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# Law relating to Non-performing Asset with special reference to Recovery of Non-performing Asset in Banks

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SRIVIDYA.S<sup>1</sup>

## ABSTRACT

*Non-performing Asset is one of the biggest problem in India. It is a threat to the country and hinders the development of the country. Non-performing Asset is higher in banking sector. In recent years it has been increasing to a great extent, especially in the public sector banks. The increasing Non-performing Asset has its implications on profitability, liquidity of the banks. It will also affect the goodwill and public image of the banks. Non-performing Asset should be recovered as much as possible. There are certain ways to recover the Non-performing Asset under the various laws in India. This paper is to understand the laws that governs the Non-performing Asset and ways to recover it. This paper will also analyze the different modes of recovery adopted by the banks to recover Non-performing Asset and which is the more effective mode of recovery.*

**Keywords:** *Non-performing Asset, legal framework, banking sector, recovery of Non-performing Asset.*

## I. INTRODUCTION

Non-performing Asset (NPA) are those assets which are not generating any income or revenue for the business. Non-performing Asset that to in the past few decades, it has been increasing at a rapid rate. This will affect the economy, growth and development of the country. So, Non-performing Asset can be said as a major problem to the country.

When a loan is given to a particular borrower, if the person does not repay the loan then it can be termed as Non-performing Asset. Non-performing Asset is defined as a loan or advance where interest and/ or installment of principal remain overdue for a period of more than ninety days in respect of a term loan.<sup>2</sup>

Reserve Bank of India is the one monitoring the banks Non-performing Asset and giving

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<sup>1</sup> Author is a LLM student at Reva University, India.

<sup>2</sup> Reserve Bank of India, Master Circular, RBI/2009-10/39, DBOD.no.BP.BC.17/21.4.048/2009-10, dated July 1, 2009

guidelines from time to time. Reserve bank of India plays an important role to manage the NPA in banks and Non-Banking Financial companies (NBFCs). Banking sector is the one which is having highest Non-performing Asset in the country. The increasing Non-performing Asset has many implications towards banks such as it decreases the profitability of banks, the banks have to adhere to more provisions regarding to NPA and effects the public image of the banks also.

### **(A) Classification of NPA**

The NPA can be classified into:

1. Substandard Asset: Substandard Asset are those assets which has been as Non-performing Asset for term of twelve months or less than twelve months.
2. Doubtful Asset: Doubtful Asset are those assets which has been as Non-performing Asset for a term more than twelve months.
3. Loss Asset: Loss Asset are those asset which cannot be collected. It can be said as unrecoverable.

### **(B) Objectives**

1. To understand the laws governing the Non-performing Assets.
2. To study the methods of recovery of Non-performing Assets in banks.
3. To study which method of recovery has been effective in recovering the Non-performing Assets in banks.

### **(C) Research Methodology**

This study is based on secondary data. The secondary data is collected from journals, newspaper articles, previous research papers, Reserve Bank of India reports, Reserve Bank of India bulletins and other online sources.

## **II. NON-PERFORMING ASSET IN BANKS**

Banking is one of the most important sector for the development of the economy in the country. It helps the growth and development of the country. Banks are the financial institution which will help the people who wants to start a business by giving them the money required to invest in the business as loans. But the person who has taken the loan should repay the loan along with the interest in installments.

When these borrowers does not repay the money then it becomes a Non-performing Asset to the banks. The Non-performing Asset is increasing in the banking sector, especially in the public sector banks. As per the Financial Stability Report of December 2021, released by

Reserve Bank of India (RBI) it stated that the macro stress test for credit risk indicated that the Gross Non-performing Asset ratio of the scheduled commercial banks may increase from 6.9% in September 2021 to 8.1% by September 2022 under the baseline scenario and 9.5% under severe stress scenario.<sup>3</sup>

### **III. LAWS GOVERNING NPA**

The existing laws which govern the Non-performing Assets are

#### **1. RECOVERY OF DEBTS DUE TO BANKS AND FINANCIAL INSTITUTIONS ACT, 1993**

Banks and other financial institutions play a major role in the development of the country. The main function of the banks and financial institutions are to lend money for the needy people who want to start their own business or to invest money in some business to earn profit, for a specific percentage of interest. The borrower then need to pay small amounts of installments to the banks and financial institutions at regular intervals. But the banks and financial institutions were not able to recover these amounts. And when a suit is filed against the borrower for recovery of the debts due at various courts, those courts had many other matters and importance were not given for debt recovery cases. As of September 1990 there were more than fifteen lakhs of cases filed by public sector banks and about three hundred and four cases filed by the financial institutions which were pending in various courts.<sup>4</sup> So, to overcome the problem the committee headed by Shir. M. Narasimham gave recommendations of setting up of special tribunals with powers for taking up cases of debt recovery so that the case can be adjudicated in a speedy manner.

