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BETWEEN LAW AND REALITY: A CRITICAL ANALYSIS OF INDIA'S LEGAL FRAMEWORK FOR NON-PERFORMING ASSET RESOLUTION[1]

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ABSTRACT

For a long time, the Indian Banking Industry has been struggling against high NPAs (Non-Performing Assets), which is not only an important problem for availability of credit but also economic growth and financial stability. Parliament and the Reserve Bank of India (RBI) has responded with a series of legislative and regulatory actions over three decades, namely, Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDDBFI Act); Securitisation and Reconstruction of Financial Assets & Enforcement of Security Interest Act, 2002 (SARFAESI Act); but most significantly, the Insolvency and Bankruptcy Code, 2016 (IBC).

Such reforms have been complemented by the establishment of institutional mechanisms aimed at operationalising these changes such as Debt Recovery Tribunals (DRTs), Asset Reconstruction Companies (ARCs), the Prompt Corrective Action framework, and special attention given to accounts being classified under SMA. However, even with this thick network of law and regulation, NPAs remained at crisis scales through the 2010s and are still a structural weakness today.

This article makes the case that the NPA legislation in India is marked by a dissonance between law and implementation that betrays an accumulation of failures, not merely concurrent but mutually reinforcing: weak enforcement capacity in adjudicative instruments, failure of preventive frameworks that are called into play too late and selectively enforced, and enduring unwillingness to impose real accountability alongside economic power on politically connected defaulters. The proposals covered by the article conclude with serious reform demands that go to the root causes instead of treating symptoms.

Keywords: Non-Performing Assets, Insolvency and Bankruptcy Code, Debt Recovery Tribunals, Banking Regulation, Credit Risk, Financial Stability

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1. INTRODUCTION: THE ARCHITECTURE OF A PERSISTENT CRISIS

The state of a country's banking system is not just a sector issue; it is also a measure of the ability State to mobilize capital for productive purpose and enforce rule of contract. Among the many interesting results in India was that the continued failure of Non-Performing Assets (NPAs) to fall away from their highest recorded levels has revealed a structural tension between legislative ambition and institutional reality: governments have introduced ever more powerful creditor remedies, yet NPAs remain untamed.

An asset is defined as a non-performing asset when interest or principal repayments are that have passed due date but remain unpaid, for over 90 days (the standard has been set uniformly across all banks as per RBI and Basel Accord). But there is a deeper pathology beyond this dry technical definition. Thus NPAs are with regards to a multi-dimensional failure of credit appraisal, post disbursement monitoring, legal enforcement and finally governance. They entrap productive capital in unproductive accounts, compel banks to funnel profits into provisioning, hike the cost of credit for all borrowers, and stifle that monetary transmission mechanism through which RBI hopes to steer the macro-economy.

This article starts from a primary thesis: India has designed an appropriate legal framework for the resolution of NPAs, but structurally unsound. The laws passed after 1993, and the institutional apparatus set up in relation to these statutes, possesses the formal powers required to resolve troubled credit. What they have not done consistently is to have the institutional bandwidth and political will along with procedural efficiency to deploy those powers in a way that makes deterrence credible and recovery predictable. It produces a system that addresses NPAs in an episodic rather than systemic way, tackling the stock of bad loans without neutralising the flows that keep importing new such loans.

The subsequent analysis is organized around three interrelated sets of questions. So first, what is the conceptual and classificatory rubric under which Indian law identifies and deals with NPAs? The question is, second, how effective has the recent legislative interventions been viz. the RDDBFI Act (Recovery of Debts and Bankruptcy Act), SARFAESI Act (Securitization and Reconstruction of Financial Assets And Enforcement Of Security Interest) and IBC(Insolvency & Bankruptcy Code)? Third, what do the preventative mechanisms like CIBIL, PCA, SMA reveal about the system's capacity to avert trouble before it devolves into crises? Each these questions produces a different set of criticisms, and in concert they suggest an institutional design based reform agenda over additional legislation.

