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SUIT FILED CASES IN INDIAN BANKS AN EMPIRICAL ASSESSMENT OF LEGAL RESOLUTION OF NPAS

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Abstract: *An asset becomes non-performing when it ceases to generate income for the bank and is then termed as Non-Performing Asset (NPA). It has been observed that with passage of time, recovery prospects usually diminish. NPA is an important parameter in the analysis of financial performance of a bank as it results in higher provisioning requirements and thus decreasing margin. It affects liquidity and profitability, in addition to posing threat on quality of asset and survival of banks. It points out the credit risk of the banks. It has become a subject of detailed study about 25 years ago in our banking sector. Mounting level of NPAs can severely affect the economy in many ways. If NPAs are not properly managed, it can cause financial and economic degradation which in turn signals an adverse investment climate.*

Researchers have investigated many factors and dimensions which influence NPA level in banks however not much work seems to have been done for assessment of potential loss due to poor recovery from NPA cases.

This paper looks at an empirical analysis of the entire universe of 46 banks (comprising 26 PSU Banks and 20 Private sector banks) and attempts to find high level linkages spanning banking and legal segments of the economy. Statistical findings are analysed over a period of last 15 years based on secondary data appearing in RBI reports, database related to NPAs and CIBIL Database of Suit Filed Cases.

Keywords : *Suit-Filed Cases, Recovery, Non-Performing Assets (NPA), Private Sector Banks, Public Sector Banks, Legal Resolution of NPA*

1. INTRODUCTION

The banking sector is one of the most important pillars of Indian economy and contributes immensely towards economic growth. Indian banks have supported growth of entrepreneurs and markets in a big way. To cope up with ever changing economic conditions, Indian banks are putting in their best effort to meet the demand while managing their businesses.

In this paper, an attempt has been made to outline the down side of industrial growth – viz the mechanism for handling disputes between lender and borrowers

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and how this has changed over the last 15 years. Reserve Bank of India (RBI) the regulator of Indian banks has from time to time advised banks to disseminate information relating to their operations. This paper, in a sense also relates to the far end of the credit process.

When different stakeholders for a project are involved in a principal-agent relationship, the outcomes could be quite different from rational or normal outcomes. Notwithstanding principles of corporate finance, the reasoning and actions of the agents may not be optimal for both parties at the same time. Usually, the principal suffers on account of the acts of the agent who basically acts in his own interest and tries to distort the rules of the game.

Since late 1990s, RBI has advised banks to disclose the position of cases where suits have been filed against borrowers relating to a sum exceeding Rs 1 crore. This analysis looks at 46 Scheduled Commercial Banks (SCBs) comprising 26 PSU banks and 20 Private Sector Banks as contained in the RBI Profile, 2013. Hence, this analysis is a part of the mosaic of suit filed cases but comprehensive. Since these cases purely relate to a sort of business dispute, there is a strong reason to categorise such accounts while investigating the phenomenon of Adverse Selection insofar as they relate to a wrong choice by the bank in selection of borrower.

Non Performing Assets (NPA) is also known as Problem Loans, Defaulting Loans, Bad Loans and Non Performing Loans (NPL) in the academic literature. NPA have been studied in the financial sector across the world for a long time as they impact on bank profitability and ultimately on bank survival / existence. However, a structured approach to the study of NPAs appears to be underway to a large extent only during the last 25 years or so. NPA originate from the pool of assets / lending done by the bank due to non-payment of dues by borrowers to the bank as per the agreed repayment schedule.

India's banking system has amassed a massive pile of non-performing loans in the aftermath of an economic slowdown that, coupled with delays in securing statutory approvals and completing land acquisition, stalled many projects, squeezed corporate cash flows and made it difficult for borrowers to repay loans. There are four stages of dealing with stressed assets—identification, recording, reporting of this particular subject has been turned satisfactorily, but resolution, which is the fourth leg, needs to be worked (on) more as stated by Shri Urjit Patel, Governor RBI post the first Monetary Policy Committee meeting.