The Act has six chapters and 37 sections and the act does not apply for the banks and financial institutions in which the amount to be recovered is more than twenty lakhs, so if the amount is less than twenty lakhs then it cannot be recovered under this Act through debt recovery tribunals.<sup>5</sup> Certain amendments has been made to the act from time to time.

The Act gives definitions of various terms under section 2, section 3 to 16 deals with establishment of tribunal and appellate tribunal, section 17 and 18 provides the jurisdiction, powers and authority of tribunals, section 19 to 24 talks about the procedure of tribunals.<sup>6</sup>

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<sup>3</sup> RBI Financial stability report, December 2021, Ministry of Finance  
[https://www.rbi.org.in/Scripts/BS\\_PressReleaseDisplay.aspx?prid=52996](https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=52996)

<sup>4</sup> Jain, Sankalp, Recovery of Debts Due to Banks and Financial Institutions: Legal Framework in India (November 12, 2015). Available at SSRN: <https://ssrn.com/abstract=2808408> or <http://dx.doi.org/10.2139/ssrn.2808408>

<sup>5</sup> Recovery of Debts due to Banks and Financial Institutions, 1993, No. 51, Acts of Parliament, 1993.

<sup>6</sup> *ibid*

## **2. SECURITIZATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT, 2002**

Under the act the banks and financial institution are given certain procedures where the secured creditors can go forward and recover the Non-performing Asset without going to any courts. Under the Recovery of Debt due to Banks and Financial Institution Act, 1993 the banks needed to go tribunal which were specifically was established to deal with recovery of Non-performing Asset, as time passed there were a huge number of cases still pending in the tribunals and also it was for a debt, if it exceeds a certain amount. But even the tribunal started to get more number of cases there was more procedure and it took more time consuming. So, Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 was enacted to make the recovery of Non-performing Asset easy. The objective of this act is to make laws for recovery of secured loans, to regulate the securitization and reconstruction of financial assets and enforcement of the security interest.

This Act has six chapters and 42 sections it extends to the whole of India. Section 2 gives definition of various terms, section 3 to 12B provides regulation of securitization and reconstruction of financial assets of banks and financial institutions, section 13 to 19 deals with enforcement of security interest, section 26B to 26E gives procedure for registration of secured creditor and other creditor, section 27 to 30D provides various offences and penalties for those offences.<sup>7</sup>

## **3. INSOLVENCY AND BANKRUPTCY ACT, 2016**

This act is newly enacted statute with an objective to consolidate and amend laws relating to reorganization and insolvency resolution of corporate persons, partnership firms, individuals in a time bound manner for maximization of value of assets of such person, to promote availability of credit and balance of interest of all stakeholders.<sup>8</sup>

In India even though Recovery of Debts Due to banks and Financial Institution act, 1993 and Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest act, 2002 was enacted for recovery of Non-performing Assets, it was very time consuming and very complex. And there was a huge number of cases still pending under the courts. The Non-performing Assets in India was increasing in a rapid rate. So the Government wanted to bring a new law to consolidate the existing insolvency laws into one act and amend the laws further

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<sup>7</sup> The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, no. 54, Acts of Parliament, 2002.

<sup>8</sup> The Insolvency and Bankruptcy Code, 2016, no.31, acts of Parliament, 2016.

more. It led to the enactment of the Insolvency and Bankruptcy Code, 2016. Under this act corporate insolvency resolution process can be commenced when a default is committed by a corporate debtor. There are five parts and 255 sections in this act. Under this act insolvency and bankruptcy board of India was established which has the powers to regulate matters relating to insolvency professionals, insolvency professional agencies and information utilities. The act provides easy and fast adjudication, gives new procedures for reorganization of the company's debt and also gives liquidation process which is fast.

