

# Protecting Borrowers and Securing Stability: A Critical View of Debt Recovery Processes in India

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## ABSTRACT

India's lending landscape is marked by its central role in economic growth, so it is important to look closely at how debt is recovered. This study goes into detail about the laws that govern collecting debts, which is important for keeping the economy stable. Loans are often backed by collateral or financial assets, so strict supervision is needed to make sure the terms are followed. For example, financial institutions use internal debt recovery teams and legal options like the Debt Recovery Tribunal (DRT) set up by the "Recovery of Debt Due To Banks and Financial Institutions Act, 1993" to lower the risk of default. By looking at the reasons why lenders take these extreme steps, this study sheds light on the levels that require legal action and the complicated steps that are needed. It also looks at things from the point of view of borrowers, pointing out the consequences of not paying and possible ways to ease debt loads. This study shows how lending practices, regulatory frameworks, and debt recovery mechanisms all work together in a complex way by looking at legal safeguards and borrower protections. In the end, it aims to help people understand better how to handle debt in today's financial world.

**Keywords:** DRT, Debt, Recovery, Tribunal, SARFAESI.

## Introduction

The lending ecosystem in India is a key driver of economic growth and development, making it easier for people and businesses to get access to capital. But this system comes with risks that both borrowers and lenders have to deal with. Debt recovery is at the heart of this dynamic. It is a key part of keeping the economy stable and making sure that lending systems work properly.<sup>1</sup>

When borrowers don't make their loan payments on time, lending companies may start collection actions to get the money back. Most of the time, this is done by debt recovery teams inside the institution.<sup>2</sup> The specific ways that debts are recovered depend on the lender's rules and the terms of the loan agreement. Lenders may change the terms of repayment sometimes to make it easier for borrowers to meet their obligations. But if efforts to get the money back fail, lenders may take back collateral, which are things that were put up as security for the loan. There are legal ways for lenders to get their money back if the debt gets too big. For example, the "Recovery of Debt Due To Banks and Financial Institutions Act, 1993" set up the Debt Recovery Tribunal (DRT). There is a formal way to settle debt recovery disputes

<sup>1</sup> Bengt. Holmstrom, "Understanding the role of debt in the financial system" (2015).

<sup>2</sup> A Chopra and P Bhilare, "Application of ensemble models in credit scoring models" (2018) 6(2) BPR 129-141.

through the DRT. This gives lenders a way to protect their rights and gives borrowers a chance to be heard.<sup>3</sup> The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) is a significant legislation in India that aims to empower secured creditors, including banks and financial institutions, to enhance their ability to recover outstanding dues in cases of borrower non-payment.<sup>4</sup>

This research paper will go into detail about how to recover debts in India. It will look at the different methods used by lending institutions and the laws that govern these activities. We want to give you a full picture of how debt recovery works in India by looking at the roles and responsibilities of both borrowers and lenders, as well as the regulatory protections that are in place. In the end, we want to shed light on the difficulties and chances that come with managing debt and add to the ongoing conversation about making the lending environment more stable and fair.

### Research Questions

- What are the primary debt recovery methods used by lending institutions in India?
- How do lending institutions determine the threshold for taking legal action, such as contacting the Debt Recovery Tribunal (DRT)?
- What factors influence borrowers' ability to repay loans and navigate debt recovery processes?
- What regulatory frameworks and legal safeguards exist to protect the rights of borrowers and lenders during debt recovery proceedings?
- What are the potential challenges and opportunities for debt recovery processes in the Indian lending landscape?

### Research Objectives

- To examine Indian lending institutions' debt recovery methods.
- To examine lenders' criteria for legal interventions like Debt Recovery Tribunal recourse.
- To assess how well existing regulatory frameworks and legal protections protect borrowers and lenders during debt recovery.
- To identify ways to improve and modify Indian debt recovery mechanisms for efficiency and fairness.

