BANKING AND INSURANCE

UNIT 2

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BANK CREDIT

The term bank credit refers to the amount of credit available to a business or individual from a banking institution in the form of loans. Bank credit, therefore, is the total amount of money a person or business can borrow from a bank or other financial institution. A borrower's bank credit depends on their ability to repay any loans and the total amount of credit available to lend by the banking institution. Types of bank credit include car loans, personal loans, and mortgages. Bank credit is usually referred to as a loan given for business requirements or personal needs to its customers, with or without a guarantee or collateral, with an expectation of earning periodic interest on the loan amount. The principal amount is refunded at the end of loan tenure, duly agreed upon, and mentioned in the loan covenant.

Characteristics of Bank Credit

- **Borrower:** Person who borrows money.
- **Lender:** The person who lends money is usually the bank.
- **Rate of Interest:** The interest rate can be fixed or floating rate of interest. The floating interest rate is based on benchmark rates like LIBOR or MIBOR.
- **Terms of Repayment:** These are mentioned in the loan covenant and strictly adhere to avoid the prepayment penalty.
- **Mode of Loan:** Normally given in cash but sometimes will be given in the form of raw material or fixed assets.

DIFFERENT TYPES OF ACCOUNTS

1. SAVINGS ACCOUNT

These are deposit accounts meant to help consumers save their money. A savings account can be opened by any individual in India who holds an Aadhaar card and a PAN card, both of which are mandatory to open a bank account in India.

Key Features of a Savings Account

Limit. There is no limit to the amount of money that can be saved in a savings account. The number of transactions may be capped in some cases, depending on your bank.

Balance. A consumer is expected to maintain a mandatory minimum balance in most cases to maintain a savings account. Exception to minimum balance requirements is for select accounts, such as savings accounts that have been opened under the Indian federal government's financial inclusion plan called the Pradhan Mantri Jan Dhan Yojana (PMJDY).

Interest. A consumer earns interest on the deposits made in a savings account. This interest rate varies from one bank to another. For example, interest rate for savings bank deposit is 2.70% for account balance of up to INR 1 lakh at India's largest public sector bank, State Bank of India. While, interest rate for savings bank deposit is 3% for account balance below INR 50 lakh at India's largest private sector bank, HDFC Bank.

Benefit. Savings accounts serve as the easiest way to earn interest on idle money lying in banks.

2. CURRENT ACCOUNT

Current accounts are mostly business accounts where money is frequently transferred between financial accounts. These accounts are best suited for transactions by corporations and business owners for daily business activities.

Key Features of a Current Account

Limit. There is no limit to how much money can be put in a current account. Current accounts also do not have a transaction limit.

Balance. A current account has a higher minimum balance requirement than savings accounts.

Interest. Consumers do not earn any interest on current accounts.

Benefit. These accounts allow an overdraft facility, which permits consumers to withdraw more money from the account that there is actually in the account.

3. SALARY ACCOUNT

These accounts are opened by banks upon the request of big corporations and businesses that pay their employees through banks. Each employee is eligible to maintain a salary account in which the company they are employed with credits a monthly salary.

Key Features of a Salary Account

Limit. There is no limit to how much money can be put in a salary account. Each employee receives salaries based on disbursal from their employees. Independent transactions can be made by employees to transact between this kinds of bank account with another.

Balance. A salary account is a zero balance account and employees can withdraw all the money credited in the account at any point.

Interest. Employees do not earn any interest on salary accounts.

Benefit. These accounts can be converted into savings accounts at any point in time. Upon inactivity for more than three months, banks hold the rights to convert these accounts into savings accounts, the regulation for which is different.

4. NRI ACCOUNT

These accounts are opened by non-resident Indians who wish to maintain a financial bank account in India. There are three kinds of NRI accounts that can be opened:

A. Non-Residential Ordinary Account (NRO)

These accounts hold deposits in Indian rupee denomination. The money deposited is from proceeds earned in India.

