






RECOVERY OF RETAIL LOANS

Special Mention Accounts (SMA)














 RBI introduced SMA classification in 2014 to identify early signs of financial stress before a loan turns into an NPA.

SMA Classification Table:

SMA Category	Overdue Principal/Interest Payment
SMA-0 	1 - 30 days overdue
SMA-1 	31 - 60 days overdue
SMA-2 	61 - 90 days overdue

 If a loan remains unpaid for more than 90 days, it is classified as a Non-Performing Asset (NPA).

Action Plan for SMA Accounts

SMA Stage	Actions Taken
SMA-0 	 Early warning signals identified  Bank reaches out to the borrower for clarification.
SMA-1 	 Reminder notices sent   Calls & follow-ups with the borrower 
SMA-2 	 Field visits by the bank   Recovery teams involved  Restructuring options

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	explored
NPA (>90 days) 📉	✗ Loan recall notice issued ⚖️ ✗ Legal action initiated ✗ Collateral assets seized

🛡️ Preventive Measures to Reduce Loan Defaults

- ✓ **Early Warning Systems (EWS):** AI-based systems that track spending patterns and detect signs of financial distress.
- ✓ **Timely Follow-Ups:** Continuous communication with borrowers to remind them about upcoming EMIs.
- ✓ **Incentives for Timely Payments:** Banks offer lower interest rates or cashback for prompt repayment.
- ✓ **Credit Bureau Monitoring:** Borrower's credit history is monitored (CIBIL score tracking).
- ✓ **Strict Verification Process:** Proper due diligence before loan sanctioning to avoid lending to high-risk individuals.

📌 Key Takeaways

- ✓ **SMA categorization** helps identify stressed accounts before they turn into NPAs.
- ✓ **Genuine defaulters** need assistance, while **wilful**

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defaulters require strict action.

✓ **Loan monitoring** is crucial for maintaining asset quality in banks.



✓ **Early intervention strategies** prevent loans from turning into bad debts.

Prudential Norms for Irregular Loan Accounts (As per RBI Guidelines)

To maintain financial discipline, RBI has introduced prudential norms for **asset classification, provisioning, and income recognition** in a phased manner.

Asset Classification (NPA Categories)

Loans are classified based on their **repayment status** and the likelihood of recovery.

Asset Category 	Definition
 Standard Assets	Performing loans with regular repayments and no default history . These generate

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	continuous income for banks.								
◆ Sub-Standard Assets	Loans that have remained NPA for up to 12 months . Recovery is still possible, but risk exists.								
⚠ Doubtful Assets	Loans classified as NPA for more than 12 months . The probability of full recovery is low. <table border="1" data-bbox="486 840 1385 1422"><thead><tr><th>Category</th><th>Time in NPA Status</th></tr></thead><tbody><tr><td>Doubtful-I</td><td>Up to 12 months in doubtful category</td></tr><tr><td>Doubtful-II</td><td>12 months - 3 years in doubtful category</td></tr><tr><td>Doubtful-III</td><td>More than 3 years in doubtful category</td></tr></tbody></table>	Category	Time in NPA Status	Doubtful-I	Up to 12 months in doubtful category	Doubtful-II	12 months - 3 years in doubtful category	Doubtful-III	More than 3 years in doubtful category
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Doubtful-III	More than 3 years in doubtful category								
🗑 Loss Assets	Loans where recovery is impossible , and the entire amount is written off . Classified based on RBI/Bank auditors' assessment.								

📌 📊 **Provisioning Norms (Loan Loss Provisions)** 🏢

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Provisioning norms require banks to **set aside funds** for potential loan losses.

NPA PROVISIONING NORMS BY RBI			
ASSET CLASSIFICATION	PERIOD OF NPA	Loan Type	PROVISIONING %
Standard	Before NPA	SME/Agri	0.25%
		Commercial Real Estate Residential Housing Sector	0.75%
		Commercial Real Estate	1.00%
		Others	0.40%
Substandard	Upto 12 Months of NPA	Secured Loan	15.00%
		Unsecured	25.00%
Doubtful 1	Substandard for 1 Year	Secured Loan	25.00%
		Unsecured	100.00%
Doubtful 2	Substandard for 2nd to 3rd Year(As NPA 3rd-4th Years)	Secured Loan	40.00%
		Unsecured	100.00%
Doubtful 3	Substandard for 4th Year(As NPA 5th Year)	Secured & Unsecured	100.00%
Loss Assets	From the Date of Classification as Loss	Secured & Unsecured	100.00%

Income Recognition Norms

1 Income from NPA loans is not recognized on an accrual basis – banks can only record interest income when it is actually received (cash basis).