In view of the foregoing, NPA may be viewed as contamination of the loan portfolio, which needs to be arrested in order to maintain the financial health of the system / economy. NPA demonstrate elements of toxicity which, if not addressed, may lead to severe disorders in the economic system. As outlined by RBI, the level of NPA is recognized as a critical indicator for assessing banks' credit risk, asset quality and efficiency in allocation of resources to productive sectors.

2. LITERATURE REVIEW

Ranjan & Dhal (2003), Das & Ghosh (2007), Gupta & Jain (2010), Misra & Dhal (2010), Rawlin et al (2012), Swamy (2012), Siraj & Pillai (2012), Siraj &Pillai (2013) and Dubey and Binilkumar (2014) studied different groups of banks and applied modeling techniques to model the NPA position. They used a large number of variables and researched on their annual movements as also established relationships amongst them for different periods of time under study.

On the advice of RBI, CIBIL has been authorized to collect and disseminate information relating to banks, displaying amongst others, particulars of Suit Filed cases of an amount greater than Rs 1 crore. Banks have been advised to furnish this information to CIBIL under an act for setting up of Information Companies. RBI in its Reports on Trends and Progress in Banking (RTPB) for the past years has presented rich systemic information relating to operations of SCBs during each year. The reports also mention the position of recoveries out of NPAs from different channels used by the bank. The solvency crises of financial systems across countries have in large measure been a consequence of accumulation of problem loans over time. In order to contain the growth of NPAs, recovery management has become a keyword for the banking industry in recent years. In the Indian context, several initiatives have been taken by the RBI in conjunction with the government to contain NPAs of banks.

Williamson (1986) stated that borrowers are identical ex-ante, but not all applicants receive loans. After entering into a contract, borrower and lender are asymmetrically informed about the return on the borrower's project and borrower will have an incentive to falsely default on the loan. This points to the need for costly monitoring by financial intermediaries.

Jappelli & Pagano (2000) reported that asymmetric information can hinder efficient allocation of credit. It induces adverse selection problems in addition to moral hazard issues. If lenders operate on a large scale, lenders can screen and monitor borrowers for statistical risk management to grant and price loans based on past performance.

Sharma *et al.* (2001) while discussing recovery in rural credit state that experience has shown that legal support is critical to recovery management. The recovery of loans through crystallised collateral and other back-stoppings is subject to a prolix process as the present legal system normally does not provide a fast and effective exit route. The security obtained for a loan account has only one major objective, that, in the event of default, the lender should be able to recover the money through the security. It could be by sale of the security or through the compromise process as the borrower would not like to lose the security.

Claus & Grimes (2003) stated that financial intermediaries transform risk as they can overcome market failure and handle information asymmetry. Adverse selection increases likelihood of transformation of loans to bad credit risks.

Mishkin (2003) elaborated that adverse selection occurs before the financial transaction takes place and that in many emerging market and transition countries, government interventions to direct credit is observed through stipulation of interest rates or creation of development finance institutions to lend to certain entities, resulting in less efficient investment and slower growth.

Mehrteab (2005) pointed out that information is asymmetric and costly to acquire. In credit market a lot depends on repayment probability of borrower. According to Stiglitz, financial contracts lead to adverse selection and moral hazard. Lending activity is essentially long term where the importance of each counter party changes with time / flow of funds. While the lender may have a reasonably good idea about the average characteristics of the pool of potential borrowers, he may not have full information on the characteristics of each borrower and the riskiness of his project. Often, the bank is assumed to be ignorant of the probability of success of individual borrower projects.

Chaudhuri (2005) states that it is realized that if a resolution strategy for recovery of dues from NPAs is not put in place quickly and efficiently, these assets would deteriorate in value over time and little value would be realized at the end, except may be its scrap value.

Siraj & Pillai (2012) studied SBIG, NB, FB and PrSB for 2001-11 to explore movement of GNPA, NNPA, Additions to NPA, Reductions to NPA, Provisions towards NPAs and compared it with Total Advances and Total Deposits of Banks. Average Annual Growth was used to represent time series data. Authors used OLS and submitted four equations, one for each type of bank. Multiple regression was run taking additions to NPA as dependent variable and Total Deposits and Total Advances as independent variable.

