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Rise of Non-Performing Assets: A Critical Analysis and Sustainable Growth in India

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ABSTRACT

The banking sector is the backbone of the Indian economy since it performs a variety of services that directly and indirectly contribute to the country's growth and development. The banking industry is vital to India's financial system. One of the primary duties of a bank is to make loans to individuals, businesses, governments, and non-governmental organisations.

When these individuals or corporations fail to return their loans, it is a big problem for the bank. As it will have an impact on other financial functions and mechanisms in banks. Debt financing is a form of asset for Indian banks. When this asset fails to provide revenue, it becomes a non-performing asset (NPA). NPA can reduce a bank's financial stability and profitability. Indian banks mainly focus to provide lending to the priority sector and non-priority sector. The Indian debt finance environment is dynamic and prone to continual development.

The Indian Finance Ministry unveiled a number of strategic proposals within the framework of the 2022–2023 Union Budget to encourage increased private sector investments, bolster credit accessibility for emerging industries like digital infrastructure and green energy, and increasing credit assistance for micro, small, and medium-sized enterprises (MSME). Nevertheless, persistent barriers impeding the efficiency of the loan cycle encompass unnoticed leakages, subpar returns, and prolonged recuperation periods. Notably, despite stringent oversight and internal processes, financial institutions—both public and private sector banks—face the challenging problem of non-performing assets (NPAs). To offer policy recommendations for NPL management and mitigation that are both successful and efficient, a full understanding of the non-performing loan status in financial institutions is required.

This research paper's main objective is to review a variety of journals, news items, and reports in order to evaluate the impact and results on the Indian economy. This study conducts a detailed investigation of the main causes of the non-performing loan (NPL) problem in India, emphasising its seriousness. The first step in managing non-performing assets (NPAs) is to proactively identify and carefully categorise loans that are in trouble. Financial institutions utilise a wide range of risk assessment techniques, such as stress

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testing and credit scoring models, to determine whether loans are at danger of default. Examine the legal processes for managing non-performing loans (NPLs), encompassing methods for collection and settlement. Examine the efficacy of various strategies for handling troubled loans. Subsequently, specific techniques are employed to address non-performing loans. These methods may involve restructuring, recovery, or liquidation procedures. These procedures are through SARFAESI ACT and RDBFI ACT.

Keywords: *Banking Sector, Debt Financing, Non-Performing Assets, RDBFI Act, SARFAESI ACT*

I. Introduction

When an asset, including a leased one, ceases to generate income for a bank, it is classified as a non-performing asset (NPA). Any asset held by a financial institution that fails to yield revenue falls under this category. As defined by Investopedia, an NPA is a "debt obligation where the borrower has failed to make principal and interest payments to the lender for an extended period as per the agreed terms." This means that the lender does not receive any financial returns from the asset in the form of principal or interest. If a borrower does not repay the loan within 90 days, the outstanding principal and interest are designated as non-performing.

A non-performing asset refers to "an asset or account of a borrower that a bank or financial institution has categorized as sub-standard, doubtful, or a loss asset— (a) if the financial institution is governed by an authority or regulatory body established by law, then it is classified based on the asset classification guidelines issued by that authority; (b) in all other cases, it follows the directives and classification norms set by the Reserve Bank of India (RBI)."

The profitability of banks largely depends on the difference between the interest earned from borrowers and the interest paid to depositors. While loans extended to customers are recorded as assets on a bank's balance sheet, NPAs pose a significant liability. They not only jeopardize bank profits and revenue streams but also create difficulties in paying interest to savers, ultimately reducing the economic value of loan assets.

Customers do not accumulate bad debt immediately after obtaining loans. Typically, banks provide a grace period, after which overdue obligations are classified as past due. Beyond a specific period—ranging from 90 to 180 days—such loans are categorized as non-performing. Generally, consumer loans overdue for more than 180 days and business loans overdue for more than 90 days are classified as NPAs. In the case of agricultural loans, a loan is deemed non-performing if interest and/or principal payments remain overdue for two harvest seasons. However, this period cannot exceed two years, after which any unpaid loan is designated as a

non-performing asset.

II. CLASSIFICATION OF NON-PERFORMING ASSETS

Until the mid-1980s, the responsibility of managing non-performing assets (NPAs) primarily rested with banks and auditors. In 1985, the A. Ghosh Committee on Final Accounts introduced recommendations that led to the creation of India's first asset classification framework. This framework, known as the "Health Code System" (HCS), categorized bank advances into eight groups, ranging from Category 1 (acceptable) to Category 8 (bad and questionable debt)[3].