#### **IV. RECOVERY OF NON-PERFORMING ASSETS**

Non-performing Assets is one of the biggest problem in India. It actually slows the development and growth of the country. Therefore Non-performing Assets should be tried and recovered as soon as possible. There are many modes of recovery of Non-performing Assets through which it can be recovered. They are

1. Lok Adalat
2. Debt Recovery Tribunal
3. Securitization
4. Asset Reconstruction
5. Enforcement of security interest
6. Under Insolvency and Bankruptcy Code

##### **1. LOK ADALAT**

Lok Adalat is one of the forums where disputes between the parties are settled or compromised by themselves before entering the court. It is a dispute redressal mechanism. When a case of Non-performing Asset recovery is before the court, a chance is given for the parties to compromise the dispute at a pre-litigation stage. There the banker and the borrower can come to an understanding and try to settle the amount of Non-performing Asset. The banker can also give a choice to make a one-time settlement which is a little less than the total amount to be recovered from that borrower.

Under the Legal Services Authorities Act, 1987 the Lok Adalat is organized to promote justice<sup>9</sup>. In Lok Adalat all the Non-performing Assets within the limitation period, even cases at pre-litigation stage, and the decree granted is binding and cannot be challenged also.<sup>10</sup> It is

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<sup>9</sup> The Legal Services Authorities Act, 1987, no. 39, Acts of Parliament, 1987

<sup>10</sup> Sunita Chaki, Kshamta Chohan & Anita Daryal, Journey towards recovery: Insolvency & Bankruptcy Code of India- A Mirage or a Milestone, 8, *International Journal of Recent Technology and Engineering*, October 2019

just like a civil court decree, but it cannot be appealed before the court. Generally Lok Adalat deals with cases involving a very small amount of Non-performing Asset.

## 2. DEBT RECOVERY TRIBUNAL

Debt Recovery Tribunal (DRT) was established under the Recovery of Debt due to Banks and Financial Institutions Act, 1993. The Central Government can establish one or more tribunals by notifications known as Debt Recovery Tribunals.<sup>11</sup> The main aim of Debt Recovery Tribunal was to provide speedy adjudication of debt recovery cases of banks and financial institutions. The tribunal consists of one person only called as Presiding Officer who is appointed by the Central Government.<sup>12</sup> To be a Presiding Officer he should be qualified to be a district judge.

Any bank or financial institution which want to recover the Non-performing Asset can make an application to the Debt Recovery Tribunal. The applicant should state particulars of debt, estimated value of securities etc. The Debt Recovery Tribunal after giving both the parties opportunity to be heard will pass an order. If any party is not satisfied with the order passed by the Debt Recovery Tribunal can appeal to Debt Recovery Appellate Tribunal within specified time period as provided under the act.

The limitation is that bank or financial institutions can make an application only when the amount exceeds twenty lakhs rupees or more.<sup>13</sup>

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 also provides that the borrower can file an application in the Debt Recovery Tribunal against action taken for enforcement of security interest.<sup>14</sup>

At present there are 39 Debt Recovery Tribunals and 5 Debt Recovery Appellate Tribunal functioning across the country.<sup>15</sup> It has become possible to ensure speedy recovery and implant confidence to the borrower that they will be heard fairly. It has become a forum of rapid recovery of debt in public and private sector banks. But still even though these tribunals were established to adjudicate the cases fast as there are also large number of cases, there are a lot of cases still pending.

## 3. SECURITIZATION

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<sup>11</sup> Supra Note4, section 3

<sup>12</sup> Ibid, section 4

<sup>13</sup> Debt Recovery Tribunals, Available at: <https://drt.gov.in/front/actrules.php>, Accessed on: 30/3/22 at 6.20 p.m.

<sup>14</sup> ibid

<sup>15</sup> About Debt Recovery Tribunal, Available at: <https://financialservices.gov.in/about-debt-recovery-tribunal#:~:text=At%20present%2C%2039%20Debts%20Recovery,Officer%20and%20a%20Chairperson%20r> respectively. Accessed on: 30/3/22 at 6.35 p.m.

Securitization can be said as a conversion of loans into securities which is marketable. That means which can be sold to others to generate income.

Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 provides for securitization of financial assets. Section 2 (z) of the act defines securitization and section 2 (l) defines financial assets. Under this act only banks and financial institution can securitize their financial assets. The banks or financial assets when they require money immediately, but if the money is blocked by ways of loans then the banks can securitize the financial assets and generate money. This can be done by the asset reconstruction companies which is formed for the said purpose. So, the banks sells the financial assets to Asset Reconstruction Company who will convert the financial assets into marketable securities and sell it to qualified institutional buyers. The main advantage of securitization is that it helps the banks to raise funds for different purpose when required by the banks.

