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With this thought, we hereby present to you

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# **DEBT RECOVERY REGIMES IN INDIA:** **REVEALING ISSUES, ETHICAL AND LEGAL** **CONSIDERATIONS- INSIGHTS FROM** **COMMITTEE REPORTS**

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## **Abstract**

*Debt recovery regimes are the legal and procedural frameworks established by governments to facilitate the collection of outstanding debts owed by individuals, businesses, or other entities. These regimes are important for maintaining the integrity of financial systems and ensuring that the creditors can recover money owed to them. This paper addresses the issues and challenges faced in the country with respect to debt recovery through the various committee reports. Each committee report suggested some ramifications that were needed in the existing systems at each point of time. They made minute changes and had not studied the bankruptcy system as a whole until the Bankruptcy Law Reforms Committee studied the recovery of debt system as a whole and introduced the Insolvency and Bankruptcy Code, 2016. Yet, issues persisted to emerge and another committee was formed called the Insolvency Committee and some more suggestions were made. There is a need to for balance of the creditors and debtors' rights. Legal and Ethical considerations in the recovery of debts practices in India, if followed diligently, could be beneficial to the interests of both the creditors as well as the Debtors.*

### **Keywords:**

*Development, Debt Recovery Regime, Committee Report, Issues, Recommendations, Ethical practice, Creditor, Debtor*



## **Introduction**

A legal and procedural framework in place for the creditors to collect money owed by debtors who have defaulted on their financial obligations is called a debt recovery regime. The rights and responsibilities of both the creditor and the debtor is explicitly drafted in the regime to resolve the debt-related disputes. The Debt recovery regime covers laws, regulations and mechanisms that govern the process of pursuing, negotiating, and if necessary, enforcing the repayment of debts within its ambit. The regime can include legal remedies, administrative bodies, and alternative methods for resolving the debt issues, such as negotiations, mediation, and court proceedings.

There are several laws applicable to all banking transactions depending upon their nature. The recovery of debt can be enforced by creditors with the aid of general laws such as the law of Contract, Transfer of Property Act, Specific Relief Act, and Specific Performance Act. The Banks can recover the debt by filing a civil suit which is an ordinary civil suit for recovery against the defaulting borrowers or a summary suit. Filing cases in the courts proved to be a cumbersome and time-consuming process as the Courts could not provide speedy remedy to the parties involved and could not recover their dues effectively which leads to liquidation. Another way for recovery of debt is by applying for foreclosure of mortgage. These processes consumed several years in litigation.

The Financial Crisis ,2008 added to the hardship of the creditors to recover debt. Reforms were introduced to control NPA growth. Recovery of debt became a difficult task by the creditors. The Supreme Court had expressed its intent that banks have a right to recover debt but only through legal means.

The government started has also aided the creditors by introducing amendments to present statutes as well as creating tribunals for the efficient recovery of debts. To protect the creditors from delinquent borrowers, there was a need for judicial reforms strengthening the rights of the creditors.

### **a) Defining Debt**

Debt, as per the Insolvency and Bankruptcy Code, 2016 under Section 3(11), means a liability or obligation in respect of a claim that is due from any person and includes a financial debt and operational



debt. Financial Debt defined under Section 5(8) of the same Act provides for an inclusive definition. It includes money borrowed against the payment of interest, or any amount claimed due under a financial contract. Financial Debt can be in the nature of loans, debentures or any other financial instrument. Operational debt, defined under Section 5(21) of the above-mentioned Act, pertains to a claim for the provision of goods and services, including employment-related dues. It is associated with day-to-day business operations and can include trade payables and other operational obligations. Debt, under the Debt Recovery Tribunals (DRT) Act, is not defined but it includes the money borrowed, interests and other charges and the enforcement of security interests. This act provides for procedures and mechanisms to enforce their security interest.

It is important to define a debt as this has practical significance when the suits are being put forth in the Courts or Tribunals. There lies a dispute among the parties with respect of the nature of the transactions that have occurred between them and the counsels for the parties argue upon the very nature of debt.

