

# Evaluation of Debt Recovery Laws in India

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## 1. Role of banks in an economy

Banking comprises a significant part of Indian financial sector, and with reach across the length and breadth of the country, the sector has gained humungous size. Financial intermediaries like banks perform the necessary asset transformation<sup>1</sup> function in an economy. They accept deposits from depositors (depositor interface) and grant loans to borrowers from such deposits (borrower interface). The cycle is complete when banks receive promised and timely returns from such assets to repay their liabilities, and the earn margins in the process.

## 2. Weakness in borrower interface in India

A successful asset transformation is dependent on efficient conduct of depositor and borrower interface. Over the period of time, the efficiency in borrower interface has seen significant diminution.

The levels of gross non-performing assets (GNPAs) and net NPAs (NNPAs) for the system have been elevated. As on March 31, 2015, while the GNPAs have increased to 4.45 percent, the NNPAs have also climbed up to 2.36 percent. When seen in isolation, the NPA ratios do not appear very distressing; however, if we add the portfolio of restructured assets to the GNPA numbers, this rises alarmingly. Stressed Assets Ratio<sup>2</sup> as a whole stood at 10.90 percent as at the end of March 2015. The level of distress is not uniform across the bank groups and is more pronounced in respect of public sector banks (PSBs). The Gross NPAs for PSBs as on March 2015 stood at 5.17 percent while the stressed assets ratio stood at 13.2 percent, which is nearly 230 bps more than that for the system<sup>3</sup>. This indicates the increasingly deteriorating quality owing to weak borrower interface, required to successfully run asset transformation business.

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### **3. Fixing accountability of borrowers**

When borrowers default on loans, lenders typically re-negotiate the contract. If renegotiation fails, they resort to various legal forums or extra-judicial measures, available for recovery of debt due.<sup>4</sup> Accordingly, they could approach debt recovery tribunals (DRTs), or invoke the provisions of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act), to enforce repayments.<sup>5</sup>

Both the Recovery of Debts due to Banks and Financial Institutions Act, 1993 (DRT Act) and SARFAESI Act originally aimed at providing alternative recovery mechanism to the cumbersome court processes. However, these state interventions did not seem to visualise the case wherein the designated agencies/ measures under the statutes fail to execute their assigned tasks. This can be substantiated with slow and low recovery of debt under various debt recovery mechanisms.

While the total number of matters referred under various debt recovery mechanisms<sup>6</sup> increased by a whopping 78 percent to 1.86 million in the Fiscal 2014, only 18 percent of the amount in question (i.e., Rs. 1,731 billion) was actually recovered. Further, the amount banks recover from defaulted debt is also long delayed.<sup>7</sup>

*Who pays for this low and slow recovery of debts?* The delayed and under-recovery is not merely a problem between the two contracting parties. Entwined with this contract is the general welfare of the public as well, out of whose deposits the bank grants loans, or who effectively make good such losses in the form of increased taxes or higher interest payments. Thus, a huge cost is to be borne by multiple stakeholders<sup>8</sup>, owing to regulatory failure/imminent regulatory failure<sup>9</sup>.

### **4. Regulatory Impact Assessment**

In order to correctly understand the causes of regulatory failure, a systematic approach to assess the impact of regulatory measures is crucial. Critical legislations/ regulations in-place will have to be analyzed in case they fail to achieve the desired objectives. This helps to identify sub-optimal provisions or issues remain unaddressed in such legislations/regulations, and development of optimal alternatives, having the potential to achieve the desired objective, with maximum net

benefits on the stakeholders involved. This approach is known as Regulatory Impact Assessment (RIA).

RIA is an important element of an evidence-based approach to policy making, as it essentially comprises stakeholder engagement in policy making and review. It aids in devising optimal regulatory interventions to alter natural state of market to achieve desired objectives. As regulatory interventions usually change behaviour of multiple stakeholders, and thus impose additional costs on them. RIA helps in designing most justifiable regulatory intervention, using tools like cost-benefit analysis (CBA).<sup>10</sup>

The following sections present a brief RIA of the problem of low and slow recovery of debts in India.

## **5. Understanding the baseline**

Post defining the problem (i.e., slow and low recovery of debts), the next step in RIA is identification of lacunae/sub-optimal provisions (impeding speedy debt recovery), by stakeholder interaction, in-depth literature review and analysis of relevant provisions in select legislations.

The following sections are divided into two broad heads - DRT Act and SARFAESI Act, providing analysis of issues under respective legislations.

### **DRT Act**

The DRT Act provides for the establishment of DRTs and DRATs (collectively referred as 'RTs') as dedicated adjudicatory bodies to enable speedy recovery of due amounts. However, it seems to have failed to achieve this objective by a significant mark. This is evident from the fact that as on March 31, 2014, 66,971 cases amounting to Rs. 1,415 billion are pending at DRTs.<sup>11</sup> This could be because its provisions leave the scope for delay in decision making; and/or otherwise impeding performance of RTs.

According to the Annual Review (2011-12) of the Internal Audit Wing, Ministry of Finance, Government of India, out of total 1,113 Original Applications (OAs)<sup>12</sup> pending with Chandigarh DRT-II as on March 31, 2011, 429 OAs were pending for

more than three years and remaining 684 for more than one year.<sup>13</sup> Similarly, a recent study<sup>14</sup> also suggests that around one-third of total 21 cases (randomly selected) analysed were pending for more than 3 years.

Experts have also raised concerns that only about one-fourth of the cases pending at the beginning of the year get disposed of during a particular year.<sup>15</sup> This effectively defeats the very purpose of its (DRT Act) enactment.

