

Effectiveness of the SARFAESI Act in resolving non-performing assets

Kartick Saw¹, Dr. Kishwar Parween²

¹ Research Scholar, Department of Law, Seacom Skills University, Birbhum, West Bengal, India

² Professor, Department of Law, Seacom Skills University, Birbhum, West Bengal, India

Abstract

Introduction: Non-Performing Assets (NPAs) are a steadily growing issue in the Indian banking sector, particularly in the private banking sphere, as they impact the viability of a given entity and its financial well-being significantly. This paper explores the recent increase in NPAs in the banks of the private sector in India and studies the key causation factors, the consequences that the NPAs have on the performance of the bank as well as the important remedial measures that can be adopted against the developing bad loans.

Methodology: This utilizes both primary and secondary data in the analysis with primary data collected via survey and secondary data collected via industry report. To outline the main NPA drivers, the mixed quantitative-qualitative method was chosen, with economic recessions, predatory lending, and ineffective credit risk assessment being singled out as the most relevant ones. Moreover, the work determines to an extent how the problem of NPAs has been solved in the regulation process through regulatory interventions such as Insolvency and Bankruptcy Code (IBC) and the SARFAESI Act.

Findings: This is corroborated by the findings which indicate that, although some progress has been registered by the regulatory measures, several challenges like poor borrower profiling, sectoral concentration risks and the failure of its governance are still immense. As a result, the research has realistic suggestions: enhancing credit-risk management systems, utilizing technological tools that allow classifying loans and ensuring their control, bolstering governance mechanisms that prevent building up NPAs and long-term stability in the banking environment.

Conclusion: According to the research, some gains have been achieved using regulatory responses, but it is still a conspicuous issue. The banking sector needs to improve credit-risk controls, use the most advanced technology to conduct constant monitoring of the loans and strengthen governance controls to combat this.

Keywords: Non-performing assets (npas), private-sector banks management of credit-risk, regulation, financial stability, insolvency and bankruptcy code (ibc), sarfaesi act, banking sector, risk-examination, governance.

Introduction

SARFAESI Act passed in 2002 was a direct response to the increases in the problem of non-performing assets (NPAs) in the banking system of India. This industry was experiencing a great problem because there were sluggish processes of recovering loans. Prior to the enactment of SARFAESI, banks were forced to contend with significant legal barriers and time delays in their capacity to recover due because most processes took a lot of time to be handled in a court or tribunal (Dhar, 2012; Savadi, 2018; Kumar and Khosla, 2017) [2, 4, 5, 10]. The Act was supposed to assist the banks and other financial institutions in recovering NPAs in a more efficient manner by allowing the banks to take security interests and seize secured assets without relying on the court (Act & Goguru, 2018; Dhar, 2012; Ravi, 2016) [2]. Pre-SARFAESI Regime: The legal system was debtor friendly. There was little that banks could do in order to recover in time, and this led to NPAs growing fast and credit growth declining (Savadi, 2018; Dhar, 2012; Act & Goguru, 2018) [2, 10].

Legislative Evolution: The Recovery of Debts Due to Banks and Financial Institutions Act (RDDBI Act, 1993) established Debt Recovery Tribunals (DRTs), the work of which was also not successful due to the delays in the working process (Dhar, 2012; Singh, 2022) [2].

Narasimham Committee Recommendations: SARFAESI came to be founded on the basis of their recommendations

to enhance creditor rights and to make it easier to recover assets (Kumar & Khosla, 2017; Dhar, 2012) [2, 4, 5].

Creditor Empowerment: SARFAESI will enable the banks to directly sell and seize the secured property of non-performing borrowers without issuing court orders (Act & Goguru, 2018; Dhar, 2012; Ravi, 2016) [2].

Several Recovery Channels: The Act collaborates with alternative means such as DRTs and Lok Adalats but is perceived to be more effective because it is a non-judicial procedure (Act & Goguru, 2018; Kumar, 2017; Fatima and Ashraf, 2020) [3, 4, 5].

Asset Reconstruction Companies (ARCs): ARCs also became a possibility due to the Act as it allowed to recover bad loans and manage them (Meher & Puntambekar, 2018; Sinha, 2016) [7, 12].

