

An Overview of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002(SARFAESI Act)

Dr Chandra Shekhar Kumar

Research Scholar, B. R. A. Bihar University Muzaffarpur

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ABSTRACT: The banking sector in India is in burden of bad loans provisioning and the decline in profitability of commercial sector banks particularly Public sector Banks. The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) is piece of one such legislation that focuses on strengthening the rights of the secured creditors against the defaulting debtors. In the early nineties, banks faced a lot of difficulties in recovering their loans which they have landed just because of the inordinate delay in deciding cases which were in Civil Courts and also because of other technical issues. This article studies the history, applicability, operation mechanism, and loop-holes of SARFAESI Act 2002. Furthermore, this article aims to examine the effectiveness of the recovery mechanism and certain problems in the implementation of the Act itself. This paper also endeavours to present some important court judgments. Thereafter, concluding it with suggestions.

KEYWORDS: Securitisation, Reconstruction Non-Performing Assets, Recovery, Loop-Holes.

I. INTRODUCTION

The financial sector has been one of the key drivers in India's efforts to achieve success in rapidly developing its economy. Since our existing legal framework relating to commercial transactions has not kept pace with the changing commercial practices and financial sector reforms. This has resulted in slow pace of recovery of defaulting loans and mounting levels of nonperforming assets of banks and financial institutions.

Narasimham Committee I and II and Andhyarujina Committee was constituted by the Central Government for the purpose of examining banking sector reforms have considered the need for changes in the legal system in respect of these areas. These Committees, among others, have suggested enactment of a new legislation for

securitisation and empowering banks and financial institutions to take possession of the securities and to sell them without the intervention of the court. Acting on these suggestions, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 was promulgated on the 21st June, 2002 to regulate securitisation and reconstruction of financial assets and enforcement of security interest and for matters connected therewith or incidental thereto. It extended to the whole of India

Amendment in the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) vide the enforcement of the Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016. Ministry of Law and Justice on 16th August, 2016 hereby published for general information in the Official Gazette, the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016. It is an Act further to amend four laws:

- (i) Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI)
- (ii.) Recovery of Debts due to Banks and Financial Institutions Act, 1993 (RDBFI),
- (iii) Indian Stamp Act, 1899 and
- (iv) Depositories Act, 1996, and for matters connected therewith or incidental thereto.

II. SCOPE OF THE PRESENTATION

- To know the history behind the enactment of Securitisation and Reconstruction of Financial Assets and Enforcement of Interest Act, 2002.
- To understand the mechanism how the Act operates in banking sector.
- To identify the loop-holes present in the Act.
- To provide possible solutions to the loop-holes of the act in order to ensure proper implementation of the said act.

III. HISTORICAL BACKGROUND

- Under the guidelines of the Central and State Government, Banks and Financial Institutions granted loans liberally to the small & large industries, companies etc.
- As a consequence it resulted into increasing amount of dues and Banks & FI's faced difficulty in recovery of Loans.
- Public money got stuck and led to a rise of Non-performing assets (NPAs).
- The Sick Industrial Companies (special provisions) Act, 1985 aggravated further the problem of NPAs.
- The Central Govt. in order to meet the crisis, formed a committee under the chairmanship of Mr. Narasimham.
- On 30th Sept. 1990 more than 15 lacs cases were filed by public sector banks and 304 cases by FI's found pending in various courts for recovery of loans. A whopping sum of 6013 crores was found due.
- The committee suggested for the establishment of Debt Recovery Tribunals, hence THE RECOVERY OF DEBTS DUE TO BANKS AND FINANCIAL INSTITUTIONS ACT, 1993 came up.
- The Reserve Bank of India took various possible decisions to control the problem of rising NPAs, e.g. One Time Settlement (OTS) Scheme introduced in 1997, Corporate Debt Restructuring (CDR) scheme in 2001.
- Still the problem of rising NPAs could not be curbed down as there was a lack of proper Securitisation law in Indian legal framework.
- The amount of debt was 12000 Crores hence the Central Govt. once again appointed another committee under the chairmanship of Mr. Andhyarujina to examine banking sector reforms in the legal system.
- The committee suggested that there is a need of an act which would deal with securitisation. Hence in the year 2002, Securitisation and Reconstruction of Financial Assets and Enforcement of Interest Act, 2002 was enacted by the parliament.

IV. OBJECTIVES AND SCOPE OF THE ACT

- Registration & regulation of securitisation companies or reconstruction companies by Reserve Bank of India.
- Securitisation and Reconstruction of Financial Assets.
- Enforcement of security interest.

- The said Act enables and empowers the secured creditors to take possession of their securities, to deal with them without the intervention of the court or tribunal and also alternatively to authorise any Securitisation or Reconstruction Company to acquire financial assets of any Bank or Financial Institution.
- The Act has been empowered with the overriding effect over the other legislation and it shall be in addition to and not in derogation of certain legislation.
- The act extends to the whole of India.

