THE SECURITIZATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT, 2002

LEARNING OUTCOMES

At the end of this Chapter, you will be able to:

- Explain the concept of Securitisation and reconstruction
- Know the objective and key features of SARFAESI Act
- Explain the functioning of the Asset reconstruction companies
- Understand the framework for enforcement of security interest
- Know of an applicability of the act
- State the concept of central registry and registration of security interest
1. 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 Andhyarujiina 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.


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.

Chapter II, of this amendment Act deals with the amendments to the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

This amendment Act is "an act to regulate securitisation and reconstruction of financial assets and enforcement of security interest and to provide for a central database of security interests created on property rights, and for matters connected therewith or incidental thereto."

The Act deals with the following:
(a) Registration and regulation of Asset Reconstruction Companies (ARCs) by the Reserve Bank of India;

(b) Facilitating securitisation of financial assets of banks and financial institutions with or without the benefit of underlying securities;

(c) Facilitating easy transferability of financial assets by the ARC to acquire financial assets of banks and financial institutions by issue of debentures or bonds or any other security in the nature of a debenture;

(d) Empowering ARCs to raise funds by issue of security receipts to qualified buyers

(e) Facilitating reconstruction of financial assets acquired by exercising powers of enforcement of securities or change of management or other powers which are proposed to be conferred on the banks and financial institutions

(f) Declaration of any securitisation company or reconstruction company registered with the Reserve Bank of India as a public financial institution for the purpose of section 4A of the Companies Act, 1956

(g) Defining 'security interest' as any type of security including mortgage and change on immovable properties given for due repayment of any financial assistance given by any bank or financial institution;

(h) Empowering banks and financial institutions to take possession of securities given for financial assistance and sell or lease the same or take over management in the event of default, i.e. classification of the borrower's account as non-performing asset in accordance with the directions given or under guidelines issued by the Reserve Bank of India from time to time

(i) The rights of a secured creditor to be exercised by one or more of its officers authorised in this behalf in accordance with the rules made by the Central Government;

(j) An appeal against the action of any bank or financial institution to the concerned Debts Recovery Tribunal and a second appeal to the Appellate Debts Recovery Tribunal;

(k) Setting up or causing to be set up a Central Registry by the Central Government for the purpose of registration of transactions relating to securitisation, asset reconstruction and creation of security interest;

(l) Application of the proposed legislation initially to banks and financial institutions and empowerment of the Central Government to extend the application of the proposed legislation to non-banking financial companies and other entities

(m) Non-application of the proposed legislation to security interests in agricultural lands, loans not exceeding rupees one lakh and cases where eighty per cent, of the loans are repaid by the borrower.
2. STRUCTURE

The Act is divided into six chapters and 42 sections:

- **Chapter I-** Preliminary (Section 1-2)
- **Chapter II-** Regulation of securitisation and reconstruction of financial assets of banks and financial institutions (Section 3- 12A)
- **Chapter III-** Enforcement of security interest (Section 13- 19)
- **Chapter IV-** Central registry (Section 20-26A)
- **Chapter IVA-** Registration by secured creditors and other creditors (Section 26B-26E)
- **Chapter V-** Offences and penalties (Section 27-30)
- **Chapter VI-** Miscellaneous (Section 37-42)

3. IMPORTANT CONCEPTS

The Act introduced multiple new concepts and infrastructures to support ease of recovery actions such as:

- Formation of Securitisation or reconstruction companies
- Recovery without interference of courts
- Framework for revival or reconstruction of the borrowers’ business
- Central registry
- Qualified buyers
- Security receipts
4. ROLE OF THE ACT

- **Securitization of financial assets and issue of security receipts**
  - Acquire financial assets by issuing debentures or bonds or by agreement. Realise the same and redeem the security receipts issued to the QBs

- **Reconstruction of Financial assets**
  - Take measures for proper management, sale, debt restructuring, settlement, or take possession subject to RBI guidelines from time to time

- **Enforcement of security interest**
  - Enforce security interest by the secured creditor without the intervention of the court