Key Features of an NRO

Limit. There is no limit to how much money can be put in an NRO account.

Balance. Any amount of balance can be maintained.

Interest. The principal and the interest earned on that principal fall under the taxable category.

Benefit. These accounts are unaffected by the rate of conversion. An NRI can open a current account, a savings account or a fixed deposit account via the NRO account.

B. Non-Residential External Account (NRE)

These accounts hold deposits in Indian rupee denomination. The money deposited, however, is not from proceeds earned in India; in other words, the money deposited is earnings or savings from the country where the non-resident Indian lives.

Key Features of an NRE

Limit: There is no limit to how much money can be put in an NRE account.

Balance: Any amount of balance can be maintained.

Interest: The principal and the interest earned on that principal do not fall under the taxable category.

Benefit: These accounts bear the impact of a prospective change in the rate of conversion. An NRI can open a current account, a savings account or a fixed deposit account via the NRE account.

C. Foreign Currency Non-Residential Account (FCNR)

These accounts hold deposits in the currency approved by the central bank of India, the Reserve Bank of India. Any NRI or a person of Indian origin can hold deposits in an approved currency in which they earn their income. If the income is earned in a currency other than the approved list of currencies, then an approved currency is chosen for the conversion of the earnings or the proceeds to be deposited.

Key Features of an FCNR

Limit. There is no limit to how much money can be put in an FCNR account.

Balance. Any amount of balance can be maintained.

Interest. The principal and the interest earned on that principal do not fall under the taxable category.

Benefit. These accounts bear the impact of a prospective change in the rate of conversion. An NRI can open only a fixed deposit account with a minimum maturity of one year via the FCNR account.

5. RECURRING DEPOSIT (RD) ACCOUNTS

These accounts are opened as deposit accounts by consumers who are interested in earning interest on their money. Commonly known as RDs, these accounts are the easiest ways to earn an income higher than that offered by savings accounts.

Key Features of a Recurring Deposit

Limit. The minimum limit to open an RD differs from one bank to another. Consumers can opt for a minimum limit as low as INR 1,000 per month and open an RD account with any bank of their choice.

Balance. RDs are deposit accounts that allow consumers to collect a monthly amount set at the beginning of the tenure of the account.

Interest. A fixed amount is deducted every month and collected in the RD account, where it earns interest month-on-month. This interest is often higher than savings accounts.

Benefit. The flexible tenure of the RD makes it a consumer-friendly financial decision. Consumers can opt for anywhere from six months to up to 10 years to deposit their money in an RD and earn interest on the deposited amount. RD accounts can be discontinued before the end of the tenure without losing the interest earned.

6. FIXED DEPOSIT (FD) ACCOUNTS

These accounts are opened to earn interest on deposits for a fixed period of time until maturity. Fixed deposits are among the safest financial instruments to save and earn interest on idle money.

Key Features of a Fixed Deposit

Limit. There is no limit to how much money can be put in a fixed deposit account. The higher the money allocation, the more interest is paid at the end of the account's tenure.

Balance. An FD account holds a lump sum amount as investment.

Interest. The bank pays an interest on this deposit. This interest is paid once the tenure of the FD is complete. Upon breaking the FD in the middle of its tenure, consumers risk losing out on the interest and often receive only the principal amount.

Benefit. FDs are risk-free investments with high returns. Most banks in India offer an FD interest rate higher than savings accounts' interest rates and RDs' interest rates, owing to the fixed tenure benefit a bank enjoys in the case of FDs.

CREDITWORTHINESS

Creditworthiness is how a lender determines that you will default on your debt obligations, or how worthy you are to receive new credit. Creditworthiness is what creditors look at before they approve any new credit. Creditworthiness is determined by several factors including repayment history and credit score. Some lending institutions also consider available assets and the number of liabilities to determine the probability of default.