Early victories: SARFAESI brought significant reduction in the NPAs, particularly of the banks belonging to the public sector, and higher recovery rates than the previous procedures (Misra and Aspal, 2011; Sharma, 2013; Act and Goguru, 2018) [8, 11].

Limitations: Notwithstanding its success, there are still certain issues. They are legal conflicts, constitutional challenges, and the necessity to introduce additional

changes to address the current NPA issues (Dhar, 2012; Sinha, 2016; Singh, 2022) [2, 12].

The SARFAESI Act was a very essential reform which aimed at addressing the NPA crisis by providing banks with faster and court-free ways of recovering. Although it has enhanced recovery rates and NPAs have been minimized, it still faces challenges which indicate that continuous legal and operational advancements are needed.

1. Statement of the Problem

High NPA ratios in the Indian private banking system have now become a prominent issue to the overall banking establishment. Such non-performing assets consume earnings by compelling the banks to tie up large amounts of internal funds with provisioning and hence reduce their lending powers and limit credit supply to the productive sectors of the economy. This kind of relationship negatively influences the result of growth and welcomes the reduced investor trust. Although numerous regulatory frameworks such as the Insolvency and Bankruptcy Code (IBC), the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, and the Prompt Corrective Action (PCA) are being actively executed by the Reserve Bank of India (RBI) and the Government of India, the problem of NPAs is still being experienced with the total figure of distressed assets on the increase (Mohan, 2020).

Though the capability of identifying risks and analyzing credits appears to be relatively high in specific private-sector banks, they still have to deal with several obstacles such as the lack of adequate methods of credit-risk assessment, flaws in the governance system, and vulnerability to the risky areas. The effectiveness of the regulatory structure in place to curtail the NPAs is often put into question due to long delays in recovery and weaknesses in profiling the borrowers. The NPA ratio in the banks operating in the private sectors was 2-1 percent as of 2023, which is way lower than the one at 6.2 percent in the public-sector banks (RBI, 2023). However, recent NPAs are so huge that they are threatening the capital adequacy of the private sector and financial stability at large.

This paper will therefore attempt to explain the factors that have led to increased NPAs in the Indian banking sector of the private banks and then measure its impact upon the financial performance of the sector, and finally assess the efficacy of the current prejudicial systems put in place by the regulators and banks of India in addressing recovery efforts. In addition, the magnitude of exposure to certain sectors whereby there is high risk to economic cycle fluctuations and financial turmoil like lending out to real estate, infrastructure lending and SMEs is analyzed. The last task to be accomplished in the research is the proposal of practical measures that should be taken by the private banks in order to improve asset-quality governance and minimize the growing NPA load.

2. Objectives

The paper at hand aims at

1. investigating the key sources of the recent increase in non-performing asset (NPA) ratios in Indian private sector banks, largely via the prism of credit risk evaluation shortfalls, an overtly expansionist lending approach and sector-specific susceptibility that are rife.

2. the influence of high NPA ratios on the overall financial performance and profitability-oriented indicators of such organizations is checked.
3. evaluating the efficacy of the applicable regulatory instruments most notable the Insolvency and Bankruptcy Code (IBC) and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests Act (SARFAESI Act) in curbing the penetration of NPA.
4. the role of the governance practices in successful management of credit risk and NPA in the private banks.

3. Need and Significance of the Study

The current research is relevant since it provides a methodological analysis of factors contributing to an increase in non-performing assets (NPAs) in the Indian banking business-related to the private sector and the associated overall consequences of the industry. Considering the growing power of privatized banks in the national financial framework, it is necessary to explain the bottlenecks faced by these institutions in managing NPAs unless sought after by policymakers, regulators, and the participants of the banking sector. The findings of the study will be based on empirical evidence regarding the way in which the private banks in India can perfect their credit-risk management system, rescue plans, and introduce specialized technological resources that can reduce NPAs. Simultaneously, the regulatory tools like the Insolvency and Bankruptcy Code and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests Act have been criticised in the light of the analysis, thus contributing to a logical debate on the sufficiency of the frameworks in the management of distressed-assets. Lastly, the article attempts to address a research gap by comparing the unique difficulties faced by the private banks and those faced by their counterparts in the government sector, thus giving a sophisticated explanation of risk in terms of sector, lack of governance and scientific intervention that forms the foundation of the NPA crisis. Such recommendations and findings therefore represent practical instruction to banks in terms of negotiating this complex problem.