Balasubramaniam (2012) reported that a reduction in the total gross and net NPAs in the Indian financial system indicates a significant improvement in management of NPAs. This is also on account of various resolution mechanisms viz. SARFAESI, OTS, DRT and Corporate Debt Restructuring (CDR) mechanism. The total number of resolution approaches (including cases where action is to be initiated) is greater than the number of NPAs, indicating some double counting. Suit Filed and Bureau of Industrial Finance &Reconstruction (BIFR) are the two most common approaches to resolution of NPAs in PSU Banks. Rehabilitation has been considered/ adopted in only about 13% of the cases. Settlement has been considered only in 9% of the cases. It is likely to have been adopted in even fewer cases.

Rawlin *et al.* (2012) modeled NPA of a mid-sized NB as a function of Advances for 2001-10. Linear and non linear models were developed. Authors state that it could prove useful in order to forecast bank's NPA as soon as advances are made. Model accuracy can be improved by combining different non-linear models to arrive at a better fit.

Samir and Kamra (2013) states that setting up of Asset Reconstruction Company Limited (ARCIL), DRT and enactment of SARFAESI Act have been effective in recovering of NPAs in the banking sector. Several techniques have been tried to curb NPAs (viz., BIFR/SICA, Lok Adalats, DRTs, OTS, SARFAESI etc) but nothing has hit the mark in tackling NPAs. NPA management does not start after filing a suit but starts with the identification of a right borrower. Banks must apply basic principles of financial management to solve the problems of mounting NPA. Banks need to improve recovery management by developing suitable recovery programs for assessing and classifying the over dues, monitoring accounts, keeping regular contact with borrowers, fixing recovery targets, arranging recovery camps, training the personnel and linking marketing of produce and recovery in addition to improving the credit management process Further, effective legal system has to be in place. There are some flaws in each legal measure which need improvement in order to bring down NPA in banks. CIBIL can prevent those who take advantage of lack of system of information sharing amongst leading institutions to borrow large amount against same assets and property, which has in no measures contributed to the incremental of NPAs of banks. Banks and FIs depend heavily on DRTs, set up for suits of the value of recovery over Rs. 10 lakh, while High Courts and District Courts would take up cases of lesser values. They have the huge task on their hands. SARFAESI has also helped. Using the new options, banks and financial institutions accelerated their recovery of NPAs. All these efforts have contributed to improved recovery of NPAs by commercial banks.

In a certain sense, the problem of suit filed cases can be studied under the domain of Adverse Selection, as it relates to a situation where a wrong choice has been made by the lender in selection of borrower and over a period of time, the account has deteriorated to the such an extent that prospects of recovery diminish and legal recourse is adopted by the bank. This paper extracts and presents relevant information available in public domain.

3. RESEARCH GAP

Looking to the literature review, it can be seen that a lot of research has been done to understand reasons of rising NPA in Indian banks, influence of various factors on NPAs and impact of NPA on banks' business, its management and overall efficiency. Some work has also been done to analyze banks' recovery performance over the years, yet more needs to be done.

Therefore, this gap has been identified and is explored in the present study of "Suit-Filed Cases in Indian Banks – An Empirical Assessment of Legal Situation of NPA".

4. RESEARCH OBJECTIVE

1. To analyse movement of suit filed cases reported by Indian banks over the years.

2. To analyse recovery performance from different channels reported by banks.
3. To estimate minimum potentially lost amount arising out of the above.

5. RESEARCH DESIGN

5.1. Methodology and data collection

Data collection – The study is based on secondary data from 2002-16. The secondary data pertaining to banks was sourced from Reserve Bank of India database, CIBIL database augmented by data from various issues of Report of Trends and Progress in Banking. Different types / categories of banks viz State Bank of India and its Associates, Nationalised Banks, Old Private Sector Banks and New Private Sector Banks, i.e. SBIA, NB, OPSB and NPSB respectively have been studied using methodology of trend analysis.

5.2. Findings and Analysis

5.2.1. Suit Filed Cases - All bank types / groups for the period of 2002-2016

Table 1 contains amounts of Suit Filed Cases in Rs crore for all years. The total amount as on March 31, 2016, as reported by all banks to CIBIL was Rs 1,54,623 crore.