### Hypothesis

- Legal actions like approaching the Debt Recovery Tribunal depend on the amount of debt, the likelihood of recovery, and the cost-effectiveness of legal recourse.
- Regulations like the "Recovery of Debt Due To Banks and Financial Institutions Act, 1993" protect borrowers and lenders during debt recovery proceedings.
- The efficacy of loan recovery procedure depends upon both DRT Act and SARFAESI Act.
- Transparency, accessibility, and borrower education can improve Indian debt recovery outcomes.

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<sup>3</sup> Dwivedi, M. and Raza, A., 2016. Debt Recovery Tribunals in India: The Legal Framework. Indian Journal of Law and Policy Review, ISSN, 2456(3773), pp.46-65.

<sup>4</sup> THOMAS, ROSHNY. THE SECURITISATION & RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT, 2002-A CRITIQUE. Diss. National law school of India University, 2008.

## Recovery of Debt Due To Banks and Financial Institutions Act, 1993

### • Background

In 1981, the Government of India formed a committee, headed by Mr. T. Tiwari, to evaluate the process of recovery. The committee proposed the establishment of a quasi-judicial entity specifically focused on banks and financial institutions.<sup>5</sup> Later, in 1991, a separate committee led by M. Narasimham reiterated this suggestion, highlighting the importance of a dedicated institution to handle cases related to banks and financial entities in a prompt manner. The Recovery of Debts due to Banks and Financial Institutions Bill, 1993 was introduced in Parliament in accordance with these recommendations. After its enactment, Debts Recovery Tribunals (DRT) and Debts Recovery Appellate Tribunals (DRAT) were established.<sup>6</sup> The purpose of these tribunals was to effectively resolve recovery cases and expedite the fair judgement and repayment of debts owed to Banks and Financial Institutions. Nevertheless, the legality of the provisions in the act was questioned, resulting in a thorough examination by the courts. The Supreme Court ultimately affirmed the constitutionality of the act in *UOI v. Delhi HC Bar Ass*<sup>7</sup> taking into account the amendments made to specifically address constitutional concerns.

### • Establishment of DRT and DRAT

According to Section 3 of the DRT Act, the central government is required to establish one or more tribunals and define their jurisdiction through a notification. Each Debt Recovery Tribunal (DRT) consists of a solitary member, designated by the central government, who acts as the presiding officer. The central government has the authority to grant permission to the presiding officer of one tribunal to carry out the responsibilities of another tribunal. The presiding officer must meet the necessary qualifications to serve as a district court judge and serves in office for a period of five years or until reaching the age of sixty-two. The process of reviewing tribunal decisions by superior courts through appeals is essential for a well-functioning judicial system. The Debt Recovery Appellate Tribunal, established by the central government, is responsible for hearing appeals that arise from orders issued by the Debt Recovery Tribunal. The Appellate Tribunal is comprised of a sole member who acts as the chairman. This individual must either have previously been or currently be eligible to serve as a High Court Judge. Additionally, they must have a minimum of three years of experience in Grade I of the Indian Legal Service or have held the position of Presiding Officer of a Tribunal for at least three years.<sup>8</sup>

### • Jurisdiction, Powers and Authority of tribunals

Section 17 of the DRT Act grants the tribunal the authority to consider and make decisions on applications submitted by financial institutions and banks seeking to recover debts owed to them. The tribunal possesses the jurisdiction to adjudicate on matters pertaining to the retrieval of debts. Additionally, in accordance with the aforementioned section, the appellate tribunal is tasked with adjudicating appeals that arise from orders issued by or considered to have been issued by the Debt Recovery Tribunal (DRT). In addition, Section 17A confers upon the chairperson of the appellate tribunal the authority to oversee and govern the tribunals under their jurisdiction. In addition, they have the authority to relocate cases from one tribunal to another in order to expedite their resolution. Section

<sup>5</sup> Simran Chaudhary, "DEBT RECOVERY INDIA:IN-DEPTH STUDY OF THE LEGAL FRAMEWORK & EFFECTIVENESS OF DEBT RECOVERY TRIBUNALS" (May 6, 2023) <https://www.brillopedia.net/post/debt-recovery-india-in-depth-study-of-the-legal-framework-effectiveness-of-debt-recovery-tribunals> (March 26 March 2024).