Asset Reconstruction Company (ARC) can after acquiring the financial assets offer security receipts to qualified institute buyers for subscription in accordance with the provision of the act and should maintain separate account for every financial assets and ensure realization of such financial assets.<sup>16</sup>

#### **4. ASSET RECONSTRUCTION**

Asset Reconstruction can be said as acquiring the financial assets of banks or financial institution by the Asset Reconstruction Company. Asset Reconstruction Company is defined as a company registered with Reserve Bank for the purpose of carrying on the business of asset reconstruction or securitization or both.<sup>17</sup>

Asset Reconstruction Company in order to carry the business it should registered and should have certificate of registration. In order to obtain the certificate of registration certain criteria should be fulfilled by the company. If not the Reserve Bank can reject the registration.

After registration Asset Reconstruction Company are given certain powers and rights under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. It can acquire the Non-performing Asset of the banks and sell. So, Asset Reconstruction can be said as realization of Non-performing Asset of banks through the Asset Reconstruction Company.

#### **5. ENFORCEMENT OF SECURITY INTEREST**

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<sup>16</sup> Supra Note 6, section 7.

<sup>17</sup> Ibid, section 2 (ba).



The Securitization and Reconstruction of Financial Asset and Enforcement of Security Interest Act, 2002 under chapter three from section 13 to 19 deals with the enforcement of security interest.

The banks and financial institution can recover the Non-performing Asset which arise from the secured debt by enforcing the security interest. Secured debt are those loans for which security is taken from the borrower. The bank becomes secured creditor. Whenever borrower fails to pay the installment then when it becomes Non-performing Asset the banks can give a final notice to the borrower to make payment and if the payment is not made then the bank can take possession of the secured asset and has the right to even sell the secured asset without any intervention of the court or tribunals.

The bank if it is wants to sell the secured asset then it should in writing request the Metropolitan Magistrate or the District Magistrate within whose jurisdiction such secured asset is situated, then the bank should publish a notice in newspaper after that the possession of the secured asset and documents can be made.<sup>18</sup>

## **6. UNDER INSOLVENCY AND BANKRUPTCY CODE, 2016**

The Insolvency and Bankruptcy Code, 2016 has four main pillars which are firstly Insolvency and Bankruptcy Board of India (IBBI), secondly information utilities, thirdly insolvency professionals and lastly the adjudicating authorities.

The Insolvency and Bankruptcy Code, 2016 gives the regulation of insolvency and bankruptcy for corporate person, individual and partnership firm. Under the said act the corporate insolvency resolution process is given where a corporate debtor commits a default in payment of debt the financial creditor can file an application against the corporate debtor before the adjudicating authority.<sup>19</sup> The adjudicating authority for the corporate person is NCLT (National Company Law Tribunal).<sup>20</sup> And the adjudicating authority for individuals and the partnership firm is Debt Recovery Tribunal (DRT).

Insolvency and Bankruptcy Board of India (IBBI) is established with a main task of managing an effective and transparent execution of the insolvency code.<sup>21</sup> The Act also provides rules for information utilities who are professional organization which are registered with IBBI and are

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<sup>18</sup> Ibid, section 14 and 15

<sup>19</sup> Supra Note 7, section 6 and 7.

<sup>20</sup> Ibid, section 60.

<sup>21</sup> Dr. Manoj Pandey, CA Manav Vigg, CA Chhavi Agarwal and Dr. Pacha Malyadri, Impact of the Insolvency and Bankruptcy code on NPA Resolution, 12, Journal of Xi'an University of Architecture and Technology, 923, (2020).

entrusted with the task of maintaining authentic information regarding debts.<sup>22</sup> This act provides quick resolution process which helps the banks and financial institutions for the recovery of Non-performing Asset. This will help save time of the parties involved and also to recover the debt.

## V. RECOVERY OF NON-PERFORMING ASSETS BY BANKS

The banking sector is the one which is suffering from the higher Non-performing Asset in the country. The banks try to recover the Non-performing Asset from the above mentioned different modes of recovery. So that it does not affect the banks, growth and development of country.

Now as there are many ways by which Non-performing Assets can be recovered by banks, it is better to know which method is more effective to recover the Non-performing Assets.