Following factors are attributable to the delay in decision making:

➤ ***Absence of mandatory time limits for disposal of matters***

The DRT Act provides that cases before the DRT and DRAT should be disposed of in 180 days<sup>16</sup> and 6 months<sup>17</sup>, respectively. Thus, the Act prescribes only a *reasonable effort* obligation on the RTs but does not require them to *mandatorily* dispose of application within a specific period. Consequently, the recommendatory timeframe to dispose of the application/appeal is rarely complied with.

This was corroborated with data collected from Chandigarh DRT, Jabalpur DRT, Jaipur DRT and Lucknow DRT. The results show that around 75 percent of cases were dragged for more than a year. In addition, analysis of 22 cases (randomly selected, to the extent available in public domain)<sup>18</sup> pending at DRAT Chennai<sup>19</sup> also gives the similar results.<sup>20</sup>

This is a result of lax enforcement of recommendatory provisions with respect to disposal of applications, and absence of mandatory prescriptions. As a result, RTs are not made accountable for non-complying with stipulated timeframes.

➤ ***Insufficient RTs***

The DRT Act authorises the central government, to establish one or more RTs, and specify their jurisdiction.<sup>21</sup> However, it does not provide any guidance on the factors which should be considered while establishing RTs, or the need to ensure existence of adequate number of RTs in the country.

As a result, as on date, there are 39 DRTs<sup>22</sup> and 5 DRATs<sup>23</sup>, with some states have more than one DRT<sup>24</sup> and some do not having even one exclusive DRT<sup>25</sup>. Further,

no intelligible classification criteria are available in public domain, for assigning jurisdiction to DRTs. Consequently, while some DRTs are dealing with huge backlog of cases, situation might be better in some others.<sup>26</sup>

On an average, approximately 2,000 cases are pending per DRT at present, which is virtually 2.5 times of adequate number of cases ought to be pending.<sup>27</sup>

The situation is no better at DRATs, with each DRAT having appellate jurisdiction over multiple DRTs.<sup>28</sup>

➤ ***Inadequate composition of RTs***

RTs consist of one person only i.e. Presiding Officer (PO)<sup>29</sup> in case of DRT and Chairperson<sup>30</sup> in case of DRAT, who could be authorised to discharge functions of PO/Chairperson of another DRT/DRAT, as the case may be. During a review of functioning of different DRTs, it was found that from June to December, 2014, all matters listed for hearing before the PO of Chennai DRT-III were transferred to the PO of Chennai DRT-II.<sup>31</sup>

Further, DRTs have witnessed exponential increase in matters filed, in last 5 years (2009-10 to 2013-14), from 6,019 to 28,258<sup>32</sup>. Therefore, it might be beyond the capacity of one person, to expeditiously deal with such increase in filing.

In addition, if a PO/Chairperson is on temporary leave, all cases listed on the day are usually long adjourned, resulting in delay in decision making. A review of cases filed in Chennai DRAT revealed that more than 70 cases listed before the Chairperson in the month of November, 2014 were adjourned to different dates, mostly after 2 month period, as the Chairperson was on leave.<sup>33</sup>

➤ ***Absence of technical member at RTs***

A review of practice at other tribunals reveals that such bodies are usually manned by two members, viz. a legal and a technical,<sup>34</sup> contrary to one person RT. As a result of such technical member, the quality of decisions is usually high and the time taken to reach at the decision is usually less.<sup>35</sup> Consequently, this has the potential to result in procrastinating debt recovery.

➤ **Sub-optimal process of filing vacancies**

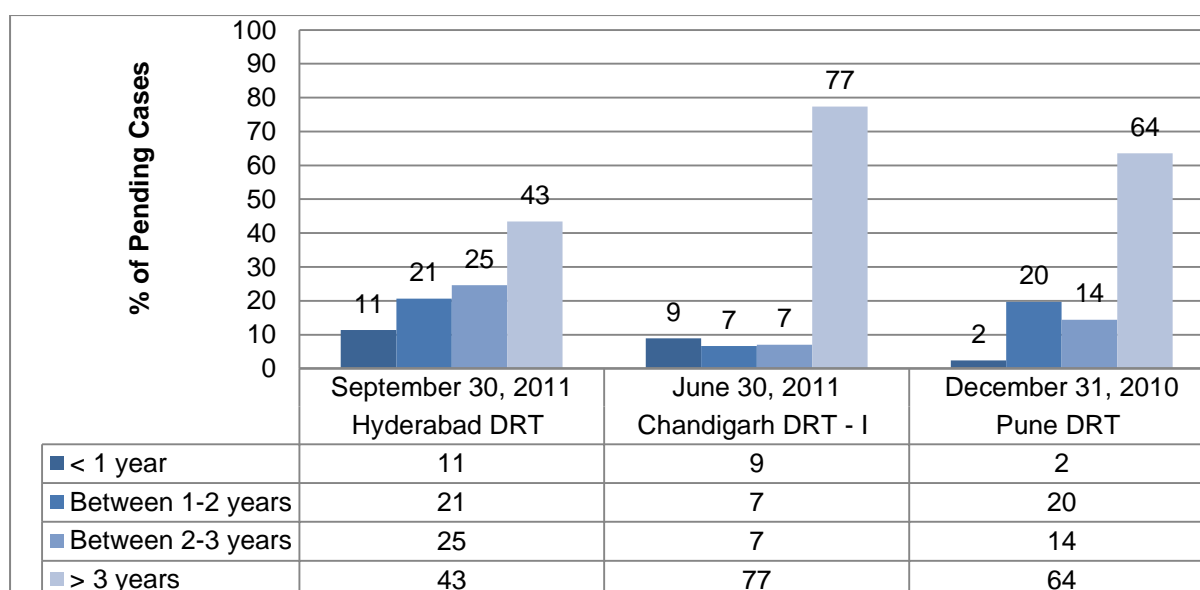
The central government is empowered to fill the vacancy/casual vacancy under the DRT Act. However, the Act does not envisage any mechanism to detect potential vacancy, neither does it provide for a reliable time bound mechanism within which such vacancy must be filled.

