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Legal Mechanisms for Recovery and Management of Non-Performing Assets

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ABSTRACT

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 empowers banks to take possession and sell secured assets without court intervention after 90 days of default, following which these assets are termed as Non-Performing Assets (NPAs). NPAs are loans or advances where principal or interest payments are overdue for a specific period, typically 90 days, meaning the asset is not generating income for the lender. Other mechanisms include the Insolvency and Bankruptcy Code, 2016 which provides for a unified framework for resolving insolvency, allowing creditors or banks to initiate resolution proceedings within a strict timeline of 180, and extendable up to 90 days. The Recovery of Debts Due to Banks and Financial Institutions (RDDDBFI) Act, now the Recovery of Debts and Bankruptcy Act, 1993 established the Debts Recovery Tribunals and Debts Recovery Appellate Tribunals to expedite the process of recovery of debts exceeding rupees 20 lakhs. This provides a specialized and quicker mechanism than civil courts and allows lenders to recover blocked funds and protect their interests. The Act was amended and renamed in order to incorporate provisions for insolvency resolution for individuals and partnership firms under Part III of the Insolvency and Bankruptcy Code. The stability of the financial sector is intrinsically linked to the health of its credit portfolios. Non-performing assets (NPAs) pose a significant threat to the liquidity and profitability of banking institutions. This paper examines the primary legal mechanisms established in India to address the recovery and management of these assets, specifically focusing on the SARFAESI Act, 2002, the Insolvency and Bankruptcy Code, 2016, and the Recovery of Debts and Bankruptcy Act, 1993. By analyzing these frameworks, the paper illustrates the shift from protracted litigation to time-bound, specialized recovery processes.

KEYWORDS

SARFAESI, NPAs, DRT, RDDBFI, IBC

INTRODUCTION

Non-Performing Assets (NPAs) refer to loans or advances where borrowers default on their repayment obligations for a specific period, typically 90 days or more. NPAs significantly affect the financial stability of banks, leading to reduced profitability, capital erosion, and a negative impact on credit availability. As per the Reserve Bank of India (RBI) data, NPAs have been a consistent issue for Indian banks, with the gross NPA ratio in the Indian banking system reaching alarming levels in recent years. The management and recovery of NPAs require a multifaceted approach, combining legal, financial, and operational measures.¹ Legal mechanisms, in particular, provide the backbone for recovering bad debts and safeguarding the interests of both lenders and borrowers. These mechanisms include laws related to loan recovery, bankruptcy proceedings, debt restructuring, and asset recovery. This article delves into the legal frameworks that govern the recovery of NPAs, particularly focusing on legislative reforms, judicial interventions, and mechanisms in various jurisdictions.

1. DEFINITION AND CLASSIFICATION OF NON-PERFORMING ASSETS

A Non-Performing Asset (NPA) is a loan or advance for which the borrower has stopped making interest or principal payments for a specific period, generally 90 days or more. The classification of NPAs depends on the aging of the default and the risk associated with the loan. Typically, NPAs are categorized into three types:

- **Substandard Assets:** Loans that are overdue for less than 12 months.
- **Doubtful Assets:** Loans that have been overdue for more than 12 months but are still recoverable.
- **Loss Assets:** Loans that are not expected to be recovered and are written off by banks.

As per regulations (such as those issued by the RBI in India), banks and financial institutions must properly identify, classify, and make provisions for Non-Performing Assets (NPAs) in their financial statements. This process helps present a clear and honest picture of their

¹ *Annual Report*, Reserve Bank of India

<https://www.rbi.org.in/Scripts/AnnualReportPublications.aspx?year=2020>.

(accessed on 10th Jan, 2026)

financial health and ensures accountability and financial discipline.

2. LEGAL FRAMEWORK FOR RECOVERY OF NON-PERFORMING ASSETS

Several legal mechanisms exist to address the problem of NPAs, ranging from civil remedies to insolvency proceedings. These legal frameworks aim to help creditors recover outstanding dues while ensuring due process and fairness to debtors.

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

The SARFAESI Act is one of the most important tools for banks and financial institutions in India for the recovery and management of NPAs. This legislation empowers banks to take direct action against borrowers without the need for court intervention. Key provisions of the SARFAESI Act include:

- **Enforcement of Security:** Banks can seize and sell assets pledged by borrowers as security against loans, without the need for a court order.
- **Securitization and Reconstruction:** The Act allows financial institutions to sell NPAs to Asset Reconstruction Companies (ARCs), which specialize in recovering bad debts.
- **Recovery Process:** Banks can initiate proceedings for the recovery of dues through a special procedure, including the appointment of a receiver to manage and recover the asset.

The SARFAESI Act has been instrumental in reducing the time and cost of recovery, although its success has been mixed, with challenges in enforcement and concerns over asset stripping².

