Vidya (2020) Vol : 15(1)

Research Paper

ISSN: 2321-1520

Regulating Collateral Management in Public Sector Banks: Need of the Hour

Hitesh N. Dave[1] & S. P. Rathor[2]

1. Research Scholar &Advocate,

2. Professor & Head, Department of Environment & Legal Order,

University School of Law,Gujarat University,Ahmedabad.

E-mail:sprathorsp@yahoo.co.in

*Corresponding Author

Received Date:16-11-2019

Published Date: 15-03-2020

Abstract

Performance of Public Sector Banks in India plays very important role as a part of Fiscal Assessment of the Development of the Country. Profitmade by the Public Sector Banks isthe income in the exchequer of Government. People put trust on the Banks to park their Money, so money lying with the Banks considered asPublic Money. It requires to be handle with due care and caution. However, due to variety of reasons the profitability of the Banks reduced from time to time and thereby the Government needs to infuse money which is a resultant loss to the Public Exchequer. Non-Performing Assets increases due to failure of Banks in effectively supervising of Loan given to borrowers.The bottleneck of such causes is poor Credit Appraisal System and lack of Collateral Management. Authors analyse the cause for the Non-Performing Assets and poor Regulatory regimes in this research Article. Attempt is also made to suggest certain corrective measures for the Reduction of Non-Performing Assets by introducing Regulatory measures.

Keywords : Collateral Management, Non-Performing Assets, Public Sector Banks, Stringent Regulations

Introduction

The Indian Banking Sector has been facing serious problem of rising level of Non-Performing Assets (NPA) for several years. Public Sector Banks manages Public Money and the people have the trust on the Banks. Banks are therefore, the Trustee of Public Money and it could not be divested in the form of loss due to NPAs.County's Development can be pursued through the Economic Growth which is influenced by the prevailing Financial System, as such, financial system of the country considered to be vital in measuring the performance of the country.

The economic progress of a nation and development of banking is invariably interrelated. The Banking sector is an indispensable financial service sector supporting development plans through channelizing funds for productive purpose, intermediating flow of funds from surplus to deficit units and supporting financial and economic policies of government.

The banking sector has been facing the serious problems of the rising level of NPAs. But the problem of NPAs is more in public sector banks when compared to private sector banks and foreign banks. The NPAs in PSB are growing due to external as well as internal factors.

Objectives of the Research Article

The objective of this research is to study and compare NPAs of the Public Sector Banks and rising level of the NPAs despite regulatory guidelines and laws prevailing for recovery of the NPAs and to suggest measures for efficient management of NPAs through Effective Collateral Management.

Methodology of Study

This Article is based on Analytical Researchon the study, so Secondary Data available from RBI reports, magazines, news papers, bulletins, websites and the Articles published in various research journals and papers have been used.

Review of Literature

The Guidelines issued by the Reserve Bank of India on the NPAs have been studied. Comparative evaluation of NPAs from the RBI published data is the main source and the statutory enactments like the Debt Recovery Tribunal and the proceedings under the Securitisation and Reconstruction of FinancialAssets and Enforcement of Security Interest, 2002 has been studied in depth.

Dr. Suresh Naidu Boddu, in his Research Article on prevention of NPAs, analysed Risk Management Framework and suggested the preventive measures for reducing NPAs and concluded that the Indian Public Sector Banks have to apply Preventive Measures to combat the NPAs.

ShaleenSrivastava and PratapsinhChauhan, in their Research Paper Institutional Factors influencing NPA, assessed requirement of Artificial Intelligence, (AI) for the NPA Reduction and given the thrust on the Risk Management and Credit Monitoring.

MeenuBhandari, in Research Paper a study on NPA concluded by suggesting several measures to tackle the NPAs and the focal point was on Credit Risk Management, Tightening Credit Monitoring Policy and Improvement of Corporate Governance.

Department of Financial Services, Ministry of Finance, Government of India in Reforms Agenda for Responsive and Responsible PSBs, to enhance the Service Excellence, recommended six things made by PSBs. Central Focal point on the responsible Banking, Financial Stability, Improved Governance and Creation of Stress Assets Management Verticaland the Performance of Governance of the Banks, besides check aggressive and imprudent lending.

Katia D'Hulsterin his brief on the subject Regulatory and Supervisory Development for Non-Performing Loans, considered the financial difficulties on several counts and one of the important factors considered was the accepting lower levels of Collateralisation. It was concluded on the policy actions for harmonisation of provisioning and collateralisation.

