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# Legal Remedies for Non-Performing Assets (NPAs) in India: An Assessment of Enforcement and Recovery Mechanisms

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## ABSTRACT

*Non-Performing Assets (NPAs) remain a critical challenge in India's banking sector, affecting credit flow, profitability, and financial stability. This paper assesses the effectiveness of legal remedies such as the SARFAESI Act, Debt Recovery Tribunals (DRTs), Insolvency and Bankruptcy Code (IBC), Lok Adalats, and Asset Reconstruction Companies (ARCs) in resolving NPAs. It also examines enforcement challenges, sector-specific issues, and the role of regulatory bodies like the RBI and Government of India. The study highlights the need for judicial reforms, inter-creditor coordination, and institutional strengthening to improve recovery outcomes and ensure a more robust, efficient, and accountable financial ecosystem.*

**Keywords:** *Non-Performing Assets, SARFAESI Act, Insolvency and Bankruptcy Code (IBC), Debt Recovery Tribunal (DRT), Asset Reconstruction Companies (ARCs), Lok Adalats, Legal Remedies, Banking Sector, NPA Resolution, Financial Enforcement.*

## I. INTRODUCTION

Non-Performing Assets (NPAs) represent loans or advances where the borrower has stopped making interest or principal repayments for a specified period—typically 90 days for commercial banks in India. NPAs are a key indicator of the health and efficiency of the banking sector, and their high incidence poses a serious threat to financial stability, credit flow, and economic growth (Reserve Bank of India [RBI], 2023).

The Indian banking system has been grappling with mounting NPAs, especially since the mid-2010s, with public sector banks bearing the brunt due to high corporate exposures and legacy lending practices. At its peak in 2018, the gross NPA ratio for scheduled commercial banks exceeded 11%, prompting urgent legal and policy responses (International Monetary Fund [IMF], 2022).

Given the limitations of traditional recovery mechanisms—such as civil courts and informal

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settlements—the government and regulators introduced a robust legal framework aimed at improving the resolution and enforcement of bad loans. This includes laws such as the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002, the Insolvency and Bankruptcy Code (IBC), 2016, and the establishment of specialized tribunals like the Debt Recovery Tribunals (DRTs).

This article critically examines these legal mechanisms, assesses their effectiveness in the Indian context, and highlights the ongoing challenges that continue to impede swift and efficient recovery of NPAs.

## **II. OVERVIEW OF LEGAL FRAMEWORK GOVERNING NPAS**

The legal framework governing Non-Performing Assets (NPAs) in India has evolved significantly over the last two decades, transitioning from a borrower-friendly approach to a more creditor-oriented regime. Initially, banks relied on civil litigation under the Civil Procedure Code for loan recovery, which was time-consuming and ineffective. Recognizing the limitations of this approach, the Indian government introduced several legislative reforms aimed at expediting asset recovery and strengthening creditor rights (RBI, 2023).

The first major initiative was the establishment of Debt Recovery Tribunals (DRTs) under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, which aimed to provide a dedicated forum for financial institutions to recover dues efficiently. While DRTs provided an alternative to traditional courts, their performance was hindered by understaffing and procedural delays (Chaudhary & Sharma, 2021).

The landmark SARFAESI Act, 2002, further empowered banks to enforce security interests without judicial intervention, allowing seizure and auction of assets from defaulting borrowers. This marked a paradigm shift in India's legal approach to NPAs, placing more power in the hands of creditors (Ghosh & Roy, 2021).

However, the most comprehensive reform came with the enactment of the Insolvency and Bankruptcy Code (IBC), 2016, which consolidated various laws related to insolvency and provided a time-bound resolution framework for both corporates and individuals. The IBC has become the centerpiece of India's NPA resolution architecture and has significantly altered the borrower-lender dynamics (IMF, 2022).

Complementing these laws are supportive regulatory measures introduced by the Reserve Bank of India (RBI), including asset classification guidelines, provisioning norms, the Prompt Corrective Action (PCA) framework, and the identification of Special Mention Accounts

(SMAs) to flag early signs of distress.

In summary, India's legal framework for NPA recovery now comprises a blend of judicial, quasi-judicial, and administrative mechanisms designed to strengthen enforcement, promote resolution, and reduce the systemic risk posed by bad loans.

### **III. THE SARFAESI ACT, 2002**

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 was a landmark legislation enacted to empower banks and financial institutions to recover dues efficiently without the need for court intervention. It marked a significant shift in India's approach to NPA resolution by placing legal authority directly in the hands of lenders for the enforcement of secured assets (Ghosh & Roy, 2021).

Under SARFAESI, if a borrower defaults on repayment for more than 90 days and the loan is classified as an NPA, banks can issue a demand notice and, if unpaid within 60 days, take possession of the collateral assets and dispose of them through auction or sale (RBI, 2023). This process bypasses the need for judicial procedures, significantly reducing recovery timelines.