In 1991, the Narasimham Committee on the Financial System observed that the HCS did not align with international standards. As a result, the committee recommended a revised classification system that grouped bank loans into four major categories:

1. **Standard Assets:** These are assets that do not exhibit any financial distress and do not pose a significant risk to the bank. They are considered performing assets.
2. **Sub-Standard Assets:** Loans that remain non-performing for up to one year fall into this category. If the terms of a loan are renegotiated or modified, the asset may also be classified as sub-standard. However, the reclassification of an asset does not automatically occur merely due to changes in loan terms unless compliance with revised conditions is ensured for at least a year.
3. **Doubtful Assets:** If an asset continues to remain in the sub-standard category for over a year, it is reclassified as a doubtful asset. These assets share the inherent risks of sub-standard assets, but their full recovery becomes highly uncertain due to financial constraints and valuation concerns.
4. **Loss Assets:** This category includes NPAs where a loss has been identified by a bank, an auditor, or an RBI inspection. While the asset may still have some residual recovery value, it is deemed uncollectible and no longer viable as a bankable asset unless fully written off.

As per an RBI directive, banks are required to classify NPAs as sub-standard, doubtful, or loss assets based on the duration since they were first designated as non-performing[4]. In 1992, prudential norms for asset classification, income recognition, and provisioning were gradually introduced. The **Narasimham Committee on Banking Sector Reforms (1998)** later

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[3] A. Ghosh Comm. on Final Accts., Reserve Bank of India, Report on Final Accounts ¶ __ (1985).

[4] Reserve Bank of India, Master Circular - Prudential Norms on Income Recognition, Asset Classification and Provisioning Pertaining to Advances ¶ 1.2 (July 1, 2014), https://www.rbi.org.in/commonman/Upload/English/Notification/PDFs/74MIR010714FL.pdf.

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recommended further tightening of prudential standards to strengthen regulatory measures and adapt to India's evolving financial landscape. By 2001, India's NPA classification framework was aligned with global standards with the adoption of the **90-day norm**, which defined non-performing assets based on overdue payments exceeding 90 days.

III. Importance of the issue of non-performing assets

The higher the proportion of non-performing assets (NPAs) in a bank, the weaker its revenue system becomes within the economy. While banks typically maintain substantial reserves or capital buffers to absorb short-term losses, a prolonged increase in NPAs can deplete these reserves, ultimately threatening the bank's ability to expand and sustain operations.

Net NPAs, measured as a percentage of net advances, increased from 1.0% during 2007–2009 to 1.8% in the 2012–2014 period. Similarly, the Gross NPA ratio of Scheduled Commercial Banks rose from 2.96% in 2012 to 4.28% in 2017, highlighting a concerning trend.[5]

The impact of NPAs on banking performance is significant, particularly due to their adverse effects on return on assets (ROA). Since interest income is recognized only upon receipt, banks experience a decline in their overall earnings. Additionally, provisioning for doubtful debts and eventual write-offs as bad debts further reduce profitability. This situation also leads to a decline in Return on Investment (ROI) while increasing capital costs and interest rates on loans.

Beyond the banking sector, the presence of NPAs has broader economic consequences, contributing to financial instability and hindering growth. As banks accumulate higher levels of NPAs, the availability of funds in India's securities market diminishes. Furthermore, banks become increasingly reluctant to extend loans unless they are assured of repayment, which restricts credit availability. This, in turn, negatively affects shareholders, as struggling banks experience losses, leading to diminished investor confidence and market uncertainty.

The repercussions extend to the lending environment, with rising NPAs driving up interest rates on loans. This increase directly impacts investors seeking credit for industrial and infrastructure projects, making borrowing more expensive. Retail borrowers, too, bear the burden, facing higher interest rates on loans such as home loans and auto loans.

The cumulative effect of these challenges results in reduced fund mobilization in the securities market, ultimately weakening overall demand within the Indian economy. Additionally, the rise in capital expenditure due to higher borrowing costs contributes to slower economic growth and

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[5] Bawa, J. K., Goyal, V., Mitra, S. K., & Basu, S. (2019). An analysis of NPAs of Indian banks: Using a comprehensive framework of 31 financial ratios. *IIMB Management Review*, 31(1), 51–62. https://doi.org/10.1016/j.iimb.2018.08.004.

elevated inflation rates.

IV. Reasons behind the country's increasing NPA

The sharp rise in total non-performing assets (NPAs) across banks during the 2012–2013 fiscal year highlighted a significant deterioration in asset quality within the banking sector. Public sector banks, in particular, saw their percentage of unrecovered loans increase from 2.07% in 2007–2009 to 4.4% by March 2014. This indicates that between March 2010 and March 2015, gross NPAs nearly quadrupled.

In response to a Right to Information (RTI) request filed by *The Indian Express*, the Reserve Bank of India (RBI) disclosed that in the two years from 2013 to 2015, 29 public sector banks collectively wrote off bad debts amounting to ₹1.24 lakh crore. The surge in NPAs can be attributed to several factors, including the adoption of a system-based approach by public sector banks for NPA recognition, a slowdown in economic growth, and excessive lending by banks during previous periods of economic expansion. Consequently, by March 2015, the overall NPA ratio—including loans from both public and private sector banks—rose from 2.37% to 3.90%[6]. The infrastructure sector witnessed an even steeper rise, with NPAs increasing from 3.24% to 8.32%.