- **Other functions**
  - Act as agent of banks or FIs for recovery; Act as manager of the secured assets appointed by the lender; or act as receiver appointed by court

5. FUNCTIONING OF ARC IN A NUT SHELL

- **Issue of security by raising of receipts or funds by ARC from QBs**
- **Registration/Formatting of Asset Reconstruction Company**
- **Acquisition of rights or interest in financial assets**
  - Enter into an agreement for transfer of financial assets
  - Issue debentures or bonds or security

- **Take measures of asset reconstruction**
  - 1. Proper management of the borrower’s business
  - 2. Sale or lease of business
  - 3. Rescheduling of debts
  - 4. Enforcement of security interest
  - 5. Settlement of dues
  - 6. Possession of secured assets

- **Enforcement of security interest**
  - 1. Take possession
  - 2. Take over management
  - 3. Appoint a manager
  - 4. Notice for payment of dues
6. DEFINITIONS

Some key definitions are explained below:

- "Asset reconstruction" means acquisition by any securitisation company (SC) or reconstruction company (RC) of any right or interest of any bank or financial institution in any financial assistance for the purpose of realisation of such financial assistance [Section 2(b)]

  The term "financial assistance" means any loan or advance granted or any debentures or bonds subscribed or any guarantees given or letters of credit established or any other credit facility extended by any bank or financial institution; [Section 2(k)]

  The purpose of acquisition by securitisation company (SC) or reconstruction company (RC) is to realise such assets and not to stay invested by becoming the shareholders of the company. However it has the right to take over the management of the business, subject to RBI’s guidelines from time to time. Such realised amount should be held and applied towards redemption of investments and payment of returns assured to the QIBs

- "Asset reconstruction company (ARC)" means a company registered with Reserve Bank under section 3 for the purposes of carrying on the business of asset reconstruction or securitisation, or both. [Section 2(ba)]

  An ARC is not a banking company although it is regulated by RBI. Such company cannot carry out any other business other than securitisation or reconstruction.

- "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 or who has raised funds through issue of debt securities. [Section 2(f)]

- "Default" means:
  (a) non-payment of any debt or any other amount payable by the borrower to any secured creditor consequent upon which the account of such borrower is classified as non-performing asset in the books of account of the secured creditor; or
  (b) non-payment of any debt or any other amount payable by the borrower with respect to debt securities after notice of ninety days demanding payment of dues served upon such borrower by the debenture trustee or any other authority in whose favour security interest is created for the benefit of holders of such debt securities. [Section 2(j)]

Conditions for calling default under this act is:
- debt or any other amount- The amount due should be in the nature of debt.
- Secured creditor- An unsecured creditor doesn’t have recourse to this act
- Classification of NPA- A stressed asset which is yet to be classified as NPA cannot be resolved through this act.
- For non-payment of debenture or bonds to be called default, a notice of 90 days is a pre-requisite by the debenture trustee or beneficiary of the security

- "Debt" shall have the meaning assigned to it in clause (g) of section 2 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and includes—
  (a) unpaid portion of the purchase price of any tangible asset given on hire or financial lease or conditional sale or under any other contract;
  (b) any right, title or interest on any intangible asset or licence or assignment of such intangible asset, which secures the obligation to pay any unpaid portion of the purchase price of such intangible asset or an obligation incurred or credit otherwise extended to enable any borrower to acquire the intangible asset or obtain licence of such asset; [Section 2(ha)]

- "Financial asset" means debt or receivables and includes-
  (i) a claim to any debt or receivables or part thereof, whether secured or unsecured; or
  (ii) any debt or receivables secured by, mortgage of, or charge on, immovable property; or
  (iii) a mortgage, charge, hypothecation or pledge of movable property; or
  (iv) any right or interest in the security, whether full or part underlying such debt or receivables; or
(v) any beneficial interest in property, whether movable or immovable, or in such debt, receivables, whether such interest is existing, future, accruing, conditional or contingent; or

(va) any beneficial right, title or interest in any tangible asset given on hire or financial lease or conditional sale or under any other contract which secures the obligation to pay any unpaid portion of the purchase price of such asset or an obligation incurred or credit otherwise provided to enable the borrower to acquire such tangible asset; or

(vb) any right, title or interest on any intangible asset or licence or assignment of such intangible asset, which secures the obligation to pay any unpaid portion of the purchase price of such intangible asset or an obligation incurred or credit otherwise extended to enable the borrower to acquire such intangible asset or obtain licence of the intangible asset;

(vi) any financial assistance; [Section 2(l)]

An asset which is not a financial asset cannot be securitised, acquired or transferred under this Act.