The Five Cs of Credit

- **Capacity:** Lenders must be sure that the borrower has the ability to repay the loan based on the proposed amount and terms. For business-loan applications, the financial institution reviews the company's past cash flow statements to determine how much income is expected from operations. Individual borrowers provide detailed information about the income they earn as well as the stability of their employment. Capacity is also determined by analyzing the number and amount of debt obligations the borrower currently has outstanding, compared to the amount of income or revenue expected each month.
- **Capital:** Lenders also analyze a borrower's capital level when determining creditworthiness. Capital for a business-loan application consists of personal investment into the firm, retained earnings, and other assets controlled by the business owner. For personal-loan applications, capital consists of savings or investment account balances. Lenders view capital as an additional means to repay the debt obligation should income or revenue be interrupted while the loan is still in repayment.
- **Conditions:** Conditions refer to the terms of the loan itself, as well as any economic conditions that might affect the borrower. Business lenders review conditions such as

the strength or weakness of the overall economy and the purpose of the loan. Financing for working capital, equipment, or expansion are common reasons listed on business loan applications. While this criterion tends to apply more to corporate applicants, individual borrowers are also analyzed for their need for taking on the debt. Common reasons include home renovations, debt consolidation, or financing major purchases.

- **Character:** Character refers to a borrower's reputation or record vis-à-vis financial matters. The old adage that past behaviour is the best predictor of future behaviour is one that lenders devoutly subscribe to. Each has its own formula or approach for determining a borrower's character, honesty, and reliability, but this assessment typically includes both qualitative and quantitative methods.
- **Collateral:** Personal assets pledged by a borrower as security for a loan are known as collateral. Business borrowers may use equipment or accounts receivable to secure a loan, while individual debtors often pledge savings, a vehicle, or a home as collateral. Applications for a secured loan are looked upon more favourably than those for an unsecured loan because the lender can collect the asset should the borrower stop making loan payments. Banks measure collateral quantitatively by its value and qualitatively by its perceived ease of liquidation.

THE CREDIT PROCESS

The credit process begins with a thorough analysis of the borrower's creditworthiness, or capacity and willingness to repay the loan. The examiner should find an assessment by the credit officer of:

- The borrower's current and expected financial condition.
- The borrower's ability to withstand adverse conditions or "stress."
- The borrower's credit history and a positive correlation between historical and projected repayment capacity.
- The optimal loan structure, including loan amortization, covenants, reporting requirements – the underwriting elements.
- Collateral pledged by the borrower – amount, quality and liquidity; bank ability to realize the collateral under the worst case scenario. And,
- Qualitative factors, such as management, the industry and the state of the economy.

This process begins with the collection, analysis and evaluation of information required to determine the creditworthiness of the borrower seeking credit from the bank. After the credit analysis is completed and borrower has been determined to be an acceptable risk, the credit officer proposes a loan structure for approval that preserves the strengths and protects against identified weaknesses of the borrower. The process ends with determination of a risk rating for the credit and loan approval (or rejection). The bank's credit policy, lending standards and procedures create the parameters for this process, thereby establishing the bank's appetite for risk, conservative or aggressive.

ADVANCING OF THE LOAN AND ITS DIFFERENT TYPES

A loan can be defined as the money which is borrowed for a limited period with the guarantee of return. The deposits received by the bank are not allowed to remain idle. So after keeping some cash reserves, the balance is given to the needy borrowers and interest is charged for them which is the main source of income for these banks. Different types of bank loans are:

1. Unsecured Bank Loans

They are the loans that don't need collateral for giving loans. The Bank keeps into account many factors to discern whether loans must be given or not like an estimation of the previous connection with the borrower, score of credit etc. As there is no way of regaining the amount of loan if borrowers bankruptcies, the rate of interest is higher for these loans. The various types of unsecured loans are:-

- **Personal Loans**

One can prefer to go for personal loans for their requirements like education, health, weddings etc. We can see an increase in several personal loans for different purposes in recent times. Many reasons exist for the increase in personal loans like low rates of interest, liquidity, etc. The documents required are:

- Know Your Customer documents like Aadhar card, driving license
- One's slips of salary of last Two months and proof of income for employed persons,
- Copy of Statement of income tax
- Statement of savings account.

