

LEGAL IMPLICATIONS OF NPAS IN INDIA IN THE LIGHT OF THE INSOLVENCY BANKRUPTCY CODE

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The Bank plays a very significant role in Today's Economy. They are the ultimate support for any industry and trade, Even the Securities Market which is very common in today's system are also under the purview of Reserve Bank of India and there are regulations already framed for lending of money to any creditors be it the Traditional System of borrowing or be it raising funds from Securities Market under the IPO regime.

But In spite of all these rules and regulations framed still there is a loophole which is existing in the system due to which NPA's are on the rise. The assets of the banks which don't perform (that is - don't bring any return) are called Non Performing Assets (NPA) or bad loans. Bank's assets are the loans and advances given to customers. If customers don't pay either interest or part of principal or both, the loan turns into bad loan. According to RBI, terms loans on which interest or installment of principal remain overdue for a period of more than 90 days from the end of a particular quarter is called a Non-performing Asset. Since Public Sector Banks are Providing Near to 80% of Credit to Industries and Traders But due to Uncertainty in Business due to Change in Working, Political and Demand Often leads to Dis-Balance in Cash inflows and Cash Outflows which in turn ultimate affects the repayment capacity of the Creditors and in turn NPA's Grows and ultimately affects the Economy where in there is no return on the funds initiated.

There are different regulations based to recover the amount but still due to some complexity of laws and coupled with some Political Pressure it is difficult for the Lending Institutions especially for the Public Sector Banks get the Returns on the Amount Outsourced to the Different Business Enterprises. The Reserve Bank of India is trying its best to Make Regulations more Bolster and also the Government is Very Precise in manner of merging Small public Sector banks in order to minimize and also by enacting the New regime under the Insolvency Bankruptcy code as well Developing the National Company Law Tribunal and Keeping it as a Separate Entity will boost the regime under which the proceedings take place in a channelized

way and thus doesn't affect the economy by losing huge sum which happened in case of Kingfisher Airlines. The Best regime to break the upward trend of rising NPA's is being enacted in Insolvency Bankruptcy Code. It must now follow up with reforms that address the imperfections in the market for distressed assets and all Political will need to be sacrificed.

The Banks Plays Very Important role in and Growing Economy , Especially in India which ranks at top and if further the NPA's puts breaks upon the role in Capital Formation , Channelizing growth and full utilization of resources . Thus it is very important to set aside the part which is leading to downfall and in turn will affect the economy as whole.

INTRODUCTION

The banking system in India is of commercial and cooperative banks, of which the former accounts for more than 90% of banking system's assets. Besides a few foreign and Indian private banks, the commercial banks includes the nationalized banks (majority equity holding is with the Government), The State Bank of India Group (majority equity holding being with the Reserve Bank of India) and the associate banks of SBI (majority holding being with State Bank of India) are already being merged in SBI Group now. These banks, with regional rural banks, consists the public sector (state owned) banks in India. The Quality of the Asset wasn't primary concern in Indian banking sector till 1991, be that as it may, was basically centered around execution destinations, for example, opening wide systems/branches, higher employment generation by developing the rural areas and lending in priority sector, etc. While the mandatory function of banks is to lend funds as loans to various sectors such as personal loans, housing loans, agriculture, industry etc., but due to changing conditions in the market recently the banks have become very cautious in extending loans.¹ The reason being a growth in nonperforming assets (NPAs) and nowadays these are one of the big concern for banks in India. Bankers are called custodians and distributors of the liquid capital of the country. Therefore most important function of the banks is to mobilize the savings of the people by accepting deposits from the public. The banker becomes the trustee for the public for their Surplus balances.²

¹ Gupta, R., & Sikarwar, N. S. (Mar. 2013). A CASE STUDY OF RECOVERY POSITION OF NON PERFORMING ASSETS OF PUNJAB NATIONAL BANK OF INDIA AND HDFC BANK LIMITED.

² Srinivas, K. T. (2013). A Study on Non- Performing Assets of Commercial Banks in India.