K.S. Venkateswara Kumar, K. Sripath and S. HanumanthaRao, in their Study on Role of Statutory Bodies in handling NPAs traced out the immediate need for the effective measures to be taken by the Government as well as proper follow up and continuous watch on the movement of the borrowers and stocks and assets.

Dr. SivakumarMuthyala, in his study suggested the diversification of credit was one of theissuein increasing the NPA.

SaugataChaudari, RasBihari Singh, KausikMondalCognizant 20-20 insights, in their Article on the

Collateral Management arrived at opportunity lying in Revenue Generation through Collateral Management and it was concluded to adopt strategic approach and advance technology platform for handling the collaterals.

Concept of NPA & Classification

The concept of Non-Performing Assets was introduced on the recommendations made by the Narsimhan Committee on "Financial System Reforms" and on the said recommendations the Reserve Bank of India evolved prudential norms on Income Recognition, Asset Classification and provisioning and issued the instructions from time to time. Non-Performing Assets is an asset including a leased asset, becomes non performing when it ceases to generate income for the Bank. It further states that a Non Performing Assets is a Loan or an Advance where –

- Interest and/or instalment of principal remained overdue for a period of more than 90 days in respect of a Term Loan;
- The Account remains out of order in respect of an overdue/ cash credit;
- The Bill remains overdue for a period of more than 90 days in the case of Bills Purchased and Discounted;
- The Instalment of principal or interest thereon remains overdue for two crop seasons for short duration of crops;
- The instalment of principal or interest thereon remains overdue for one crop season for long duration crops;
- The amount of liquidity facility remains outstanding for more than 90 days in respect of a securitisation transaction undertaken in terms of guidelines on securitisation dated 01/02/2006;
- In respect of derivatives transactions, the overdue receivable representing positive market-to-market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment.

Assets Classification

Broadly, in terms of Banking parlance assets can be bifurcated in two parts :

i) Performing Assets;

ii) Non Performing Assets

Classification of categories of NPAs

Banks are required to classify Non Performing Assets further into the following three categories based on the period for which the asset has remained Non Performing and realisability of the dues :

i) Sub Standard Assets :

ii) Doubtful Assets ;

iii) Loss Assets

Types of NPAs

NPAs are broadly divided into:

a) Gross NPAs, and

b) Net NPAs

a) Gross NPAs:Gross NPAs are the sum total of all loan assets that are classifiedas NPAs as per RBI guidelines as on Balance Sheet date. Gross NPA reflects the quality of the loans made by banks. It consists of all the non standard assets like as sub-standard, doubtful and loss assets.

b) Net NPAs: Net NPAs are those type of NPAs in which the bank has deductedthe provision regarding NPAs. Net NPA shows the actual burden of banks. In India, bank balance sheets contain a huge amount of NPAs and the process of recovery and write off of loans is very time consuming, the provisions the banks have to make against the NPAs according to the RBI guidelines. That is why the difference between gross and net NPA is quite high.

Discussion

Reserve Bank of India issues the guidelines on 'Prudential Framework for Resolution of Stressed Assets'. Last guideline issued by the Reserve Bank of India on the NPA is June 7, 2019. That RBI in the said guideline Revised the Framework for Resolution of Stressed Assets and it was stated in the guideline that the implementation of Resolution Plan shall be implemented in phased manner.

Despite the Reserve Bank of India (RBI) being the Apex Bank and regulator of Banks and Financial Institutions, still the performance of the Banks and particularly the Public Sector Banks shown the tendency of rising level of NPAs year-by-year, due to its hands off policy till the loan recovery reach a serious and irrevocable stage.

It is observed that Valuation Reports are obtained from Banks' empanelled Valuers and Bank do not follow the practice of obtaining Valuation Report from practicing Member from the Institute of Chartered Accountant of India, the same was revealed by the Press Information Bureau, Government of India, Ministry of Finance. As per the inputs received from PSBs as on 31/03/2019, FIRs have been filed against 3154 Wilful Defaulters. To strengthen PSBs the Government has implemented a comprehensive 4R's strategy, consisting of recognition of NPAs transparently, resolution and recovery value from stressed accounts, recapitalising PSBs and reforms in PSBs and Financial Eco System to ensure a responsible and clean system.