It is widely believed that an economic slowdown leads to higher interest rates, making it more difficult for businesses to repay their loans, thereby contributing to the rise in NPAs. However, the increase in NPAs cannot be solely attributed to economic downturns[7]. Other contributing factors can be broadly categorized into two groups: internal challenges faced by banks and external economic conditions.

(A) Internal Factors

- State-owned banks lack a strict system, which makes it harder to monitor warning signs on time and erodes the effectiveness of loan assessment processes. This is especially true for infrastructure projects, many of which take 20 to 30 years to complete and during which time the borrowers struggle to repay the loans.
- As a percentage of all advances made to the infrastructure sector, gross non-performing assets (NPAs) and restructured standard advances have climbed significantly from 4.56% at the end of March 2008 to 18.53% at the end of March 2014.

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[6] Ministry of Finance, *Economic Survey 2016-17*, at 82, https://www.indiabudget.gov.in/budget2017-2018/es2016-17/echapter.pdf.

[7] PRS Legislative Research, *Examining the Rise of Non-Performing Assets in India*, https://prsindia.org/theprsblog/examining-the-rise-of-non-performing-assets-in-india.

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The soundness of the nation's banking industry is further hampered by the banks' inadequate and ineffective methods of loan collection. The wait and watch strategy employed by banks has frequently been held responsible for the increase in non-performing assets since it allows failing assets to worsen in the hopes of a turnaround and occasionally presents corporates with restructuring options. In order to prevent their non-performing assets from continually ballooning, state-owned banks should cease "ever-greening," or repeatedly restructuring corporate debt, according to a parliamentary commission looking into the rising incidence of non-performing assets. The panelists believed that although the dire economic conditions lead to non-performing assets, there are organizational problems with loans that are constantly becoming greener. These problems may be avoided by "not renewing loans, particularly of corporate" kind.

(B) External Factors

- **Reasons relating to the Business Sector**

The world economy has also shown signs of slowing down, in addition to the Indian economy. This has negatively impacted India's corporate sector. The persistent unpredictability in international markets has led to a reduction in the export of a number of goods, including engineering goods (which saw a 9.38% drop in October 2016 to $5.03 billion), gems (which saw a 3% fall in October 2018), petroleum products (which saw a 44% fall in October 2018), etc[8]. As a result, the negatively impacted corporate sector is having difficulty repaying the bank loans that were extended to them.

The performance of the corporate sector has been significantly impacted by a number of other issues, which has further reduced their ability to repay the loans that have been extended to them. These factors include the prohibition on mining projects and the delays in environmental licenses that affect the iron and steel sector.

- **Reasons associated with the Priority Sector**

India's banks are subject to strict regulations. Priority Sector Lending (PSL) is one of the restrictions imposed on banks, requiring them to allocate a specific percentage of their loans to specific segments of the population. These include MSMEs (micro, small, and medium-sized enterprises), IT parks, farmers, and members of Scheduled Castes (SCs) and Scheduled Tribes (STs). It makes sense to assume that the poorer groups covered by priority sector lending should bear the brunt of the blame in this case. Nevertheless, this assumption is untrue. The Standing

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[8] Ministry of Commerce & Industry, *Export Performance of Gems & Jewellery Sector* (2018), https://commerce.gov.in/writereaddata/GemsJewelleryReport.pdf.

Committee on Finance is poised to investigate the reasons behind the elevated level of non-performing assets in Public Sector Banks (PSBs), according to press reports[9]. The record that was provided to the Standing Committee shows that there are significantly more non-performing assets in the corporate sector than in the priority sector. In contrast, the priority sector saw a greater increase in non-performing assets in relation to micro, small, and medium-sized businesses, with agriculture coming in second. Nonetheless, the non-performing asset count has increased significantly due to the priority lending industry. Furthermore, it is more difficult to recover these loans from the business and non-corporate sectors due to India's sluggish judicial system and the banks' inconsistent and ineffective efforts.