<sup>6</sup> Ibid.

<sup>7</sup> (2002) 4 Sc 275.

<sup>8</sup> Visaria, Sujata. "Legal reform and loan repayment: The microeconomic impact of debt recovery tribunals in India." *American Economic Journal: Applied Economics* 1, no. 3 (2009): 59-81.

18 limits the authority of all courts and bodies, except for the Supreme Court and High Court, in relation to the matters specified in Section 17. This provision guarantees that the Debt Recovery Tribunal (DRT) and the appellate tribunal have sole authority over debt recovery issues, preventing any other entities from intervening in such cases.<sup>9</sup>

- **Procedure to be followed by tribunals**

According to Section 19 of the DRT Act, banks or financial institutions can submit an application to the tribunal within its jurisdiction to recover debts in the following situations:

- a. Where the defendants who reside in a particular place willingly engage in business or personal activities.
- b. In cases where there are multiple defendants, and at least one of them willingly resides or engages in business activities.
- c. When the cause of action arises entirely or partially within the jurisdiction of the tribunal.

In addition, other banks or financial institutions have the option to collaborate with the applicant in the process of recovering debts from the same debtor, as long as the application is filed against the same individual or entity. After receiving these applications, the tribunal sends a summons to the defendant, demanding that they provide a valid reason within 30 days as to why relief should not be granted. The defendants are required to submit their written defence either prior to or during the first hearing, or within the timeframe allowed by the tribunal. The tribunal has the authority to consider counterclaims made by defendants, but these counterclaims must be submitted within the designated time period. Provisional orders can be issued to prohibit the defendant from disposing of assets without obtaining prior approval from the tribunal. If the tribunal determines that the defendant is inclined to liquidate their assets, it has the authority to demand them to furnish collateral.<sup>10</sup>

Noncompliance with tribunal orders may lead to the seizure of the defendant's assets or confinement in a civil prison. The tribunal possesses the power to designate receivers, expel individuals from property possession, and undertake other essential measures to guarantee justice. Applications must be discarded within 180 days of receiving them in order to speed up the process. Individuals or organisations who are dissatisfied with tribunal rulings have the option to submit appeals to the Debt Recovery Appellate Tribunal within a period of 45 days, unless there are valid justifications for any delays. Although the tribunal and appellate tribunal are not legally obligated to follow the Civil Procedure Code of 1908, they are required to abide by the principles of natural justice. They are bestowed with powers akin to those of a civil court as outlined in the Code of Civil Procedure, 1908, in order to carry out their duties. The Limitation Act of 1963 is applicable to applications submitted to the tribunal, specifying the time frame within which these applications must be filed.

- **Recovery of debt determined by tribunal**

Section 25 of the DRT Act delineates the duties of the recovery officer upon receipt of a copy of the certificate issued under sub-Section (7) of Section 19. The recovery officer is required to commence debt recovery procedures using different methods, such as seizing and selling property, apprehending the defendant, or appointing a receiver to oversee the defendant's assets. In addition, Section 28 provides specific information about alternative methods of debt recovery, such as deductions. Section 31 pertains to the transfer of ongoing legal cases. It states that any lawsuit or legal proceeding that was already in progress before the establishment of a Tribunal will be moved to the corresponding Tribunal.

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<sup>9</sup> Supra note 8.

<sup>10</sup> Supra note 8.

Nevertheless, this provision is not applicable to appeals that are currently awaiting a decision from any court. Section 34 confers priority to the DRT Act over other legislation. However, it explicitly states that the regulations of the DRT Act and its rules are additional to, rather than conflicting with, specific other acts, such as the Industrial Finance Corporation Act, 1948, the Unit Trust of India Act, 1963, the State Financial Corporations Act, 1951, the Sick Industrial Companies (Special Provisions) Act, 1985, the Industrial Reconstruction Bank of India Act, 1984, and the Small Industries Development Bank of India Act, 1989.<sup>11</sup>