Below mentioned data would reveal the past performance of the Banks and increasing level of the NPAs :

Year (end-March)	**Non-Performing Assets (NPAs)**					
	Gross			**Net**		
	Amount	As Percen-tage of Gross Advances	As Percen-tage of Total Assets	Amount	As Percen-tage of Gross Advances	As Percen-tage of Total Assets
2008-09	45918	2.0	1.2	21155	0.9	0.6
2009-10	57301	2.3	1.3	29643	1.1	0.7
2010-11	71042	2.3	1.3	36055	1.1	0.7

2011-12	112488	3.2	1.9	59391	1.5	1.0
2012-13	164461	3.6	2.4	90037	2.0	1.3
2013-14	227264	4.4	2.9	130635	2.6	1.6
2014-15	278468	5.0	3.2	159951	2.9	1.8
2015-16	539956	9.3	5.9	320376	5.7	3.5
2016-17	684732	11.7	7.0	383089	6.9	3.9
2017-18	895601	14.6	8.9	454473	8.0	4.5

The above Table goes to show that the Gross NPA of the Public Sector Bank rise from 1.2% to 8.9% for the year between 2008 and 2017-2018 and the net NPA also increasedfrom 0.9% to 8% as percentage of Gross Advances.

Impact ofNPAs :

- Impact on Profitability of Bank;
- Impact on Liquidity of Money in Bank;
- Involvement of Management and time consumption for the efforts of recovery;
- Loss of Credit of Bank

Consequences of NPA :

- Costs of fund increases, resultant effect, the Bank charge higher interest rates, so not to compete with the other Banks;
- Failure to receipt return from the market and profitability of the Bank reduced so as to Bank may not able to generate profit;
- Shortage of liquidity, payment to depositors may not be paid on time, harm on bank's capital base;
- change in banker's sentiments which may hinder credit expansion to productive purpose;
- Impact on share holders due to non marketability of shares or due to poor performance the share holders would not get the proper return on investment;

Collateral Management :

Various factors play role for the NPAs, these can be characterised as the internal and external. So far as the internal factors are concerned, one of the major factor can be described as defective lending process. Banks need to adhere to i) Principles of safety, ii) Principle of liquidity and iii) Principles of profitability. By safety it means that the borrower is in a position to repay the loan both principal and interest. The repayment of loan depends upon the borrower's - a) Capacity to pay, b) Willingness to pay. Further, Capacity to pay depends upon, the security offered as collateral security. It is in the terms of Tangible assets and Non Tangible Assets. Poor Credit Appraisal System, is a majorfactor for the risein NPAs. Due to poor credit appraisal the bank gives advances to those who are not intend to pay or offer less security so as not to recover the entire loan amount and resultant effect is slippage of accounts in the form of NPAs.

The review of performance of Collateral Substitutes concluded with the List of Items that need to be further investigated. The working paper submitted on the Social Finance Programme concluded the most important findings where :

- Collateral Deficiencies are an important constraint for very small to medium size enterprise in different ways;
- Lack of Collateral can be a constraint also for the Lender;
- Collateral Free Lending would lead to high level of Interest Rates;
- Adverse Selection problem is the most serious problem;
- Collateralisation is closely linked to the Loan size, the larger the loan, the more likely is a Collateral Requirement;
- Cumbersome Judicial Process to liquidate the certain type of collateral may have the side effects;
- There is a wide range of views on the Collateral Substitutes like the Joint Liability, Probation and informal co-maker arrangements;
- Collateral is governed by different legal fields and there is no governing law and regulations;
- Collateral Law influences the choice of Collateral Instruments by contracting parties;

Further work is required with Collateral related transaction cost, the stability of joint liability groups and the actual extent of Collateral Free Credit Scoring. In the said case Collateral issues requires to be open for dialogues :

- Can efforts to reduce the transaction cost due to judicial process be efficiently combined with the identification and wider use of collateral substitutes?
- Do modification of Collateral in the Legal and Regulatory environment also affect micro finance outside the formal financial sector?
- Is there a link between the degree of targeting and the use of effectiveness of Collateral Substitutes?
- What is the threat for accepting the market related instruments as a collateral?