An analysis of different DRTs suggests that while the position of PO in DRTs at Chennai (DRT-III), Delhi (DRT-I), Nagpur and Patna remained vacant for almost 6 months<sup>36</sup>, in case of Chandigarh (DRT-I) it remained vacant for a period of almost 4 months<sup>37</sup>. This resulted in delay in decision making, and consequent delay in recovery.

➤ **Inefficient recovery process**

DRT Act empowers the central government to provide DRT with one or more Recovery Officers (RO), as it may deem fit, in order to ensure recovery of due amount. Further, the Act describes the modes of recovery which could be employed by the RO.

During 2011-12, the Internal Audit Wing (Ministry of Finance) undertook audits of 9 DRTs and 1 DRAT. The audit revealed huge pendency of recovery certificates (RC) before ROs of certain DRTs. On average, around 60 percent of the RCs were pending for more than 3 years.



In addition, 744 RCs out of total 999 RCs were pending before RO-I & II of Chandigarh DRT-II for more than 3 years as on March 31, 2011. This could be attributable to absence of statutory provisions requiring ROs to recover the amounts within a particular timeframe.

➤ ***Exercise of jurisdiction by other courts/authorities***

DRT Act bars jurisdiction of any court or any other authority in relation to debt recovery matters covered by the Act.<sup>38</sup> However, it neither provides for any remedy in case other courts/authority exercises jurisdiction, nor expressly invalidating the proceedings at such other court/authority.

It is observed that the provision of barring any court/ authority in relation to debt recovery matters is often overlooked by them, despite strict directions from the Apex Court.<sup>39</sup> However, the situation seems to not have improved.

➤ ***Lack of clarity on powers of RTs***

While the DRT Act have pecuniary jurisdiction in cases wherein the amount of debt exceed Rs. 10 lakhs, it does not seem to have express power to conclusively determine the amount of debt involved.

The dispute in relation to amount of debt due would usually arise when (i) borrower files its written statement to summons issued by the DRT, (ii) appeal is filed in DRAT and the borrower is required to deposit a portion of amount due<sup>40</sup>; or (iii) application is filed against action by lender under SARFAESI Act.

Consequently, absence of powers with respect to determination of debt amount, or providing for the procedure for such determination has the potential to result in delays in decision making.

### **SARFAESI Act**

SARFAESI Act provides for several modes to financial intermediaries for enforcing their security interest. It envisaged use of such modes without intervention of courts or judicial authorities, thereby avoiding delays hitherto been experienced in (judiciary led) recovery process. However, evidence suggests that it has not been able to meet

expectations either. The ratio of amount recovered is reduced to 25.8 percent in fiscal 2013-14 from 27.1 percent in 2012-13.<sup>41</sup>

This is because its provisions leave scope of delay in recovery; and provisions/absence of provisions otherwise impeding debt recovery.

Following factors are attributable to the delay in recovery:

➤ ***Absence of time period for Magistrate to take possession of secured asset***  
SARFAESI Act requires the secured creditor to approach the Chief Metropolitan Magistrate (CMM)/ District Magistrate (DM), for assistance in taking possession of secured asset.<sup>42</sup> The CMM/DM may take possession, or authorise any officer subordinate to it to take possession.

However, it fails to specify any time period within which the direction, steps and consequent possession must be taken, and subsequently, possession must be transferred to the secured creditor. This could delay the recovery process.<sup>43</sup>

➤ ***No accountability if application is not disposed of by RTs within prescribed period***

SARFAESI Act provides that an application made u/s 17 should be disposed of within 60 days from the date of such application. It further provides that the DRT may, from time to time, extend the said period for reasons to be recorded in writing, however, that the total period of pendency of application with the DRT, shall not exceed four months from the date of making of such application. If the application is not disposed of by the DRT within four months, any party to the application may make an application to the DRAT for directing the DRT for expeditious disposal of the application.

However, such direction by DRAT does not seem to be binding on DRT, owing to lack of explanation of the term 'expeditious disposal' and absence of accountability provisions in case matters are not disposed of by RTs within the prescribed timeframe.



➤ ***Exercise of jurisdiction by other judicial foras***

SARFAESI Act bars civil courts from entertaining any suit or proceeding in respect of any matter which a RT is empowered to determine.<sup>44</sup> Further, no injunction can be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under the SARFAESI Act/ DRT Act.

However, the legislation fails to prescribe consequences of entertaining suit, or grant of injunction, by civil courts or any other court.<sup>45</sup> Absence of provisions specifying accountability consequences, make its provisions ineffective, and inconsequential.

➤ ***Taking over management by secured creditor for limited period***

The law allows the secured creditor to take over management of borrower's business for the purpose of recovery of debt.<sup>46</sup> It further requires the secured creditor to restore management of business to the borrower upon realisation of its debt in full. The intention of such provisions seems to prevent unjust enrichment of secured creditor.

It must be realised that it is the duty of borrower to manage its business efficiently, and repay the debt due to the secured creditor. The secured creditor will not benefit from putting in any additional efforts to turn around the business of the borrower, save recovering the original debt. Such sub-optimal provisions often make the measures available for debt recovery unattractive.