### **b) Reforms Suggested by the Commissions upon issue identified by them in prevailing system**

The government forms commissions to develop frameworks, policies and mechanisms for more efficient debt recovery. The commissions or committees have been responsible for the establishment and oversight of debt recovery regimes to address issues related to non-performing assets and the recovery of debts. There are some committees and commissions that played significant roles in shaping the debt recovery regime in India.

The Narasimham Committee was appointed by the government of India under the Chairmanship of M. Narasimham, a former RBI governor. This committee made recommendations to reform and strengthen the Indian banking sector, which included measures to address the issue of non-performing assets (NPAs) and improve debt recovery mechanisms.

The Andhyarujina Committee, chaired by Arvind P. Dandekar, was constituted by the Reserve Bank of India (RBI) to review the existing laws and procedures governing debt recovery in India and

suggested reforms. The ten-member committee was set up in February 1999 to formulate specific proposals to give effect to the suggestions made by the Narasimham Committee Report for making wide ranging changes in the legal framework concerning the banking system. The Committee had recommended amending the Recovery of Debts due to the Banks and Financial Institutions Act, 1993 and Sick Industrial Companies Act, 1995. It has recommended for amendment of Section 28 of the Indian Contracts Act, 1872 and a new legislation for banks and financial institutions to take possession and sale of securities without intervention of the Court, in respect of both immovable property and moveable assets and on securitization.<sup>1</sup> The Committee's recommendations led to legislative changes and the enactment of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act in 2002.

The Jankiraman Committee was appointed to review and suggest reforms to the SARFAESI Act. The committee encouraged the use of Asset Reconstruction Companies to acquire Non- Performing Assets from banks, manage and restructure the assets, and facilitate their recovery. The recommendations aimed to improve and streamline the process of debt recovery through asset reconstruction companies.

In 1997, the Justice Eradi committee was formed to review and recommend changes to the legal framework for debt recovery, particularly regarding the legal aspects of the debt recovery process in India. The Government had constituted this committee to examine the existing law relating to winding up proceedings of companies in order to re-model it in line with the latest developments and innovations in the corporate law and governance and to suggest reforms in the procedure at various stages following in the insolvency proceedings of companies to avoid unnecessary delays in tune with the international practice in the world. It identifies issues such as delay in realization of debts under the then existing system and took the example of M/s Sahara Deposits and Investment (India) Ltd wherein it is noted that the Liquidator had to file over 12,000 cases against the debtors. This proved to be an enormous and expensive task which did not help with the actual realization of the debt. Other issues that have been identified by the committee was delay in taking over the possession and sale of assets of the Company by the Liquidators, delay in settlement of list of creditors, delay in the

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<sup>1</sup> Andhyarujina Committee submits report on Legal Reforms in Banking Sector available <https://archive.pib.gov.in/archive/releases98/1yr2000/rmay2000/r10052000.html> (accessed on 14 October 2023)

settlement of the list of contributories and payment of calls, and long drawn court proceedings. Changes were made in the provisions applicable to sick industrial companies to expediate the winding up by the court. It was strongly urged upon the Committee in various representations made to it to consider the possibility of making a recommendation for the replacement of SICA by a reformed and improved statute which would provide for an alternate Tribunal.<sup>2</sup> It suggested a fair and international harmonized legislation on Cross-Border Insolvency needs to be adopted.<sup>3</sup>

In 2013, The Raghuram Rajan Committee on Financial Sector Reforms recommended measures to strengthen the banking sector and address the issue of stressed assets and NPAs.