2 If a loan turns into an NPA, past accrued interest

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(unrealized) must be reversed from the bank's income statement.

3 Banks can only **reclassify NPA to a standard asset** when the borrower **repays all past dues** and meets financial obligations.


Example:

If a bank had booked ₹5 lakh in interest on an NPA loan but hasn't received it, the amount must be **reversed from income**.

Recovery Policy of Banks – Guidelines & Best Practices



The **recovery policy** of banks is structured to **balance customer dignity** while ensuring **timely collection of dues**.

Banks must follow a **fair, transparent, and non-coercive** approach in loan recovery. 

 **Fundamental Guidelines for Loan Recovery** 

 **Respect & Fair Treatment:**

- Banks follow a **dignified approach** in collecting dues.
- No **harassment or undue coercion** is allowed.

 **Loan Repayment Schedules:**

- Designed based on the **borrower's financial capacity & cash flow**.
- Borrowers are expected to **adhere to the agreed schedule**.


 **Security Repossession Policy:**

- bank **Security Repossession Policy** aims at **recovery of dues** in the event of default .
- **Fair & transparent process** is followed.

 **Communication with Borrowers:**

- Customers should be **contacted at a preferred location** (home, office, etc.).
- **Authorized representatives** will disclose their identity & authority.

 **Notice to Borrowers**

 **Before taking any legal action or repossession of security, banks must provide written notice to the borrower.**

Example:

A bank will send an official **loan default notice** mentioning:

- Overdue amount
- Deadline for payment
- Legal consequences of non-payment


 **Repossession of Security (Loan Collateral)**

 **Three-Step Process:**

1 Repossession – The bank **takes over the secured asset** (e.g., vehicle, house, machinery).

2 Valuation of Security – The asset is **evaluated for fair market value** before sale.

3 Realization of Security – Asset is **sold through auction or private sale** to recover outstanding dues.

 **Example:** If a customer defaults on a **car loan**, the bank can **seize and auction the vehicle** after issuing a notice.

  **Principles Followed in Asset Sale:**

✓ **Fair Market Valuation:** Asset valuation is done as per legal norms.


✓ **Transparent Process:** The sale is conducted in a fair & open manner (public auction, online bidding).

✓ **Right to Set-Off:** The bank can use sale proceeds to adjust outstanding dues.

 **Example:** A borrower's home loan goes into default, and the bank auctions the house for ₹50 lakh.

- If **outstanding dues = ₹40 lakh**, the bank returns ₹10 lakh after deducting legal & recovery costs.
- If **outstanding dues = ₹55 lakh**, the borrower still owes ₹5 lakh after the auction.

 **Opportunity for the Borrower to Reclaim Security**


 **Borrowers have the right to reclaim their property before the sale if they clear all outstanding dues.**

- The bank will **return the repossessed asset** once the loan is fully repaid before auction/sale.

 **Example:**

Before a **repossessed car is auctioned**, the borrower **pays the full outstanding amount**. The bank **returns the car** instead of selling it.

 **SARFAESI Act, 2002 – A Complete Guide**  

The **SARFAESI Act (Securitization and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002)** was enacted to **empower banks and financial institutions to recover non-performing assets (NPAs) without court intervention.** 

 **Key Features of the SARFAESI Act**

- ✓ **Allows banks to take possession** of secured assets (except agricultural land) in case of loan default.
- ✓ **Empowers financial institutions** to auction commercial or residential properties of defaulting borrowers.
- ✓ **Applicable to secured loans only** (loans backed by assets).

✓ **No need to approach the court**, making the process faster and more efficient.

