

LEGISLATION FOR SECURITIZATION AND EMPOWERING BANKS AND FINANCIAL INSTITUTIONS TO GAIN POSSESSION OF THE SECURITIES AND TO SELL THEM WITHOUT ANY INTERVENTION OF THE COURT.

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Abstract

“ SARFAESI Act was based on recommendations of a) Committee on Banking Sector reforms (Narasimham Committee Report II) and b) Restructuring of Weak Public sector Banks (Verma Committee). The Government passed the SARFAESI Act on 21 June 2002 in order to give teeth to the banks to proceed against the “willful defaulter”, and affect recoveries without the intervention of courts and tribunals. This Act aims at speedy recovery of defaulting loans and to reduce the mounting levels of Non-performing Assets of banks and financial institutions. The provisions of the Act enable the banks and financial institutions to realize long-term assets, manage problems of liquidity and asset liability disparities and to improve recovery by exercising powers to take possession of securities, sell them and reduce non-performing assets by adopting measures for recovery or reconstruction. The Act provides three alternative methods for recovery of NPAs, viz; Securitization, Asset Reconstruction, Enforcement of Security without intervention of the court.”

Key words : None Profit Assets (NPA), Bank and FIs, Profitability, Speedy recovery, willfull defaulter, SARFAESI Act, Without intervention of Courts and Tribunals, Enforcement.

I.Introduction and Meaning of Securitization :

Securitization, the process of converting illiquid loans into tradable securities, has emerged as an important tool for financing worldwide. Securitization implies the issue of security receipt by raising of funds or receipts by SCs / ARCs. The Securitization company or Reconstruction company raises from the Qualified Institutional Borrowers (QIBs) by way of schemes to acquire funds. They have to maintain proper book of accounts separately for each and every acquiring asset on the investments made by QIBs. Qualified Institutional Buyers are those who have expertise and sound knowledge to evaluate and make their investment in the Capital Markets.

II. Role of Assets Reconstruction Companies :

Assets Reconstruction companies buy the NPAs from Banks and take measures to recover the bad loans amount from the borrowers and also empower with,

- Proper Management of the borrower business,
- Change of management in the business
- Take Over
- Sale or lease,
- Restructuring the business of the borrower,
- Rescheduling of the repayments of debts payable by the borrower,
- Possession of Secured assets.
- RBI permitted ARCs to convert the debt / outstanding loans of borrowers in to “Equities” as a functional process of restructurings the loan amount of NPAs.
- Shareholding shall not exceed 26% of the post converted Debt Equity as a reconstruction.

The companies under equity reconstruction, as a part of Enforcement of Security interest, the permission given by Secured Creditors holding should not be less than 60% of the amount outstanding to a borrower as against 75% as on date.

The amount recovered through this process will be used by ARCs, to reconstruct the company's management.

III. Enforcement of Security Assets and Highlights of the Act :

The Act provides notwithstanding anything contained in the Registration Act 1908, for the enforcement of Security Interest without Court Intervention. 1) any security receipt issued by SC / ARC, under sec 7 of the Act, and not creating, declaring, assigning, any right, or title or interest to property except in so far as it entitles the holder of the registered instrument, or 2) any transfer of security receipts, shall not require compulsory registration. At present, there are 19 ARCs in India. But collectively, their capital base is also insufficient to tackle the countries nearly 8 lakh crore NPAs. The main problems in the sector are: low capital base of ARCs, low fund with ARCs, valuation mismatch of bad assets between banks and ARCs etc. Several steps were taken by the RBI and the Government to bring life into the asset reconstruction activities. In one such step, the government raised FDI in the sector to 100% similarly the ARCs may get a vital role for assets restructuring under the new insolvency and bankruptcy code. In 2016 the RBI amended the SARFAESI act to give the ARCs more power and efficiency.

Highlights of the Act :

1. In case the borrower of an NPA account fails to pay the dues of the bank within 60 days from the date of the notice sent by the bank, the bank can exercise any of the following rights under sub-section 13(4) to recover his secured debt- Take possession of the secured assets of the borrower and transfer the same by way of lease, assignment or sale for releasing the dues without intervention of the DRT/Court. Take over the management of the borrower's concern. Appoint a manager or Court Receiver to manage the secured assets. Send notice to a third person who has acquired the assets from the borrower without the consent of the bank

2. In case NPA account is a consortium account or under multiple finance the right to enforce securities can be exercised by the banks/Financial institutions, only when secured creditors representing not less than three fourth in value on the amount outstanding are agreeable as laid down in sub-section 13(9).

3. After acquiring the possession of the assets charged to the bank and selling the same and appropriation of sale proceeds towards the dues of the bank, then the bank can approach DRT for recovering the balance amount, if any, from the borrower/ guarantor as laid down in sub-section 13(10)

4. If the bank feels that there can be resistance for acquiring the assets charged to the bank from the borrower, in such a case the bank can approach the concerned Chief Metropolitan Magistrate or the District Magistrate by filing a written request for taking possession of the said assets (section 14).

5. After issuance of 60 days notice by the bank to the borrower, the borrower shall not deal with the assets which are charged to the bank. However, dealing in the said assets in the said assets in the ordinary course of business of the borrower is permitted.