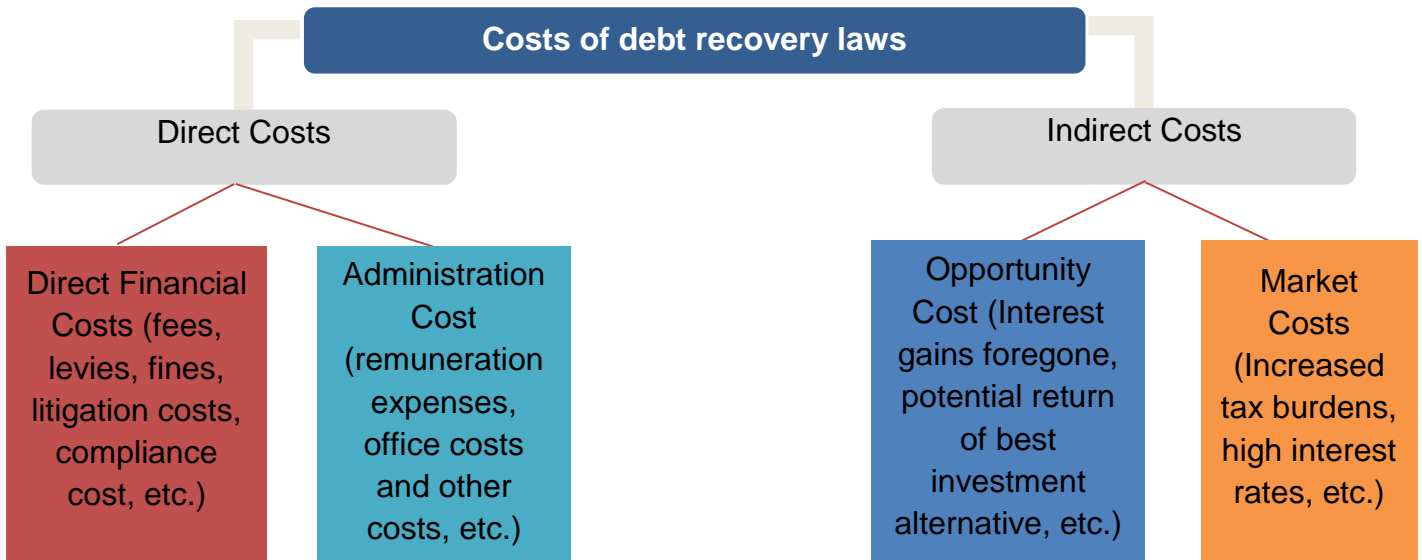
➤ ***Requirement for consent of borrower for sale of movable property***

The Security Interest (Enforcement) Rules, 2002 provide that sale of moveable property/ security by any method other than public auction or public tender shall be on such terms as may be settled by parties in writing. It is not clear if consent of the borrower is required to sell moveable property by a private treaty.

In the matter of *J. Rajiv Subramaniam v. Pandian*<sup>47</sup>, it was held that that in case of sale by private treaty, there needs to be consent of the defaulter. This makes the sale by private treaty very difficult, costly, time consuming and hinders the debt recovery process.

## 6. Estimation of costs

The next step in RIA is to undertake a theoretical estimation of additional costs of the as-is/prevaling scenario, on multiple stakeholders. Broadly, costs are categorized into Direct and Indirect Costs.



Following section provides a theoretical estimation of superfluous costs imposed on various stakeholders, owing to sub-optimal provisions/ absence of optimal provisions in DRT act and SARFAESI Act.

### **DRT Act**

As highlighted above, cases in RTs are subject to long delays, and consequently result in incremental costs on stakeholders' involved as amounts locked up in legal proceedings results in severe under-utilisation of resources.

Following costs are imposed on stakeholders, due to deficient nature of provisions/ absence of provisions in the DRT Act.

### Opportunity Cost

With respect to debt recovery, opportunity cost includes the interest gains foregone on amount stuck in NPA cases for substantially longer periods.

As on March 31, 2014, a total of 66,971 cases involving Rs.141,500 crore are pending at all 33 DRTs.<sup>48</sup> Considering a four year wait to dispose all the pending

cases,<sup>49</sup> banks and financial institutions have to bear an additional cost of around Rs. 25,000 crore.<sup>50</sup>

### Market Cost

Market costs are the costs imposed on various stakeholders, such non-defaulting borrowers, depositors, taxpayers, etc.

The social cost of the amount of loans (i.e., Rs.161,018 crore<sup>51</sup>) written off by commercial banks in last five years is as high as it would have allowed 1.5 million of the children to get a full university degree from top private universities of the country.<sup>52</sup>

In addition, low debt recovery has resulted in credit risk premium of around 300 basis points, resulting in high cost of funds for genuine borrowers.<sup>53</sup>

### Direct Financial Cost

Direct financial costs include regulatory charges such as fees, levies and fines, in addition to the litigation cost. As a result of incredibly increasing number of cases being referred to RTs, regulatory charges in the form of application/appeal fees, puts an added burden on the litigants.

In addition, during the year 2013-14, a total of 28,258 cases (involving Rs. 55,300 crore) were referred to DRTs.<sup>54</sup> Consequently, the opportunity cost of litigation for the same period comes out to be around Rs.2,000 crore.<sup>55</sup>

### Administration Cost

Administrative cost includes executive compensation, office costs and other expenses not directly associated with the execution of the activity.

The Union Budget for 2015-16 allocated Rs.102.28 crore for RTs, which is around 35.38 per cent higher than the revised budget estimate of Rs.75.55 crore for the year 2014-15.<sup>56</sup>

## **SARFAESI Act**

Sub-optimal provisions/ absence of optimal provisions in the SARFAESI Act have resulted in inordinate delays in debt recovery, leading to imposition of significant costs on stakeholders.