V. LEGAL MECHANISM

The increasing burden of Non-Performing Assets (NPAs) in India has been a major concern for the financial sector, prompting the government and regulatory authorities to implement various legal mechanisms for debt recovery and asset management. A strong legal framework is essential to mitigate the adverse effects of NPAs on the banking system and ensure sustainable economic growth. The following are the key legal mechanisms in place to address NPAs in India:

1. The Recovery of Debts Due to Banks and Financial Institutions (RDB) Act, 1993

The Recovery of Debts Due to Banks and Financial Institutions (RDB) Act, 1993, was introduced to expedite the recovery of debts by establishing specialized Debt Recovery Tribunals (DRTs) and Debt Recovery Appellate Tribunals (DRATs). These tribunals provide a streamlined mechanism for adjudicating bank dues, minimizing reliance on traditional civil courts. The key provisions of the Act include the establishment of DRTs for speedy resolution, simplified procedures to facilitate quicker adjudication, and the empowerment of tribunals to issue recovery certificates and attach defaulters' properties. However, despite its intent, the Act faces significant challenges, including operational delays due to the heavy backlog of cases, which undermines the objective of quick debt recovery. Additionally, DRTs have limited enforcement powers, reducing their effectiveness in ensuring swift loan recoveries. Strengthening the tribunal framework, increasing the number of DRTs, and enhancing their enforcement capabilities are crucial for improving the efficiency of debt recovery mechanisms.

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[9] Standing Comm. on Fin., *Sixty-Eighth Report on Banking Sector in India – Issues, Challenges and the Way Forward*, Lok Sabha Secretariat (2017), https://prsindia.org/files/policy/policy_committee_reports/SC%20RS_Finance_Banking%20Sector%20Issues_vF.pdf.

2. The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002, was introduced to empower banks and financial institutions with faster and more efficient mechanisms to recover bad loans without prolonged court intervention. The Act allows banks to seize and sell secured assets of defaulters, thereby facilitating quicker recovery of dues. It also enables the establishment of Asset Reconstruction Companies (ARCs) to manage and resolve NPAs by acquiring distressed assets and restructuring them. Additionally, SARFAESI introduces securitization and asset-backed securities, allowing financial institutions to convert NPAs into marketable securities, improving liquidity in the financial system. However, challenges remain, including inefficiencies in asset sales due to a lack of buyers, leading to delays in the resolution process. Moreover, judicial interventions in specific cases, particularly when borrowers seek relief under other legal provisions, slow down execution. Strengthening the implementation framework, enhancing ARC efficiency, and ensuring better market participation in asset auctions are key to maximizing the effectiveness of the SARFAESI Act.

3. The Insolvency and Bankruptcy Code (IBC), 2016

The Insolvency and Bankruptcy Code (IBC), 2016, provides a comprehensive legal framework for resolving corporate insolvencies and liquidating defaulting entities efficiently. Designed to promote a creditor-driven approach, the IBC establishes a structured and time-bound process for insolvency resolution, with a statutory limit of 330 days to complete proceedings. Creditors, including financial and operational lenders, are empowered to initiate insolvency proceedings against defaulters, ensuring greater financial discipline. The National Company Law Tribunal (NCLT) serves as the adjudicating authority, overseeing corporate resolution and liquidation processes. However, despite its objectives, the IBC faces challenges such as significant delays in insolvency proceedings due to a mounting backlog of cases at NCLT. Moreover, liquidation remains a dominant outcome, as many distressed firms fail to attract viable resolution plans, reducing the overall success rate of corporate revival. Addressing these issues requires strengthening institutional capacity, streamlining NCLT processes, and incentivizing resolution over liquidation to enhance the effectiveness of the IBC.

4. The Banking Regulation Act, 1949 (Amendment in 2017)

The 2017 amendment to the Banking Regulation Act significantly strengthened the Reserve Bank of India's (RBI) role in tackling NPAs by empowering it to direct banks to initiate

insolvency proceedings under the IBC against major defaulters. This move enhanced RBI's authority in loan classification, recovery mechanisms, and overall banking oversight. The amendment also introduced stricter prudential norms and provisioning requirements, ensuring that banks maintain adequate reserves to cover potential losses from bad loans. However, challenges persist, particularly in the inconsistent enforcement of these regulations across financial institutions. While some banks have been proactive in recognizing and addressing stressed assets, others continue to delay action, leading to prolonged financial distress. Ensuring uniform implementation, improving coordination between banks and regulators, and further refining NPA resolution strategies are essential for maximizing the effectiveness of this amendment.

5. The Lok Adalat Mechanism under the Legal Services Authorities Act, 1987

Lok Adalats serve as an alternative dispute resolution mechanism, offering a quick and cost-effective way to settle small-value NPAs through mutual negotiation. They facilitate amicable settlements between banks and borrowers without the need for formal court procedures, ensuring speedy dispute resolution. This process is particularly beneficial for small borrowers who may struggle with prolonged litigation. However, Lok Adalats have limited effectiveness in resolving large corporate NPAs, where the complexities of financial restructuring require more robust legal frameworks like the IBC. Additionally, as participation in Lok Adalats is voluntary, cases may remain unresolved if either party refuses to engage in negotiations. Strengthening incentives for participation, expanding their jurisdiction for mid-sized NPAs, and integrating Lok Adalats with other debt resolution frameworks could enhance their role in NPA management.