V. APPLICABILITY OF THE ACT

- ✚ The debt must have been classified by Banks & FI's as Non-Performing Assets (NPAs).
- ✚ The provisions of this act are applicable only in case where the amount becomes due and it is above Rupees one lac.
- ✚ NPA loan accounts where the amount is less than 20% of the principal amount and interest are not eligible to be dealt with under this act.
- ✚ Loans granted by Banks & FI's should be backed by securities charged to the Bank or FI's by way of hypothecation or mortgage or assignment or charge.

V. NONAPPLICABILITY OF THE ACT

- ✚ Any lien on any goods, money or security given by or under the Indian Contract Act, 1872 or the Sale of Goods Act, 1930 or any other law for the time being in force.
- ✚ A pledge of movables within under Section 172 of the Indian Contract Act, 1872.
- ✚ Creation of any security in any aircraft as defined in Section 2(1) of the Aircraft Act, 1934.
- ✚ Creation of security interest in any vessel as defined in Section 3(55) of the Merchant Shipping Act, 1958.
- ✚ Any conditional sale, hire-purchase or lease or any other contract in which no security interest has been created.
- ✚ Any rights of unpaid seller under Section 47 of the Sale of Goods Act, 1930.
- ✚ Any properties not liable to attachment or sale under Section 60(1) of the Code of Civil Procedure, 1908.
- ✚ Any security interest for securing repayment of any financial asset not exceeding one lac rupees.
- ✚ Any security interest created in Agricultural Land.
- ✚ Any case in which the amount due is less than 20% of the principal amount and interest thereon.

VI. IMPORTANT TERMS

Securitisation:- Section 2(1)(z) of the SARFAESI Act, 2002 states that 'securitisation' means acquisition of financial assets by any securitisation company or reconstruction company from any originator, whether by raising of funds by such securitization company or reconstruction company from qualified institutional buyers by issue of security receipts representing undivided interest in such financial assets or otherwise.

Asset Reconstruction :-Section 2(1)(b) of the SARFAESI Act, 2002 states 'asset reconstruction means acquisition by any securitization company or reconstruction company of any right or interest of any bank or financial institutions in any financial assistance for the purpose of realisation of such financial assistance.

Security Interest :-Section 2(1)(zf) of the SARFAESI Act, 2002 states 'security interest' means right, title and interest of any kind whatsoever upon property, created in favour of any secured creditor and includes any mortgage, charge, hypothecation, assignment other than those specified in section 31.

Non-performing Assets :-Section 2(1)(o) of the SARFAESI Act, 2002 states 'non-performing assets' means an asset or account of a borrower which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, (a).in case such bank or financial institutions is administered or regulated by any authority or body established, constituted or appointed by any law for the time being in force, in accordance with the directions or guidelines relating to assets classifications issued by such authority or body; (b).in any other case, in accordance with the directions or guidelines relating to assets classification issued by the Reserve Bank.

Reconstruction Company :- Section 2(1)(v) of the SARFAESI ACT, 2002 states 'reconstruction company' means a company formed and registered under the Companies Act, 1956 for the purpose of asset reconstruction.

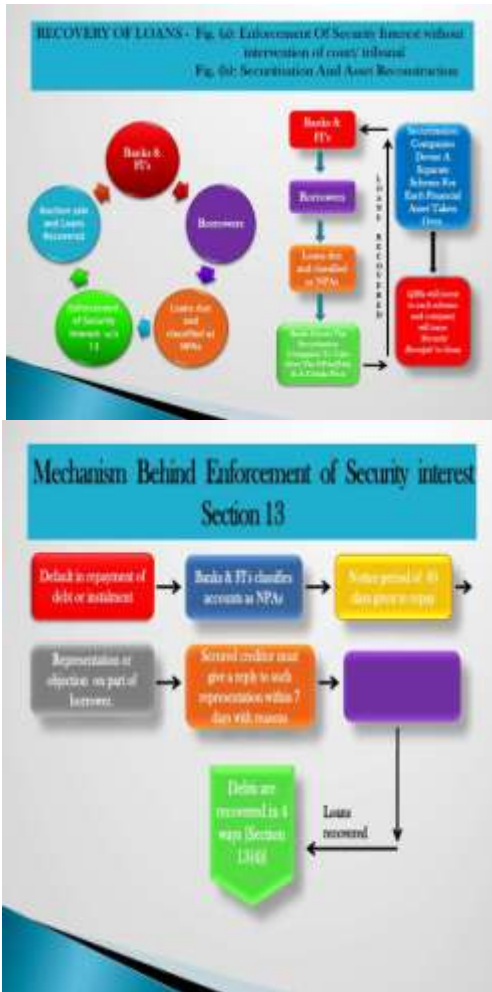
Securitisation Company :-Section 2(1)(za) of the SARFAESI Act, 2002 states 'securitisation company' means any company formed and registered under the Companies Act, 1956 for the purpose of securitisation.

Appellate Tribunal :-Section 2(1)(a) of the SARFAESI Act, 2002 states 'appellate tribunal' means a Debts Recovery Appellate Tribunal established under sec. 8(1) of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993.