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

The SARFAESI Act of 2002 grants substantial authority to creditors, specifically banks and financial institutions, to enhance the efficiency of debt recovery in instances of non-payment. Secured creditors are given significant power to enforce their security interest when borrowers fail to meet their obligations, as per Section 13 of the SARFAESI Act. The enforcement measures can encompass a range of actions, such as transferring underperforming assets to asset reconstruction companies, initiating asset securitisation, or enforcing assets that have been used as collateral by the bank. Before commencing any legal actions under the SARFAESI Act, it is required by Section 13(2) that creditors with security must provide a notice to the borrower or guarantor, ensuring that the principles of natural justice are followed. This notice must provide a comprehensive description of the outstanding balance, the assets that have been used as collateral, and the potential consequences that may occur if the borrower fails to meet their obligations. In addition, borrowers have the right to present their views or raise objections after receiving the notice, as specified in Section 13(3). Secured creditors have a duty to reply to these statements within a set timeframe, guaranteeing openness and impartiality in the procedure.

It is important to mention that the SARFAESI Act, according to Section 36, does not prolong the time limit for debt recovery. This provision ensures that creditors cannot use the Act to enforce their rights for debts that are no longer legally enforceable due to the expiration of the statute of limitations. If the borrower does not respond within the specified notice period, Section 13(4) grants the authorised officer the authority to take actions such as seizing the assets that were used as collateral. Following sections, such as Sections 14 and 17, specify the steps for acquiring movable and immovable assets, which involve issuing possession notices and assessing their value by registered valuers. The Act specifies the sale procedures for these assets, in accordance with Section 13(8) and Section 15, to ensure transparency and promote competitive bidding. After the sale is finished, a certificate of sale is given to the buyer, which confirms the transfer of ownership and provides legal clarity, as stated in Section 14(1). In addition, Section 13(10) guarantees that funds obtained from the sale will be used to cover legal expenses before being distributed to creditors. The SARFAESI Act essentially establishes a strong legal structure that enables creditors to efficiently retrieve debts, while ensuring that principles of equity and openness are maintained throughout the entire process.<sup>12</sup>

### **Relation between SARFAESI and DRT**

In terms of debt recovery and resolution, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) and the Debt Recovery Tribunal (DRT)

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<sup>11</sup> Supra note 8.

<sup>12</sup> Sapre, K., 2023. Analysis of Sarfaesi Act: Practical Approach. Issue 2 Indian JL & Legal Rsch., 5, p.1.

Act of 1993 complement one another. The SARFAESI Act primarily empowers secured creditors, such as banks and financial institutions, to effectively enforce their security interests and recover debts from defaulting borrowers. It allows secured creditors to seize and sell secured assets in the event of default, without the need for court intervention. This speeds up the debt recovery process while reducing the burden on the judicial system. On the other hand, the DRT Act of 1993 establishes Debt Recovery Tribunals (DRTs) as specialised quasi-judicial bodies to resolve disputes involving debt recovery by banks and financial institutions. DRTs have jurisdiction over cases involving debt recovery above a certain threshold and provide a forum for creditors to file legal action against defaulting borrowers. The relationship between the SARFAESI Act and the DRT Act is as follows: For starters, they provide creditors with alternative debt recovery mechanisms, including non-judicial means under the SARFAESI Act and judicial adjudication before the DRTs. Second, in cases where creditors use both statutes to recover debt, there may be interactions between the proceedings initiated under each. Borrowers can challenge actions taken by secured creditors under the SARFAESI Act by submitting appeals to the DRTs, and vice versa. Finally, while operating independently, both statutes seek to facilitate debt recovery and resolution. The coordination and harmonisation of the SARFAESI Act and the DRT Act are required to ensure consistency and coherence in the legal framework governing debt recovery proceedings.<sup>13</sup>