- **Small Business Loans**

One can benefit from a business loan for financing requirements of capital, broadening premises, and employing staff. The importance of Small Business loans are:

- The amount of loan ratified will be attributed to one's account within 24 hours and fewer documents are needed to start the operation without holdup.
- A Tenure of repayment should be chosen which does not exceed 60 months. Repayment time should be accompanied by the flow of cash.

- **Education Loan**

Dream of studying abroad and from prestigious institutions increase the demand for such loans. It can be utilized full-time or part-time in any field of their study. A special feature of this type of loan is the suspension period where students cannot pay EMI till 12 months of their course completion.

- **Vehicle Loan**

This loan is purchased for buying new vehicles or used one, whichever form it may be like a two or four-wheeler vehicle. The score of credit, ratio of debt to income, tenor of loan etc play an important role.

2. Secured Bank Loans

It requires collateral as a guarantee against borrowing. The collateral secures the lender's right if the borrower could not return the borrowings lent to him. As compared to unsecured loans, It has a low-interest rate. Varied types of secured loans:

- **Home Loans**

It offers you the money needed to buy and build a dream house. Pradhan Mantri Awas Yojana by PM Narendra Modi gave a major catalyst to home loans in India. You may apply for the loan in order to buy a new home or reselling of home, extension and furnishing of the home. The importance of this loan is:

- The sanctioned loan is disbursed to the account within 72 hours.
- There is also an option to increase your repayment period in order to assure that the loans don't give you stress and lower your cash.

- **Property Loan**

Loans against property enable you to mortgage the property to use the funds for financing your requirements of business or personal ones. Some of its important points are:

- The amount of loan expended ranges from 60-70 per cent of the market price of commercial property.
- To receive the best price on your property that satisfies your need, you can talk to the lender's representative.

- **Loan Against securities**

A Securities Loan enables you to finance your investments by promising to fund borrowing for personal or business requirements. Options of promising investments are shares, mutual funds etc. Its importance is:

- Promise several authorized securities such as shares, mutual funds, bonds etc for obtaining a loan of 70 percent of the units promised.
- Obtaining the benefits of options of multiple repayments and no charges of prepayment.

- **Gold Loans**

For many years, gold has been one of the most preferred asset classes. A gold loan requires one to promise gold jewellery or assets as collateral. A certain percent of the gold's virtue promised is the loan amount consent. A gold loan is short-term as compared to home or property loans.

- **Loans against Mutual Funds and Shares**

Mutual funds can also be promised as loan collateral. One can promise capital funds to financial institutions for giving loans. For this, one needs to write to the financier who would write to a registrar of mutual funds, and a lien is put on a particular number of units to be promised.

- **Fixed Deposit Loan**

It not only gives definite returns but caters to your immediate needs. It ranges between 70 to 90 percent of the value of FD and also varies among lenders.

ELIGIBILITY CRITERIA FOR BANK LOANS

- A reasonable score of credit
- The continuous flow of income
- Age should be between 23 -60 years
- Some collateral like FDs, non-movable property, investments, etc
- Good connection with bank
- The Debt Repayment history should be a timely one.

CHARACTERISTICS AND BENEFITS OF LOAN

- Based on several factors, many types of loan can be classified. One can choose the kind of loan that one wishes to take depending on the prerequisite and eligibility.
- Many persons who lend loans give instant loans that take less time to get disbursed.
- There is much flexibility on where to spend the money received from bank loan. Bank doesn't provide guidelines on how to spend the money
- Mostly, Bank loans have a cheap rate of interest. The rate of interest one pay is less and cheaper than with credit cards, venture capital etc.
- There is no need to give capital while taking a loan from a bank. However, venture capitalists and investors force you to pay equity.