Table 1
Bank Type Wise Amount of Suit Filed Cases (Rs crore)

Year	*SBIA*	*NB*	*OPSB*	*NPSB*	*TOTAL*
2002	9771	33412	1341	4517	49041
2003	9597	41405	1710	5083	57795
2004	9701	29649	1993	5081	46424
2005	7029	30072	2114	4162	43377
2006	8657	27826	1560	2630	40674
2007	5356	34030	1704	2892	43982
2008	4327	22058	1846	2470	30702
2009	4999	23906	2019	3039	33965
2010	6451	33726	1898	3407	45482
2011	8541	18923	1622	5248	34333
2012	12212	28458	2263	5937	48869
2013	17312	31857	2263	6376	57808
2014	21312	26284	3177	10496	61269
2015	35229	40503	3938	12573	92242
2016	50498	77214	7930	18981	154623

Source: Empirical analysis of data

Table 2 contains descriptive statistics of SF cases.

Table 2
Descriptive Statistics of SF Cases (amounts in Rs Crore)

Parameter	*Min*	*Max*	*Average*	*St Dev*	*Times**
SBIA	4327	50498	14066	12871	5.6
NB	18923	77214	33288	13619	13.4
PSU	4327	77214			
OPSB	1341	7930	2492	1643	1.0
NPSB	2470	18981	6193	4538	2.5
PRIVATE	1341	18981			
TOTAL	1341	77214			

* : relates to a multiple of the relevant category vis-à-vis the category with the lowest average amount i.e. OPSB
Source: Empirical analysis of data

It may be seen from the table that on an average, the OPSB had the lowest average amount of suit filed cases, followed by NPSB at 2.5 times, then SBIA at 5.6 times, and finally, NB at 13.4 times. This also partly reflects the size and scale of operations of the banks, in the same order. Quite like this, the minimum amount of total of suit filed cases was for OPSB at Rs 1341 crore, and the maximum amounts also displayed the same relative positioning of different types of banks, with the largest being Rs 77,214 crore for NB. Year-wise movement of amount underlying the suit filed cases is presented in Figure 1.

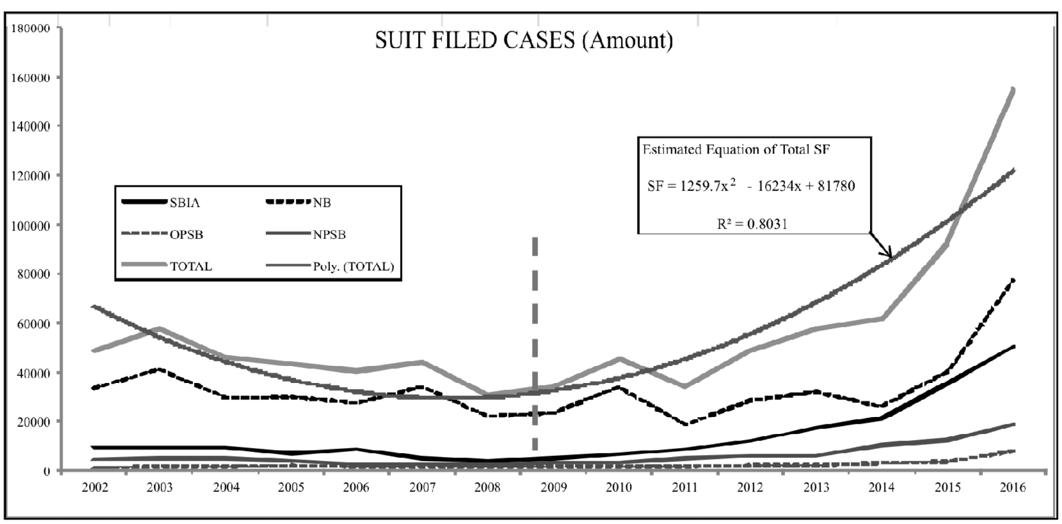

Figure 1 : Suit Filed Cases (Rs crore) of all bank categories

Source: Empirical analysis of data

The above figure has a plot of the data in Table 1, together with an estimated trendline for Total SF cases, using built in feature of MS Excel. It appears that 2007 was perhaps the best year when the total amount was at the lowest level, however, it may be seen that 2007 was in a way a totally different era. In recent times, the SF cases are increasing, partly due to the efforts of the RBI to clean up bank books and also due to banks efforts to use different channels for resolution of NPAs. Based on the trend line, the SF cases is likely to increase in the future.