Example: Value of an unsecured land in the balance sheet of the borrower cannot be acquired by an ARC by way of issuing security receipts.

- "Non-performing asset (NPA)" 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 institution is administered or regulated by an 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 classifications issued by the Reserve Bank. [Section 2(o)]

- "Qualified buyer" means a financial institution, insurance company, bank, state financial corporation, state industrial development corporation, trustee or asset reconstruction company which has been granted a certificate of registration under sub-section (4) of section 3 or any asset management company making investment on behalf of mutual fund or pension fund or a foreign institutional investor registered under the Securities and Exchange Board of India Act, 1992 (15 of 1992) or regulations made thereunder, any category of non-institutional investors as may be specified by the Reserve Bank under sub-section (1) of section 7 or any other body corporate as may be specified by the Board; [Section 2(u)]

An ARC cannot raise funds from investors which is not a qualified buyer (QB) as defined above.
For example, a manufacturing company looking to invest surplus cash by investing in the ARC, or a Public sector unit, or a strategic investor who wish to acquire the assets of the borrower company etc.

- "Securitisation" means acquisition of financial assets by any asset reconstruction company from any originator, whether by raising of funds by such asset reconstruction company from qualified buyers by issue of security receipts representing undivided interest in such financial assets or otherwise [Section 2(z)];

The process of securitisation helps the ARC to acquire financial assets like Loans from banks due to which the ARC shall be deemed to be the lender and all the rights of such bank or financial institution shall vest in such company in relation to such financial assets.

- “Secured creditor” means-
  
  (a) any bank or financial institution or any consortium or group of banks or financial institutions holding any right, title or interest upon any tangible asset or intangible asset as specified in clause (l);
  
  (b) debenture trustee appointed by any bank or financial institution; or
  
  (c) an asset reconstruction company whether acting as such or managing a trust set up by such asset reconstruction company for the securitisation or reconstruction, as the case may be; or
  
  (d) debenture trustee registered with the Board appointed by any company for secured debt securities; or
  
  (e) any other trustee holding securities on behalf of a bank or financial institution, in whose favour security interest is created by any borrower for due repayment of any financial assistance [section 2 (zd)]

- "Security interest" means right, title and interest of any kind, other than those specified in section 31, upon property created in favour of any secured creditor and includes—
  
  (a) any mortgage, charge, hypothecation, assignment or any right, title or interest of any kind, on tangible asset, retained by the secured creditor as an owner of the property, given on hire or financial lease or conditional sale or under any other contract which secures the obligation to pay any unpaid portion of the purchase price of the asset or an obligation incurred or credit provided to enable the borrower to acquire the tangible asset; or
  
  (b) such right, title or interest in any intangible asset or assignment or licence of such intangible asset which secures the obligation to pay any unpaid portion of the purchase price of the intangible asset or the obligation incurred or any credit provided to enable the borrower to acquire the intangible asset or licence of intangible asset [Section 2(zf)];
A creditor shall not be called as secured creditor unless its interest over the assets of the debtor or borrower is covered under the above definition. Refer section 31 (Provisions of this Act not to apply in certain cases) for specific exclusions of rights that shall not be treated as security interest.

7. REGULATION OF SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS OF BANKS AND FINANCIAL INSTITUTIONS

This part of the Act is covered in chapter II of the Act, comprising of Sections 3 – 12. This chapter provides for regulation of securitisation and reconstruction of financial assets of banks and financial institutions.

