (NPA) is defined as a credit facility in respect of which the interest and / or instalments of principal has remained 'overdue' for a 'specified period' of time.

The concept of 'specified period' is reduced in a phased manner. The shortening of the period is from 4 quarters in 1993 when the concept of IRAC norms was first introduced in India to present level of 90 days.

### Asset Classification-

(i) Substandard Asset: Substandard asset is one which has remained NPA for a period less than or equal to 12 months. Its Asset Code is 20.

(ii) Doubtful Asset: It consists of 3 stages - Doubtful I, Doubtful II and Doubtful III. The provision requirement in each stage of Doubtful asset will be as under:

(a) Doubtful I (Code 31) – Assets remaining for a period of 12 months in Doubtful category – provision requirement shall be 50% of RVS + 100% of shortfall in security (i.e. NPAs over 12 months upto 24 months)

(b) Doubtful II (Code 32) – Assets remaining for a period of further 24 months in Doubtful category – provision requirement shall be 60% of RVS + 100% of shortfall in security (i.e. NPAs over 24 months upto 48 months)

(c) Doubtful III (Code 33) – Assets remaining for more than 3 years in Doubtful category and require a provision of 100%.

(iii) Loss Assets – Code 40

A loss asset is one where loss has been identified by Bank or internal or external creditors or RBI inspectors but the amount has not been fully written off.

## RESOLUTION MECHANISM UNDER SARFAESI ACT, 2002

The Act specifies three alternative methods for resolution of stressed assets viz:

- (i) Securitization
- (ii) Asset Reconstruction
- (iii) Enforcement of Security without court intervention

### Securitization:

Securitization involves the issue of security receipt by raising of funds or receipts by SCs / ARCs {Section 2(1)(z)}. The Securitization Company or Asset Reconstruction Company in turn raises funds from the Qualified Institutional Borrowers (QIBs).

### Assets Reconstruction:

Assets Reconstruction companies buy the stressed assets from Banks and take measures for its resolution. It may involve:

- (i) Proper Management of the borrower business,
- (ii) Change of management in the business
- (iii) Take Over
- (iv) Sale or lease ,
- (v) Restructuring the business of the borrower,
- (vi) Rescheduling of the repayments of debts payable by the borrower ,
- (vii) Possession of secured assets

### Enforcement of Security Assets:

The Act provides notwithstanding anything contained in the Registration Act 1908, for the enforcement of Security Interest without Court Intervention. 1) any security receipt issued by SC / ARC, under sec 7 of the Act, and not creating, declaring, assigning, any right, or title or interest to or immovable property except in so

far as it entitles the holder of the registered instrument, or 2) any transfer of security receipts, shall not require compulsory registration.

### Review of literature

1) Shardha and Jain (2016) studied the process and effect of SARFAESI Act, 2002 and its impact in recovering NPAs in PSBs in India and found the Act to be quite effective in doing so.

2) Banana and Chepuri (2016) found SARFAESI Act, 2002 more effective as compared to other recovery channels throughout the study.

3) Swain et al (2017) study inferred that of different mechanisms evolved by the regulator, SARFAESI Act, 2002 is the most viable reform measure in the Indian banking industry for recovery of stressed assets..

4) Rani Chanchal (2013)-International Journal of Research in Economics and Social Sciences-Evaluation of various techniques used by the public sector banks for the management of Non Performing Assets (NPA)- to know the impact of securitisation legislation in the management of NPAs in select financial institutions.

5) Munish Gupta(2018)-Effectiveness of SARFAESI Act in Controlling NPAs of Indian Banking Sector- studied the impact of the act and its effectiveness in improving recovery in NPAs.

### Objectives of the study:

This research is based on following two objectives, they are:

- 1) Study of impact of SARFAESI Act 2002 on Non-Performing Assets.
- 2) Measure the extent of recovery of Non-Performing Assets involving SARFAESI Act 2002, in last decade.

**Methodology:** The paper follows a mixed approach mixing the qualitative analysis as well as the quantitative analysis of the data collected from various reports of Reserve Bank of India, For qualitative analysis, various guidelines issued by RBI , articles and papers published in different journals, magazines, newspaper, periodicals were studied and data extracted from various sources on NPAs recovery have been used for analysis.