2. THE CONCEPTUAL ARCHITECTURE OF NPA CLASSIFICATION: PRECISION WITHOUT PREVENTION

So before proposition of remedies, the understanding of those diagnostic framework which carry these is imperative. The RBI's income recognition and asset classification (IRAC) norms, which largely reflects the Narasimham Committee Reports of 1991 and 1998[2], prescribes a matrix for credit quality: Standard Assets, Sub-Standard Assets, Doubtful Asset, Loss Assets. The taxonomy is not merely descriptive; its provisions and resulting reporting implications directly affect a bank's profitability and capital.

Standard Assets - those that are standard and have not gone into arrears after 90 days - must maintain a general allowance range of between 0.25% and 1% relative to sector exposure. Sub-Standard Assets - those that have been in Non Performing status for a period of time (up to 12 months) - require a provision of approximately 15% of total outstanding, and 25% for unsecured. Doubtful Asset provisions range from 25% (on the secured portion) for assets considered doubtful for less than a year to 100% (on both secured and unsecured portions) for assets considered doubtful for more than three years. Full provisioning will occur, and if possible, a write off will occur for Loss Assets where there is no reasonable expectation of recovery.[3]

2.1 The Provisioning System: Fiscal Prudence or Regulatory Optics?

The IRAC is both a doctrine and process. As it is a prudential tool, it forces banks to reserve against predictable losses which ensures depositors are protected and even systemic stability. It offers a transparent signal of asset quality, serving as a disclosure mechanism for regulators, investors, and the public. The progressive provisioning burden is meant to disincentivise banks from dragging their feet on NPAs: the longer an asset stays classified, the more provisions which come out of capital and earn nothing that they have to make.

But in practice this incentive structure has been systematically undermined. Creative restructuring was used by many public sector banks (PSBs), who routinely postponed loan repayment schedule by rescheduling loan terms just ahead of the accounts formally crossing the ninety-day threshold, so that assets could be classified as 'Standard' and

[2] M Narasimham, *Report of the Committee on the Financial System* (Reserve Bank of India 1991); M Narasimham, *Report of the Committee on Banking Sector Reforms* (Reserve Bank of India 1998).

[3] Reserve Bank of India, *Master Circular - Prudential Norms on Income Recognition, Asset Classification and Provisioning Pertaining to Advances* (RBI 2024).

therefore avoid incurring provisioning costs. Evergreening was clearly documented in the RBI's own Financial Stability Reports where banks extended new credit to defaulting borrowers with the sole purpose of servicing old debt, preventing detections of NPAs.[4] This practice exposes a structural weakness in the design: The IRAC norms will work only as well as the supervision imposed on them and, historically speaking, that scrutiny has been uneven.

2.2 Agricultural and Sectoral Carve-Outs: Necessary Flexibility or Systemic Loophole?

This is a substantial carve-out for agriculturally relevant innovations within the IRAC framework, which ties the standard moment when FDA reaches its default determination (two harvest seasons not to exceed two and one half years) to crop seasons rather than the ninety-day rule otherwise generally imposed by law. This concession is understandable in the context of the seasonality and climate-dependence of agricultural income. But it has unintendedly shielded a big and politically delicate credit portfolio from tight performance reviews. The 2008 Agricultural Debt Waiver and Debt Relief Scheme, one of such efforts, with an estimated loan write off of about Rs.52,000 crore[5] for outstanding loans in excess of Rs.1 lakh gave rise to a culture of not paying back since the borrowers have reasoned that future forgiveness is guaranteed due to historical precedence and government-directed debt waiver schemes. The moral hazard embedded in these schemes is, arguably, as significant a driver of agricultural NPAs as the underlying agrarian distress they seek to address.

3. LEGISLATIVE INTERVENTIONS: A CHRONOLOGY OF ESCALATING CREDITOR POWER

Three representative legislative phases have been developed by India in moving from a debtor-dominant legal environment to a creditor-oriented legal environment. Each phase is based upon the shortcomings of the previous phases, demonstrating the need for this progression to be understood as part of a whole when determining if the current structure has solved the structural problem or has simply transferred the problem to another location.

[4] Reserve Bank of India, *Financial Stability Report* (RBI, various issues). See also Reserve Bank of India, *Annual Report 2024–25: Trends and Progress of Banking in India* (RBI 2025).
[5] Ministry of Finance, *Agricultural Debt Waiver and Debt Relief Scheme* (Government of India 2008). The scheme waived approximately Rs 52,000 crore in agricultural loans across small and marginal farmers.