🔍 **Conditions for Initiating SARFAESI Action**

A bank can invoke SARFAESI **only if the following conditions are met:**


- ✓ **Loan account must have been classified as NPA, backed by security other than Agriculture land**
 - ✓ **Outstanding dues should be ₹1 lakh or more including the interest accrued/applied**
 - ✓ **Outstanding dues should be 20% or more of the principal and interest.**
 - ✓ **The asset must be secured (except agricultural land).**
 - ✓ **In case of multiple lenders, 60% of lenders must agree to take SARFAESI action.**
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📌 **Process of Initiating SARFAESI Act** 🔄

📌 **Classification as NPA**

- If a loan remains overdue for **90+ days**, the account is classified as an NPA.

2 Demand Notice Under Section 13(2)

 The **bank issues a Demand Notice** to the borrower, guarantor, or mortgagor.

 **Borrower is given 60 days** to clear the outstanding dues.


Contents of Demand Notice:

 **Total amount payable** (principal, interest, penalties).

 **Details of secured assets** (collateral).

 **Date from which the loan became NPA.**

3 Response from Borrower


 The borrower can:

Repay the dues within 60 days.

Raise objections, which the bank must reply to within 15 days.

If the borrower fails to pay, the bank proceeds with **seizing the asset**.

4 Taking Possession of Secured Assets

 If the borrower **fails to repay within 60 days**, the bank can **take possession of the secured asset**.

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✓ The **Authorized Officer** takes possession in the presence of **two witnesses**.

✓ A **Possession Notice** must be:

- **Delivered to the borrower/guarantor.**
- **Affixed at a conspicuous place** on the property.

✓ **Within 7 days**, the notice is published in **two newspapers**.

📌 **Modes of Possession:**

◆ **Symbolic Possession:** Legal ownership transferred to the bank.

◆ **Physical Possession:** Bank takes control of the property with the help of magistrate/court.

💡 **Example:**

🏠 A borrower defaults on a **home loan of ₹50 lakhs**. The bank, after following due process, **seizes the house and auctions it to recover dues**.

🏠 Application to Debts Recovery Tribunal (DRT)

📌 Borrower can **challenge the bank's action** in **DRT** within **45 days**.

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✂ The DRT, as per the recovery of debts due to the Banks and Financial Institutions Act, 1993 and the Rules made there under, is required to **dispose of the application as early as possible** but **within 60 days**.

If the application is **not disposed of within 4 months** borrower can approach to the **Appellate Tribunal** for **requesting early disposal of Application**.

6 Appeal to Appellate Tribunal

✂ If the borrower is dissatisfied with the **DRT's order**, they can appeal to the **Appellate Tribunal** within 30 days.


✂ To appeal, the borrower must **deposit 50% of the outstanding debt**.

7 Sale Notice & Auction

✂ After taking possession, the bank **issues a Sale Notice** detailing:

- ✓ **Reserve price**
- ✓ **Auction date & time**
- ✓ **Auction terms & conditions**

 **Example:**

 A commercial property pledged for a ₹5 crore loan goes to auction with a reserve price of ₹4.5 crores. The highest bidder wins and pays the bank.


 **Advantages of SARFAESI Act**

- ✓ **Fast-track loan recovery process** without court intervention.
 - ✓ **Reduces NPA burden** on banks.
 - ✓ **Provides security to banks**, boosting confidence in lending.
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 **Limitations of SARFAESI Act**


- ✗ **Not applicable to unsecured loans** (like personal loans, credit cards).
 - ✗ **Not applicable to agricultural land.**
 - ✗ **Does not extend to small borrowers** (loans below ₹1 lakh).
 - ✗ **Time-consuming due to DRT appeals & borrower resistance.**
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◆ Introduction to DRT

Debt Recovery Tribunals (DRT) and Debt Recovery Appellate Tribunals (DRAT) were established by the Recovery of Debts Due to Banks and Financial Institutions Act, 1993  to expedite the recovery of bad debts owed to banks and financial institutions.

Structure of DRT

Authority	Function
Presiding Officer	Sole judicial authority, must be or have been a District Judge . Holds office for 5 years .
Recovery Officer	Executes recovery orders by attaching & selling assets, appointing receivers, etc.