(I) Registration of ARCs (Section 3)

- **Commencement of business of securitisation or asset reconstruction**: Such a company can commence or carry on the business of securitisation or asset reconstruction only after obtaining a certificate of registration granted under this section and having the net owned fund of not less than one hundred crore rupees or such other higher amount as the Reserve Bank, may, by notification, specify.

However, the term "net owned fund" is not defined in the Act and hence we have to refer to the definition of “net owned fund” as mentioned in the explanation to Section 45I of the Reserve Bank of India Act.

- **Conditions**: The Reserve Bank may, for the purpose of considering to grant its approval for the application for registration of an ARC to commence or carry on the business of securitisation or asset reconstruction, as the case may be, require to be satisfied, by an inspection of records or books of such ARC, or otherwise, that the following conditions are fulfilled, namely:-

  (a) that the ARC has not incurred losses in any of the three preceding financial years;

  (b) that such ARC has made adequate arrangements for realisation of the financial assets acquired for the purpose of securitisation or asset reconstruction and shall be able to pay periodical returns and redeem on respective due dates on the investments made in the company by the qualified buyers or other persons;

  (c) that the directors of ARC have adequate professional experience in matters related to finance, securitisation and reconstruction;

  (d) that any of its directors has not been convicted of any offence involving moral turpitude;

  (e) that a sponsor of an ARC is a fit and proper person in accordance with the criteria as may be specified in the guidelines issued by the Reserve Bank for such persons;
(f) that ARC has complied with or is in a position to comply with prudential norms specified by the Reserve Bank.

(g) that ARC has complied with one or more conditions specified in the guidelines issued by the Reserve Bank for the said purpose.

- **Issue of certificate of registration to ARC:** A certificate of registration is thereafter granted to the ARC to commence or carry on business of securitisation or asset reconstruction, and it must be noted that the Reserve Bank may also prescribe any other conditions, which it may consider, fit to impose. In case the Reserve Bank is of the opinion that the above conditions are not satisfied then it may reject the application, after the applicant is given a reasonable opportunity of being heard.

- **Requirement of prior approval of RBI:** Once a company is registered as an ARC, it must obtain prior approval of the Reserve Bank for the following purposes:
  
  (a) any substantial change in its management, including appointment of any director managing director or chief executive officer
  
  (b) change of location of its registered office
  
  (c) change in its name

- **Decision of RBI shall be final & binding:** The decision of the Reserve Bank, whether the change in management of an ARC is a substantial change in its management or not, shall be final and binding. The expression "substantial change in management" means the change in the management by way of transfer of shares or change affecting the sponsorship in the company by way of transfer of shares or amalgamation or transfer of the business of the company.

(II) **Cancellation of certificate of registration (Section 4)**

- The Reserve Bank may cancel a certificate of registration granted to an ARC, if such company-
  
  (i) ceases to carry on the business of securitisation or asset reconstruction; or
  
  (ii) ceases to receive or hold any investment from a qualified buyer; or
  
  (iii) has failed to comply with any conditions subject to which the certificate of registration has been granted to it; or
  
  (iv) at any time fails to fulfil any of the conditions referred to in clauses (a) to (g) of sub-section (3) of section 3; or
  
  (v) fails to-
      
      (a) comply with any direction issued by the Reserve Bank under the provisions of this Act; or
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(b) maintain accounts in accordance with the requirements of any law or any direction or order issued by the Reserve Bank under the provisions of this Act; or

(c) submit or offer for inspection its books of account or other relevant documents when so demanded by the Reserve Bank; or

(d) obtain prior approval of the Reserve Bank required under sub-section (6) of section 3:

- Before cancelling a certificate of registration on the ground that the ARC has failed to comply with the provisions of clause (c) or has failed to fulfil any of the conditions referred to in clause (d) or sub-clause (iv) of clause (e), the Reserve Bank, unless it is of the opinion that the delay in cancelling the certificate of registration granted under sub-section (4) of section 3 shall be prejudicial to the public interest or the interests of the investors or the ARC, shall give an opportunity to such company on such terms as the Reserve Bank may specify for taking necessary steps to comply with such provisions or fulfilment of such conditions.