3.1 The RDDBFI Act, 1993: Specialised Adjudication Without Adequate Capacity

The Recovery of Debts Due to Banks and Financial Institutions Act, 1993 was introduced by the Government of India based on the recommendations of the Tiwari Committee[6], This act marked the first time Parliament recognised that civil courts cannot provide timely solutions to banking disputes, due to their jurisdiction not being based on providing expedient resolutions to banking disputes because they were not designed as expeditiously. The Act created Debt Recovery Tribunals (DRTs) which are courts having exclusive jurisdiction over debt recovery cases and any case with an amount claiming to exceed Rs 1,000,000.[7] The Act also created Debt Recovery Appellate Tribunals (DRATs) as Regional Appellate Tribunals.[8] The Act provides the procedure to be followed before the DRT and DRATs to be a very ways. Some of these ways include no pre-hearing examination of the claim made, limiting the time limits established by the procedures for all pleadings and providing the bankruptcy court with the ability to sell property, secure it against the debtor deed in execution and to the bank/financial institution becomes final.

It was correctly construed from the perspective of legislation to establish a dedicated court system designed and governed by officers with a good understanding of the banking system and therefore expediting the administrative process to ensure that the recovery takes no longer than a few months rather than years.

3.1.1 The Gap Between Promise and Performance

The DRT (Debt Recovery Tribunal) system in India has consistently failed to deliver satisfactory performance due to three fundamental flaws in its structure. The primary problem stems from having inadequate resources assigned to the DRT system right from the start. Since there are twenty-eight public sector banks, hundreds of private and cooperative banks, and tens of millions of loan accounts in India, establishing only five or six DRTs initially was grossly insufficient. In addition, the DRT's growth did not keep up with the explosive growth of NPAs (Non-Performing Assets) from 2000 to 2010 or with the huge surge in NPAs between 2011 and 2018. According to ongoing reports from the Ministry of

[6] Recovery of Debts Due to Banks and Financial Institutions Act 1993, Preamble. The Act was enacted on the recommendation of the Tiwari Committee, which examined the delays in debt recovery through ordinary civil courts.
[7] Recovery of Debts Due to Banks and Financial Institutions Act 1993, s 1(4) read with s 17.
[8] Recovery of Debts Due to Banks and Financial Institutions Act 1993, s 20.

Finance, DRTs continue to experience extraordinarily high numbers of cases pending for lengthy periods of time, with many of these backlogs extending into the tens of thousands and average timeframes for processing cases ranging from several months to many years.[9]

Second, the quality of DRT appointments has been uneven. The position of Presiding Officer equivalent to a District Judge is frequently treated as a posting of last resort rather than a specialist appointment, and the technical complexity of banking law and financial analysis demands expertise that generalist judicial training does not provide. Third, the Act's design contains a structural vulnerability: while it streamlined creditor claims, it left borrowers with extensive procedural rights to contest claims, file cross-objections, and seek stays, rights which skilled legal counsel routinely deploy to extend proceedings well beyond the Act's intended timelines. The DRT was conceived as an expedited forum but has frequently operated as a contested one.

3.2 The SARFAESI Act, 2002: Creditor Empowerment and Its Constitutional Limits

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 represents a significant change in the relationship between secured creditors and defaulting borrowers. It enabled secured creditors, when they classify an account as an NPA, to issue a notice demanding repayment of the full amount of the debt within 60 days, and then take possession of the secured asset, manage and sell it by auction without the involvement of the courts. It also created the legal framework for securitisation and the operation of Asset Reconstruction Companies (ARCs)[10], so that banks could transfer NPAs to specialist recovery entities to clear their balance sheets.

The significance of this break from the traditional rule of law cannot be underestimated. Before SARFAESI, the only way to enforce security was via court decree which could take many years through DRT or civil courts. This Act replaced judicial enforcement with administrative enforcement thereby giving creditors the first line of coercive powers instead of reverting to the State as with traditional practice. This matter was the subject of constitutional controversy and the Supreme Court's subsequent judicial

[9] Ministry of Finance, *Annual Report* (Government of India, various years). See also Reserve Bank of India, *Annual Report 2024-25: Trends and Progress of Banking in India* (RBI 2025).
[10] Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002, ss 3–5.

review in *Mardia Chemicals Ltd v Union of India*[11] was both expected and necessary.