6. The Corporate Debt Restructuring (CDR) Mechanism (2001-2015) and Strategic Debt Restructuring (SDR) (2015)

The Corporate Debt Restructuring (CDR) mechanism was introduced to assist corporate borrowers facing temporary financial distress by restructuring their debt to ensure business continuity. Similarly, the Strategic Debt Restructuring (SDR) scheme allowed banks to convert debt into equity in defaulting companies, giving lenders ownership control and the ability to find new management. However, both mechanisms faced significant challenges. The CDR framework had a low success rate due to a lack of accountability, as many firms failed to turn around despite debt restructuring. SDR, on the other hand, was largely ineffective because banks struggled to find suitable buyers for the equity they acquired, leading to prolonged financial instability. These shortcomings eventually led to the introduction of the IBC, which

provided a more structured and legally binding framework for debt resolution.

7. The Prudential Framework for Resolution of Stressed Assets, 2019

The RBI's Prudential Framework for Resolution of Stressed Assets was introduced to replace earlier restructuring schemes and create a more disciplined approach to NPA resolution. It mandates lenders to classify NPAs promptly and initiate time-bound resolution plans, ensuring early intervention in stressed assets. The framework also encourages out-of-court settlements and alternative resolution mechanisms, reducing dependency on lengthy legal proceedings. However, a major challenge lies in banks' reluctance to classify stressed assets on time, as doing so increases provisioning burdens and impacts their financial statements. This often leads to delayed resolutions and a buildup of bad loans. Strengthening enforcement, imposing stricter penalties for non-compliance, and incentivizing proactive resolution efforts are crucial for improving the framework's effectiveness.

8. The Asset Quality Review (AQR) by RBI

The Asset Quality Review (AQR), initiated by the RBI in 2015, aimed to accurately identify and recognize stressed assets in banks' balance sheets, ensuring transparency in financial reporting. This initiative led to a sharp rise in officially reported NPAs, as previously underreported or restructured loans were reclassified as non-performing. While AQR compelled banks to take corrective measures, such as higher provisioning and improved risk assessment, it also exposed deep systemic weaknesses in India's banking sector, including poor credit appraisal practices and excessive reliance on restructuring schemes. Despite its short-term challenges, AQR played a crucial role in strengthening banking regulations and laying the foundation for more robust NPA resolution frameworks like the IBC.

VI. Efficacy of the Laws Governing NPA

In 2011–2012, a total of Rs. 144 billion in nonperforming assets (NPAs) were recovered through Lok Adalats, DRTs, and SARFAESI. Of this amount, only Rs. 101 billion, or 70%, were recovered through the SARFAESI Act. 2012–2013 saw a substantial increase in the SARFAESI Act's share. Of the Rs. 232 billion in total NPAs recovered in 2012–2013, Rs. 185 billion were collected solely through the SARFAESI Act, meaning that this Act accounted for 80% of the NPAs recovered. SARFAESI was responsible for up to 25.56% of the total recovered in 2013–2014, while DRT and Lok Adalat were responsible for 9.83% and 8.31% of the total, respectively.

Thus, it demonstrates that the SARFAESI Act is the primary avenue via which Indian banks

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can recover NPAs. Thus, it can be said that the laws passed and actions made to address the problem of non-performing assets have been fairly successful. Furthermore, as of April 1, 2015, all newly created restructured loans will be categorized as bad loans under the RBI provisioning law, which will discourage banks from readily offering restructured loans. Even so, there is still room for a highly equitable legal framework guiding the recovery of secured loans, and the Tribunals and Appellate Tribunals can be granted well-drafted authorities to direct the Bank when necessary[10].

VII. AUCTIONING NON-PERFORMING ASSETS

The phrase **"as is, where is, what is, and whatever is"** is typically found in auction notices that secured creditors (financial institutions) issue. This clause gives the winning bidder in the auction complete authority over the item. The Secured Creditor then loses control over all associated charges and obligations[11]. This control encompasses the asset's legal and physical conditions. The sale of an asset with outstanding liens, erroneous title, or other flaws becomes plausible when done in this way.

By claiming that the buyer must conduct due diligence and invoking the caveat emptor doctrine, secured creditors frequently ignore the assertions of purchasers. This clause typically applies when Secured Creditors want to avoid having to pay back money after discovering pending encumbrances or other title flaws. The consumers have been duped several times as a result of this flaw.

In **Rekha Sahu v. U.CO Bank**, it was decided that, in accordance with Section 55 of "Transfer of Property Act," the Secured Creditor's official must perform due diligence and disclose all relevant information while selling an asset. Furthermore, it was maintained in **Atishaya Construction Pvt. Ltd. v. Central Bank of India** that the clause could no longer shield the seller or creditor from liability. The buyer's losses must be compensated for by the creditor. Legal discourse has also emphasized that the sale can be void and the buyer can demand a refund without forfeiting security if the encumbrances make the property transfer difficult or render the buyer homeless.