 **Jurisdiction of DRT: ✓ Minimum loan amount for filing a case: ₹20 lakh**

✓ Application Fee:

- ₹12,000 for loan amounts up to ₹20 lakh
- ₹12,000 + ₹1,000 per lakh above ₹20 lakh, up to a maximum fee of ₹1.5 lakh






Step-by-Step Process of Debt Recovery at DRT

Step	Description
1. Filing the Case	The bank/financial institution files an application before the DRT .
2. Issuance of Summons	DRT issues a summons to the borrower requiring them to appear within 30 days .
3. Submission of Written Statement	The borrower submits a reply defending their case.
4. Interim Order (if needed)	DRT may prohibit asset transfers by the borrower.
5. Hearings & Evidence Presentation	Both sides present evidence & arguments .
6. Final Order for Payment	DRT orders the borrower to repay the debt within a timeframe .
7. Appeal to DRAT (if needed)	If dissatisfied, either party can appeal within 30 days .



Note: If the DRT's order was made with the consent of both parties, **no appeal is allowed**.

Modes of Debt Recovery Under DRT

- ✓ **Attachment & sale of movable/immovable property** 
- ✓ **Taking possession of assets pledged as security** 
- ✓ **Arrest & detention of the defaulter in prison** 
- ✓ **Appointment of a receiver to manage debtor's assets**

VS DRT vs. SARFAESI Act

Recovery Through Lok Adalat

What is Lok Adalat?

Lok Adalat (People's Court) is a **dispute resolution mechanism** established under **The Legal Services Authorities Act, 1987**. It provides **quick, cost-effective, and amicable settlement** of legal disputes, including **loan recovery cases by banks**.

Key Features of Lok Adalat:

- ✓ **Alternative Dispute Resolution (ADR) mechanism**
- ✓ **Quick & cost-effective resolution (No court fees)**
- ✓ **Mutual consent-based settlement (No forced decision)**

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- ✓ Legally binding decision (Equivalent to a civil court decree)



Lok Adalat's Jurisdiction in Loan Recovery

- ✓ Handles loan recovery cases where the debt is ₹20 lakh or less
- ✓ Covers both secured & unsecured loans
- ✓ Applicable for NPAs (Non-Performing Assets)
- ✓ Decisions are final (No appeal, but parties can approach regular courts if unsatisfied)



Steps for Banks to Recover Loans via Lok Adalat

Step	Action Taken
1 Identify Eligible NPAs	The bank identifies loan accounts (up to ₹20 lakh) that have become Non-Performing Assets (NPA) .
2 Prepare Petition	A petition is filed for each account separately before the Legal Services Authority (LSA) .
3 Convince Borrower	The bank personally contacts the borrower to explain the benefits of

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	resolving the case through Lok Adalat.
4 Lok Adalat Hearing	Both parties (bank & borrower) appear before Lok Adalat on the scheduled date.
5 Settlement & Award	If both parties agree on a settlement , Lok Adalat passes an award with mutually decided repayment terms.
6 Compliance & Payment	The borrower pays the agreed amount , which may be in full or installments .



Lok Adalat Structure

Authority	Function
National Legal Services Authority (NALSA)	Apex body for legal aid in India.
State Legal Services Authority (SLSA)	Manages Lok Adalat at the state level .
District Legal Services Authority (DLSA)	Handles cases at the district level .
Taluk Legal Services Committee	Conducts Lok Adalat at the taluk level .





Key Terms of Settlement in Lok Adalat

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- ✓ **Down Payment Settlement** – Borrower pays a lump sum amount upfront.
- ✓ **Full Settlement in Short Duration** – Borrower clears dues within a short time.
- ✓ **Instalment-Based Repayment** – Borrower repays the amount in easy instalments.

Advantages of Lok Adalat for Loan Recovery

For Banks 	For Borrowers 
Quick recovery without lengthy legal proceedings.	No legal fees & court expenses.
No further litigation once settlement is reached.	Mutually agreed repayment plan.
Binding decision (enforceable like a court order).	Opportunity for amicable settlement without legal pressure.
Better relationship with customers.	Lower settlement amount possible through negotiation.

Limitations of Lok Adalat

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- ✗ Only works if both parties agree – No forced settlements.
- ✗ Cannot handle high-value cases (above ₹20 lakh).
- ✗ No appeal against Lok Adalat's award, but if dissatisfied, the borrower may approach civil courts.