3.2.1 Mardia Chemicals and the Constitutional Bargain

The Supreme Court in Mardia Chemicals Ltd v. Union of India found that requiring an appeal to deposit 25% of the claim amount in the DRT was contrary to Article 14 of the Constitution of India and amounted to unreasonable restriction upon access to justice. This case created a rule that while the legislature could grant extraordinary powers to a creditor for enforcement, no financial barrier could be placed which would deny access to judicial review for an individual with a legitimate grievance.

Further, the law upholding SARFAESI was also based upon the court's conclusion that it serves a valid public purpose of restoring discipline and promoting stability of creditors; that the 60-day notice along with being able to appeal to the DRT provided due process protection. The constitutional precedents established by the ruling have held and still today SARFAESI offers the creditor the greatest remedy under Indian Law.

3.2.2 Operational Effectiveness and Its Limits

As far as operational success goes, SARFAESI has had attributable success in the recovery of well-secured loans that possess real estate (commercial or residential) collateral that possesses sufficient market value to be recovered. The enforcement mechanism of the SARFAESI Act works best where there is limited exposure to risk; that is, when the loan is secured by an asset that can be easily identified, has an estimated market value, and has a clear title. However, for a large portion of the non-performing assets, which consist of pledged plant and machinery, agricultural assets with fragmented title, and assets that have deteriorated in value due to the business closing, the SARFAESI Act does not have successful enforcement action. Leveraged distressed assets tend to sell for significantly less than the outstanding amount of the loan; this reflects both the deterioration of the value of the asset and the current lack of a secondary market for distressed assets.

In addition, the intention to create an efficient secondary market for distressed debt by establishing the Asset Reconstruction Companies (ARCs) has not materialized.

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[11] *Mardia Chemicals Ltd v Union of India* (2004) 4 SCC 311 (SC).

The Reserve Bank of India (RBI) indicates that ARCs have consistently provided very minimal cash for the purchase of non-performing assets (NPA) — cash as low as 5–15% of the outstanding NPA value — while issuing Security Receipts (SR) for the difference in the NPA. In effect, this results in the originating bank retaining most or all of its credit exposure because of its SRs; therefore, the transfer of credit risk associated with the non-performing loan has not occurred.

3.3 The Insolvency and Bankruptcy Code, 2016: A Structural Revolution in Distressed Debt

In its most structurally ambitious intervention within India's NPA management framework, the Insolvency and Bankruptcy Code, 2016 creates a fundamentally different approach to insolvency than that employed by SARFAESI whereby creditors have the right to realise their rights to assets that act as security for the loan. The IBC, on the other hand, looks at the root problem within insolvency – that of a company being eligible or not for its future viability as either a going concern or an orderly liquidation of the company's assets. The core buzz of this Code is the Corporate Insolvency Resolution Process (CIRP) in which an Insolvency Professional has been appointed as the Possessor of the distressed entity under the supervision of a Committee of Creditors (CoC) with the goal to make a resolution plan for the company or liquidate within 330 days of initiating CIRP.

The operational philosophy of the Code as expressed by the above features has been made clearly creditor-focused. Initiating a moratorium when beginning a CIRP, displacing the company's management through the appointment of a Resolution Professional and the CoC's ability to approve or reject resolution plans, represents a definitive drift away from a debtor-centric approach that was a dominant aspect of pricing and/or governance with respect to the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA). Under SICA, the Board for Industrial and Financial Reconstruction (BIFR) became, in essence, a means to prolong the existence of unsustainable companies by creditors while denying credit to their creditors through the use of automatic stays of recovery processes to impede action from being taken against promoters. The IBC further confirms its rejection of SICA through its explicit prohibition, without exception or qualification, against any form of government or Court intervention pre- or post-CIRP regarding the administration and operation of the assets of a company subject to CIRP.