It is observed that Valuation Reports are obtained from Banks' empanelled Valuers and Bank do not follow the practice of obtaining Valuation Report from practicing Member from the Institute of Chartered Accountant of India, the same was revealed by the Press Information Bureau, Government of India, Ministry of Finance. As per the inputs received from PSBs as on 31/03/2019, FIRs have been filed against 3154 Wilful Defaulters to strengthen PSBs the Government has implemented a comprehensive 4R's strategy, consisting of recognition of NPAs transparently, resolution and recovery value from stressed accounts, recapitalising PSBs and reforms in PSBs and Financial Eco System to ensure a responsible and clean system.

<u>Fraud Cases – Bank Group-wise</u>

Bank Group/ Institution	2017-18		2018-19	
	Number of Frauds	Amount Involved (Rs. million)	Number of Frauds	Amount Involved (Rs. million)
Public Sector Banks	2,885 (48.8)	382,608.7 (92.9)	3,766 (55.4)	645,094.3 (90.2)

Banks need to form strong Credit Appraisal and Assessment mechanism for recovery of loan, in case of account turn to default or NPAs.

Credit assessment and Risk management mechanism are ever lasting solution to the problem of NPAs. Managing credit risk is a much more forward-looking approach and is mainly concerned with managing the quality of credit portfolio before default takes place. The documentation of credit policy and credit audit immediately after the sanction is necessary to upgrade the quality of credit appraisal in banks. In a situation of liquidity overhang the enthusiasm of the banking system is to increase lending with compromise on asset quality, raising concern about adverse selection and potential danger of addition to the NPAs stock. It is necessary that the banking system is equipped with prudential norms to minimize if not completely avoid the problem of credit risk and develop an effective internal credit risk models for the purpose of credit risk management.

Conclusion

Reserve Bank of India has issued the guidelines for the formation Public Credit Registry for asymmetric data on Registration of Credit. So, Managing and Supervising Collateral is also a tough task after the loan is granted. It is required to introduce strict law on the Credit Management and Recovery from Collateral by taking effective steps, so as to minimise the risk of loan account slipping into the category of NPAs. which are listed below:

- Unique Identifier Number to each Borrowers regardless credit size;
- Single Point Reporting of Collateral and strict segregation of pre and post sanction roles and responsibilities for appraisal, monitoring and recovery;
- Development of Artificial Intelligence and Centralisation of Collateral Management by developing three tier reporting system to (i) Valuer, (ii) Collateral Management Department, (iii) Legal Department;
- Standardisation, Consolidation and Assimilation of Data and Validation of Stock;
- Stricter Accountability and Rigorous provision for Civil and Penal Liability in case of loss of security grade-wise and the higher punishment for the fraud;
- Technical Compatibility and Uniform Format for data reporting of stocks, variance and default;

- Self Assessment Formula for the Bank for the increase and decrease in rank and staff appraisal system in accordance with the credit portfolio;
- Recruitment of Professional Staffs for Valuation of the Collateral and Managing the Collateral Securities, separate Department for Collateral Supervision;
- Daily Supervision on the price updation with Security Markets and the Global Market for any drastic change in the price variance be reported;
- Taking timely decision either to Sell the Collateral, taking possession of Collateral, preparing the list of prospective purchasers of the Collateral dealing with the same line and maintaining such data for immediate realisation from the sale of collaterals without any legal hurdles;
- Provision for Fixing the liability in terms of the Accountability, Responsibility of the Staff;
- Recruitment of In House Experts in the Project Evaluation and understanding the project output, likely competition, expertise and versatility of the Promoters and the extent of their reliability should be assessed independently;
- Mitigation of Risk at the earliest point of time and to take the prudent decision for the mitigation of the future loss;
- Robust Development of Project Monitoring and Artificial Intelligent System with the help of the professional bodies like IT Professionals, Chartered Accountants, Company Secretaries, Cost Accountants, Legal Experts, Marketing Personnel as per the size of the Loan;
- Post Scrutiny and Monitoring physical existence of Stock should be develop in a way that the fluctuations and any sort of variance like Sale and Purchase of the Stocks shall be automatically reportedto Three Tier System for timely legal action;
- To achieve the ambitious Loan Target and for merely distribution of Loan or on asking by the Government/Bureaucrats the loan should not be disbursed;
- Stop the grant of Loan on Credit Guarantee Back Scheme of the Government without

any security;