Reserve Bank of India (RBI) has suggested some prudential norms suggested, That a bank cannot book interest on an NPA on accrual basis. In other words, Reserve Bank of India (RBI) has advised some prudent norms advised, That a bank cannot book interest on associate degree NPA on accounting. In different words, such interests is set-aside only it's been really received. Therefore, this has become what's known as a 'critical performance space of the banking sector because the level of NPAs affects the profitability of a bank.

- A NPA could be a loan or associate degree advance where;
- Interest and/ or installment of principal stay owed for a amount of quite ninety days in respect of a term loan,
- The account remains "out of order" in respect of associate degree overdraft/ money credit,
- The bill remains owed for a amount of quite ninety days within the case of bills purchased and discounted.

Categories of NPAs

Banks are required to classify nonperforming assets further into the following three categories based on the period for which the asset has remained nonperforming and the reliability of the dues:

- **Substandard Assets**
- **Doubtful Assets**
- **Loss Assets**

Substandard Assets

An substandard asset would be one, which has remained NPA for a period less than or equal to 12 months. In such cases, the current net worth of the borrower/ guarantor or the current market value of the security charged is not enough to ensure recovery of the dues to the banks in full. In other words, such an asset will have well defined credit weaknesses that jeopardize the

liquidation of the debt and are characterized by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.³

Doubtful Assets

An asset would be classified as doubtful if it has remained in the substandard category for a period of 12 months. A loan classified as doubtful has all the weaknesses inherent in assets that were classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, – on the basis of currently known facts, conditions and values – highly questionable and improbable.⁴

Loss Assets

Where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. In other words, such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.⁵

Causes for Non Performing Asset (NPA)

BORROWER	BANK	OTHER
<ul style="list-style-type: none"> • Too ambitious Project • Heavy borrowing • Poor credit collection • Poor quality management • Willful Default • Dependent on few customers • Fail to bring required Fund • Lack of Proper Planning 	<ul style="list-style-type: none"> • Poor credit appraisal • Non inspection of unit • Defective lending process • Lack of trained staff • System overloaded • Lack of commitment to recovery • Lack of technical support • Inefficient recovery system 	<ul style="list-style-type: none"> • Lack of infrastructure • Lack of Government support • Government policies • Changes related to Banking amendments • Natural Calamities • Recession and variation in economic conditions.

³ https://rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=7357#41

⁴ https://rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=7357#41

⁵ https://rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=7357#41

Impact of NPA'S

A. Liquidity

Money is getting blocked lead to lack of enough cash in hand which lead to borrowing money for short period of time from outside which lead to additional cost to the bank. Difficulty in operating the functions of bank is another cause of Assets which are not performing. Due to lack of money Routine payments and dues are not paid on time.

B. Credit loss

When the bank is facing problem of Assets which are not performing then it adversely affect the value of bank in terms of market credit. It will lose its goodwill and brand image because as we have discussed earlier that bank is not able to pay its dues on time and its negative impact is that people start withdrawing their money from bank which then cause liquidity problem and also decrease in credibility.

C. Involvement of management

Time and efforts of management is another indirect cost which bank has to bear due to Assets which are not performing otherwise time and efforts of management in handling and managing Assets which are not performing would have been diverted to some fruitful activities, which would give good returns. Now a day's banks have special employees to deal and handle Assets which are not performing, which is additional cost to the bank.

D. Profitability

Assets which are not performing means booking of money in terms of bad asset, which occurred due to wrong choice of client. Because of the money getting blocked the profitability of bank decreases not only by the amount of Assets which are not performing but this lead to opportunity cost also as that much of profit can be invested in some return earning project/asset. So these assets non performing not only affect current profits but also future stream of profits, which may lead to loss of some long-term beneficial opportunity.

Another impact of reduction in profitability is low ROI (return on investment), which adversely affect current earning of bank.