Literature Review

SARFAESI Act was enacted in 2002, and this legislation allowed creditors or banks to recover NPAs without court proceedings. This created faster and effective recovery of assets. Several studies indicate that SARFAESI has proven to be a successful instrument particularly in comparison to the previous procedures such as Debt Recovery Tribunals (DRTs) and Lok Adalats. The implementation of the Act led to a 80 percent decline in NPA in the years 2001-2002 to 2009-2010 by public sector banks (Misra and Aspal, 2011; Savadi, 2018; Kumar, 2017; Sharma, 2013; Dhar, 2012) [2, 4, 5, 8, 10, 11]. It has shown that SARFAESI is always faster and more successful in recovery ratio than other recovery approaches, becoming thus the most effective legal mechanism in NPA resolution in planned commercial banks (Fatima and Ashraf, 2020; Kumar, 2017; Sharma, 2013) [3, 4, 5, 11].

Although SARFAESI has enhanced recovery rates, such is not the ultimate solution. Research has indicated that NPAs continue to increase owing to the problem of poor credit risk rating, governance and sector risk. Delays in the

enforcement of the Act, legal problems, and its inability to address the causes of NPAs also limit its effectiveness. There has been some progress in Asset Reconstruction Companies (ARCs) formed under SARFAESI which do not have sufficient capacity to handle all stressed assets (Arora & Kumar, 2025; Meher and Puntambekar, 2018; Sinha, 2016) ^[1, 7, 12]. Recent studies imply that digitalization (e.g., e-auctions and online tracking) within the framework of the SARFAESI has maximized the efficiency of recovery further; nevertheless, technological and regulatory impediments are present (Malek, 2025; Reddy and Shaw, 2025) ^[6, 9].

1. Research Gap

Although most literatures have been conducted on NPAs, there are no clear studies that dwell in details on banks belonging to the privately sector of banking in India; more so in relation to the governance structure and internal practices within banks. Both the available literature and the research that has already been conducted have focused mainly on the public sector banks or have generalized the analysis with references to other sectors of banking but have not considered the peculiarities of the banking practices in the private sector. Also, as much as the contribution of aggressive lending and inappropriate credit risk assessment is a widely described issue, there exist unexplored risks within the sector, that contributes to the proliferation of NPAs, e.g. risks inherent to real estate, infrastructure, and SME sectors.

Also, the use of technology, like AI-driven credit scores, blockchain to track loans, and predictive analytics, is proving to be an avenue of a possible solution to control the NPAs in a better way. Nonetheless, not much is known concerning how these technologies can be incorporated into the current NPA management structure in the case of private banks to increase risk assessment programs and early warning systems.

Lastly, the regulatory framework to redress NPAs in the case of the private banks has not been studied sufficiently, in regards to their efficiency in lowering the NPA burden and enhancing loan recoveries, in the case of the IBC and SARFAESI Act. The proposed paper is expected to fill these gaps as this paper presents an in-depth discussion on the causes, consequences and controls of NPAs in India

regarding the role of governance, risks on the industry and the application of technology as for the sources of the NPAs in the Indian banks in the private sector.

Research Methodology

1. Research Design

This paper adheres to a descriptive research design that is applied to come up with an idea of what causes, effects, and approaches are used in handling NonPerforming Assets (NPAs) in the Indian private banking system. The descriptive research is suitable in this research because it seeks to describe the association between the variables in question, identify underlying factors that cause NPAs, and establish the initiative of strategies to control NPAs. The sources of both qualitative and quantitative data have been applied to reveal the findings concerning the research questions.