### **Challenges in loan recovery in light of DRT Act and SARFAESI Act**

The Debt Recovery Tribunal (DRT) Act and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI Act) have been instrumental in facilitating loan recovery for banks and financial institutions. However, despite the existence of these legislative frameworks, several challenges persist in the realm of loan recovery. One significant challenge is the delay in the resolution of cases within the DRTs. While these tribunals were established to expedite the process of debt recovery, the backlog of cases and procedural complexities often lead to considerable delays. This delay not only prolongs the time taken for creditors to recover their dues but also increases the financial burden on both creditors and borrowers. Another challenge arises from the limitations of the SARFAESI Act, particularly regarding the enforcement of security interests. While the SARFAESI Act empowers creditors to take possession of and sell secured assets without court intervention, challenges such as legal encumbrances, regulatory hurdles, and resistance from defaulting borrowers can impede the smooth execution of this process. Additionally, the requirement for creditors to follow stringent procedures and provide adequate notice to borrowers can further prolong the recovery process. Furthermore, the effectiveness of both the DRT Act and the SARFAESI Act is contingent upon the judicial infrastructure and the capacity of enforcement agencies. Insufficient resources, including a shortage of trained personnel and technological deficiencies, can hinder the timely resolution of cases and enforcement of recovery measures. Moreover, borrowers often resort to legal remedies and procedural tactics to delay or evade loan recovery proceedings. They may file appeals, seek adjournments, or challenge the validity of loan documents, thereby prolonging the litigation process and frustrating creditors' efforts to recover their dues.<sup>14</sup>

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<sup>13</sup> Pratap, A., 2021. DRT and enforcement of debt recovery procedures in India: A half fulfilled promise of the RDDBFI act 1993 (Doctoral dissertation).

<sup>14</sup> Supra note 13.

## Conclusion

Ultimately, the Debt Recovery Tribunal (DRT) Act and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI Act) are crucial in India's debt recovery system, as they offer methods for creditors to recover outstanding amounts from borrowers who have defaulted. Nevertheless, there are still a number of obstacles that remain, such as the prolonged resolution of DRT cases, the constraints imposed by the SARFAESI Act, insufficient judicial infrastructure, and resistance from borrowers. These obstacles impede the prompt and effective retrieval of loans, affecting both lenders and borrowers.

The research findings generally align with the hypotheses proposed. Legal actions taken, such as resorting to the Debt Recovery Tribunal, depend on various factors including the size of the debt, the likelihood of recovery, and the cost-effectiveness of legal measures. In addition, regulations such as the "Recovery of Debt Due To Banks and Financial Institutions Act, 1993" play a crucial role in protecting the interests of both borrowers and lenders during the debt recovery process. In addition, the study indicates that the efficiency of loan recovery procedures depends heavily on the interaction between the Debt Recovery Tribunal Act and the SARFAESI Act. Finally, improving transparency, accessibility, and borrower education may indeed result in improved debt recovery outcomes, as hypothesised.

## Recommendations

There are a few recommendations that can be considered to address these challenges and improve the effectiveness of debt recovery processes in India:

- Improving DRT processes: Steps should be taken to speed up case resolution within DRTs, such as increasing tribunal capacity, improving procedural efficiency, and utilising technology for case management.
- Improving SARFAESI Act enforcement: It is important to address any legal encumbrances and regulatory hurdles that may hinder the effective implementation of SARFAESI Act provisions. In addition, implementing recovery measures can be enhanced through training and capacity-building initiatives for enforcement agencies.
- Improving judicial infrastructure: Investments in judicial infrastructure, such as recruiting and training personnel and implementing technology for case management, can lead to shorter delays and increased efficiency in debt recovery proceedings.
- Encouraging borrower education and awareness: By providing borrowers with information about their rights and responsibilities, as well as the potential outcomes of defaulting on their debts, they can take control of their financial situation and work collaboratively with creditors to reach positive resolutions.
- Promoting alternative dispute resolution mechanisms: Promoting the use of alternative dispute resolution mechanisms, such as mediation and conciliation, can aid in resolving debt recovery disputes more quickly and efficiently, alleviating the strain on the judicial system.

By following these suggestions, stakeholders can strive for a debt recovery framework that is more efficient, transparent, and fair. This will help maintain the stability and resilience of India's lending ecosystem by finding a balance between the interests of creditors and borrowers.

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