### Analysis of Data and Findings

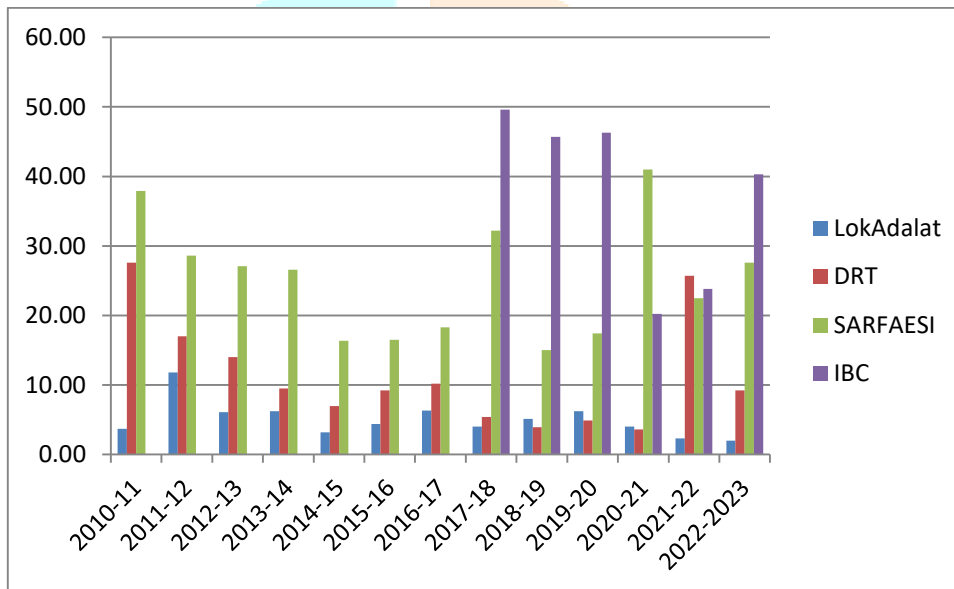
*Table 1.NPA of Scheduled Commercial Banks vis-à-vis total advances year wise*

| Year | Gross NPA(Amt in Rs Crore) | Net NPA(amt in Rs. Crore) | NPA as percent of Gross advances | NPA as percent of Net advances |
|------|----------------------------|---------------------------|----------------------------------|--------------------------------|
| 2011 | 97900                      | 41700                     | 2.5                              | 1.1                            |
| 2012 | 142300                     | 64900                     | 3.1                              | 1.4                            |
| 2013 | 194100                     | 98700                     | 3.2                              | 1.7                            |
| 2014 | 264400                     | 142600                    | 3.8                              | 2.1                            |
| 2015 | 323300                     | 175400                    | 4.3                              | 2.4                            |
| 2016 | 611900                     | 349800                    | 7.5                              | 4.4                            |
| 2017 | 791800                     | 433100                    | 9.3                              | 5.3                            |
| 2018 | 1039700                    | 520700                    | 11.2                             | 6                              |
| 2019 | 936474                     | 355068                    | 9.1                              | 3.7                            |
| 2020 | 899803                     | 289531                    | 8.2                              | 2.8                            |
| 2021 | 835138                     | 258050                    | 7.3                              | 2.4                            |
| 2022 | 743653                     | 204226                    | 5.8                              | 1.7                            |
| 2023 | 571546                     | 135333                    | 3.87                             | 0.9                            |

Above table shows divergent trend of Gross NPA and Net NPA in Scheduled Commercial Banks (SCBs) from 2011 to 2023. Though, Net NPA is normally used for analysis, Gross NPA has also been shown as it presents the severity of the NPAs on Bank's bottom line.

**MAJOR FINDINGS OF THE STUDY:****Table 2.1 Recovery in SCBs through various channels(%)**

| FY/CHANNELS | LokAdalat | DRT   | SARFAESI | IBC   |
|-------------|-----------|-------|----------|-------|
| 2010-11     | 3.70      | 27.60 | 37.90    | NA    |
| 2011-12     | 11.80     | 17.00 | 28.60    | NA    |
| 2012-13     | 6.10      | 14.00 | 27.10    | NA    |
| 2013-14     | 6.20      | 9.51  | 26.59    | NA    |
| 2014-15     | 3.18      | 6.97  | 16.33    | NA    |
| 2015-16     | 4.40      | 9.20  | 16.50    | NA    |
| 2016-17     | 6.30      | 10.20 | 18.30    | NA    |
| 2017-18     | 4.00      | 5.40  | 32.00    | 49.60 |
| 2018-19     | 5.10      | 3.90  | 15.00    | 45.70 |
| 2019-20     | 6.20      | 4.90  | 17.40    | 46.30 |
| 2020-21     | 4.00      | 3.60  | 41.00    | 20.20 |
| 2021-22     | 2.30      | 25.70 | 22.50    | 23.80 |
| 2022-23     | 2.00      | 9.20  | 27.60    | 40.30 |

**Table 2.2.****Year wise Recovery Percentage of SCBs through Various channels**

The following are the major observations of this research:

- The result of the table 2.1 & 2.2 revealed that percentage of NPAs recovered in SCBs through SARFAESI Act 2002 has maintained a steady streak in past 13 years and at the same time recovered more than any other channel.
- It can be observed that SARFAESI Act 2002 has successfully managed to curb down the growth level of NPAs and a better execution and modifications will make it better.

**CONCLUSION**

The SARFAESI Act was enacted with a distinct purpose to facilitate banks and financial institutions to recover dues in a speedy manner by enforcement of security interest without intervention of the court. The object of the debt recovery laws is to reduce non-performing assets and increase liquidity in the market. We find that the Act has given positive results and thus heralded a new chapter in the Indian Banking Sector.

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