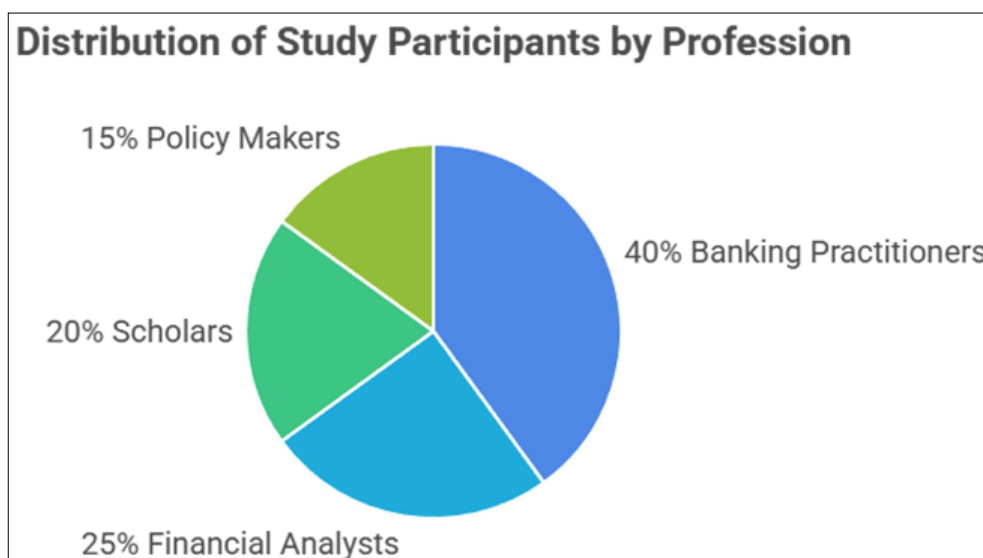
2. Data Collection

The training conducted as part of this research was administered by using a structured questionnaire containing both the closed-ended and open-ended questions and was considered as the primary data of this research. The survey would be structured in such a manner that it captures the ideas of various banking experts, financial analyst and academic researchers. The questionnaire was drawn according to the intensive literature review and the aims of the research.

The secondary data has been collected or retrieved using acceptable sources, such as the reports within the industry, scholarly journals, publications of RBI, and literature in supporting the primary data to offer an expanded situation surrounding the primary data. The primary data was complemented by secondary data which gave the statistical picture of trends and patterns associated with the NPA issue.

3. Sampling Method

A purposive sampling approach was used to ensure that the participants used in the study have relevant skill and experience in banking. The last sample included
40 practitioners in banking;
25 financial analysts;
20 scholars;
15 policy makers.



The comprises 100 respondents. This strategic choice was undertaken to achieve the representation of practitioners with direct involvement in the NPA management who were well informed about the bankruptcy sphere.

4. Data Analysis

Today, the investigation used descriptive and inferential statistical techniques. To explain central tendencies and response distributions, a descriptive framework, which uses frequency, mean, median, and mode, was first utilised. This was the initial procedure that allows concise and understandable summarization of surveying results. Percentage analysis was thus used to determine the number of the participants who ascribed certain causalities, or supported certain management approaches hence identifying significant determinants of NPAs. After that, a chi-square test was conducted to interrogate the relationships between the categorical variables, such as government intervention and NPA reduction; the test revealed that the differences between results of the groups are statistically significant. The regression analyses, in turn, estimated the effect of the independent factors, of which the most important is the stringency of loan approval, on a dependent one, the level of NPA. Lastly, the extraction of the recurrent themes on governance, managerial strategy, and the role of technology in NPAs mitigation was possible through the thematic analysis applied to open-ended qualitative data.

5. Limitations

The current research is based on a limited number of participants (100 respondents), and it is hardly possible that this sample will allow covering the entire variety of opinions in the field of the banking industry.

Self-reported findings were used to generate results that may be vulnerable to the techniques of bias, which include the response bias and social desirability bias.