3.3.1 Judicial Reinforcement and the Waterfall Problem

The provisions of the IBC have placed an emphasis on the interests of creditors while also permitting due process. In 2020, the Supreme Court has upheld that CoC has the right to use reasonable judgment in determining how they will accept resolution plans and continue to hold that the operational creditors do not have the same rights/claims as the financial creditors. By upholding the waterfall rule of the IBC, the Supreme Court has confirmed that the secured financial creditors will receive the value of their secure collateral first before operational creditors, employees and governmental claims can be paid from any remaining balance resulting from the liquidation of the debtor's assets. The Supreme Court stated that it is left up to the Parliament as to whether these outcomes are economically sound or socially equitable.

3.3.2 The Time-Limit Problem: Design Versus Reality

Of all the major aspects of the IBC, none is more frequently challenged in court than its most well-known aspect: a statutory timeline of 330 days for the CIRP to conclude. Following the Supreme Court of India's decisions on multiple occasions, the tension between procedural completeness and a firm deadline has led to much litigation and confusion amongst litigants. The size and complexity of large corporate insolvency cases, which often include trans-border assets, multilayered creditor structures, and disputed asset valuations, have resulted in a significant amount of litigation being held beyond the statutory deadline. The ability of judges to provide extensions for CIRP has created unpredictability for the timelines and ultimately, with regard to the threat of swiftly resolving an NPA, created anticipatory behaviour from promoters and will reduce the threat of rapid resolution.

Another significant problem with respect to NPA resolution is the level of creditor recovery that creditors have experienced since implementation of the IBC. With respect to CIRP, creditors have received, on average, 25% to 45% of their admitted claims, which is outpaced only by liquidation value, and significantly less than outstanding loan amounts (creditors can expect much lower recoveries during liquidation). The IBC has primarily served as a threat to debtors, resulting in many out-of-court settlements and accelerated payments just from the initiation of CIRP; only a fraction of NPA will ever resolution under the IBC.

4. THE PREVENTIVE ARCHITECTURE: IDENTIFYING STRESS BEFORE IT BECOMES CRISIS

An in-depth examination of NPA management should not only concern itself with resolving NPAs but also look toward how to prevent NPAs from occurring in the first place; that is, early identification of stressed credit accounts through the use of NPA prevention mechanisms allows for suitable corrective action to be taken prior to a default occurring in those accounts. The Indian regulatory framework includes many types of NPA prevention tools; however, there are 3 specific NPA prevention tools that require further review to understand their effectiveness.

4.1 The Credit Information Bureau (CIBIL) and the Limits of Information Sharing

CIBIL, or Credit Information Bureau of India Limited was established in 2000 and is one of four licensed Credit Information Companies by the Reserve Bank of India. The Bureau collects repayment histories of borrowers from member financial institutions and produces a credit score for use in creating an efficient environment for lending to creditworthy individuals and businesses while imposing higher risk premiums on habitual defaulters.

In theory this should provide the best prevention against future defaults. By allowing lenders to accurately price the risk associated with the loan at the time of origination, they should see fewer loans go into default after the loan was made.

In reality, CIBIL is limited in its effectiveness by three issues. First, while there is extensive coverage for individual and corporate borrowers in the formal financial sector, the Bureau's coverage is limited for agriculture and the huge informal sector of the economy; these sectors are where the greatest percentage of "non-performing assets" (NPAs) currently exist. The second issue affecting CIBIL is that the value of the service to lenders is dependent on the quality and timeliness of the data submitted to the Bureau by its member institutions. There is significant evidence that data quality varies widely, especially among co-operative and small financial institutions within the Bureau. Finally, the third and most serious limitation hampering the effective usage of CIBIL by lenders is at its highest form where there is politically motivated lending taking place: the decisions regarding the extension of credit is primarily made by various levels of government.

4.2 The Prompt Corrective Action Framework: Intervention That Arrives Late

The Reserve Bank's Prompt Corrective Actions (PCA) framework, which was established in 2002 and significantly updated in both 2017 and 2021, allows the RBI to impose operating constraints on any bank that falls below a specified level of capital adequacy, asset quality or profitability. Constraints may include restricting dividend payments; restrictions on opening additional branches; restrictions on lending to higher-risk sectors; and restrictions on new capital projects. The PCA framework is split into three levels of risk associated with financial performance, each responding to increasingly severe restrictions as the financial condition of a bank declines.