In **Mathew Varghese v. M. Amritha Kumar,** the Apex Court ruled that in accordance with Rule 8(6)(f) of the Security Interest (Enforcement) Rules and Section 55 of the TOPA, the purchasers should be made aware of the nature of the property, the extent of liability on the said

[10] Standing Comm. on Fin., *Sixty-Eighth Report on Banking Sector in India – Issues, Challenges and the Way Forward*, Lok Sabha Secretariat (2017), https://prsindia.org/files/policy/policy_committee_reports/SC%20RS_Finance_Banking%20Sector%20Issues_vF.pdf.
[11] Union Bank of India v. Rajat Infrastructure Pvt. Ltd., (2019) SCC OnLine SC 640 (India).

property, any other encumbrances, the minimum bidding price, and the borrower's complete liability to the Creditor. In light of this paradox, the courts have upheld the principle of caveat vendor, which states that the seller should be aware of the defects and disclose them before selling them.

Similar to this, the Supreme Court declared in **Janatha Textiles v. Tax Recovery Officer** that "the appellant SFC was required by **Sections 55 (1)(a) and (b)** of the Transfer of Property Act, 1882 to disclose to the respondent the nonexistence of the independent passage to the unit. " Additionally, the appellant SFC had a responsibility to notify the respondent that the passage indicated in the revenue record was unfit for vehicular traffic." Only in the event that the auction notice expressly places the onus of determining the property's substantial attributes on the buyers does this responsibility fall on them. In all other cases, however, the seller/secured creditor is required to reveal all relevant information. The courts have further confirmed that the encumbrance certificate will not be seen as strictly complying with Rule 8(6) even if it is made available to the buyer prior to the transaction. Even the disclosure order for the tax department's attachment is required to be disclosed by the banks in the selling order itself. The caveat emptor principle has persisted in usage despite the existence of such clauses and precedents.

VIII. Analyzations over Bad Bank

One of the main issues is that this settlement procedure needs to have a sunset provision[12]. A set amount of time should be chosen for the bad bank's existence because it shouldn't last forever. It should be obvious that a quicker conclusion is the goal. Therefore, it is critical to design time-bound strategies for the resolution of assets, or else the bad bank will be reduced to a mere parking space of bad loans. One major criticism of NARCL is that PSBs, which hold significant ownership in it, are indirectly repurchasing their own bad loans, leading to potential conflicts of interest and obscuring decision-making.

Additionally, formulating a precise resolution plan remains a challenge, as a bad bank alone may lack the necessary assets and structure to function effectively, necessitating a data-driven rehabilitation strategy. A sudden surge in assets for sale could also distort pricing and reduce recovery values. Unlike ARCs, which acquire NPAs at market-driven rates, NARCL purchases them at net book value, raising regulatory concerns. To address these issues, a robust system for maintaining asset quality until settlement is essential. The success of NARCL will depend

[12] See Sunset of the Settlement Commission: Impact, Challenges, and Interim Measures, SCC Online (Mar. 3, 2025), https://www.scconline.com/blog/post/2025/03/03/sunset-settlement-commission-impact-challenges-interim-measure/.

on its ability to efficiently resolve bad loans without undue influence from PSBs. Ensuring transparency in asset valuation and sale processes is crucial to maintaining market confidence. Additionally, collaboration with private investors and global best practices may help in strengthening its effectiveness.

IX. Global scenario

Rising NPAs have become a major concern in emerging markets like China, Brazil, South Africa, and India, particularly in the aftermath of the 2008 global financial crisis and the COVID-19 pandemic, which led to widespread corporate defaults, declining asset quality, and excessive lending by financial institutions. In response, governments have implemented bailout packages, debt restructuring schemes, and regulatory measures to stabilize the banking sector. In contrast, developed economies such as the U.S., the EU, and Japan benefit from stronger regulatory frameworks that help manage NPAs more effectively. However, these economies are not immune to financial crises, recessions, or trade disruptions, as seen during the 2008 subprime mortgage crisis, which triggered an explosion of NPAs and required massive government intervention to restore financial stability. The COVID-19 pandemic further worsened the NPA situation globally, as prolonged lockdowns, business closures, and reduced repayment capacities led to a sharp increase in loan defaults.

While governments introduced moratoriums, liquidity support measures, and restructuring policies to prevent financial collapses, hidden NPAs have continued to surface as economies recover, particularly in small and medium enterprises (SMEs) and heavily leveraged corporate sectors. Addressing these challenges requires a combination of prudent risk management, stricter lending regulations, and innovative financial restructuring strategies to ensure long-term economic stability.