Another key provision of the Act is the creation and regulation of Asset Reconstruction Companies (ARCs), which acquire NPAs from banks at a discount and attempt to restructure or recover them. This allows banks to clean up their balance sheets while shifting the burden of recovery to specialized institutions.

Despite its advantages, the Act has faced limitations. For instance:

- It applies only to secured loans, excluding unsecured retail loans or agricultural loans.
- It is inapplicable to cooperative banks, although this was later partially rectified by judicial interpretation.
- In many cases, borrowers challenge the actions taken under SARFAESI in civil courts or high courts, leading to delays in enforcement (Chaudhary & Sharma, 2021).

Moreover, recovery through SARFAESI has been uneven across banks, and the success of the process depends significantly on the quality and marketability of the collateral. Still, the Act remains one of the most widely used legal tools for bad loan recovery, particularly in medium-sized corporate defaults.

Overall, SARFAESI has strengthened the position of creditors, improved credit discipline, and complemented other legal mechanisms such as the Insolvency and Bankruptcy Code

(IBC), providing banks with multiple avenues for NPA resolution.

#### **IV. THE INSOLVENCY AND BANKRUPTCY CODE (IBC), 2016**

The Insolvency and Bankruptcy Code (IBC), 2016 is considered the most comprehensive legal reform for NPA resolution in India. It was introduced to consolidate and streamline various insolvency laws, providing a time-bound and creditor-driven mechanism to resolve stressed assets. The IBC applies to individuals, partnerships, and companies, and it has fundamentally altered the relationship between debtors and creditors (IMF, 2022; Sengupta & Sharma, 2017).

The key feature of the IBC is the Corporate Insolvency Resolution Process (CIRP), which allows financial creditors to initiate insolvency proceedings before the National Company Law Tribunal (NCLT) once a borrower defaults on repayment. Upon admission, a moratorium is imposed, and an Insolvency Professional (IP) is appointed to manage the debtor's affairs. A Committee of Creditors (CoC) then decides on a resolution plan, which must be completed within 330 days, including litigation periods (RBI, 2023; Batra, 2018).

The IBC has improved recovery rates significantly compared to earlier mechanisms. According to RBI data, average recovery under IBC stood at 32.8% in FY 2022–23, which, although lower than its initial years, remains higher than recoveries through SARFAESI, DRTs, or Lok Adalats (RBI, 2023). Notable successes include the resolution of large accounts such as Essar Steel, Bhushan Steel, and Alok Industries, which were part of the RBI's "dirty dozen" list of top defaulters (Pattnaik, 2020).

However, the Code faces several challenges:

- Delays in resolution, with many cases exceeding the 330-day limit;
- Overburdened NCLTs, resulting in pendency of cases;
- Frequent litigation by operational creditors and promoters, creating procedural hurdles;
- Concerns about haircuts taken by banks, sometimes exceeding 80% of the loan value (Chaudhary & Sharma, 2021; KPMG, 2021).

In response, the government has made several amendments, including pre-packaged insolvency for MSMEs, fast-track processes, and suspension of fresh insolvency filings during COVID-19. Despite these challenges, the IBC remains central to India's NPA resolution strategy, promoting accountability, improving credit culture, and enabling quicker resolution compared to legacy systems.

## **V. DEBT RECOVERY TRIBUNALS (DRTS) AND DEBT RECOVERY APPELLATE TRIBUNALS (DRATS)**

The Debt Recovery Tribunals (DRTs) were established under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, as a specialized judicial mechanism to enable faster adjudication and recovery of bad debts. Their primary mandate is to resolve disputes where the amount due to banks and financial institutions exceeds ₹20 lakh. Appeals against DRT decisions are heard by Debt Recovery Appellate Tribunals (DRATs) (RBI, 2023).

DRTs were envisioned to overcome the limitations of traditional civil courts, which were overburdened and slow in handling loan recovery cases. The DRT process includes the filing of an Original Application (OA) by a bank or financial institution, followed by proceedings for issuing recovery certificates, attachment of assets, and final enforcement through Recovery Officers (Chaudhary & Sharma, 2021).

While the establishment of DRTs initially led to an improvement in recovery speed, systemic inefficiencies have increasingly undermined their effectiveness:

- Acute shortage of presiding officers and support staff;
- Delays in case resolution, often stretching over several years;
- Technological backwardness in case management and tracking;
- Limited geographical reach, especially in rural and northeastern regions (Ghosh & Roy, 2021).

According to the Parliamentary Standing Committee on Finance (2022), as of March 2022, more than 1.4 lakh cases involving over ₹6 lakh crore were pending before DRTs across India, pointing to severe capacity constraints.