The PCA framework uses a well-reasoned regulatory philosophy which attempts to use graduated intervention based on objective measures that allows for the RBI to address bank-specific weaknesses before they become systemic. The available data indicates, however, that the PCA framework is reactive rather than proactive. Generally, banks come under the PCA framework only after they have already accumulated many double-digit NPA ratios and have materialized below the required level of capital adequacy at which time the components of the PCA framework serve to compound recovery efforts instead of preventing deterioration of banks. The issue appears to be one of timing; namely: Has the PCA framework been initiated in time to provide preventive measures to banks before the bank experiences actual or potential systemic problems?

The political economy behind PCA triggers is also important to consider. For many years, numerous public sector banks in India were not included in the PCA framework even though they had clearly shown declining numbers that would have met the criteria for PCA. The RBI has consistently commented on how public sector banks present lower figures than actually reported in terms of Non-Performing Assets. The delay in implementing PCA measures due to the limited observation period allowed by the banking supervisory authority has resulted in most of these banks requiring significant amounts of government funds to be recapitalised by the time any restrictions were put into effect. The implicit backing by the government for the solvency of public sector banks creates a moral hazard that cannot be resolved with appropriate design of the PCA framework without true regulatory independence.

4.3 The Special Mention Account System: Early Warning or Administrative Formality?

In 2014, the Reserve Bank of India launched the Special Mention Account (SMA) framework as a part of the Framework of Restructuring Distressed Assets. The SMA system is a way of categorising loans prior to National Park Authority (NPA) designation. Each loan falls into one of three SMA classes, which reflect its likelihood of becoming an NPA based on signs of stress: SMA0 (has shown signs of stress but is not past due), SMA1 (has been overdue for 31-60 days) and SMA2 (has been overdue for 61-90 days). The expectation is that lenders will take corrective action to either restructure or at least increase their monitoring of loans showing signs of stress before they reach NPA status.

The SMA system is conceptually important because it changes the timing and trigger for lender intervention from formal default to visible signs of pre-default stress. If lenders were to act decisively based on SMA classifications, there should be a predictable reduction in the number of accounts that will go into NPA status. However, available evidence indicates that SMA classifications are often treated as administrative formalities rather than true precursors to default or as an early warning system to notify lenders of potential default situations. Lenders are under increasing pressure to reduce publicly reported NPAs and therefore have a strong incentive to delay converting a loan to an SMA classification; and even where an SMA classification has been accurately identified, the resulting conversations between lenders and borrowers regarding restructuring are typically not productive, as borrowers frequently have little motivation to negotiate when they have not yet gone into formal default.

The Joint Lenders Forum (JLF) is intended to facilitate coordinating the efforts of multiple lenders regarding large, troubled loans, and was introduced at the same time as the SMA classification system.

5. CRITICAL EVALUATION: DIAGNOSING THE IMPLEMENTATION GAP

We have mapped out the legislative and regulatory system in order to provide a structural understanding of why India's NPA framework has produced poor outcomes, with many compounding failures needing sustained attention.

5.1 Institutional Capacity Deficits: The Courts Cannot Do What the Legislature Promises

This is not a criticism of the adjudicators but of the governance decisions that have consistently underfunded and understaffed these institutions. A legal system that creates powerful creditor remedies but fails to build the judicial infrastructure to deliver them is not a reform but a gesture. The legislature's preference for enacting new statutes over adequately resourcing existing ones is a recurrent feature of Indian governance, and the NPA sector illustrates its consequences with particular clarity.

5.2 The Political Economy of Default: Accountability That Stops at the Boardroom Door

The reason that recovery rates under India's NPA statutes are much lower than what they should be is, in part, due to institutional capacity issues. The DRT system has tens of thousands of cases yet only a fraction of that number of judges; hence, therefore, the DRT at this time is overwhelmed by the volume of work needing to be done. Moreover, although the NCLT is critical to the IBC process, it has difficulty processing cases within statutory time frames and has substantial backlogs with no apparent end in sight. The NCLAT has an appeal backlog that is equally as significant.