As a next step, the average size of SF cases is analysed based on total SF amount (Rs crore) in each category / by no. of cases contained in those SF cases, presented in Table 3.

Table 3
Average Size of SF Cases (Rs crore)

Parameter	*Min*	*Max*	*Average*	*St Dev*	*Times**
SBIA	5	19	8.3	5	1.4
NB	5	13	7.4	2	1.2
PSU	5	19			
OPSB	4	10	6.0	2	1.0
NPSB	6	15	10.0	2	1.7
PRIVATE	4	15			
TOTAL	4	19			

* : relates to a multiple of the relevant category vis-à-vis the category with the lowest average amount i.e. OPSB
Source: Empirical analysis of data

It may be seen from this table that on an average, the OPSB had the lowest size of cases at Rs 4 crore. The biggest size of suit filed cases was observed in SBI cases at Rs 19 crore, followed by NPSB at Rs 15 crore and NB at Rs 13 crore. As in the case of total amounts, in terms of relative average sizes, the NB was about 1.7 times that of OPSB, SBIA was 1.4 times that of OPSB and NPSB was at 1.7 times that of OPSB. Year-wise movement of sizes of cases underlying the suit filed cases is presented in Figure 2.

5.2.2. Recovery from different channels - All banks for the period of 2004-2016

Table 4 shows underlying amount of recovery contained in the recovery documents from different channels in Rs crore. Figures have been reproduced from different annual reports of RTPB by RBI. It appears that Lok Adalat, DRT and SARFAESI are the only channels being pursued by the banks, and it also appears that ARC information is contained within the SARFAESI information. It has been indicated in the RTPB that OTS has since been discontinued. The amounts relate to all banks in the system and separate disclosures for types of banks is not available as of now.

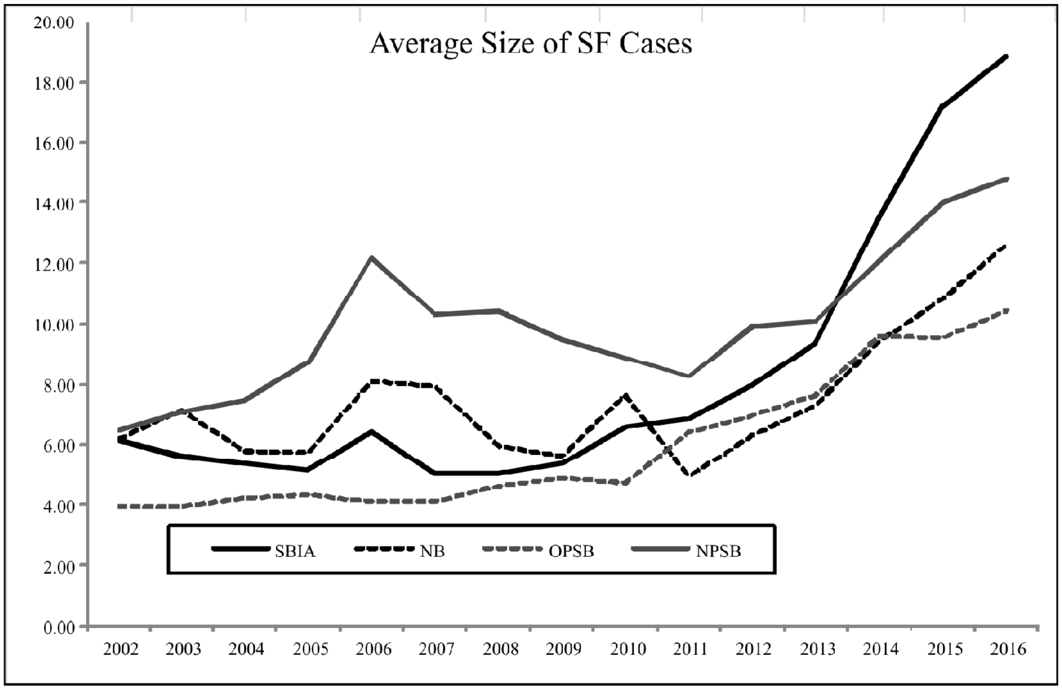

Figure 2 : Average Size of SF Cases for all bank categories

Source: Empirical analysis of data

Table 4
Underlying Amount Sought to be recovered from Different Channels (Rs crore)