- **Appeal to an order of cancellation:** In case the ARC is aggrieved by the order of cancellation of certificate of registration by the Reserve Bank, then it may prefer an appeal, within a period of thirty days from the date on which such order of cancellation is communicated to it, to the Central Government (Secretary, Ministry of Finance, and Government of India). The Central Government must also give such company a reasonable opportunity of being heard before rejecting the appeal.

- It must be noted that an ARC, which is holding investments of qualified buyers and whose application for grant of certificate of registration has been rejected or certificate of registration has been cancelled shall, notwithstanding such rejection or cancellation be deemed to be an ARC until it repays the entire investments held by it (together with interest, if any) within such period as specified by the Reserve Bank.

(III) Acquisition of rights or interest in financial assets (Section 5)

- **Acquiring of financial assets of any bank or financial institution:** Notwithstanding anything contained in any agreement or any other law for the time being in force, any ARC may acquire financial assets of any bank or financial institution-
  
  (i) by issuing a debenture or bond or any other security in the nature of debenture, for consideration agreed upon between such company and the bank or financial institution, incorporating therein such terms and conditions as may be agreed upon between them; or

  (ii) by entering into an agreement with such bank or financial institution for the transfer of such financial assets to such company on such terms and conditions as may be agreed upon between them.

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Any document executed by any bank or financial institution as mentioned above, in favour of the ARC acquiring financial assets for the purposes of asset reconstruction or securitisation shall be exempted from stamp duty in accordance with the provisions of section 8F of the Indian Stamp Act, 1899

Provided that the provisions of this sub-section shall not apply where the acquisition of the financial assets by the asset reconstruction company is for the purposes other than asset reconstruction or securitisation.

Such exemption is provided in order to encourage banks or FIs to resolve non performing assets (NPA) issues by offloading it to ARCs.

Debenture as we commonly known, is an acknowledgement of debt. Bond also refers to the same nature of instrument as a debenture. Both of them acknowledge a debt and hence an obligation to pay.

In case where bank or financial institution is a lender in relation to any financial assets acquired by the ARC: Then such ARC shall, on such acquisition, be deemed to be the lender and all the rights of such bank or financial institution shall vest in such company in relation to the subject financial assets.

If the bank or financial institution is holding any right, title or interest upon any tangible asset or intangible asset to secure payment of any unpaid portion of the purchase price of such asset or an obligation incurred or credit otherwise provided to enable the borrower to acquire the tangible asset or assignment or licence of intangible asset, such right, title or interest shall vest in the asset reconstruction company on acquisition of such assets.

All contracts, deeds, bonds, agreements, powers-of-attorney, grants of legal representation, permissions, approvals, consents or no-objections under any law or otherwise and other instruments of whatever nature which relate to the said financial asset and which are subsisting or having effect immediately before the acquisition of financial asset and to which the concerned bank or financial institution is a party or which are in favour of such bank or financial institution shall, after the acquisition of the financial assets, be of as full force and effect against or in favour of the ARC, as the case may be, and may be enforced or acted upon as fully and effectually as if, in the place of the said bank or financial institution, securitisation company or reconstruction company, as the case may be, had been a party thereto or as if they had been issued in favour of ARC, as the case may be.

If, on the date of acquisition of financial asset, any suit, appeal or other proceeding of whatever nature relating to the said financial asset is pending by or against the bank or financial institution, save as provided in the third proviso to sub-section (1) of section 15 of the Sick Industrial Companies (Special Provisions) Act, 1985 the same shall not abate, or be discontinued or be, in any way, prejudicially affected by reason of the acquisition of financial asset by the ARC, as the case may be, but the suit, appeal or other proceeding may be continued, prosecuted and enforced by or against the ARC, as the case may be.
• On acquisition of financial assets, the ARC, may with the consent of the originator, file an application before the Debts Recovery Tribunal or the Appellate Tribunal or any court or other Authority for the purpose of substitution of its name in any pending suit, appeal or other proceedings and on receipt of such application, such Debts Recovery Tribunal or the Appellate Tribunal or court or Authority shall pass orders for the substitution of the ARC in such pending suit, appeal or other proceedings

(IV) Transfer of pending applications to any one of Debts Recovery Tribunals in certain cases (Section 5A)

• If any financial asset, of a borrower acquired by an ARC, comprise of secured debts or more than one bank or financial institution for recovery of which such banks or financial institutions has filed applications before two or more Debts Recovery Tribunals, the ARC may file an application to the Appellate Tribunal having jurisdiction over any of such Tribunals in which such applications are pending for transfer of all pending applications to any one of the Debts Recovery Tribunals as it deems fit.