The management of NPAs varies across countries, with unique challenges and policy responses shaping financial stability. In the U.S., the 2008 subprime mortgage crisis resulted from excessive housing market lending, causing a banking collapse that required a $700 billion bailout under the Troubled Asset Relief Program (TARP). The subsequent Dodd-Frank Act imposed stricter banking regulations, improving financial oversight and risk management, but concerns persist over rising corporate debt and student loan defaults. In the European Union, many Eurozone economies suffered banking crises post-2008 due to sovereign debt defaults, weak banking regulations, and economic downturns, with Greece's NPA ratio exceeding 35% at its peak and Italy and Spain facing double-digit NPA levels. The European Central Bank (ECB) introduced "Bad Banks" to absorb distressed assets, and the Basel III framework

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imposed stricter capital requirements, successfully reducing NPAs by 2020, though post-pandemic financial stress has renewed concerns. China's NPA crisis stems from state-controlled lending and the expansion of shadow banking, where unregulated loans have led to rising bad debts, often concealed in official reports. The government has responded by creating Asset Management Companies (AMCs) to restructure bad loans and implementing supply-side reforms, but hidden debt vulnerabilities persist, as highlighted by the Evergrande crisis in the real estate sector[13]. Japan's experience with NPAs dates back to the 1990s "Lost Decade," where excessive real estate lending and economic stagnation resulted in a prolonged banking crisis. The government introduced "Bad Banks" and the Financial Reconstruction Law (1998) to implement strict asset classification and resolution frameworks, stabilizing the financial sector but failing to fully revive economic growth.

Globally, best practices for sustainable NPA management include the use of "Bad Banks" and asset reconstruction models, as seen in the U.S., EU, and Japan, with India following a similar approach through its National Asset Reconstruction Company Limited (NARCL). The Basel III norms have pushed banks worldwide to maintain higher capital reserves and improve risk management, with countries like Germany and Canada keeping NPA ratios lower due to their stringent prudential norms. Technological innovations, such as AI-driven credit risk assessment and blockchain-based loan tracking, offer proactive solutions to detect NPAs early and prevent fraud in lending. Government-led debt resolution frameworks, like South Korea's and Sweden's state-backed resolution funds, have successfully mitigated banking crises, with India's Insolvency and Bankruptcy Code (IBC) (2016) following a structured insolvency resolution model. Additionally, public-private partnerships in debt recovery, such as the U.S. TARP program, have demonstrated the effectiveness of combining government and private sector expertise in managing distressed assets. These strategies collectively contribute to more resilient financial systems and ensure long-term stability in global banking sectors.

X. Lessons for India from the Global NPA Crisis

To effectively address the growing NPA problem, India must enhance its asset reconstruction mechanisms by strengthening its "bad bank" model and encouraging the participation of international investors, which would bring in global expertise and best practices to improve debt resolution efficiency. A more structured and transparent approach to handling distressed assets will ensure better financial recovery for banks. Additionally, the strict implementation of Basel

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[13] See Evergrande Crisis: Implications for China's Financial Sector, Bloomberg (Oct. 10, 2021), https://www.bloomberg.com/news/articles/evergrande-crisis.

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III norms is essential to curbing reckless lending and ensuring that Indian banks maintain adequate capital reserves, thereby reducing systemic risks and enhancing financial stability. Strengthening regulatory oversight and imposing stricter compliance measures can help mitigate the risk of future NPA crises.

The adoption of digital credit monitoring through AI and blockchain-based risk assessment tools should be mandated across Indian banks to enable early detection of potential NPAs. AI-driven predictive models can analyze borrower behavior and financial patterns to identify risks before they escalate, while blockchain technology can enhance transparency and prevent fraudulent loan disbursements. Revamping the Debt Recovery Tribunals (DRTs) and improving the enforcement of the SARFAESI Act will further expedite legal resolution frameworks. Speeding up case disposal, increasing tribunal efficiency, and ensuring stricter enforcement of recovery measures will significantly enhance the debt recovery process.

Furthermore, strengthening the Insolvency and Bankruptcy Code (IBC) is critical to resolving corporate debt in a time-bound manner. Reducing judicial delays, increasing the efficiency of the National Company Law Tribunal (NCLT), and ensuring that insolvency proceedings are completed within the stipulated time frame will enhance creditor confidence and improve asset recovery rates. A well-functioning insolvency framework is key to maintaining financial discipline among borrowers and fostering a healthier lending environment. By implementing these reforms, India can build a more resilient financial system, minimize future NPAs, and create a sustainable banking environment conducive to economic growth.

XI. Impact of NPAs on Sustainable Economic Growth

High NPAs have widespread economic consequences, significantly impacting the banking sector and overall financial stability. Reduced bank profitability arises as mounting bad loans erode interest income, limiting banks' ability to generate returns and weakening their financial health. This leads to a credit crunch, where banks become increasingly risk-averse and restrict lending, slowing down economic expansion by limiting credit availability to businesses and individuals. Additionally, the increase in fiscal burden forces the government to intervene by recapitalizing struggling banks, diverting crucial funds away from developmental and welfare initiatives. Rising NPAs also erode investor confidence, discouraging foreign investment due to concerns over financial stability and governance in the banking sector. Furthermore, sectoral disruptions become evident as industries heavily reliant on bank credit, such as infrastructure, MSMEs, and real estate, face funding shortages, hampering growth and employment generation. Addressing these challenges requires a proactive approach, including stricter

banking regulations, technological innovations in risk assessment, and stronger legal frameworks to ensure efficient debt resolution.