LOAN PRICING

Loan pricing means determining the interest rate for granting loan to creditors, be it individuals or business firms. It is one of the most important, however difficult task in lending funds to business firms and other customers. Because it is always very difficult to exactly know what the actual loan risk a particular loan application is. Generally the lender wants to charge a high enough rate to make sure that the loan will be profitable as well as it will covers enough compensation against the default risk. On the other hand loan price must be set low enough that helps the customers to find it easy for successful repayment of loan.

Loan pricing is the process of determining the interest rate for granting a loan, typically as an interest spread (margin) over the base rate, conducted by the book runners. The pricing of syndicated loans requires arrangers to evaluate the credit risk inherent in the loans and to gauge lender appetite for that risk. For market-based loan pricing, banks incorporate credit default spreads as a measure of borrowers' credit risks. It is standard procedure in loan pricing to benchmark a loan against recent comparable transactions ("comps") and select the base rate on which the financing costs are pegged. A comparable deal is one with a borrower in the same industry, country and of the same size with the same credit rating, for which a certain market rate of return is required.

A bank's credit rating has a direct impact on its cost of funding and, thus, the pricing of its loans. Banks with a high credit rating generally have access to lower cost funds in debt markets and low counterparty margins in swap and foreign exchange markets. The lower cost of funds can be passed on to borrowers in the form of lower loan pricing. Institutions usually charge a fixed interest rate or a floating interest rate on a home loan, business loan or personal loan. Also, along with the interest rate percentage, it is important to keep a check on the type of interest rate (fixed or floating). Fixed interest on loans refers to the interest rate being the same for the entire duration of the loan tenure. While floating interest rate refers to the variable interest rate that changes during the duration of the loan/ debt obligation tenure.

Fixed vs Floating Interest Rate

Basis of Difference	**Fixed Interest Rate**	**Floating Interest Rate**
Meaning	The interest rate remains the same for the entire duration of the debt obligation/ loan.	The interest rate changes and is not the same for the entire duration of the debt obligation/ loan.
Interest Rate	Higher interest rate. 1-2.5% more than the floating interest rate.	Lower interest rate than the fixed interest rate. However, Higher than the repo rate. Also, the lending institution adds a spread (additional interest) to the repo rate.
Monthly Payments (EMI)	EMI is the same for the entire loan tenure.	The EMI and also loan tenure may change with the change in the interest rates.
Market Factor	If the interest rates are going to be stable or increase, it’s better to opt for a fixed interest rate loan.	If the interest rates are going to fall, a floating interest rate loan is better.
Market Conditions	Not affected by market conditions.	Affected by market conditions.
Suitability	Suitable for individuals who wish to have a fixed EMI amount and are not willing to undertake the interest rate volatility.	Suitable for individuals who are willing to undertake the interest rate volatility and also who can adjust their budget with the changing rates.

Prepayment	A fixed interest rate scheme may penalise the prepayment of the loan.	Also, a floating interest rate scheme doesn't penalise prepayments.
Financial Planning	Budget planning is possible as EMI and also the tenure are fixed.	Difficult to budget as the interest rates fluctuate.
Tenure	Suitable for short to medium tenure (3 to 10 years)	Suitable for long term (20 to 30 years)
Risk	Comparatively less risky	Comparatively high risky

COST-BENEFIT LOAN PRICING

Cost-benefit loan pricing is a method for pricing loans that add all costs of making a loan and compares those costs to all expected revenues generated by a loan. A cost-benefit analysis is a systematic process that businesses use to analyze which decisions to make and which to forgo. The cost-benefit analyst sums the potential rewards expected from a situation or action and then subtracts the total costs associated with taking that action.

- A cost-benefit analysis involves measurable financial metrics such as revenue earned or costs saved as a result of the decision to pursue a project.
- A cost-benefit analysis can also include intangible benefits and costs or effects from a decision such as employees morale and customer satisfaction.
- The outcome of the analysis will determine whether the project is financially feasible or if the company should pursue another project.