Engaging Direct Recovery Agents in Banks

 What is Direct Recovery Agent Engagement?

- ✓ Banks & financial institutions hire external agencies or individuals to recover loan dues from **delinquent borrowers**.
- ✓ **Public Sector Banks (PSBs)** handle loan recovery internally.
- ✓ **Private & Foreign Banks** outsource recovery to **third-party agents**.










RBI Guidelines on Engaging Recovery Agents

The **Reserve Bank of India (RBI)** has issued **strict guidelines** for engaging recovery agents to **ensure fair & legal recovery practices**.

Key Guidelines by RBI

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 Guideline	 Requirement
 Due Diligence Process	Banks must perform due diligence before hiring recovery agents.
 Informing Borrowers	Banks must notify borrowers before forwarding cases to a recovery agency.
 Contact Information	The borrower must receive contact details of the recovery agency, including telephone numbers .
 Handling Complaints	If a borrower has lodged a complaint , the recovery process must be paused until resolved.
 Grievance Mechanism	Banks must set up grievance redressal mechanisms for borrower complaints.
 Training & Certification	Recovery agents must undergo DRA (Debt Recovery Agent) training and pass an exam .
 Incentives Control	Banks should ensure that high incentives do not lead to harassment of borrowers .

Training & Examination for Recovery Agents

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✓ Training Hours:

📅 Graduates: 50 hours

📅 Non-Graduates: 100 hours

✓ DRA (Debt Recovery Agent) Examination: 📌 Conducted by: Indian Institute of Banking & Finance (IIBF)

📌 Minimum Passing Marks: 50%

📢 Only certified agents can be engaged in loan recovery.

⚠️ Legal Means for Loan Recovery

Banks **CANNOT** seize assets illegally! 🚫

✓ SARFAESI Act, 2002 allows banks to auction assets legally.

✓ Valid repossession clauses must comply with Indian Contract Act.

✓ Clear communication of repossession terms is mandatory.

🏛️ Complaints Against Banks or Recovery Agents

✓ Banks are responsible for the actions of their agents.

✓ Recovery agents must follow RBI & BCSBI (Banking

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Codes & Standards Board of India) guidelines.

✓ RBI can ban banks from engaging recovery agents if they violate guidelines.

🚫 Abusive recovery practices = Strict Action by RBI! 🚫

🏠 Conclusion

✓ Recovery agents help banks recover loan dues but must operate within legal limits.

✓ RBI mandates ethical recovery practices & protects borrower rights.

✓ Banks must ensure due diligence, fair treatment, & grievance redressal mechanisms.

📢 Need further clarity on loan recovery processes? Let's discuss! 🤝

📢 Engaging Direct Recovery Agents in Banks 🏠 🔄

🔍 What is Direct Recovery Agent Engagement?

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🎓 Training & Examination for Recovery Agents

Training Requirements	Details
Graduates	50 hours of training
Non-Graduates	100 hours of training
Certification Exam	Debt Recovery Agent (DRA) Exam by IIBF
Passing Marks	50% or more

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⚠️ Legal Means for Loan Recovery

◆ Banks **CANNOT** seize assets illegally! Ⓣ

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Complaints Against Banks or Recovery Agents

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✓ RBI can ban banks from engaging recovery agents if they violate guidelines.



Abusive recovery practices = Strict Action by RBI! 



Summary Table: Recovery Agents in Banks

Aspect	Key Points
Who engages recovery agents?	Private & foreign banks; PSBs handle internally
Purpose	Recover overdue loan payments from delinquent borrowers

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Aspect	Key Points
RBI Guidelines	Due diligence, proper borrower notification, grievance mechanism
Training Requirement	50 hours (Graduates), 100 hours (Non-Graduates)
Certification	DRA Exam by IIBF (Minimum 50% passing marks)
Legal Compliance	Must follow SARFAESI Act & Indian Contract Act
Complaint Handling	RBI can ban banks from hiring recovery agents if misconduct occurs

Conclusion

✓ Recovery agents help banks recover loan dues but must operate within legal limits.

✓ RBI mandates ethical recovery practices & protects borrower rights.

✓ Banks must ensure due diligence, fair treatment, & grievance redressal mechanisms.

 Need further clarity on loan recovery processes? Let's discuss! 

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