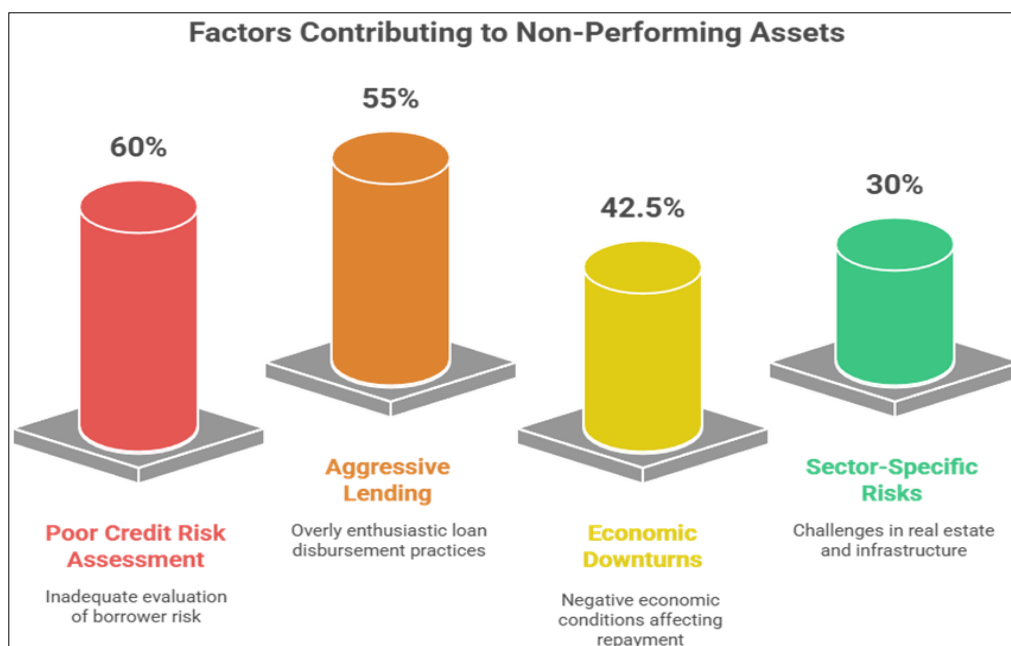
Besides, the analysis has also the risk of neglecting external economic factors-such as international financial crisis and change in the dynamics of international trade, which are also likely to affect NPAs.

Results and Discussion

This study will depend on the empirical data which will be based on 100 respondents, who are Banking professionals, financial analysts, academicians, and policymakers. Descriptive statistics, percentage, chi-square tests, and regression analysis have been used to explain the factors determining the non-performing assets (NPAs), preferred method of recovery, and the effectiveness of the regulatory interventions.

1. Descriptive Analysis

The point of departure in the analytical process was descriptive statistical processes that were used to outline central tendencies in the set of data. The information was categorized into significant variables with special mention being cause-of-default classifications, recovery strategies implemented and the comparative weight assigned to the interventions done by the government.



The values show that out of the 100 samples six of the respondents are of the view that the development of Non-performing assets (NPAs) is caused by inadequate credit risk assessment that is in a figure of 60 percent, and deficient credit risk assessment is accompanied by aggressive lending practice where 47 percent of the sample stated that aggressive lending practice is another factor. 42.5 % of the respondents listed economic downturns as a major factor and other risks related with real estate and infrastructure were also cited to further increase the NPA burden.

Conclusion

The analysis demonstrates that, even though the regulatory interventions such as the SARFAESI Act and the Insolvency and Bankruptcy Code (IBC) present a means of recovering and clearing troubled assets, the problem of non-performing assets in the Indian banking sector is still present in the sphere of the private sector of banks. The results show that aggressive lending behavior, lack of proper credit-risk management, and inefficiencies in selected industries, particularly real estate, infrastructure, and SMEs continue to maintain NPA high. Although the risk-management systems

of private banks are superior to those of the public banks, the situation is aggravated by the issues of governance, inadequate borrower profiling, and external influences such as economic recessions.

In order to be able to maintain its financial stability in the long-run, private banks should not simply abide by the regulations. They ought to be proactive in the management of risks. It encompasses enhancing credit-risk management, technology, such as AI, to profile the borrower better and make predictions, and establish more transparent governance framework to mitigate the deterioration of asset quality. Also, regulatory frameworks are to be revised on a regular basis to ensure that delays in the recovery speed are reduced and accountability is enhanced.

Ultimately, effective management of NPAs in the banks of private sector necessitates an all round solution that incorporates regulatory assistance, technology and good governance. It is only at this point that Indian private banks are likely to safeguard profitability, investor trust, and play a role in the sustainability of the overall economy.

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