- Waiver of Loan should not be given to particular sector frequently;
- Timely Identification and Measurement of NPA is the most consequential responsibility of Banks and Prudential Supervision for the effective Financial Stability. Reserve Bank of India may be empowered to take action against Lenders' Bank;
- Industry profile should be studied as per the extant prevailing market situation the loan may be disbursed, risk factor may be taken into account;
- It is recommended to introduce Stricter Provisions of Recovery Laws and Amendment of the Provisions of the Recovery of Debts and Bankruptcy Act, 1993 by suitable amendment and empowering the Debt Recovery Tribunals to deal with the cases of Lenders Liability and empower to fix the Banker's Liability;
- On the side of the Regulatory Framework the Reserve Bank of India should take initiative by incorporating the necessary provisions in the Banking Regulation Act by mandating the Public Banks to develop and evolve the Uniform Policy on Lending, Centralisation of Credit Appraisal System, Daily Reporting of Credit Monitoring to Banks link with the Reserve bank of India and with the expert assistance of the technocrats the evaluation should be done by constant monitoring on the collaterals.

References

B.Balkenhol and H. Schutte, Collateral, Collateral Law and Collateral Substitute, Second Edition, Social Finance Programme Working Paper No. 26, Employment Sector, International Law Labour Office, Geneva

Circular issued by Reserve Bank of India, DBOD-MC on IRAC Norms – 2015, www.rbi.org.in Website accessed on 05/10/2019

DBR.No.BP.BC.45/21.04.048/2018-19, retrieved from the RBI Website www.rbi.org.in on 01/08/2019

Dr. Suresh Naidu Boddu (2019), "Prevention of NPAs : A Comparative Study on India Banks", International Journal of Scientific Research Publications, Volume 9, Issue 1, January, 2019, ISSN 2250-3135

[1]Dr. SivakumarMuthyala, "*Non PErforming Assets in Banks as an Offshoot of Failure In Corporate Governance*", www.ascgujarat.org, ISSN No. 0974-035X, Feb. 2018, Vol. 10. Special Issue for ICGS -2018, Page Nos. 229 to 237

Fraud Cases – Bank Group-wise, www.indiatoday.in, accessed on 29/08/2019

Fraud Cases – Bank Group-wise, www.indiatoday.in, accessed on 29/08/2019

RBI Data, www.rbi.org.in, accessed on 1/11/2019

Hitesh N. Dave, 2019, Public Credit Registry in India : A Perspective, IJRAR May 2019, Vol 6, Issue 2, E-ISSN 2348-1269 P-ISSN 2349-5138, www.ijrar.org

Katia D'Hulster, "*Regulatory and Supervisory Developments for Non- Performing Loans*" http://pubdocs.worldbank.org/en/685901527523168861/Regulatory-and-supervisory-developments-for-NPLs.pdf

K.S. Venkateswara Kumar, K. Sripathi and S. HanumanthaRao, "*A Study on Role of Statutory Bodies in Handling NPAs*", International Journal of Applied Business and Economic Research, ISSN : 0972-7302

ShaleenSrivastava and PratapsinhChauhan, (2019) "*Institutional Factors influencing Non Performing Assets (NPA) in Indian Banking Sector and use of Artificial Intelligence as a remedial tool*" https://www.iimidr.ac.in/wp-content/uploads/Vol10-1-04.pdf, accessed on 05/ 11/2019.

MeenuBhandari, (2019) "*A Study of Non-Performing Assets (NPAs) of Public and Private Sector Banks – Comparative Analysis*" International Journal of Basic and Applied Research, www.pragatipublication.com, ISSN 2249-3352 (P) 2278-0505 (E), June 2019 Volume 9 Number 6, UGC Approved Journal

NPAs Written of By PSBs, Press Information Bureau , 9th July, 2019, https://pib.gov.in/

Pressreleaseshare.aspx?PRID=1578985 accessed on 10/11/2019

NPAs Written of By PSBs, Press Information Bureau , 9th July, 2019, https://pib.gov.in/PressReleseDetail.aspx?PRID=1578027 accessed on 10/11/2019

Reforms Agenda for Responsive & Responsible PSBs, D.O. No. 7/38/2014 – BOA dated 24th January, 2018, website, https://pib.gov.in/newsite/PrintRelease

SaugataChaudari, RasBihari Singh, KausikMondalCognizant 20-20 insights, June 2013 "*Collateral Management in Focus*" https://www.cognizant.com/whitepapers/Collateral-Management-in-Focus.pdf

❑