### Opportunity Cost

The recovery rate of matters pending under SARFAESI Act in the FY 2011-12 was 28.62 percent, which subsequently reduced to 27.16 percent and 25.80 percent in 2012-13 and 2013-14, respectively.<sup>57</sup> Therefore, the average recovery ratio comes out to be around 27 percent, which means that even assuming that the entire amount would be recovered in due course, it would still take atleast 3.5 years to do so.<sup>58</sup>

As on March 31, 2014, total amount remain unrecovered under the SARFAESI mode was Rs.70,200 crore.<sup>59</sup> Considering that three and half years would be required to recover the total amount, the total additional cost to be borne by banks/financial institutions would be around Rs.10,000 crore.

### Market Cost

The government is looking at the option of setting up of National Asset Management Company (NAMCO) for transferring bad assets to it. NAMCO will require 1,00,000 crore of equity capital, and borrowed funds in the form of government-guaranteed bonds.<sup>60</sup>

Therefore, setting up of NAMCO has an opportunity cost as Rs.1,00,000 crore of public money could retire Rs.1,00,000 crore of public debt or build 10,000 crore of six-lane expressways.<sup>61</sup>

## **7. Developing and selection of alternative**

Developing and selection of alternatives using the tools like CBA is the final step in RIA. The following section attempts to provide legislative alternatives to select provisions under select legislations, with the objective of reduction in costs. The section is divided into two broad sub-sections discussing legislative alternatives to select provisions of DRT Act and SARFAESI Act, and their consequent impact.

## DRT Act

### ➤ *Number of RTs*

Below table compares the baseline scenario with respect to the number of RTs and the suggested alternatives.

Particulars	Baseline	Alternative 1		Alternative 2
		Scenario 1: High pendency (assuming increasing in pendency of cases by 50 percent) <sup>62</sup>	Scenario 2: Low pendency (assuming no change) <sup>63</sup>	
Description	39 DRTs (6 being proposed in the budget of the year 2014) and 5 DRATs	Establishment of 73 additional DRTs <sup>64</sup>	Establishment of 24 additional DRTs <sup>65</sup>	E-governance in RTs <sup>66</sup>
Costs	Low efficiency, high pendency, low disposal rate	Rs. 192 cr. <sup>67</sup> , and one time infrastructure cost.	Rs. 63 cr. <sup>68</sup> , and one time infrastructure cost.	Rs. 200 cr. <sup>69</sup>
Benefits	Low administration cost	Significant reduction in pendency and significant increase in disposal rate	Reasonable reduction in pendency and reasonable increase in disposal rate	Improvement in performance

### *Recommendation*

Above table reveals that scenario 1 under alternative 1 and alternative 2 are expected to impose significant costs. Further, implementation of scenario 1 in a phased manner of around three years would be akin to implementation of scenario 2. Consequently, it is recommended that suggestions under scenario 2 be implemented, subject to review of impact, after one-year period.

### ➤ *Performance of adjudicating officers and staff*

Below table compares the baseline scenario with respect to the performance of adjudicatory officers and staff and the suggested alternatives.

Particulars	Baseline	Alternative 1	Alternative 2	Alternative 3	Alternative 4
Description	<ul style="list-style-type: none"> <li>• Sub-optimal eligibility criteria</li> <li>• One PO / Chairman per RT</li> <li>• No performance review or performance linked incentives</li> <li>• No public disclosure of performance</li> </ul>	Revision of eligibility criteria to include experience/knowledge in banking/debt recovery	Provision of technical members at RTs	Provision for performance linked incentives, by a performance review committee	Periodic public disclosure of performance
Costs	Sub-optimal performance, high pendency, low disposal rate	Salary: Rs. 2.64cr. p.a (Rs. 6 lakhs * 1 officer * 44 RTs)	Salary: Rs. 6.6cr. p.a (Rs. 15 lakhs * 1 officer * 44 RTs)	Salary: Rs. 60 lakhs p.a. [(Rs. 12 lakhs*3 members) + (Rs. 6 lakh*4 staff)]	Salary: Rs. 2.64 cr. p.a (Rs. 6 lakhs * 1 officer * 44 RTs)
Benefits	Low administration cost	Selection of better quality candidates and improvement in performance	Improved analysis and quality of orders, reduction in pendency rate	Increased motivation for better performance, improvement in quality	Increased public scrutiny of RTs performance, and improvement in accountability

### *Recommendation*

Comparison of costs and benefits of different alternatives as listed in the above table reveals that net benefits of alternative 2 are expected to surpass the net benefits under any other alternatives. Consequently, adoption of alternative 2 is recommended.

### ➤ **Process of filling vacancies**

Below table compares the baseline scenario with respect to process of filling vacancies and the suggested alternatives.

Particulars	Baseline	Alternative 1	Alternative 2
Description	Selection committee comprising government representatives	Inclusion of part time experts in selection committee	Constitution of independent advisory body to recommend candidates
Costs	Sub-optimal quality of	Salary cost: Rs. 25.80 lakhs p.a. [(Rs. 15000	Salary cost: Rs. 20.40 lakh p.a. [(Rs. 20000 * 3 meetings

Particulars	Baseline	Alternative 1	Alternative 2
	adjudicatory officers, resulting in low quality orders and high pendency	* 3 members * 4 meetings) + (Rs. 6 lakhs * 4 members)]	* 4 meetings) + (Rs. 6 lakhs * 3 members)]
Benefits	Low administration cost	Reasonable possibility of selection of better quality candidates and improvement in RTs performance	

### *Recommendation*

Comparison of alternatives in the above table suggests that the net benefits of alternative 2 are expected to surpass the net benefits of alternative 1. This is because the independent advisory committee is expected to work independently. Consequently, adoption of alternative 2 is recommended.