Additionally, the DRTs often lack the authority to handle complex corporate debt restructuring, especially in cases involving multiple lenders or cross-border insolvency. As a result, the relevance of DRTs in resolving large NPAs has diminished post the enactment of the Insolvency and Bankruptcy Code (IBC), which now serves as the preferred resolution route for big-ticket cases.

Nonetheless, DRTs continue to play a crucial role in handling smaller NPA cases, especially retail and SME defaults, and serve as an essential component of the broader recovery ecosystem. Their effectiveness, however, is contingent on judicial reforms, staff capacity enhancement, and integration with digital legal infrastructure.

## **VI. LOK ADALATS AND COMPROMISE SETTLEMENTS**

Lok Adalats, or “People’s Courts,” are an alternative dispute resolution (ADR) mechanism designed to provide inexpensive, speedy, and mutually agreeable solutions for disputes, including loan defaults. Governed by the Legal Services Authorities Act, 1987, Lok Adalats are organized by State Legal Services Authorities and are particularly effective in resolving small-value NPAs, especially in the priority sector, self-help groups, and retail lending (RBI, 2023).

Banks refer eligible NPA accounts to Lok Adalats in coordination with the RBI and civil courts. These forums operate with flexible procedures and focus on compromise settlements, allowing banks and borrowers to agree on repayment terms without litigation. One key advantage of Lok Adalats is that the settlement awards have the status of a civil court decree, making them legally binding on both parties (Chaudhary & Sharma, 2021).

The Reserve Bank of India (RBI) actively encourages banks to use Lok Adalats for NPAs under ₹20 lakh. As per RBI guidelines, banks should hold periodic Lok Adalats in collaboration with the District Legal Services Authority (DLSA) to clear backlog cases, especially for unsecured loans or where legal action is disproportionately costly.

However, the effectiveness of Lok Adalats in large-scale NPA recovery is limited due to:

- Focus on low-value disputes only;
- Voluntary participation, which means borrowers may decline to settle;
- Lack of enforcement if borrowers default again after settlement;
- Limited legal and financial expertise in evaluating complex credit matters (Ghosh & Roy, 2021).

Similarly, compromise settlements or one-time settlements (OTS) are non-statutory recovery options offered by banks to settle NPAs by accepting a reduced payment from the borrower. Although widely used, these settlements are often criticized for encouraging strategic defaults when not backed by strong recovery follow-up.

Despite their limitations, Lok Adalats and compromise settlements remain important for reducing the burden on formal courts and for enabling faster resolution of retail NPAs, especially in rural and semi-urban areas where cooperative and regional banks are active.

## **VII. ASSET RECONSTRUCTION COMPANIES (ARCS)**

Asset Reconstruction Companies (ARCs) were introduced as a key institutional mechanism

under the SARFAESI Act, 2002, to support banks in managing and recovering bad loans. ARCs acquire NPAs from banks and financial institutions, typically at a discounted price, and then attempt to resolve, restructure, or liquidate these assets to maximize recovery (RBI, 2023).

The functioning of ARCs is regulated by the Reserve Bank of India, which licenses and monitors them. These entities issue Security Receipts (SRs) to Qualified Institutional Buyers (QIBs), including the selling banks, against the underlying asset pool. The ARC then acts as a trustee and recovery agent, using measures such as asset sales, legal action, or restructuring to recover dues.

The ARC model provides banks with a mechanism to clean their balance sheets and focus on core operations, while specialized agencies handle recovery. As of 2022, there were around 28 registered ARCs in India, with a few dominant players such as Edelweiss ARC, ARCIL, and Reliance ARC (Chaudhary & Sharma, 2021).

However, the performance of ARCs has been mixed:

- Recovery through ARCs has declined in recent years, with the ratio of SR redemption falling to below 20% for many firms (RBI, 2023).
- Limited capital availability and overdependence on selling banks have constrained their capacity to manage large and complex NPAs.
- ARCs are more effective in handling secured retail and SME assets, but struggle with large industrial NPAs due to legal complexity and operational challenges (Ghosh & Roy, 2021).

To strengthen the ARC framework, the Government of India announced the establishment of the National Asset Reconstruction Company Ltd. (NARCL) or “bad bank” in 2021. NARCL was designed to aggregate and resolve large-value stressed assets exceeding ₹500 crore, while an associated entity, India Debt Resolution Company Ltd. (IDRCL), would manage resolution.

The introduction of NARCL is expected to bring scale, uniformity, and government backing to the ARC space, addressing many structural weaknesses of existing private ARCs. However, its success depends on transparent governance, efficient valuation of assets, and timely legal resolution.

In conclusion, ARCs, though promising, require regulatory strengthening, capital depth, and improved enforcement mechanisms to play a more effective role in India’s NPA ecosystem.