The distribution of Non-Performing Assets (NPA) in India is not evenly spread. Many of the NPA's originate from a few very large corporate borrowers, of which a large proportion of them had their loans issued by way of political instruction or without proper due diligence. This behavior demonstrated by these borrowers who intentionally do not repay their loans (i.e. Willful Default) is an intersection between Banking Failure and Governance Failure.

According to RBI, Willful Defaulters can be subjected to numerous legal procedures through which action can be taken against such borrowers. SARFAESI proceedings, CIRP proceedings, criminal prosecution for Banking Fraud, and legal sanctions through RBI's public disclosure of Willful Defaulters are the types of recourse available. However, in practice these remedies have not been applied uniformly and or in a timely manner. Highly publicized insolvency cases involving the promoters of politically connected corporations produce systematic legal challenges exploiting every procedural right available and lengthy delays in prosecuting the promoters for committing criminal acts against the country.

The introduction of Sec. 29A of the IBC was another attempt to foster accountability in

the resolution process by prohibiting some categories of persons (including All promoters of companies that defaulted) from submitting resolution plans. This provision has been the subject of endless litigation over its statutory interpretation and implementation.

5.3 The Origination Problem: Addressing Symptoms While Ignoring the Source

The Indian Non-Performing Asset (NPA) resolution process has a major flaw. We have a resolution framework that works Generally after Non-Performing Assets arise rather than while NPA is happening. The resolution processes which we have are the SARFAESI Act, the IBC, the DRT, and the ARC. The processes are all After the Event and do not look back to how credit was originally created. These processes do not deal with the organizational culture and the incentive structures Nigerian Regulator's banks have and the organizational cultures in the public sector banks which lead to Problem Loans. The Public Sector Banks in India have been the major contributor to the NPA accumulation and these banks are governed by very distorted governance structures, in that boards are primarily politically appointed and those who are appointed are not necessarily banking experts; and there is a potential post facto vigilance action against senior officers for authorizing Loans that subsequently Default to create a Risk-Aversion Culture, Favours Politically Directed Loans over Commercially Driven Loans. So a vicious circle exists, where the same governance structure that promotes Politically Directed Lending also punishes Individual Officers when Politically Directed Lending results in Non-Performing Loans. The P.J. Nayak Committee Report (2014) on Governance of Boards of Banks in India correctly diagnosed the problem, and produced a comprehensive Plan for the Reforms Required to Correct the Issues with Political Appointments to Bank and the Governance of Banks in Public Sector and Private Sector Banks.

6. TOWARDS A COHERENT REFORM AGENDA: STRUCTURE OVER STATUTE

The proposals presented hereafter are purposely structural in nature. The diagnostic analysis above reflects that India's NPA problem does not principally stem from legal issues that could be solved through statutory measures but fundamentally derive from institutional concerns which require reforming levels of governance and capability, incentives structures and acumen.

6.1 Radical Expansion and Specialisation of NPA Adjudicative Capacity

A top priority for reform should be to substantially increase capacity at both the DRT and NCLT offices based on actual caseload rather than political expediency. This goes beyond just adding additional benches; it also requires that the Presiding Officers be appointed with true expertise in both financial law and insolvency practice. There should also be consideration given to establishing a specialized cadre of adjudicators focused on insolvency and banking law who are trained and specialized in the same way as members of the tax tribunals, and who have a dedicated career path in which adjudication of NPAs is treated as a specialization, not just a posting. Finally, targets for pendency with consequences for non-compliance should be built into the governance framework of these institutions.

6.2 Strengthening Preventive Mechanisms Through Aligned Incentives

Both the PCA and SMA frameworks require changes to the architecture to achieve true incentive alignment. For example, the Reserve Bank of India's (RBI) supervision of banks should also incorporate systematic reviews for both SMA and NPA classifications, together with enforcement measures for banks that consistently under-classify overdue accounts. Currently, the supervisory framework primarily relies on annual inspections and asset quality reviews; therefore, the frequency and depth of these reviews for banks with high volumes of overdue assets should be increased to make classification avoidance extremely costly.

The PCA framework should be triggered by leading indicators, such as the number of SMA-2 accounts against total loans/advances, as opposed to only lagging indicators such as reported NPA ratios. In other words, using a predictive trigger system to trigger PCA would enable RBI to intervene earlier in the default cycle when recovery options are more varied and less costly.