### **SARFAESI Act**

#### ➤ **Possession of secured asset by Magistrate**

Below table compares the baseline scenario with respect to possession of secured assets by Magistrate under SARFAESI Act and the suggested alternatives.

Particulars	Baseline	Alternative 1	Alternative 2
Description	No specific time period for the Magistrate to take possession	Specific time period within which the Magistrate will be required to take possession	Specific provision authorising secured creditor to approach RTs to direct Magistrate to take possession, and justify the delay, in case the position is not taken within a reasonable time
Costs	Inordinate delays in taking possession by Magistrate	Increase in administration and management costs of Magistrate	<ul style="list-style-type: none"> <li>• Increase in administration and management costs of Magistrate</li> <li>• Possibility of increase in matters filed at RTs, thereby increasing the burden at RTs</li> </ul>
Benefits	Low administrative cost	Reduction in delays to order taking over of possession by Magistrate	

### *Recommendation*

The comparison of impact of alternative 1 and 2 would reveal that net benefits under the former are expected to surpass those under the latter. This is because

alternative 2 is expected to impose additional burden on RTs as well, and further delay debt recovery. Consequently, adoption of alternative 1 is recommended.

➤ ***Taking over of management by secured creditors/ securitisation/ reconstruction agencies***

Below table compares the baseline scenario with respect to taking over of management under the SARFAESI Act and suggested alternatives.

<b>Particulars</b>	<b>Baseline</b>	<b>Alternative 1</b>	<b>Alternative 2</b>
Description	Statutory requirement to restore management of business to borrower upon realisation of debt	Statutory provision of additional management fee for the secured creditor, who could stay in control of possession of secured asset, up to recovery of management fee, in addition to debt	Amendment to scope of debt to include priority to recover cost of turnaround of borrower's management
Costs	Cost to secured creditor in turning around borrower's business without commensurate compensation, resulting in limited take up of this measure	Increase in cost to borrower in terms of greater fund outflow and delayed repossession of secured asset	
Benefits	No need for the borrower to file for bankruptcy, and it remains afloat	Greater motivation to secured creditors to use this measure and consequent increase in debt recovery	

*Recommendation*

A comparison of alternatives 1 and 2 reveal that the net benefits under alternative 1 are expected to surpass those under alternative 2. This is because alternative 2 mandatorily increases the time of possession of secured asset with the secured creditor. Consequently, adoption of alternative 1 is recommended.

**Common Issues**

➤ ***Time limit for disposal of matters***

Below table compares the baseline scenario with respect to time limits for disposal of matters and the suggested alternatives



<b>Particulars</b>	<b>Baseline</b>	<b>Alternative 1</b>	<b>Alternative 2</b>
Description	Recommendatory time limit for disposal	Provision for mandatory time limit with reimbursement of application fee on non-compliance	Periodic public disclosure of non-compliance with time lines and reasons thereof
Costs	Low compliance with the statutory time period, high opportunity and litigation costs	<ul style="list-style-type: none"> <li>• Reimbursement cost to RTs/ government: Rs. 24 cr. p.a. (Rs. 12000 * 20000 cases)<sup>70</sup></li> </ul>	<ul style="list-style-type: none"> <li>• Salary cost: Rs. 2.64 cr. p.a. (Rs. 6 lakhs * 1 officer * 44 RTs)</li> <li>• Additional information, communication and technology cost</li> </ul>
Benefits	Low administration cost	<ul style="list-style-type: none"> <li>• Reimbursement benefit to litigants: Rs. 24 cr. (annual)</li> <li>• Opportunity cost saved: Rs. 3 cr. (annual)<sup>71</sup></li> <li>• Improvement in disposal rate</li> </ul>	Greater public scrutiny of RT performance, reduction in pendency and increase in disposal rate

### *Recommendation*

A comparison of alternative in the above table reveals that the net benefits under alternative 1 are expected to surpass those under alternative 2. The possibility of reimbursement of application fee will push the government to take measures for improvement of performance of RTs. Consequently, adoption of alternative 1 is recommended.

### ➤ ***Exercise of jurisdiction by other courts/ judicial authorities***

Below table compares the baseline scenario with respect to exercise of jurisdiction by other courts/ judicial authorities and the suggested alternatives

<b>Particulars</b>	<b>Baseline</b>	<b>Alternative 1</b>	<b>Alternative 2</b>
Description	Unrestricted exercise of jurisdiction by other courts/ judicial authorities despite contrary provisions	Public disclosure of matters pending on account of orders of other courts/ judicial authorities, amount involved	Penalising the party approaching other judicial authorities
Costs	Low compliance with the statutory time period, high opportunity and litigation costs	<ul style="list-style-type: none"> <li>• Salary cost: Rs. 2.64 cr. p.a. (Rs. 6 lakhs * 1 member * 44 RTs)</li> <li>• Additional</li> </ul>	Additional litigation cost to parties approaching other judicial authorities

Particulars	Baseline	Alternative 1	Alternative 2
		information, communication and technology cost	
Benefits	Low administration cost	Greater public scrutiny resulting in reduction of injunction orders by other courts/ judicial authorities	Reduction in the practice of approaching other judicial authorities, consequent improvement in disposal rate

### *Recommendation*

A comparison of alternatives in the above table reveals that the net benefits under alternative 2 are expected to surpass those under alternative 1, and ensure greater compliance of the relevant statutes. Consequently, adoption of alternative 2 is recommended.

### **Conclusion**

As evidenced from the above, absence of periodic assessment of effectiveness of provisions of DRT Act and SARFAESI Act has resulted in inadequate implementation and sub-optimal results, such as the inefficiency of securitisation and reconstruction process. Therefore, the impact needs to be assessed on all stakeholders such as government, financial institutions, judiciary<sup>72</sup> et al. Consequently, periodic ex-post review of its provisions is necessary to ensure relevance of provisions which keep track with changing realities.