CUSTOMER PROFITABILITY ANALYSIS

Customer Profitability Analysis (CPA) is a managerial accounting method that allows businesses to determine the overall profit a customer generates. A profitable customer is someone who generates a revenue stream greater than the cost of their acquisition, selling, and serving. Companies calculate the CPA on a customer level or for the entire customer group. When companies are more focused on products, departments, and locations of their offices, they often tend to lose focus on the customers. As a result, the companies have to sometimes bear the cost of maintaining unprofitable customers which is detrimental to their business.

CPA allows companies to evaluate their customers and know how beneficial it is for them to keep the customers. Based on this value they can decide upon the cost of serving them or even to decide whether to continue or let them go. It has been found in a study that the size of the customer is not directly proportional to their profitability. Sometimes even the large-sized customers can turn out to be unprofitable ones for a business.

Customer Profitability Formula

To calculate CPA, you need the annual profit per customer, and the total duration a customer stays with your business.

Annual profit = (Total revenue generated by the customer in a year) – (Total expenses incurred to serve the customer in a year)

The total revenue can be generated by the following sources that you need to include:

- Recurring revenue
- Upgrades to the higher plans
- Cross-buying relevant products

And, expenses can be incurred from the following sources which also you need to consider:

- Cost of customer service
- Maintaining a customer success team
- Loyalty perks
- Operational cost

Finally, when you have the annual profit, the customer profitability analysis calculation goes like this:

CPA = (Annual profit) x (no. of years customer stays with company)

NON-PERFORMING ASSETS (NPA)

NPA expands to non-performing assets (NPA). Reserve Bank of India defines NPA as any advance or loan that is overdue for more than 90 days. “An asset becomes non-performing when it ceases to generate income for the bank,” said RBI in a circular form 2007. To be more attuned to international practises, RBI implemented the 90 days overdue norm for identifying NPAs has been made applicable from the year ended March 31, 2004. Depending on how long the assets have been an NPA, there are different types of non-performing assets as well.

An asset for a bank: Asset means anything that is owned. For banks, a loan is an asset because the interest we pay on these loans is one of the most significant sources of income for the bank.

When customers, retail or corporates, are not able to pay the interest, the asset becomes 'non-performing' for the bank because it is not earning anything for the bank because it is not earning anything for the bank. Therefore RBI has defined NPAs as assets that stop generating income for them.

Categories of NPA

There are different types of non-performing assets depending on how long they remain in the NPA category.

a) Sub-Standard Assets: An asset is classified as a sub-standard asset if it remains as an NPA for a period less than or equal to 12 months.

b) Doubtful Assets: An asset is classified as a doubtful asset if it remained as an NPA for more than 12 months.

c) Loss Assets: An asset is considered as a loss asset when it is "uncollectible" or has such little value that its continuance as a bankable asset is not suggested. However, there may be some recovery value left in it as the asset has not been written off wholly or in parts.

NPA Provisioning

Keeping aside the technical definition, provisioning means an amount that the banks set aside from their profits or income in a particular quarter for non-performing assets; such assets that may turn into losses in the future. It is a method by which banks provide for bad assets and to maintain a healthy book of accounts. Provisioning is done according to which category the asset belongs to. The categories have been mentioned in the above section.

Gross Non-Performing Assets

Gross non-performing assets is a term used by financial institutions to refer to the sum of all the unpaid loans which are classified as non-performing loans. Credit institutions offer loans to their customers who fail to be honoured and within ninety days, financial institutions are obligated to classify them as non-performing assets because they are not receiving either principle or net payments.

Net Non-Performing Assets

Net non-performing assets is a term used by credit institutions to refer to the sum of the non-performing loans less provision for bad and doubtful debts. Credit institutions tend to provide a precautionary amount to cover the unpaid debts. Therefore, if one deducts provision for unpaid debts from the unpaid debts, the resulting amount refers to the net non-performing assets.