6.3 Reforming the ARC Architecture for Genuine Market Development

The ARC (Asset Reconstruction Company) Framework needs to implement significant structural reforms to allow for a true secondary market for "distressed debts" as opposed to the existing quasi-bank marketplace that exists today. This includes two main areas of focus :first The issuance of "security receipts" to originating banks, which are typically used as the primary form of value received in exchange for transferring non-performing loans (NPLs), will be reduced so that cash will comprise at least 50% of

total payment made by the ARC to the originating bank, ensuring that the originating bank has an economic penalty for transferring an NPL, and also ensuring that the ARC has some economic interest in the asset being purchased (i.e. "real economic exposure"). Second The ARC will be allowed and encouraged to seek out significant sources of institutional capital (both from domestic and foreign sources, such as: pension funds, endowments, etc.) in order to create liquidity to facilitate large-scale resolutions of bad debts.

6.4 Governance Reform as the Primary NPA Prevention Strategy

The only other strong reform possibility is to genuinely insulate public sector bank credit decisions from political influences. It will require implementing the most important recommendation of the P.J. Nayak Committee: that the Government of India reduce its stake in public sector banks to less than 50 percent or, alternatively, it must unconditionally commit to treating the recommendations of the Banks Board Bureau regarding appointments as binding and not advisory. Governments retaining a majority stake while, in name only, attempting to make governance more professional has failed. The incentive structure of a bank majority-owned by the government is irreconcilably at odds with the commercial credit discipline required to prevent NPAs.

Just as we must reform governance, we must also reform officer accountability. Currently, credit officers in the banks are subject to vigilance proceedings for loans that default, regardless of the quality of the loan appraisal follow-up process. This creates significant risk aversion on the part of credit officers, where they are incentivized towards either politically safe but economically questionable lending decisions or extreme conservatism in their lending decisions. Rather, we should establish an accountability framework that evaluates the quality of the decision-making process as opposed to evaluating the performance of the loan, creating a more conducive environment for credit discipline and productive lending.

6.5 Harmonising Insolvency Timelines with Institutional Capacity

The timelines stated in the IBC are appropriate from a strategic position; however, they are impractical operationally because of the level of capability presently available within institutional resources. Rather than continuing the existing trend of courts extending out the time period available to resolve matters as an alternate means to erode the credibility of the Code, Parliament ought to develop a tiered schedule of resolution

timelines; e.g., a standard of approximately 180-days for an uncomplicated corporation that is small in size and a longer but limited time for large corporations that are involved in complicated types of insolvency with a mandatory review of extension and escalation resulting in automatic transfer from a fast-track bench to an appropriate specialist bench. The primary consideration in developing an appropriate long-term extension structure is to eliminate the current practice of having extensions be granted solely on an ad hoc basis and, instead, establish that all extensions are granted within the bounds of a principled framework that produces reliable adjudication of extensions while still accommodating legitimate complexity.

7. CONCLUSION: THE LIMITS OF LAW IN THE FACE OF GOVERNANCE FAILURE

India's legal system for resolving NPA situations has seen a real change over the past several decades, but these changes came about because courts were being asked to make final decisions regarding where money should go; thus, causing an increased number of NPAs at the same time frame for resolving an NPA. Three compound failures create barriers to resolving NPA's quickly and effectively—an inability to establish a time frame for determining an NPA (institutional capacity deficit); political economy barriers preventing true accountability for large-scale NPA's (political constraints); and an origination issue resulting in a larger number of new NPAs than existing mechanisms are able to solve for (origination issue). The failure of these three reasons does not result from the statutory framework but rather indicates a failed governance structure for NPAs and, specifically a failed governance structure for the resolution of NPAs within the statutory and institutional structures of Government of India.

Therefore, it is necessary to consider a viable strategy to resolve NPAs which requires a willingness to undertake the following political uncomfortable options: 1) Depoliticised governance structures of Public Sector Banks; 2) Investing in the ability of existing institutions (PSBs) to properly adjudicate the existence of an NPA or not; and 3) Creating a resolution framework for the ARC's that facilitates real risk transfer versus an accounting fiction. Absent these three types of structural changes, the NPA framework will never function optimally within India's current governance framework.