The Bankruptcy Law Reforms Committee (BLRC), in 2015, chaired by T.K. Vishwanathan, played a significant role in formulating the framework for the Insolvency and Bankruptcy Code (IBC) in India. In the report, it is mentioned that “the recovery rates obtained in India are among the lowest in the world. When default takes place, broadly speaking, lenders seem to recover 20% of the value of debt, on an NVP basis.”<sup>4</sup> In its problem statement, it identified that lending takes place to individuals, sole proprietorships, partnerships, limited liability partnerships and stated that there are multiple contradictory elements in the legal arrangements hence the committee had chosen ‘the strategy of repealing many existing laws on bankruptcy and insolvency and write a clean and comprehensive modern law to answer the problems under Indian Conditions. The Committee, in its report has provided a table wherein it is mentioned about the various committees and the outcome of those committees. It has stated that “there lies a difference between this project and its predecessors. The previous attempts in bankruptcy reforms had involved treating the broad landscape of the bankruptcy process and undertook certain incremental changes. The BLRC, however, has the mandate of comprehensive reform, covering all aspects of bankruptcy of individuals and non-financial firms. The issue that they have reflected upon is that the bankruptcy and insolvency process in India is elaborate and multilayered. It is mentioned that “the legislative framework is completed through three major laws,

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<sup>2</sup> The Report of High level Committee on Law relating to Insolvency and winding up of Companies available on <https://ibbi.gov.in/uploads/resources/July%202000,%20Eradi%20Committee%20Report%20on%20Law%20relating%20to%20Insolvency%20and%20winding%20up%20of%20Companies.pdf> (accessed on 14 October, 2023)

<sup>3</sup> Supra note 2 Pg 8

<sup>4</sup> BLRC Report available on [https://ibbi.gov.in/BLRCReportVol1\\_04112015.pdf](https://ibbi.gov.in/BLRCReportVol1_04112015.pdf) (accessed on 14 October, 2023)

two ancillary laws and one special provision.”<sup>5</sup> The committee mentions the present available measures for recovery of debt which are approaching the Civil Court, the Debt Recovery Tribunal, the Debt Recovery Appellate Tribunals or under SARFAESI Act,2002, the secured creditors are enabled to take possession of collateral without requiring involvement of a court or a tribunal. The Committee report mentions that “the current state of the bankruptcy process for firms is a highly fragmented framework.” Different acts provide for the powers of the creditor and the debtor under insolvency. The probability for consistency and efficiency in resolution process are low when rights are separately defined. The Committee also identified the issue that it is problematic that these different laws are implemented in different judicial fora, specifically, it has condensed these problems to lack of clarity of jurisdiction and to the problem of multiple judicial fora, for which cases that were decided at the tribunal or BIFR which come for review to the High Courts for deciding the matter with consideration to rights of both the sides of the case, i.e, the creditor and the debtor. A challenge which the committee recognized is the lack of expertise and information related to insolvency and bankruptcy by the fora entrusted with adjudicating the matter which increases the vulnerability to appeals of the outcome.<sup>6</sup> The Right to Appeal is not easily accessible to the aggrieved party as the ‘deposit amount’ to be accumulated was a challenge.

In a comparative study done by the Committee, it was understood that several of the reforms that took place in other countries were structural reforms with fundamental implications on resolving insolvency and ‘a deeper redesign of the entire resolution process, rather than working on strengthening a single piece of it was needed.’<sup>7</sup> The Insolvency and Bankruptcy Code, enacted in 2016, provides for a comprehensive framework for debt resolution and insolvency proceedings.

In February 2020, a report by the Insolvency Law Committee highlighting the various issues arising from the implementation of the insolvency and Bankruptcy Code, 2016 to make recommendations to the Government.<sup>8</sup> It identified several issues and challenges with the implementation of the insolvency and Bankruptcy code, 2016 which are a lengthy resolution process which lead to delays

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<sup>5</sup> BLRC Report available at [https://ibbi.gov.in/BLRCReportVol1\\_04112015.pdf](https://ibbi.gov.in/BLRCReportVol1_04112015.pdf) ( accessed on 14 October 2023)

<sup>6</sup> Supra note 5 Pg.26

<sup>7</sup> Supra note 5 Pg.26

<sup>8</sup> Insolvency Law Committee Report, 2020 available on [https://www.mca.gov.in/Ministry/pdf/ICLReport\\_05032020.pdf](https://www.mca.gov.in/Ministry/pdf/ICLReport_05032020.pdf) (accessed on 14 October, 2023)



and increased costs and operational creditor Vs. Financial Creditor hierarchy wherein the committee attempted to strike a balance between these two categories of creditors. Group Insolvency was also an identified issue wherein the IBC didn't initially provide clear provisions for dealing with insolvency involving corporate groups. Micro, Small and Medium Enterprises often faced difficulties with the insolvency process, including high costs and time delays. This committee suggested to create a separate framework for the resolution of insolvency cases involving MSMEs. It also recommended to simplify the liquidation process because there were issues faced with respect to valuation and distribution of assets.