Difference between Gross NPA and Net NPA

One of the main difference between gross non-performing assets and net non-performing assets arises from the meaning. Gross non-performing assets refer to the total amount of the debts that an organization has failed to collect or the people owing the organization has failed to honour their contractual obligations of paying both the principal and interest amount. On the other hand, net-non performing loans is the amount that results after deducting provision for doubtful and unpaid debts from the sum of the loans defaulted. It is the actual loss that the organization incurs after loan defaults.

Default Period

Credit institutions offer a grace period after which an individual is required to start paying the loan and its associated interests. If the payment duration expires, the institution is obligated to write-off those debts which are not paid.

Non-performing loans are listed as default after ninety days which is internationally recognised. Any amount that is due after the ninety-day grace period is classified as a default. However, net-non performing asset does not have a grace period and is immediately calculated and classified as a net non-performing asset.

Method of Calculation

Gross non-performing loans are the sum of all the loans that have been defaulted by the individuals who have acquired loans from the financial institution. This means that all loans defaulted are added together to form gross non-performing assets.

Gross NPA = (A1 + A2 + A3 ……………………. + An) / Gross Advances

Where A1 stands for loans given to person number one.

On the other hand, net non-performing assets are the amount that is realized after provision amount has been deducted from the gross non-performing assets.

Net NPA = (Total Gross NPA) – (Provision for Unpaid Debts)/Gross Advances

Actual Loss

The other difference between gross non-performing assets and net non-performing assets is what the organization refers to as the actual loss facing the company. Gross non-performing assets do not constitute the actual loss facing the organization. Net non-performing assets constitute the actual loss experienced by the organization after debts have defaulted. Since the credit institution has already provided for unpaid loans, the provided amount is deducted from default amount which results in the actual loss experienced by the organization.

Causes of Gross NPA and net NPA

There are some significant factors that have been highlighted to be the extreme causes of gross non-performing assets include poor government policies, industrial sickness, natural calamities, wilful defaults, and ineffective recovery tribunal among others. Although net non-performing assets are principal products of gross non-performing assets, there is a significant difference in that the amount provided by the credit institution to cover for unpaid debts plays a vital role in determining the amount of net non-performing assets.

Effects of Gross NPA and Net NPA

Some of the significant causes of gross non-performing assets include the bad effect on the goodwill of the company and bad effect on the equity value of the organization. A company with bad equity value experiences difficulties in attracting investors due to low return on investment and low share value of the company. On the hand, net non-performing assets have significant impacts on profitability and liquidity of the company. Low liquidity means that the company does not have enough cash to meet its obligations when they fall due which means the company cannot afford to run the daily activities.

RECOVERY OF NPAS

Recovery mechanism could be a process of finishing up the recovery procedures and mechanisms required to revive the financial assets within the event of failure to repay by the borrower. An NPA as explained above is an asset that has ceased to get income and returns which if not forbidden correctly and promptly is detrimental to the bank and thus the recovery of NPAs plays a crucial role to sustain the banking system.

Mainly recovery is finished through the subsequent aspects:

1. Lok Adalats

The Lok Adalats is one among the choice dispute redressed mechanisms founded by the govt. It's a forum where disputes or cases pending within the court of law or at pre-litigation stage are settled mutually. Lok Adalats are given statutory status under the Legal Services Authorities Act, 1987. Under the said Act, the choice made by the Lok Adalats is deemed to be a decree of a civil court and is final and binding on all parties and no appeal against such a souvenir lies before any court of law.

2. Debt Recovery Tribunals (DRTs)

The Recovery of Debts because of Banks and Financial Institutions Act,1993 (RDDBFI Act) made provisions for quick redressed to lenders and borrowers through filing of Original Applications also referred to as OAs within the Debt Recovery Tribunals (DRTs) and appeals in Debts Recovery Appellate Tribunals (DRATs). Therefore, under the RDDBFI Act the DRTs and DRATs are established to assist provide for the necessity of speedy redressed for banks against NPAs.