	OTS	*Lok Adalat*	*DRTs*	*SARFAESI*	*ARC*
2004	1510	1063	12305	7847	
2005	1332	801	14317	13224	
2006	772	1101	6123	9831	
2007		758	9156	9058	
2008		2142	5819	7263	
2009		4023	4130	12067	
2010		7235	9797	14249	
2011		5254	14092	30604	
2012		17	241	353	
2013		66	310	681	
2014		232	553	953	
2015		887	3789	4705	

Source: Empirical analysis of data

Table 5 shows the number of cases referred for recovery from different channels.

Table 5
Number of Cases Referred to Different Channels of Recovery

	OTS	*Lok Adalat*	*DRTs*	*SARFAESI*	*ARC*
2004	139562	186100	7544	2661	
2005	132781	185395	4744	39288	368
2006	10262	181547	3524	38969	
2007		160368	4028	60178	
2008		186535	3728	83942	
2009		548308	2004	61670	
2010		778833	6019	78366	
2011		616018	12872	118642	
2012		476073	13365	140991	
2013		840691	13408	190537	
2014		1636957	28258	194707	
2015		9131199	171113	1241086	

Source: Empirical analysis of data

Table 6, derived from Table 4 and Table 5, shows the average size of cases referred for recovery from different channels. It can be seen that Lok Adalats are the preferred route for very small size loans while DRTs and SARFAESI Act appear to be the route for somewhat larger loans. Table 7 presents amounts recovered by lenders.

Table 6
Size of Cases Referred to Different Channels of Recovery (Rs crore)

	OTS	*Lok Adalat*	*DRTs*	*SARFAESI*	*ARC*
2004	0.01	0.01	1.63	2.95	
2005	0.01	0.00	3.02	0.34	
2006	0.08	0.01	1.74	0.25	
2007		0.00	2.27	0.15	
2008		0.01	1.56	0.09	
2009		0.01	2.06	0.20	
2010		0.01	1.63	0.18	
2011		0.01	1.09	0.26	
2012		0.00	0.02	0.00	
2013		0.00	0.02	0.00	
2014		0.00	0.02	0.00	
2015		0.00	0.02	0.00	

Source: Empirical analysis of data

Table 7
Amount Recovered from Different Channels of Recovery (Rs crore)

	OTS	*Lok Adalat*	*DRTs*	*SARFAESI*	*ARC*
2004	617	149	2117	1156	
2005	880	113	2668	2391	14506
2006	608	223	4710	3423	
2007		106	3463	3749	
2008		176	3020	4429	
2009		96	3348	3982	
2010		112	3133	4269	
2011		151	3930	11561	
2012		2	41	101	
2013		4	44	185	
2014		14	53	253	
2015		43	531	1152	

Source: Empirical analysis of data

And, finally, jointly viewing the Table 4 and Table 6 leads to a very important statistic viz percentage of recovery on pursuing recovery efforts from the three channels. These are presented in Table 8, as a heatmap.