• On receipt of such application for transfer of all pending applications under sub-section (1), the Appellate Tribunal may, after giving the parties to the application an opportunity of being heard, pass an order for transfer of the pending applications to any one of the Debts Recovery Tribunals.

• Notwithstanding anything contained in the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, any order passed by the Appellate Tribunal under sub-section (2) shall be binding on all the Debts Recovery Tribunals referred to in sub-section (1) as if such order had been passed by the Appellate Tribunal having jurisdiction on each such Debts Recovery Tribunal.

• Any recovery certificate, issued by the Debts Recovery Tribunal to which all the pending applications are transferred under sub-section (2), shall be executed in accordance with the provisions contained in sub-section (23) of section 19 and other provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 shall, accordingly, apply to such execution.

(V) Notice to obligor and discharge of obligation of such obligor (Section 6)

• The bank or financial institution may give a notice of acquisition of financial assets by any ARC to the concerned obligor and any other concerned person and to the concerned registering authority.

• The obligor shall make payment to the concerned ARC in discharge of any of the obligations in relation to the financial asset specified in the notice.
(VI) Issue of security by raising of receipts or funds by ARC (Section 7)

- Any ARC, may, after acquisition of any financial asset under section 5(1), offer security receipts to qualified buyers (or such other category of investors including non-institutional investors as may be specified by the Reserve Bank in consultation with the Board, from time to time) for subscription in accordance with the provisions of those Acts.

- An ARC may raise funds from the qualified buyers by formulating schemes for acquiring financial assets and shall keep and maintain separate and distinct accounts in respect of each such scheme for every financial asset acquired out of investments made by a qualified buyer and ensure that realisations of such financial asset is held and applied towards redemption of investments and payment of returns assured on such investments under the relevant scheme.

(VII) Exemption from registration of security receipt (Section 8)

- any security receipt issued by the ARC and not creating, declaring, assigning, limiting or extinguishing any right, title or interest, to or in immovable property except in so far as it entitles the holder of the security receipt to an undivided interest afforded by a registered instrument, or any transfer of security receipts, shall not require compulsory registration under section 17 of the Registration Act, 1908.

(VIII) Measures for assets reconstruction (Section 9)

- AN ARC may, provide for any one or more of the following measures, for the purposes of asset reconstruction-
  (a) the proper management of the business of the borrower, by change in, or takeover of, the management of the business of the borrower;
  (b) the sale or lease of a part or whole of the business of the borrower;
  (c) rescheduling of payment of debts payable by the borrower;
  (d) enforcement of security interest in accordance with the provisions of this Act;
  (e) settlement of dues payable by the borrower;
  (f) taking possession of secured assets in accordance with the provisions of this Act;
  (g) conversion of any portion of debt into shares of a borrower company:

Provided that conversion of any part of debt into shares of a borrower company shall be deemed always to have been valid, as if the provisions of this clause were in force at all material times.

- The Reserve Bank shall, for the purposes as given above, determine the policy and issue necessary directions including the direction for regulation of management of the business of the borrower and fees to be charged.
• The asset reconstruction company shall take measures in accordance with policies and directions of the Reserve Bank determined under section 9(2).

(IX) Other functions of ARC (Section 10)

• Any ARC may-
  (a) **act as an agent** for any bank or financial institution for the purpose of recovering their due from the borrower on payment of such fees or charges as may be mutually agreed upon between the parties;
  (b) **act as a manager** referred to section 13(4)(c) on such fee as may be mutually agreed upon between the parties;
  (c) **act as receiver** if appointed by any court or tribunal

Provided that no ARC shall act as a manager if acting as such gives rise to any pecuniary liability.