Table 1: Non-performing Assets recovered by banks through various modes

Years	Lok Adalat		DRT's		ARC's	
	Percentage of total amount involved	Amount recovered as percentage of amount involved	Percentage of total amount involved	Amount recovered as percentage of amount involved	Percentage of total amount involved	Amount recovered as percentage of amount involved
2003-04	5.1	13.5	53.3	30.9	41.5	8.9
2004-05	2.8	14.1	50.5	18.8	46.7	18.1
2005-06	6.5	20.3	35.9	76.9	57.6	34.8
2006-07	4.0	14.0	48.3	37.8	47.7	41.4
2007-08	14.1	8.2	38.2	51.9	47.7	61.0
2008-09	19.9	2.4	20.4	81.1	59.7	33.0
2009-10	23.1	1.5	31.3	32.0	45.6	30.0
2010-11	10.5	2.9	28.2	27.9	61.3	37.8

<sup>22</sup> Ibid.

2011-12	2.8	11.8	39.4	17.0	57.8	28.6
2012-13	6.2	6.1	29.3	14.2	64.4	27.2
2013-14	13.3	6.0	31.8	9.6	54.8	26.5
2014-15	12.5	3.2	24.3	7.0	63.2	16.3
2015-16	32.5	4.4	31.3	9.2	36.2	16.5
2016-17	13.0	6.4	36.2	10.2	50.8	18.3
2017-18	16.9	4.0	49.2	5.4	30.3	32.2
2018-19	7.4	5.1	37.0	3.9	35.6	15.0
2019-20	9.1	6.2	33.1	4.1	26.5	26.7

**Source:** RBI Bulletin, ARCs in India: A study of their Business operations and role in NPA resolution, April 2021. Available at:

[https://www.rbi.org.in/Scripts/BS\\_ViewBulletin.aspx?Id=20203](https://www.rbi.org.in/Scripts/BS_ViewBulletin.aspx?Id=20203)

Table 2: Non-performing Asset recovered by banks through IBC, 2016

Years	IBC	
	Percentage of total amount involved	Amount recovered as percentage of amount involved
2017-18	3.7	49.6
2018-19	20.4	45.7
2019-20	31.3	45.5

**Source:** RBI Bulletin, ARCs in India: A study of their Business operations and role in NPA resolution, April 2021. Available at:

[https://www.rbi.org.in/Scripts/BS\\_ViewBulletin.aspx?Id=20203](https://www.rbi.org.in/Scripts/BS_ViewBulletin.aspx?Id=20203)

If we look at table 1 it has various methods of recovery of Non-performing Asset which are in

existence from a long period of time, and in table 2 the recovery is from IBC which is relatively new mode of recovery.

From 2017-18 all these recovery methods are used, so it can be compared and look at it as to which is more effective in the recovery of Non-performing Asset in banks. So if three years is compared, that is 2017-18, 2018-19 and 2019-20 the IBC can be said to be a more effective mode because if the amount recovered as percentage of amount involved of the IBC is leading with 49.6, 45.7, 45.5 then ARCs with 32.2, 15.0, and 26.7.

## **VI. CONCLUSION**

Non-performing Asset in banking sector is a never ending problem faced in the country. The best thing the banks can do is to recover the Non-performing Asset by different modes of recovery. The government has taken initiative and enacted many legislations in order to make the recovery fast and easy as far as possible. Because the increasing Non-performing Asset not only affects the bank but also affects the growth development of the country.

Lok Adalat is not so effective in recovery of Non-performing Asset because the compromise between borrower and the banker is not always fruitful, and it will be difficult to settle the amount. The Debt Recovery Tribunals which was a special tribunal established with the sole purpose was to recovery of Non-performing Assets but they are also not so effective and many cases are still pending and there is no fast disposal of cases. Asset Reconstruction Companies are effective mode when compared to DRTs and has recovered many amounts of Non-performing Asset in banks. Under Insolvency and Bankruptcy Code, 2016 the recovery of Non-performing Asset in banks can be said to be the most effective method of recovery, but it should be long lasting. Because ARCs also were very effective in the initial stages when it was regulated under the Securities and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 but gradually the recovery rate is reduced in banks.

Non-performing Asset in banks is a threat to the banking business itself, and effective measures should be taken by the banks in order to recover the Non-performing Asset as much as possible in a speedy manner. For that purpose the IBC, 2016 has provided an effective and quick mode of recovery of Non-performing Asset. This should help for the recovery in the coming years also. It can be concluded that there is many laws governing Non-performing Asset. However the effectiveness of all the modes of recovery can be improved and help the banks to recover even more amount of Non-performing Asset.

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