### **End Notes:**

<sup>1</sup> Asset transformation is the process of creating a new asset (loan) from liabilities (deposits) with different characteristics by converting small denomination, immediately available and relatively risk free bank deposits into loans - relatively risky, large denomination asset- that are repaid following a set schedule (*Key concept definitions, Global Association of Risk Professionals, 2009*).

<sup>2</sup> (Gross NPA+ Restructured Standard Advances to Gross Advances)

<sup>3</sup> Lecture delivered by S.S. Mundra, Deputy Governor, RBI, at Bangalore as a part of the Memorial Lecture series launched by State Bank of Mysore in the memory of His Highness Sri Nalwadi Krishnaraja Wadiyar, on April 29, 2015, available at [https://rbi.org.in/Scripts/BS\\_SpeechesView.aspx?Id=955](https://rbi.org.in/Scripts/BS_SpeechesView.aspx?Id=955), last visited on May 5, 2015,

<sup>4</sup> FSLRC Working Group on Banking (2013)

<sup>5</sup> In addition to approaching Lok Adalats and civil courts

<sup>6</sup> Lok Adalats, DRT Act and SARFAESI Act

<sup>7</sup> Raghuram Rajan, *Saving Credit*, Verghese Kurien Memorial Lecture, 25 November 2013, notes, "even though the law indicates that cases before the DRT should be disposed off in 6 months, only about a fourth of the cases pending at the beginning of the year are disposed off during the year – suggesting a four year wait even if the tribunals focus only on old cases."

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- <sup>8</sup> Including banks/financial institutions, government, regulatory bodies and general public at large.
- <sup>9</sup> When existing legislations/regulations are not able to meet the desired objectives.
- <sup>10</sup> OECD, Regulatory Impact Analysis, available at <http://www.oecd.org/gov/regulatory-policy/ria.htm>
- <sup>11</sup> R. Gandhi, *Workshop for Judges of ATs and Presiding Officers of DRTs* conducted by CAFRAL on December 29, 2014, available at <http://rbidocs.rbi.org.in/rdocs/Speeches/PDFs/BDRRS010115.pdf>, last visited on April 30, 2015
- <sup>12</sup> Involving total amount of Rs.1,620.84 crore
- <sup>13</sup> Annual Review of Internal Audit Wing of Ministry of Finance, 2011-12
- <sup>14</sup> *Study on Understanding cases at the Debt Recovery Tribunal*, undertaken by the National Institute of Public Finance and Policy (NIPFP) and Indira Gandhi Institute of Development Research (IGIDR) in August, 2014
- <sup>15</sup> Talk by Dr. Raghuram G. Rajan at the Third Dr.Verghese Kurien Memorial Lecture at IRMA, Anand on November 25, 2014, available at <http://rbidocs.rbi.org.in/rdocs/Speeches/PDFs/SCR251114VER3RD.pdf>, last visited on April 30, 2015.
- <sup>16</sup> Section 19(24) of the DRT Act
- <sup>17</sup> Section 20(6) of the DRT Act
- <sup>18</sup> The information in public domain is for a limited period (say, 2010-2014). The cases might have been instituted prior to beginning of that period and could continue subsequent to end of such period.
- <sup>19</sup> Chennai DRAT, A Diary, available at <http://www.drat.tn.nic.in/ADiary.htm>
- <sup>20</sup> Around 73 percent cases were pending for more than one year.
- <sup>21</sup> Section 3 of the DRT Act
- <sup>22</sup> 6 DRTs proposed by the Government in the Union Budget of 2014
- <sup>23</sup> List of DRATs/DRTs, available at <http://financialservices.gov.in/banking/ListOfDRATsAndDRTS.asp?pageid=1>, last visited on April 30, 2015
- <sup>24</sup> Maharashtra has 5 DRTs (three in Mumbai and one each in Nagpur and Pune)
- <sup>25</sup> All North eastern states have access to a singular DRT in Guwahati
- <sup>26</sup> For instance, as on 31 March 2014, more than 1,000 matters are pending at DRT-Chennai I, but the total number cases pending at DRT-Chennai II and III on a consolidated basis is less than 900, on the same date. Similar is the case with tribunals in Delhi and Mumbai
- <sup>27</sup> According to the Report of the 'Working Group to Review the functioning of DRTs', under the Chairpersonship of Mr. N.V. Deshpande (Former Legal Advisor of RBI), the presiding officer of DRT should not have more than 30 cases on board on any given date and there should not be more than 800 cases pending before it any given point of time.
- <sup>28</sup> DRATs are situated in Allahabad, Chennai, Delhi, Kolkata and Mumbai. Each DRAT is appellate authority of multiple RTs based on a particular geographical area. For example, Allahabad DRAT has jurisdiction over three DRTs viz., Allahabad DRT, Lucknow DRT and Jabalpur DRT covering four States of Uttar Pradesh, Uttarakhand, Madhya Pradesh and Chhattisgarh.
- <sup>29</sup> Section 3 of the DRT Act
- <sup>30</sup> Section 9 and 8(3) of the DRT Act
- <sup>31</sup> Available at <http://www.drt3chennai.tn.nic.in/CauseLists/16122014.htm>, last visited on May 1, 2015.
- <sup>32</sup> Report on Trends and Progress of Banking in India, Reserve Bank of India
- <sup>33</sup> Available at <http://www.drat.tn.nic.in/A-Diary/01-30%20Nov%2014.htm>, last visited on May 1, 2015
- <sup>34</sup> Such as Securities Appellate Tribunal and Income Tax Appellate Tribunal
- <sup>35</sup> Performance of SAT has been remarkable and most decisions are made within months. Also, the decisions of SAT have adequate reasoning to enable the Supreme Court to decide one way or the other.
- <sup>36</sup> From June 9, 2014 to December 17, 2014 (*Department of Financial Services, Ministry of Finance, Government of India*)
- <sup>37</sup> From September 1, 2014 to December 17, 2014 (*Department of Financial Services, Ministry of Finance, Government of India*)
- <sup>38</sup> Section 18 of the DRT Act
- <sup>39</sup> In *United Bank of India vs. Satyawati Tondon and Ors.* III (2010) Banking Cases 495 (SC), the Supreme Court observes, '....it is a matter of serious concern that despite repeated pronouncement of this Court, the High Courts continue to ignore the availability of statutory remedies under the DRT Act and SARFAESI Act and exercise jurisdiction under Article 226 for passing orders which have serious adverse impact on the right of banks and other financial institutions to recover their dues. We hope