Table 8
Percentage of Recovery from Different Channels

	OTS	*Lok Adalat*	*DRT*	*SARFAESI*	*ARC*
2004	0.41	0.14	0.17	0.15	0.00
2005	0.66	0.14	0.19	0.18	0.00
2006	0.79	0.20	0.77	0.35	0.00
2007	0.00	0.14	0.38	0.41	0.00
2008	0.00	0.08	0.52	0.61	0.00
2009	0.00	0.02	0.81	0.33	0.00
2010	0.00	0.02	0.32	0.30	0.00
2011	0.00	0.03	0.28	0.38	0.00
2012	0.00	0.12	0.17	0.29	0.00
2013	0.00	0.06	0.14	0.27	0.00
2014	0.00	0.06	0.10	0.27	0.00
2015	0.00	0.05	0.14	0.24	0.00
Average	**0.62**	**0.09**	**0.33**	**0.31**	**0.00**

Source: Empirical analysis of data

The above heat map has a continuous and automatic coloring based on the relaive importance of the recovery percentage, which Red scale showing very poor values, Green scales showing very good values, and intermediate values around Yellow, together with continuously varying color scales. It can be seen that Lok Adalats gave as low as 2% recovery and the highest recovery of 20% of the original amount claimed in the recovery document while the overall 12 year average was

9%. On the other hand DRTs had a low recovery of 10% and a high of 81% with an overall 12 year average of 33%. Similarly, SARFAESI had a low recovery of 15% in the first year of the data period, and a high of 61% in 2008 and overall average of 31%. The low percentage of 15% may be due to the fact that SARFAESI was just introduced and there were a number of operational issues involved. Later, it reached levels closer to the overall average. It is to be noted that scheduled commercial banks have loans of different sizes – comprising, tiny loans, MSME, SME and large including retail, personal, education and other consumption loans. The gross average recovery percentage works out to 30.6%, representing the proportion of recovery realized to of recovery claimed.

In view of the foregoing, it may be stated that in case all the SF cases as shown in Table 1 i.e. Rs 1,54,623 crore were to reach settlement stage **TODAY**, we may expect recovery of about Rs 47,315 crore while the remaining amount of about Rs 1,07,308 crore may be unrecoverable, and may have to be written off.

The relevant figures for PSU banks are of the order of Rs 1,28,000 crore of SF amount, and potential recovery being about Rs 39,300 crore, the balance being unrecoverable. One should see that there is a very high possibility that all of these loans would be fully provided for, if not already written off from the books of accounts, hence there is no pressure on the banks to provide for them, however, since recovery from NPA are to be reported on a cash basis, there is a likely loss of the unrecoverable amount. And, as brought out from the literature review, other expenses relating to the suits and interest lost due to amount pending recovery have not been included in these estimates. Assuming an overall 10% rate of interest on the SF amount, and considering that the recovery amounts are not likely to be recovered in one tranche immediately on a bullet-repayment type of basis, but over a period of time, the interest loss itself could be of the order of Rs 15,000 - 20,000 crore. In this context, it is worthwhile to note that in June 2016, government decided to infuse about Rs 23,000 crore in PSU banks which appears to be a small amount considering the piled up suit filed cases and potential write offs.

The limitations are that the above figures represent only those cases which are to be mandatorily disclosed by banks, viz where suit is filed for amounts greater than Rs 100 lakh. Looking at the loan sizes, a large number of cases would yet be going unreported. Hence the real picture would be worse than what is estimated here. Suit filed cases, as reflected from the literature review, are at the far end of the credit process.

6. CONCLUSION AND POLICY RECOMMENDATIONS

Based on data and analysis, as conducted above, the following can be concluded with an element of certainty. They also go towards addressing the research questions prior to the analysis.

- Suit Filed cases have piled up across the spectrum of banks.
- The number of cases and their sizes are increasing and points towards need for urgent steps to tackle the problem.
- Banks need to find out and analyze the reasons for slow progress of recovery. Is it due to recovery systems and procedure or due to lacuna on the part of the banks in terms of documentations or timely action? Findings will help the banks to bridge the gap in recovery process.
- Regular and case to case coordination should be established between recovery department and law department of the banks to expedite each case.
- Recovery efforts need to be expedited through various means – steps to be taken by the lenders, government and the legal enabling environment.
- Banks need to ensure that important lessons are drawn from such cases with a view to prevent borrowers demonstrating such behavior from taking loans from the banks.
- Learning from the recovery process of large defaulters is to be applied to small and medium defaulters as well.
- Rigorous loan monitoring is to be implemented so as to prevent the situation of filing a suit.
- Use of modern technology to be increased for effective monitoring.
- The analysis is simplistic in nature as it is based on best available information.

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