Legal Regime to turn the Assets not Performing

Insolvency and Bankruptcy Code, 2016 (the Code) is ordered to merge and revise laws relating to indebtedness and determination. Part II of the Code manages the Insolvency Resolution and Liquidation for 'Corporate people'. Under this piece of the code; financial creditors, operational leasers and corporate account holders can start corporate indebtedness process.

Financial creditor includes a person to whom re-payment is owed⁶. And corporate person has been defined under sub section 7 of section 3 and it stipulates that corporate person includes company, limited liability partnership or any other person incorporated with limited liability. And corporate debtor means a person who owes a debt to any person⁷.

Section 7 gives power to financial creditor to file an application against corporate debtor. This research note will basically be discussing the grounds on the basis of which an application under section 7 can be accepted.

APPLICATION

Financial creditor can file application against corporate debtor only when the amount of default is not less than 1 lakh rupees. However, the threshold limit of 1 lakh rupees can be increased to 1cr rupees.⁸

ESSENTIAL INGREDIENTS

There are three important ingredients to attract section 7 of the Code:

The most important element for corporate insolvency resolution process against corporate debtor. Once the default crosses the threshold limit, an application may be filed by

⁶ Section 5(7) of the Code of the IBC

⁷ Section 3(8)

⁸Ibid Section

financial creditor(s) under section 7. Default is explained under section 3(12) of the Code and it stipulates the following:- "*default means non-payment of debt when whole or any part or installment of the amount of debt has become due and payable and is not repaid by the debtor or the corporate debtor, as the case may be*".

In the case of *Bank of India v. Tirupati Infra projects Ltd*⁹, it was held that the adjudicating authority just needs to determine whether default has occurred or not and it does not need to determine the exact amount of default. It must be noted that the said case has been challenged before the NCLAT and the same is pending.

Application under section 7(2) is complete

It is important to file a complete application. Authority Adjudicating has right to reject the application if the application is not applicable as per code. An applicant needs to file the application in accordance with Form 1 of the Code.

Section 8 states that Operational creditor needs to send notice to the other party before the application is made for initiating insolvency process against person owing money. In the landmark case of *Era Infra Engineering Ltd. v. Prideco Commercial Projects Pvt. Ltd*¹⁰, NCLAT dismissed the application because operational creditor didn't serve notice to the other party under section 8 of the Code.

Thus it can be clearly said that statutory requirements are sine qua non for initiating insolvency process. So, for taking recourse under section 7, application must be complete.

No disciplinary proceedings against the proposed resolution professional.

⁹ NCLT, New Delhi Principal Bench, C.P. No. IB – 104(PB)/2017

¹⁰ Company Appeals (AT) (Ins) 31 of 2017

NOTICE UNDER SECTION 7

The Code does not ask the applicant to provide any notice to the debtor. However, in the case of *M/s Innoventive Industries Ltd. v. ICICI Bank and Anr.*¹¹, the tribunal said that notice is to be given to the other party by the adjudicating authority as it is the right.

GROUNDS FOR REJECTION

There are various grounds on the basis of which adjudication authority is empowered to reject an application under section 7 and the same are mentioned below.

- The default has not occurred; or
- Application under section 7(2) is incomplete; Or
- Any disciplinary proceeding is pending against the proposed resolution professional.

Moreover in case of *Innoventive Industries Ltd* it was held that if the records enclosed are misleading, the application has to be rejected.

CONCLUSION

Section 7 offers liberty to financial creditor to file application against the corporate person wherever default has occurred. amazingly, the number of default isn't terribly high and therefore it are often aforementioned that in few eventualities, an equivalent provision unnecessarily place threat of closing onto the corporate person. Moreover, it's been ascertained that the compliances of the procedural needs are concerned terribly seriously by the adjudicating authority. And in few cases, application got rejected attributable to non compliance of the aforementioned needs. Thus, procedural formalities should be unbroken in mind whereas filing application beneath section 7 of the Code

¹¹ Company Appeal (AT) (Insolvency) No. 1 & 2 of 2017