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and trust that in future the High Courts will exercise their discretion in such matters with greater caution, care and circumspection.’

<sup>40</sup> 75 percent in case of matters under DRT Act and 50 percent in case of matters under SARFAESI Act

<sup>41</sup> Statistical Tables Relating to Banks in India, *Table 19: NPAs of scheduled commercial banks recovered through various channels*, December 2014

<sup>42</sup> Section 14 of the SARFAESI Act

<sup>43</sup> The Report of Working Group on Banking (2013) notes, ‘Section 14 of SARFAESI (2002) is silent on the time period within which petitions are required to be disposed of by the Chief Metropolitan Magistrate or District Magistrates. Since no time lines are prescribed, these petitions take longer than required to be disposed of leading to unnecessary delays. The Bombay High Court, noting the significant delay caused in enforcing security interests under Section 14 petitions, prescribed a time line of two months for all petitions filed under Section 14.’

<sup>44</sup> Section 34 of the SARFAESI Act

<sup>45</sup> While the Supreme Court in the matter of *Union of India vs. Satyawati Tondon and Ors*, (order dated 26 July 2010) has held that the High Courts should not interfere in the debt recovery proceedings before all alternatives available with the borrower are exhausted.

<sup>46</sup> Section 15(4) of the SARFAESI Act

<sup>47</sup> MANU/SC/0217/2014

<sup>48</sup> Supra Note 14

<sup>49</sup> Supra Note 18

<sup>50</sup> Assuming that around 25 per cent of the cases get disposed of within the recommendatory period of 180 days and considering an inflation rate of 8 percent.

<sup>51</sup> Equivalent to 1.27 per cent of the GDP

<sup>52</sup> Supra Note 18

<sup>53</sup> Supra Note 18

<sup>54</sup> Statistical Tables Relating to Banks in India, *Table 19: NPAs of scheduled commercial banks recovered through various channels*, December 2014

<sup>55</sup> Assuming an average 4 per cent litigation cost, based on stakeholders’ interaction. Also considering an inflation rate of 8 percent.

<sup>56</sup> Union Budget 2015-16 (Demand No. 35, Department of Financial Services, Ministry of Finance), available at <http://indiabudget.nic.in/ub2015-16/eb/allsbpe.pdf>, last visited on May 2, 2015.

<sup>57</sup> Report on Trends and Progress of Banking in India, Reserve Bank of India

<sup>58</sup> Stakeholders’ consultation revealed that it should ideally take not more than 6 months to recover amount outstanding dues under the SARFAESI mode.

<sup>59</sup> Supra Note 60

<sup>60</sup> ‘Asset reconstruction companies should rid banks of bad debt’, available at [http://articles.economicstimes.indiatimes.com/2014-06-30/news/50974320\\_1\\_equity-capital-bad-assets-bad-loans](http://articles.economicstimes.indiatimes.com/2014-06-30/news/50974320_1_equity-capital-bad-assets-bad-loans), last visited on May 2, 2015

<sup>61</sup> Supra Note 66

<sup>62</sup> The increase in the cases pending at DRT has been more than 50 percent from 2013 to 2014. As on March 31, 2013, total matters pending were 42,819, and the number increased to 66,971 within one year.

<sup>63</sup> The pendency in 2010, 2011, 2012, 2013, and 2014 have been around 37616, 54061, 63669, 42819, 66971 respectively, resulting an average of around 53027.

<sup>64</sup> In order to reach ideal pendency of 800 cases per DRT, the total number of DRTs required would be around 112, i.e. 73 additional DRTs.

<sup>65</sup> The total number of DRTs required to achieve ideal pendency would be around 63, i.e. 24 more than the existing number

<sup>66</sup> See, National Institute of Smart Governance, e-drt system in DRT an DRAT, at <http://nisg.org/project/37>

<sup>67</sup> Budget 15-16 allocates Rs. 102.28 cr. for 39 DRTs. Accordingly, average allocation per DRT comes to around Rs. 2.62 cr.

<sup>68</sup> Supra Note 66

<sup>69</sup> Remya Nair et al, *Plan to computerize debt recovery tribunals put on hold*, Livemint, 28 July 2013, available at <http://www.livemint.com/Politics/FKQ3PvHgfnwmZQ2Z2DjuIN/Plan-to-computerize-debt-recovery-tribunals-put-on-hold.html>

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<sup>70</sup> The minimum application fee chargeable for filing an application under the DRT Act/SARFAESI Act is Rs. 12000. Assuming that of 28258 cases referred to DRTs in FY 2013-14, around 20000 cases are not expected to be disposed of within the six months period (*Raghuram Rajan, Saving Credit*).

<sup>71</sup> Assuming an average pendency of around 2 years

<sup>72</sup> Also known as Judicial Impact Assessment