3. Sarfaesi Act

The Securitization and Reconstruction of monetary Assets and Enforcement of interest Act, 2002 better referred to as the SARFAESI Act was formed after the considerations dispensed by committees constituted by the govt. to look at the reforms and changes that are needed within the banking and legal systems for better functioning of the debt recovery mechanisms.

The Act aims to realize recovery of NPAs through three major ways which are the following:

i. Securitization:

The Section 7 of the SARFAESI Act gives an outlook of what exactly happens in securitization, it states that any securitization company or reconstruction company, may, after acquisition of any financial asset offer security receipts to qualified institutional buyers, who are people who have expertise and sound knowledge to gauge and make their investment within the Capital Markets, for subscription in accordance with the provisions of these Acts. A securitization company or reconstruction company may raise funds from the qualified institutional buyers by formulating schemes for acquiring financial assets and shall keep and maintain separate and distinct accounts in respect of every such scheme for each financial asset acquired out of investments made by a certified institutional buyer and make sure that realizations of such financial asset is held and applied towards redemption of investments and payment of returns assured on such investments under the relevant scheme.

ii. Asset Reconstruction:

In Asset Reconstruction the Securitization companies or Reconstruction Companies buy the NPAs from the banks and take measures to recover the bad loans from the borrower by carrying certain functions in step with the powers vested in them by the Act.A. pursuance of this section shall be called in question in any court or before any authority

iii. Insolvency and Bankruptcy Code (IBC)

Before the Insolvency and Bankruptcy Code, 2016 came into force there have been multiple laws and institutions that were overlapping in jurisdiction and functioning which result in lots of confusion in addressing the insolvency and bankruptcy proceedings against individuals and corporations.

PRIORITY SECTOR LENDING (PSL)

Priority Sector refers to those sectors which the Government of India and Reserve Bank of India consider as important for the development of the basic needs of the country. They are assigned priority over other sectors. The banks are mandated to encourage the growth of such sectors with adequate and timely credit. The Priority Sector Lending classifications and guidelines released by the RBI are intended to align with emerging national priorities and bring a sharper focus on inclusive development, building a consensus among all stakeholders. The Reserve Bank of India decides to allot funds to predetermined priority sectors of the economy that may require credit and financial assistance, especially in cases where the lack of PSL will lead to the heavy losses to the participants of that sector in some cases.

Categories of Priority Sector

The categories of priority sector are as follows

- Agriculture
- Micro, Small and Medium Enterprises
- Export Credit
- Education
- Housing
- Social Infrastructure
- Renewable Energy
- Others

Understanding Priority Sector Lending (PSL)

- The goal of a PSL initiative is to provide credit to the weaker sections of the society, as opposed to funding only profitable sectors or spaces that are solely important to economic growth. All sectors considered as a priority are able to easily access financial support like apply for loans that the banks are required to allot at a lower interest rate.
- The following fall into the priority sectors under the policy: agriculture (including micro financing groups like SHGs, JLGs, individual farmers, and other institutions dedicated to individuals working in the sector), micro, small and medium scale enterprises (MSMEs) and SSIs, Educational and Small Scale Industrial loans, Housing loans and other micro credit finances.
- When banks overreach their PSL targets and need additional funding to raise funds for the priority sectors, they are able to issue PSL certificates (PSLCs) only to the extent of the amount banks are allowed to lend in that specific sector. These certificates can be traded on RBI's e-Kuber platform.

Highlights of Priority Sector Lending (PSL)

- For 2020, the RBI sought channelling funds for the start-up sector.
- When introduced, only public sector banks were required to focus on the development of the predetermined priority sectors; though now private and foreign banks are also required to provide adequate care and credit.
- The way PSLCs are traded is similar to the workings of the money market, where issuing these certificates will help banks raise money. Surplus banks may be incentivized in the process, and banks facing cash shortfall may finance their short term needs.