ORIGINAL RESEARCH PAPER

Management

AN OVERVIEW OF SARFAESI ACT AND ITS IMPACT ON NPA

KEY WORDS: Non Performing assets, SARFAEIS Act, Asset Recovery

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ABSTRACT

An asset becomes non-performing when it ceases to generate income for the bank. In India, a Non-Performing Asset (NPA) is broadly defined as one with interest or principal repayment installment unpaid for more than 90 days Prior to 1993, banks had to take recourse to the long legal route against defaulting borrowers, beginning with the filing of claims in the courts. A lot of time was therefore spent in the judicial process before banks could have any chance of recovery on their loans To speed up the process of recovery from NPAs, The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI) Act was enacted in 2002 for regulation of securitization and reconstruction of financial assets and enforcement of security interest by secured creditors. This paper attempts to study impact of sarfasies act on NPA

1. INTRODUCTION

According to the Reserve Bank of India (RBI), the gross non-performing assets in Indian banks, specifically in public sector banks, are valued at around Rs 400,000 crores which represents 90% of the total NPA in India, with private sector banks accounting for the remainder. An asset becomes non-performing when it ceases to generate income for the bank. In India, a Non-Performing Asset (NPA) is broadly defined as one with interest or principal repayment installment unpaid for more than 90 days prior to 1993. A lot of time was therefore spent in the judicial process before banks could have any chance of recovery on their loans. On average, a civil suit decision took anywhere between 5 to 7 years. Under the Recovery of Debts to Banks and Financial Institutions Act 1993, Debt Recovery Tribunals (DRTs) were set up for recovery of loans of banks and financial institutions. This led to speedy recovery of loans in about 1 year's time as against the average time of 5 to 7 years required in civil suits. While initially the DRTs performed well, their progress suffered as they got overburdened with the huge volume of cases referred to them. To speed up the process of recovery from NPAs, The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI) Act was enacted in 2002 for regulation of securitization and reconstruction of financial assets and enforcement of security interest by secured creditors. The SARFAESI Act empowers Banks / Financial Institutions to recover their non-performing assets without the intervention of the Court.

2.OBJECTIVES OF THE STUDY

Ř To study the concept SARFAESI Act
Ř To analyses methods of implementation of SARFAESI Act
Ř To identify the impact of sarfaesi act on NPA

3. RESEARCH METHODOLOGY

The study mainly includes literature review from various articles published in journals. The other secondary data sources include reports of the respective banks and other relative information published on the banks and other internet sites

4. The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act-(SARFAESI) Act, 2002

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 is a legislation that helps financial institutions to ensure asset quality in multiple ways. It will address the problem of NPAs (Non-Performing Assets) or bad assets through different processes and mechanisms. The law did little until it discovered the magnitude of NPA's impact on the profitability of the bank. SARFAESI ACT was formed in Dec' 2002 based on recommendations of a) Committee on Banking Sector reforms (Narasimham Committee Report II) and b) Restructuring of Weak Public sector Banks (Verma Committee). The SARFAESI Act gives detailed provisions for the formation and activities of Asset Securitization Companies (SCs)and Reconstruction Companies (RCs). Scope of their activities, capital requirements, funding etc. are given by the Act. RBI is the regulator for these institutions. As a legal mechanism to insulate assets, the Act addresses the interests of secured creditors (like banks). Several provisions of the Act give directives and powers to various institutions to manage the bad asset problem. Following are the main objectives of the SARFAESI Act.

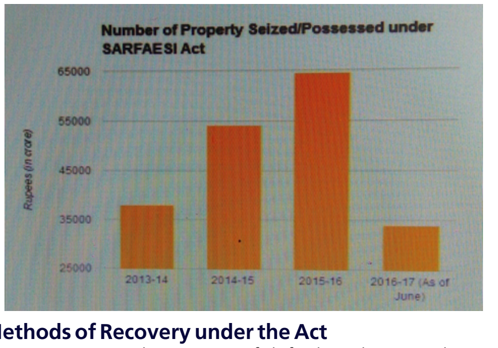
4.1Formation of SARFAESI Act, 2002

Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) was circulated –

i. To regulate securitization and reconstruction of financial assets
ii. Enforcement of the security interest for
iii. Matters connected therewith or incidental thereto It extended to the whole of India.

It is an Act further to amend four laws:

- Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI)
- Recovery of Debts due to Banks and Financial Institutions Act, 1993 (RDDBFI)
- Indian Stamp Act, 1899
- Depositories Act, 1996, and for matters connected therewith or incidental thereto



4.2 Methods of Recovery under the Act

This Act aims at speedy recovery of defaulting loans and to reduce the mounting levels of Non-performing Assets of banks and financial institutions.. The Act provides three alternative methods for recovery of non-performing assets, viz;

(I) Securitization;
(ii) Asset Reconstruction; and
(iii) Enforcement of Security without the intervention of the Court.

4.2.1Securitization

Securitization is the process of pooling and repackaging of financial assets (like loans given) into marketable securities that can be sold to investors. In the context of bad asset management, securitization is the process of conversion of existing less liquid assets (loans) into marketable securities. The securitization company takes custody of the underlying mortgaged assets of the loan taker.