2.2 *The Insolvency and Bankruptcy Code (IBC), 2016*

The Insolvency and Bankruptcy Code (IBC) play a crucial role in dealing with NPAs in India. It offers a structured and legally backed system to resolve stressed assets through a formal insolvency process³. The main objective of the IBC is to ensure that insolvency cases are resolved within a fixed time frame, bringing clarity and certainty for both lenders and borrowers. Under the IBC, when a borrower fails to repay its dues, financial creditors can initiate the Corporate Insolvency Resolution

² <https://www.indiacode.nic.in/bitstream/123456789/2006/1/A2002-54.pdf>. (accessed on 10th Jan, 2026)

³ *Insolvency and Bankruptcy Code, 2016*, (May 6, 2016), https://en.wikipedia.org/wiki/Insolvency_and_Bankruptcy_Code,_2016. (accessed on 10th Jan, 2026)

Process (CIRP). During this period, a Resolution Professional takes over the management of the debtor company and works towards recovering outstanding dues, often by restructuring the company's operations or finding a suitable resolution applicant. If no viable resolution plan is approved within the prescribed time, the company may be pushed into liquidation. Over all, the IBC has strengthened the recovery mechanism for NPAs by promoting quicker resolutions and improving recovery rates. That said, its impact has sometimes been limited by procedural delays and the complexity of legal proceedings, which can slow down the resolution process.

2.3 The Recovery of Debts Due to Banks and Financial Institutions (RDDBFI) Act, 1993

The RDDBFI Act was enacted to expedite the recovery of debts owed to banks and financial institutions. The Act established Debt Recovery Tribunals (DRTs) to provide a speedy and specialized forum for the resolution of disputes related to NPAs.⁴

Key features of the RDDBFI Act include:

- **Debt Recovery Tribunals (DRTs):** Specialized courts with the authority to adjudicate matters related to loan defaults.
- **Appeal Mechanism:** The Act provides for appeals against DRT orders, ensuring that borrowers can challenge decisions they believe are unjust.

While the RDDBFI Act has helped reduce the backlog of cases and provided a specialized forum for NPA recovery, its success has been limited by the slow pace of proceedings and frequent appeals.

3. JUDICIAL INTERVENTION AND CASE LAW

Judicial intervention has played a pivotal role in shaping the legal framework for NPA recovery. Indian courts, in particular, have delivered numerous landmark judgments that have clarified the application of the laws concerning NPAs.

- **ICICI Bank Ltd. v. Prakash Kaur (2007):** ⁵The Supreme Court ruled that banks can take possession of pledged assets under the SARFAESI Act, even in cases where the borrower challenges the

⁴ Venkat, (Oct. 1, 2004), <https://drat.tn.nic.in/Docu/RDDBFI-Act.pdf>. (accessed on 10th Jan, 2026)

⁵ *ICICI Bank Ltd. v. Prakash Kaur and Others*, Supreme Court of India, Judgment, Law, [casemine.com](https://www.casemine.com/judgement/in/5609ae5de4b01497114139c2), Judgment <https://www.casemine.com/judgement/in/5609ae5de4b01497114139c2>. (accessed on 10th Jan., 2026)

action in court. This decision reinforced the effectiveness of the SARFAESI Act.

- **Swiss Ribbons Pvt. Ltd. v. Union of India (2019):** ⁶The Supreme Court upheld the constitutional validity of the Insolvency and Bankruptcy Code, emphasizing its importance in addressing corporate insolvency and NPA resolution in a time-bound manner.

4. CHALLENGES IN NPA RECOVERY

Despite the existence of robust legal frameworks, several challenges persist in the recovery and management of NPAs:

- **Delays in Court Proceedings:** The judicial process in debt recovery cases is often slow, leading to prolonged litigation and delays in asset recovery.
- **Legal Loopholes:** The legal framework is sometimes exploited by borrowers through frivolous appeals, delaying the final resolution.
- **Lack of Transparency:** There is a lack of transparency in the functioning of Debt Recovery Tribunals and Asset Reconstruction Companies, leading to concerns about the efficacy of the recovery process.

5. RECENT REFORMS AND FUTURE DIRECTIONS

Several recent reforms aim to enhance the effectiveness of NPA recovery mechanisms:

- **Privatization of Public Sector Banks:** The Indian government has initiated steps toward the privatization of public sector banks, which is expected to enhance the efficiency of NPA recovery by improving governance and reducing political interference.
- **Digitalization of Debt Recovery:** The increasing use of technology, such as artificial intelligence and blockchain, in NPA management can improve the efficiency of asset tracking, loan restructuring, and recovery processes.
- **Stronger Enforcement Mechanisms:** Future reforms may focus on strengthening enforcement mechanisms and reducing delays in the judicial process to ensure faster recovery.

CONCLUSION

The legal mechanisms for the recovery and management of NPAs are critical for maintaining financial stability in the banking sector. While

⁶ <https://indiankanoon.org/doc/17372683/>. (accessed on 10th Jan, 2026)

significant strides have been made in reforming these mechanisms, challenges remain. The continued evolution of legal frameworks, supported by technological advancements, will be key to improving the efficiency and effectiveness of NPA resolution. Effective management of NPAs not only enhances the health of financial institutions but also supports overall economic growth by ensuring the efficient allocation of credit.

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