XII. Strategies for sustainable growth and NPA reduction

To effectively manage NPAs, a multi-pronged approach is essential, focusing on both preventive and resolution strategies. Strengthening risk assessment through AI-driven credit appraisal systems will enable banks to assess borrower credibility more accurately, reducing the chances of loan defaults. Enhanced regulatory oversight, including stricter compliance measures and frequent audits, will help detect stressed assets early and prevent NPAs from escalating. Encouraging alternative dispute resolution mechanisms, such as out-of-court settlements and mediation, can expedite NPA resolution by reducing legal bottlenecks.

Implementing sector-specific lending policies tailored for vulnerable industries, such as MSMEs, infrastructure, and real estate, will ensure structured repayment models that minimize financial distress. The promotion of ethical banking practices, including responsible lending and sustainable financial decision-making, will foster a more disciplined credit culture. Engaging public-private partnerships (PPPs) in NPA management can bring in private sector expertise, improving efficiency in asset resolution and recovery[14]. Additionally, incentivizing loan repayments by linking timely repayment to better credit ratings and financial benefits will encourage borrowers to meet their obligations, ultimately reducing NPAs and strengthening the overall banking ecosystem.

XIII. Conclusions and suggestions

Non-performing assets (NPAs) serve as a key indicator of a bank's overall performance and have long been a matter of concern in India. The country's banking sector is currently facing significant challenges due to the rising NPA levels. A sharp increase in NPAs signifies a higher likelihood of credit defaults, which directly impacts a bank's liquidity and profitability. Public sector banks, in particular, hold a disproportionately high volume of NPAs. To enhance efficiency and profitability, it is essential to implement a well-structured approach to managing these non-performing assets.

Over the years, the government has introduced various measures to reduce NPAs; however, achieving zero NPAs is highly unrealistic. The urgent need of the hour is effective NPA management. Banks must take proactive steps to recover assets before they turn into bad loans,

[14] Public-Private Partnerships in Financial Sector Reform, *OECD Report on NPA Management* (2021), https://www.oecd.org/finance.

as failure to do so can significantly affect profitability[15]. Thus, it is imperative for banks to ensure that loans are granted only to credible and financially sound borrowers. The rising NPAs pose a substantial risk to India's financial stability and economic progress[16]. While several regulatory and policy interventions have been put in place, a comprehensive approach is necessary—one that integrates technological advancements, stricter regulatory compliance, and sustainable financial practices. A strong and forward-thinking strategy can mitigate the risks associated with NPAs and build a resilient banking sector that fosters long-term economic growth.

Given the vast scale of the banking industry, addressing the threat of NPAs is of paramount importance, as it poses a severe risk to the macroeconomic stability of the Indian economy. A deeper analysis reveals that the problem is multifaceted, arising from factors such as economic slowdowns, a deteriorating business environment, inefficiencies in the legal framework, and operational shortcomings within banks. A multi-layered strategy is required to effectively tackle this issue. Relying on government bailouts using public funds to rescue state-run banks in financial distress is neither sustainable nor practical in the long run.

However, there is hope in the increasing awareness and commitment of both policymakers and banking institutions toward resolving the NPA crisis. With the right measures, timely interventions, strict regulatory enforcement, and an overall boost to the economy, NPAs can be significantly reduced. Nonetheless, prevention must be prioritized over reactive solutions. The COVID-19 pandemic has further exacerbated the situation, exposing vulnerabilities within the banking sector. According to the Reserve Bank of India's latest Financial Stability Report, gross NPAs in the banking sector were projected to rise from 7.58% in March 2021 to 9.70% in March 2022 under a baseline scenario[17].

While efforts to curb the rise of NPAs have been well-timed, it is crucial to establish clear mechanisms to ensure the independence of institutions such as the National Asset Reconstruction Company Limited (NARCL). Unlike other similar entities, NARCL must operate free from bureaucratic inefficiencies to function effectively. Global experiences suggest that such institutions must remain flexible and adaptive to address national economic challenges efficiently.

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[15] Basel Committee on Banking Supervision, *Principles for the Management of Credit Risk* (2021), https://www.bis.org.
[16] Ministry of Finance, *Economic Survey of India 2022–23*, https://www.indiabudget.gov.in/economicsurvey/.
[17] Reserve Bank of India, *Financial Stability Report* 23 (2021), https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?ID=1184.