6. The provisions of the Act are not applicable to the following transaction-

- Any security interest created for payment of financial assets not exceeding Rs. 1 lakh
- Any security interest created over agricultural lands.
- Any case in which the amount due is less than 20% of the principal amount and interest therein.
- Pledge of movable assets within the meaning of section 172 of the Indian Contract Act, 1872.
- Any conditional sale, hire purchase or lease, or any other contract, in which no security interest has been created.
- Security created in any aircraft under Aircraft Act, 1934.
- Security created in a vessel under Merchant Shipping Act.
- Any rights of unpaid seller under Section 47 of the Sale of Goods Act, 1930.
- Any property exempted from attachment under Section 60 of CPC.

7. This Act has permitted to float assets reconstructions companies which will purchase the NPA accounts from the bank at a discounted price. They will also take over the assets charged by the bank for the particular account for necessary recovery action through reconstruction of the assets or otherwise.

8. Section 17, any person including the borrower may approach DRT by filing an appeal before the DRT within 45 days from the date on which steps have been taken by the bank. But such an appeal shall not be entertained by the DRT unless a specified amount of the outstanding dues of the bank is deposited in the DRT. The right to appeal before DRAT (Debt Recovery Appellate Tribunal) within 30 days is given under Section 18 to any person aggrieved by the order of DRT. The ousts the jurisdiction of the Civil Courts and declares that no injunction shall be granted in respect of any exercise of rights conferred by this ACT. After the publication of this Act, several borrowers had filed writ petitions in the Supreme Court of India, challenging the validity of the Act. In the landmark case of *Mardia Chemical Ltd. & Others vs. Union of India & Others* (2004) 120.Comp.Case 373 (SC), the Supreme Court has upheld the validity of the Act. Some salient features of the judgement are:

i. The Court directed that the banks should evolve appropriate internal mechanism to thoroughly resolve the contentions raised by the borrower. The bank should apply its mind to the objections and communicate its reasons to the borrower. This shall be an act of fairness on the part of the bank.

ii. The court held that banks and financial institution have been have been provided with guidelines by the RBI laying down the terms, conditions and circumstances in which the debt is to be classified as non-performing assets. Hence, there is no arbitrary illusory. It is also unreasonable and violation of Article 14 of the constitution.

iii. Section 34 of the Act lays down that Civil Courts have no jurisdiction to entertain any suit in respect of any matter which DRT or DRAT (Debts Recovery Appellate Tribunal) is empowered to deal with. The court has upheld the validity of these provisions.

iv. Accordingly, the Supreme Court upheld the whole of the Act excluding Section 17 (2).

The intent of the Act is to provide a remedy to the secured creditors to minimise their NPAs. It is nobody's case that any bank or financial institution would take over a cement plant, a boutique or a hotel and actually run it. It would be handed over to an asset reconstructing company (ARC) at the earliest opportunity which, in turn, would ensure that the bank or financial institution obtains its pound of flesh from the asset. The ultimate aim of the secured creditor would be to ensure that some money hits the account of the borrower. The less litigious-minded among the defaulters' list have ensured that some repayment has been made to creditors who contemplate action under the SARFAESI Act. Hence, it all boils down to the willingness of the borrower to pay up. This is precisely the reason why certain chambers of commerce have suggested that the Act should only be made applicable to wilful defaulters. Although a thin line of difference exists between a wilful and a non-wilful defaulter, it remains a fact that a non-wilful defaulter would prefer to dispose of an asset that is bleeding him all over than hang on to the asset by taking protection from any available court in the land.

IV. Newly Provision of SARFAESI (Amendment) Ordinance- 2004 :

In the light of the Supreme Court judgment in the **Mardia Chemicals Vs ICICI Bank Ltd.** the Government promulgated the Ordinance to amend certain sections of the Act, which has been passed by the Parliament in December, 2004. Highlights of the changes are as under:

a. Amendment in Section 13: On receipt of the notice if the borrower makes any representation or raises any objection, the secured creditor shall consider such representation or objection and shall communicate within one week of receipt of such representation to the borrower.

b. Amendment in Section 17: The borrower may make an application to the DRT if the secured creditors have not accepted his representation or objection. Any application made by the borrower shall be dealt with by DRT, as expeditiously as possible and to be disposed of within 60 days from the date of such application. If the application is not disposed of by DRT within the period of 4 months, any party to the applicant may make

an application to the DRAT for directing the DRT for expeditious disposal of the application.

c. Amendment in Section 18: No appeal shall be entertained by DART unless the borrower has deposited with it 50% of the amount of debt due from him, as claimed by the secured creditor or determined by the DRT, whichever is less. DRAT may reduce the amount upto 25% of the debt.

V. Conclusion & Suggestion:

Although in a contractual matter between two private parties they are supposed to act in terms of the contract and no question of compliance with the principles of natural justice arises nor the question of judicial review of such actions need to be provided for. However, at the very outset, it may be pointed out that the contract between the parties as in the present cases, is no more as private as sought to be asserted on behalf of the respondents. If that was so, in that event parties would be at liberty to seek redressal of their grievances on account of breach of contract or otherwise taking recourse to the normal process of law as available, by approaching the ordinary civil courts. A contract which has been entered into between the two private parties, in some respects has been superseded by the statutory provisions or it may be said that such contracts are now governed by the statutory provisions relating to recovery of debts and bar of jurisdiction of the civil court to entertain any dispute in respect of such matters. Hence, it cannot be pleaded that the petitioners cannot complain of the conduct of the banking companies and financial institution for whatever goes on between the two is absolutely a matter of contract between private parties, and therefore no adjudication may be necessary.

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