4.2.2Asset reconstruction

Asset reconstruction is the activity of converting a bad or non-performing asset into performing asset. The process of asset reconstruction involves several steps including purchasing of bad asset by a dedicated asset reconstruction company (ARC) including the underlying hypothecated asset, financing of the bad asset conversion into good asset using bonds, debentures, securities and cash, realization of returns from the hypothecated assets etc. Reconstruction, is to be done with the RBI regulations and the SARFAESI Act gives the following components for

4.2.3'Enforcement of security interests

The Act empowers the lender (banker), when the borrower defaults, to issue notice to the defaulting borrower and guarantor, calling to repay the debt within 60 days from the date of the notice. If the borrower fails to comply with the notice, the bank or the financial institution may enforce security interests by Taking possession of the security, Sale or lease or assign the right over the security, Appoint Manager to manage the security or Ask any debtors of the borrower to pay any sum due to the borrower.

4.3Amendment to the SARFAESI Act in 2016

Government has amended the SARFAESI Act in August 2016 to empower the ARCs (Asset Reconstruction Companies), to rejuvenate Debt Recovery Tribunals (DRTs) and to enhance the effectiveness of asset reconstruction under the new bankruptcy law. The amendment has given more regulatory powers to the RBI on the working of ARCs. The penalty amount has been increased from Rs 5 lakh to Rs 1 crore. The amendment has brought hire purchase and financial lease under the coverage of the SARFAESI Act. Regarding DRTs, the amendment aims to speed up the DRT procedures. Online procedures including electronic filing of recovery applications, documents and written statements will be initiated. The amendments are important for DRTs as they can play an important role under the new Bankruptcy law. DRTs will be the backbone of the bankruptcy code and deal with all insolvency proceedings involving individuals. The defaulter has to deposit 50 per cent of the debt due before filing an appeal at a DRT.

Number of Cases of NPAs referred

Year	Lok Adalat	DRT	SARFAESI Act 2002
2010-11	616018	12872	118642
2011-12	479073	13365	630429
2012-13	840691	13408	190537
2013-14	1636957	28258	194707
2014-15	2958313	22004	175355
2015-16	445634	24537	173582

Source:- www.dbie.rbi.in

4.4 Impact of Sarfaesi act on non-performing assets

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, (SARFAESI Act) was born out of the Narasimham Committee-II recommendations after some modifications. Asset reconstruction companies are set up, and registered with the Reserve bank of India (RBI) as a securitization company (SC) and reconstruction company (RC) to acquire distressed secured financial assets

Recovery through various channels (in Rs

	Amount involved	Amount recovered	Percentag
k Adalats	6,600	400	6.1
ΚTs	31,000	4,400	14.0
ırfaesi Act	68,100	18,500	27.1

ce: Report on Trend and Progress of Banking in India 2012-13

According to the Reserve Bank of India's 'Report on Trend and Progress of Banking in India 2017-18', the overall ratio of amount recovered to the amount involved, improved drastically to 41.3 per cent against 13.8 per cent in the previous year. As per provisional data for 2017-18, banks recovered 5.28 lakh crores (38,500 crores in the previous year), while the amount involved was 12,78,600 crores previous year 2,78,300 crores).

Under the SARFAESI route, banks recovered 26,500 crores (25,900 crores), while the amount involved stood at 1, 06,700 crores (1,41,400 crores). The ratio of amount recovered to amount involved in this case improved to 24.8 per cent, against 18.3 per cent in the previous year. Under the Debts Recovery Tribunal route, banks' recovery declined to 7,200 crores (10,300 crores), while the amount involved stood at ₹1,33,300 crores (1,00,800 cores).

4.5Challenges in Safaesi Act

SARFAESI Act enabled banks to clean up their balance sheets, pass on the burden of recovery to an agency which could give full-time attention to realize a higher amount than what the borrower is willing to offer and thus generally help faster resolution of NPA. Asset Recovery companies ARC s' initially was effective for recovering the amount but later it was observed that offer price was low and worse and the assets are sold by them eventually to original promoters of the companies or their relatives .In a meeting called by the Central Vigilance Commission (CVC) in May 2010, and attended by CMDs of some banks, the Indian Banks Association (IBA) and CBI officials expressed the opinion that "some ARCs were found to be directly helping the defaulter in getting back the properties by paying very low amounts to banks and thereafter mark up and sell the property back to the borrower". The banks have found that when they issue notices to borrowers under SARFAESI Act, the response is much better

The one major problem the banks experience in pursuing SARFAESI permitted action is that an aggrieved party, generally the borrower, can make an application to a DRT and get a stay order on sale which is not difficult to obtain., The banks have felt use of SARFAESI has been more effective than other legal provisions. The bank officials feel that by strengthening the recovery department, they can show greater success than by handing over.

5.Conclusion

Numerous far reaching changes have been made in the Indian Banking Sector since 1991. The Indian banks were confronting more than Rs. 90,000 crores NPAs issue and were running under loss of benefit. The common laws of the nation were no effective, making it impossible to way to deal with recoup the awful credits.. Obligation Recovery Tribunals(DRTs) were set up for recuperation of advances of banks and organizations. At first DRTs performed well, however their advance was endured when they get over burdened with the vast number of cases alluded to them. Since the enactment Securitization Act 2002, Indian banks and financial institutions have been scrutinizing some of their distressed assets.. The recovery and workout process is managed by Assets Reconstruction Company (ARC) set up under the SARFAESI Act 2002 that vests them with the special recovery power. As a result, in the last two years of its existence, SARFAESI Act has had a salutary effect on NPA management in banks. Besides, the Act has paved the way for several out-of-court settlements. It has also generally helped inculcate a repayment discipline among borrowers. s. The experience with the SARFAESI Act 2002 has been very positive and has helped the Indian banking sectors reduce, to an extent, the problem of impaired assets

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