Amendment of the SARFAESI Act which included imprisonment in case of non-cooperation from the borrower and provisions for the lender to get possession of mortgaged property within 30 days were part of stringent measures undertaken to tackle the problem of recovery of debt.

### **c) Legal and Ethical Consideration in Debt Recovery Practices in India**

The development of debt recovery regimes have increasingly favored the creditors and the rights of debtors are not given importance. In India, Legal and ethical considerations in debt recovery practices are designed to protect the rights and interests of both creditors and debtors and to ensure fair and ethical treatment in the debt recovery process.

India as specific laws and regulations that govern debt recovery. The primary legal frameworks include the SARFAESI Act, The Insolvency and Bankruptcy Code and the Recovery Tribunal Act. It must be emphasized to follow the legal means to achieve the end of recovery of debt.

The collection agencies ought to adhere to the guidelines and rules outlined by the Reserve Bank of India as these guidelines emphasize ethical conduct and fairness in the debt collection process. The RBI and the Indian Bank's association have established guidelines on fair debt collection practices, which require debt collectors to treat debtors with respect and dignity and avoid harassment or unfair practices.

With respect to data privacy and Protection, it must be ensured by the debt collectors to comply with data protection laws, such as personal data protection bill, when handling debtor information. This includes obtaining consent to collect, process and share personal information.

Due process must be observed in cases where legal action is required for debt recovery, the legal system must be followed. The debtors have the right to defend themselves and seek legal remedies if they believe their rights have been violated.

Disclosures play a significant role in accepting terms of the agreements. Debt collectors are required to provide debtors with specific information and disclosures regarding their debt, such as the original creditor, the total amount owed, and the terms of the debt.

A positive view to take into consideration would be to educate and empower the debtor. Debt collectors should educate the debtors about their rights and responsibilities and provide information on financial counseling or assistance programs that can help them manage their debt.

The awareness of these legal and ethical considerations in debt recovery practices is essential for both the creditor and the debtor. Being well-informed about their rights and responsibilities can lead to more fair and respectful interactions between debtors and creditors or debt collection agencies.

A recent circular by the RBI, which is the RBI Master Circular on Fair Practices Code for NBFCs (2021), provides guidelines for Non-Banking Financial Companies (NBFCs) on adopting fair practices in lending and debt recovery. This Circular has consolidated and updated all instructions related to this subject.<sup>9</sup>

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<sup>9</sup> Master Circular- Fair Practices Code available on [https://www.rbi.org.in/commonperson/English/Scripts/Notification.aspx?Id=867#:~:text=\(a\)%20NBFCs%20should%20refrain%20from,the%20notice%20of%20the%20lender](https://www.rbi.org.in/commonperson/English/Scripts/Notification.aspx?Id=867#:~:text=(a)%20NBFCs%20should%20refrain%20from,the%20notice%20of%20the%20lender). (accessed on 14 October, 2023)

## d) Conclusion

There exists issues and challenges being faced in light of recent development in debt recovery regimes and with the study of the issues that are being faced, the government forms committees to address them. These Committees identify the issues prevalent in the existing laws and make recommendations to the Government so that the necessary changes can be carried out in the country. With the development of the system of recovery of debt, the committees have addressed the issues with possible and feasible solutions that could have been effected by the government at that time. The development in the debt recovery regimes have favored the creditors' rights more than that of the debtor. A balance was needed between the debtors and creditors. It is important to follow certain legal and ethical considerations in debt recovery practices which is favor of both the creditor and the debtor. In India, Debt Recovery Regimes that were adopted have facilitated the system of recovery of debt and addressed issues as and when the need was realized.

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