

Framework for debt recovery in India

IGIDR – IFF roundtable on individual insolvency

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Outline

- ▶ The individual credit landscape
- ▶ The framework for debt recovery

Part I

The individual credit landscape

LOANS

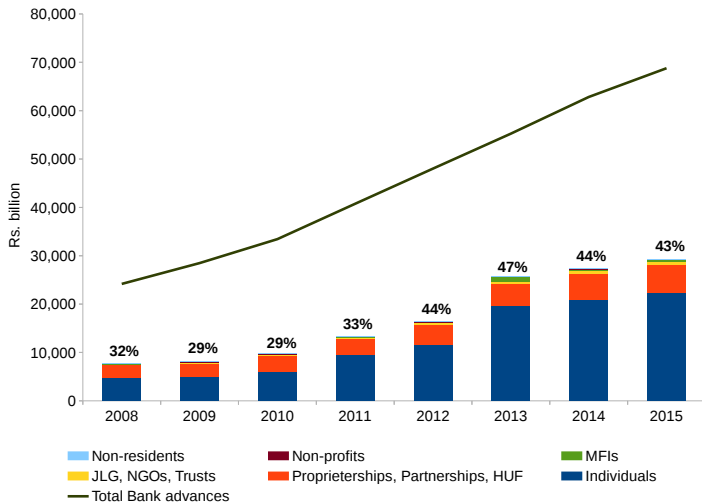


**“Do you have any other collateral...
besides this e-mail from a Nigerian prince?”**

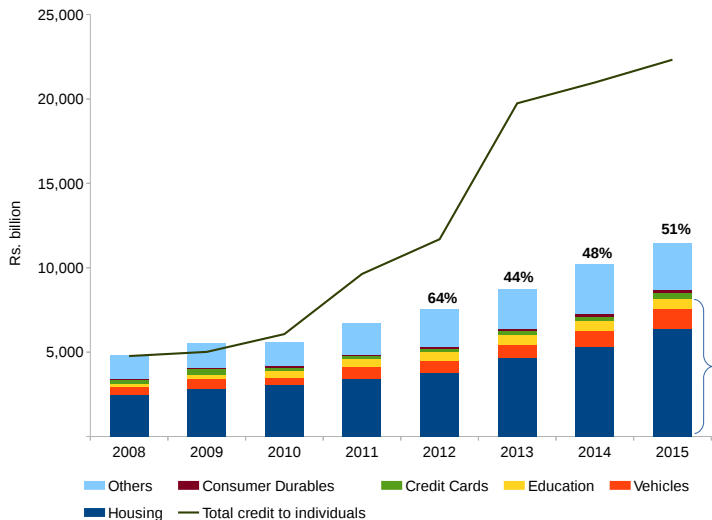
Borrowers, lenders and products

Borrowers	Lenders	Products
Individuals/ HUFs	Scheduled commercial banks	Auto loans
Self-help/ Joint liability groups	Cooperative banks	Home loans/Loans against property
	Regional rural banks	Two wheeler/ consumer durable loans
Unincorporated businesses	Non-bank finance institutions	Loan against gold/Loan against shares
	Housing finance companies	Education loans
	Micro finance institutions	Personal loans
	Cooperative credit societies	Credit cards
	Small finance banks	Business loans
	E-commerce platforms	Commercial vehicle finance
	Payment aggregators	Construction equipment finance
	Peer to peer lending platforms	Agri/Tractor finance
	Others (?)	SHG/JLG loans
		Kisan credit cards

43% of banks' advances to household sector



Consumer loans 51% of banks' advances to individuals, largely secured



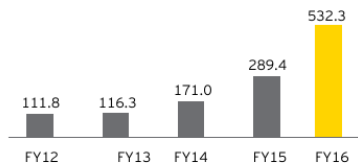
NBFCs sizable players in consumer credit

Product segments	NBFC AUM (Rs '000 Cr)	NBFC share of lending (%)
Used CV	60	90%
LAP	180	80%
CEQ	25	70%
Consumer durables	8-10	70%
New CV	25	50%
Tractor	10-15	45%
2 wheeler	10-15	45%
Mortgage	400	40%
New Car	50	30%

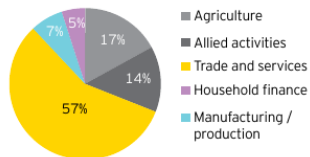
Sources: FSB Global Shadow Banking Monitoring Report 2015, RBI, Crisil NBFC Report 2014, ICRA Indian Retail Non Banking Finance Market 2015 Report, Industry interviews, BCG analysis.