• No ARC which has been granted a certificate of registration section 3(4), shall commence or carry on, without prior approval of the Reserve Bank, any business other than that of securitisation or asset reconstruction.

Provided that an ARC which is carrying on, on or before the commencement of this Act, any business other than the business of securitisation or asset reconstruction or business referred to in sub-section (1), shall cease to carry on any such business within one year from the date of commencement of this Act.

• For the purposes of this section, ARC does not include its subsidiary.
(X) Resolution of disputes (Section 11)

Where any dispute relating to securitisation or reconstruction or non-payment of any amount due including interest arises amongst any of the parties, namely,

(a) the bank, or
(b) financial institution, or
(c) ARC or
(d) qualified buyer,

Such dispute shall be settled by conciliation or arbitration as provided in the Arbitration and Conciliation Act, 1996, as if the parties to the dispute have consented in writing for determination of such dispute by conciliation or arbitration and the provisions of that Act shall apply accordingly.

(XI) Power of Reserve Bank to determine policy and issue directions (Section 12)

- In the public interest, Reserve bank may determine the policy and give directions to any ARC in matters relating to income recognition, accounting standards, making provisions for bad and doubtful debts, capital adequacy based on risk weights for assets and also relating to deployment of funds by the ARC.

- Without prejudice to the generality as above, the Reserve bank may give directions to any ARC in particular as to:
  
  (a) the type of financial asset of a bank or Financial institution which can be acquired and procedure for acquisition of such assets and valuation thereof;
  
  (b) the aggregate value of financial assets which may be acquired by any securitisation company or reconstruction company.
  
  (c) the fee and other charges which may be charged or incurred for management of financial assets acquired by any asset reconstruction company;
  
  (d) transfer of security receipts issued to qualified buyers

(XII) Power of Reserve Bank to Call for Statements and information (Section 12 A)

The Reserve Bank may direct ARC to furnish it within such time as may be specified by the Reserve Bank, with such statements and information relating to the business or affairs of such securitisation company or reconstruction company (including any business or affairs with which such company is concerned) as the Reserve Bank may consider necessary or expedient to obtain for the purpose of this Act.
(XIII) Power of Reserve Bank to carry out audit and inspection (Section 12 B)

- The Reserve Bank may, for the purposes of this Act, carry out or caused to be carried out audit and inspection of an asset reconstruction company from time to time.

- It shall be the duty of an asset reconstruction company and its officers to provide assistance and cooperation to the Reserve Bank to carry out audit or inspection.

- Where on audit or inspection or otherwise, the Reserve Bank is satisfied that business of an asset reconstruction company is being conducted in a manner detrimental to public interest or to the interests of investors in security receipts issued by such asset reconstruction company, the Reserve Bank may, for securing proper management of an asset reconstruction company, by an order—
  (a) remove the Chairman or any director or appoint additional directors on the board of directors of the asset reconstruction company; or
  (b) appoint any of its officers as an observer to observe the working of the board of directors of such asset reconstruction company:

Provided that no order for removal of Chairman or director under clause (a) shall be made except after giving him an opportunity of being heard.

- It shall be the duty of every director or other officer or employee of the asset reconstruction company to produce before the person, conducting an audit or inspection under sub-section (1), all such books, accounts and other documents in his custody or control and to provide him such statements and information relating to the affairs of the asset reconstruction company as may be required by such person within the stipulated time specified by him.

8. ENFORCEMENT OF SECURITY INTEREST

Provisions dealing with enforcement of security interest are contained in Chapter III of the Act, comprising of Sections 13 – 19.

(I) Enforcement of security interest (Section 13)

- Notwithstanding anything contained in section 69 or section 69A of the Transfer of Property Act, 1882, any security interest created in favour of any secured creditor may be enforced, without the intervention of the court or tribunal, by such creditor in accordance with the provisions of this Act.