Borrower:- Section 2(1)(f) of the SARFAESI Act, 2002 states 'borrower' means any person who has been granted financial assistance by any bank or financial institution or who has given any guarantee or created any mortgage or pledge as security for the financial assistance granted by any bank or financial institution and includes a person who becomes borrower of a securitisation company or reconstruction company consequent upon acquisition by it of any rights or interest of any bank or financial institution in relation to such financial assistance.

Banks :-Section 2(1)(c) of the SARFAESI Act, 2002 states 'bank' means- (i). A banking company; or (ii). A corresponding new bank; or (iii). The state bank of India; or (iv). A subsidiary bank; or (v). Such other bank which the central government may, by notification, specify for the purposes of the Act;

Financial Institution :- Section 2(1)(m) of the SARFAESI Act, 2002 states 'financial institution' means - (i). A public financial institution within the meaning of section 4A of the Companies Act, 1956. (ii). Any institution specified by the Central Govt. under sub-clause (ii) of clause (h) of section 2 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993. (iii). The International Finance Corporation established under the International Finance Corporation (status, immunities and privileges) Act, 1958. (iv). Any other institution or non-banking financial company as defined in clause (f) of section 45-I of the Reserve bank of India Act, 1934, which the central govt. may, by notification, specify as financial institution for the purposes of this act.



VII. RECOVERY OF SECURED DEBT IN FOUR WAYS

1. Take possession of the secured assets of the borrower including right to transfer by way of lease, assignment or sale for realising the secured asset.
2. Take over the management of the business of the borrower including right to transfer by way of lease, assignment or sale for realising the secured asset.
3. Appoint any person to manage the secured assets the possession of which has been taken over by the secured creditor.
4. Require at any time by notice in writing any person who has acquired any of the secured assets from the borrower and from whom any money is due or may become due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.

VIII. LOOP-HOLS PRESENT IN THE ACT

- ❖ Three things i.e. asset reconstruction, securitisation and enforcement of security interest at a single go slowed down the mechanism of the act on a number of occasions.
- ❖ Guidelines of the RBI in relation to classification of accounts as NPAs are not followed strictly in numerous occasions.
- ❖ Grievances of the Borrowers are not settled at first place by DRTs.
- ❖ Sale of assets under the Act, sometimes conducted without following the rules and norms.
- ❖ Civil courts very easily don't take cases related to SARFAESI Act, without even looking into the facts of the case. This happens due to Section 34.

IX. CASE LAWS

Important Judgments:-

- ✓ The Supreme Court in *Mardia chemicals Ltd v. Union of India* case (2004) 4 SCC 311, had decided that the SARFAESI Act had the constitution validity.
- ✓ In case of *Signal Apparels Pvt. Ltd v. Canara Bank* 2010(5) CTC 337, it was held that Guidelines issued by RBI in relation to classifying NPA should be followed by the bank before issuing notice under Section 13(2) of SARFAESI Act, 2002.
- ✓ In the case of *Ace Media Advertisers Pvt. Ltd. v. Bank of Baroda* AIR 2009 All 120, it was held that the process under Securitisation Act can be confined to the extent of the decree/order passed by Debts Recovery Tribunal.
- ✓ In case of *Mahavir Plantations P. Ltd. and K.K. Steel Enterprises v. ICICI Bank Ltd. And Ors.* [2005]127 CompCas 456 it was held that Demand Notice via Rule 3 of the Security Interest(Enforcement) Rules, 2002 to borrower under SARFAESI Act is mandatory. Proceedings without such notice will be vitiated.
- ✓ In case of *Yuth Development Co-operative Bank Ltd Kolhapur Vs Balasaheb Dinkarrao Salokhe Ors.* AIR 2008 Bom 167 it was held that Civil Court has no jurisdiction to entertain any suit filed in respect of action taken under SARFAESI Act, 2002.

X. SUGGESTIONS

- Proper Implementation of the sole Securitisation Law in India should be ensured.

- DRTs must ensure effective redressal of the grievances of the Borrowers.
- Banks and Financial Institutions must follow the guidelines given by the RBI in the year 2004 in relation to classification of accounts as NPAs.
- The main intention of the parliament behind the enactment of the act from an ordinance is to ensure proper recovery bad debts without intervention of courts but at the same time they never want to ignore the grievances of the Borrowers. Simply, a balance between the two must be created.

XI. CONCLUSIONS

- Though the enactment of SARFAESI Act sought to mobilise blocked funds of the banks in the non-performing assets, the various provisions of the acts have created deep sorrows for the genuine buyers.
- The various provisions meant to balance the requirements of the borrowers and the banks, have their balance of favour tilted towards the banks.
- These powers are, at majority of the times, being misused by the banks to appropriate their interests against the interests of the buyers.
- In such a situation it is pertinent for the civil courts to assume a more social responsibility for the larger interest of the borrowers on one hand and to share the responsibilities of the banks to mobilise their funds from the numerous non-performing assets.

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