MFIs relatively small but fast growing, serve a niche market

Gross loan portfolio (INR billion)



Break-up of gross loan portfolio (FY 16)



Source: MFIN Micrometer, May 2016; Note: Based on data for NBFC-MFIs reporting to MFIN and excludes SHGs

Summary: size of individual credit market, 2015

Rs. in billion	2015
Commercial banks' advances to individuals/proprietors/partnerships/HUF ¹	28,161
Non-bank finance companies retail advances ²	8,000
Micro finance companies ²	289
Total	36,450

Source:

¹ RBI statistical tables on banks;

² BCG-CII Report: NBFC 2.0, Enormous potential in non-bank finance and how to make it happen, December 2015;

³ EY-Assocham India Report: Evolving landscape of microfinance institutions in India, July 2016

At Rs. 36 trillion, credit to individuals is 29% of GDP. 75% of this is secured.

Part II

The framework for debt recovery

LOANS



**“We’re offering you an assumable mortgage.
We assume you’ll make the payments and you can
assume we’ll make your life miserable if you don’t.”**

The legal framework

- ▶ Presidency Towns Insolvency Act, 1909; Provincial Insolvency Act, 1920
- ▶ Civil remedies:
 - Civil Court System under the Civil Procedure Code, 1908 (CPC).
 - Debt Recovery Tribunals (DRTs) and Debt Recovery Appellate Tribunals (DRATs) under the Recovery of Debts due to Banks and Financial Institutions Act, 1993 (RDDBFI)
 - Arbitration and Conciliation Act, 1996

The legal framework

- ▶ Quasi-civil remedy:
 - Enforcement action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI)
- ▶ Criminal remedy:
 - Section 138 of Negotiable Instruments Act, 1881
- ▶ RBI guidelines on recovery practices for banks, NBFCs and NBFC-MFIs.

Who has access to what?

	Secured loans	Unsecured loans
Banks	SARFAESI: for loans above Rs. 1 lakh	DRTs: for loans above Rs. 10 lakhs Domestic arbitration: for loans up to Rs. 10 lakhs Civil Courts: for loans up to Rs. 10 lakhs
NBFCs	SARFAESI: for home loans through Housing Finance Companies (HFC)	Civil Courts Domestic arbitration
MFIs	Civil Courts	Civil Courts

Who uses what and why?

- ▶ Presidency and Provincial Insolvency Acts are available to all lenders. Not frequently used.

Who uses what and why?

- ▶ Presidency and Provincial Insolvency Acts are available to all lenders. Not frequently used.
- ▶ Banks:
 - prefer SARFAESI action for recovery of secured loans.
 - private banks prefer arbitration proceedings for recovery of loans up to Rs. 10 lakhs.
 - for loans above Rs. 10 lakhs, DRTs have sole jurisdiction over adjudicating recovery claims.
 - auto/vehicle loans, tractor loans, construction equipment loans are structured as hire purchase contracts to enable repossession and recovery.

Who uses what and why?

▶ NBFCs:

- home loans/LAPs are generally done through a HFC. This provides SARFAESI protection.
- auto/vehicle loans, tractor loans, construction equipment loans are structured as hire purchase contracts to enable repossession and recovery.
- they prefer arbitration proceedings over Civil Courts for recovery.

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▶ MFIs:

- tightly governed by RBI recovery guidelines. SHG/JLG model helps recoveries but defaults most often mean write offs.
- they rely more on the strength of the initial credit decision and on a pro-active collection process.

Costs and time considerations

- ▶ Civil Court fee higher than DRT fees

Court costs as % of loan value

Loan amount (Rs. lakhs)	DRT	Civil Courts
Under 10	NA	2 – 4%
10	1.2%	2.7%
25	1.1%	1.8%
100	1.0%	1.4%
200	0.8%	1.3%

- ▶ Civil Court cases take 5 – 7 years.
- ▶ DRT cases take 1 – 2 years.
- ▶ 82.3 lakh cases pending in Civil Courts of which 6 lakh for more than 10 years.
- ▶ 76,000 cases pending in DRTs. Rs. 3.8 trillion (5.6% of banking advances) filed.
- ▶ Arbitration proceedings relatively quick and low cost. Awards have equivalence of a decree.

Other considerations

- ▶ The decision to take legal action is a judgment – depends on recovery net of costs.

For small loan sizes, legal costs may be larger than the recovery.

- ▶ Consumer loans are standardised and the market intensely competitive.

To be profitable, recovery costs and NPAs have to be contained in a tight band.

Credit process an important if not more significant tool for managing portfolio quality.

- ▶ Legal action for recovery yields positive results in case of individuals.

Recovery a declining function of the resources of the debtor.

Challenges with the existing framework

- ▶ No working collective resolution mechanism available.
- ▶ Fragmented recovery framework, special laws only for banks. Even these have poor outcomes.

DRTs: 14%; SARFAESI: 24%

- ▶ DRT infrastructure unable to deal with case load under RDDBFI and SARFAESI.

Capacity augmentation needed to deal with (1) original mandate of recovery cases, and (2) new mandate of individual insolvency cases under the Insolvency and Bankruptcy Code, 2016 (IBC).

Thank you.