## **VIII. ROLE OF RBI AND GOVERNMENT IN STRENGTHENING LEGAL REMEDIES**

The Reserve Bank of India (RBI) and the Government of India have played pivotal roles in designing and strengthening the legal infrastructure for addressing the growing problem of Non-Performing Assets (NPAs). Their joint interventions span regulatory measures, institutional frameworks, and legislative actions that together form the backbone of India's NPA recovery ecosystem.

The RBI has issued comprehensive asset classification norms, provisioning guidelines, and restructuring frameworks to ensure early recognition and resolution of stressed assets. A key reform was the introduction of Special Mention Accounts (SMAs) to identify accounts that show early signs of stress, and the Prompt Corrective Action (PCA) framework, which imposes restrictions on banks that breach key thresholds such as capital adequacy or net NPAs (RBI, 2023).

In 2018, the RBI mandated that all banks refer defaulting accounts above ₹2,000 crore for resolution under the Insolvency and Bankruptcy Code (IBC) within a set timeframe, emphasizing time-bound action and creditor coordination (Ghosh & Roy, 2021). Though later relaxed due to Supreme Court rulings and COVID-related disruptions, this framework helped create urgency in dealing with large NPAs.

The Government of India, on its part, has introduced structural reforms such as:

- The IBC, 2016, which replaced fragmented insolvency laws with a unified legal process;
- The Recapitalization of Public Sector Banks, with over ₹3.1 lakh crore infused from 2017 to 2021;
- Establishment of the National Asset Reconstruction Company Ltd. (NARCL) and India Debt Resolution Company Ltd. (IDRCL) to handle legacy large-value NPAs;
- Amendment to the Banking Regulation Act, 1949, bringing cooperative banks under RBI's direct supervision post the PMC Bank crisis (Chaudhary & Sharma, 2021).

In addition, both the RBI and government have supported the development of digital recovery and credit monitoring platforms, including CRILC (Central Repository of Information on Large Credits) and Public Credit Registry, which enhance information sharing among banks and regulators.

Despite these efforts, the implementation challenges—such as delayed resolutions in NCLT, limited capacity in DRTs, and political economy constraints in cooperative banks—still

persist. Therefore, both the RBI and government must continue working together to improve enforcement mechanisms, institutional coordination, and systemic governance.

## **IX. CHALLENGES IN LEGAL ENFORCEMENT OF NPAS**

Despite the existence of a comprehensive legal framework, the enforcement of NPA recovery in India faces numerous challenges that hamper timely and effective resolution. These obstacles arise from procedural inefficiencies, institutional limitations, and borrower-side resistance, all of which affect the performance of SARFAESI, IBC, DRTs, and other legal instruments.

One of the most pressing challenges is judicial delay. The National Company Law Tribunal (NCLT) and Debt Recovery Tribunals (DRTs) suffer from severe case backlogs and a shortage of judicial officers. Although the IBC prescribes a 330-day time limit for resolution, many cases extend well beyond this due to adjournments, appeals, and procedural complexity (RBI, 2023).

Another challenge is the frequent misuse of legal remedies by willful defaulters. Borrowers often file writ petitions or injunctions in High Courts to stall enforcement actions under SARFAESI, undermining the intent of speedy recovery. In some instances, borrowers also transfer or dilute asset ownership to avoid seizure, complicating legal enforcement (Chaudhary & Sharma, 2021).

Moreover, haircuts taken by banks in IBC resolutions, often as high as 70–90%, raise concerns about the real effectiveness of legal recovery. While banks achieve closure, the recovery value is significantly eroded, impacting bank profitability and capital adequacy (Ghosh & Roy, 2021).

The lack of technical expertise among insolvency professionals, valuation agencies, and DRT personnel further weakens the enforcement ecosystem. In rural and semi-urban areas, cooperative banks in particular struggle with legal support and documentation, making it difficult to enforce securities or proceed against defaulting borrowers.

The fragmented coordination among creditors, especially in consortium lending or multi-banking arrangements, also delays unified legal action. Disputes among lenders often derail the resolution process or lead to litigation, thereby reducing the possibility of amicable settlement or fast-track recovery.

In summary, the effectiveness of legal remedies for NPAs in India is constrained by systemic inefficiencies, procedural delays, judicial backlog, and borrower resistance. Strengthening

institutional infrastructure, ensuring judicial capacity, and simplifying procedures are critical to improving the enforcement landscape.

## **X. CONCLUSION**

India's progress in tackling NPAs is evident, but legal enforcement still requires improved execution, judicial strengthening, and coordinated reforms. Enhancing institutional capacity, technology adoption, and accountability of insolvency professionals is critical. With greater public awareness, digitization support for rural banks, and robust inter-creditor mechanisms, the NPA recovery framework can become more effective. Continued reforms will ensure a more resilient, transparent, and efficient banking system in the years ahead.

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