- Where borrower makes a default payment of debt: Where any borrower, who is under a liability to a secured creditor under a security agreement, makes any default in repayment of secured debt or any instalment thereof, and his account in respect of such debt is classified by the secured creditor as non-performing asset, then, the secured creditor may require the borrower by notice in writing to discharge in full his liabilities to the secured creditor within
sixty days from the date of notice failing which the secured creditor shall be entitled to exercise all or any of the rights under sub-section (4) of Section 13.

Provided that—

(i) the requirement of classification of secured debt as non-performing asset under this sub-section shall not apply to a borrower who has raised funds through issue of debt securities; and

(ii) in the event of default, the debenture trustee shall be entitled to enforce security interest in the same manner as provided under this section with such modifications as may be necessary and in accordance with the terms and conditions of security documents executed in favour of the debenture trustee;

- **Notice prescribing the details of the debts:** This notice shall give details of the amount payable by the borrower and the secured assets intended to be enforced by the secured creditor in the event of non-payment of secured debts by the borrower. The procedure for the service of the notice is prescribed in the Security Interests (Enforcement) Rules.

- **Objection or rejection to the borrower on the notice:** If, on receipt of the notice, the borrower makes any representation or raises any objection, the secured creditor shall consider such representation or objection and if the secured creditor comes to the conclusion that such representation or objection is not acceptable or tenable, he shall communicate within 15 days of receipt of such representation or objection the reasons for non-acceptance of the representation or objection to the borrower:

- **No right to borrower to prefer an application:** Provided that the reasons so communicated or the likely action of the secured creditor at the stage of communication of reasons shall not confer any right upon the borrower to prefer an application to the Debts recovery Tribunal under section 17 or the Court of District Judge under section 17A.

- **Borrower fails to discharge his liability:** If the borrower fails to discharge his liability in full within the above specified period, the secured creditor may take recourse to one or more of the following measures to recover his secured debt:-
  
  (a) take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset;
  
  (b) take over the management of the business of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset:

  Provided that the right to transfer by way of lease, assignment or sale shall be exercised only where the substantial part of the business of the borrower is held as security for the debt:
Provided further that where the management of whole of the business or part of the business is severable, the secured creditor shall take over the management of such business of the borrower which is relatable to the security for the debt;

(c) appoint any person (hereafter referred to as the manager), to manage the secured assets the possession of which has been taken over by the secured creditor;

(d) 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.

• **Modes of enforcement of security**

- take possession of the secured assets
- take over the management (which is relatable to secured debt)
- appoint any person as the manager, to manage the secured assets
- Demand notice to the person who has acquired the secured assets

• **Discharge from payment:** Any payment made by any person referred to in section 5(4)(d) to the secured creditor shall give such person a valid discharge as if he has made payment to the borrower.

• **Right with respect to the immovable property:** Where the sale of an immovable property, for which a reserve price has been specified, has been postponed for want of a bid of an amount not less than such reserve price, it shall be lawful for any officer of the secured creditor, if so authorised by the secured creditor in this behalf, to bid for the immovable property on behalf of the secured creditor at any subsequent sale [sub-section (5A)]

Where the secured creditor, referred to in sub-section (5A), is declared to be the purchaser of the immovable property at any subsequent sale, the amount of the purchase price shall be adjusted towards the amount of the claim of the secured creditor for which the auction of enforcement of security interest is taken by the secured creditor, under sub-section (4) of section 13. [Sub-section (5B)]
The provisions of section 9 of the Banking Regulation Act, 1949 shall, as far as may be, apply
to the immovable property acquired by secured creditor under sub-section (5A). [Sub-section
(5C)]

- **Right related to transfer of secured assets by the secured creditor:** Any transfer of
  secured asset after taking possession thereof or takeover of management under sub-section
  (4), by the secured creditor or by the manager on behalf of the secured creditor shall vest in
  the transferee all rights in, or in relation to, the secured asset transferred as if the transfer
  had been made by the owner of such secured asset.

- **Recovery of expenses from the borrower:** Where any action has been taken against a
  borrower, all costs, charges and expenses which, in the opinion of the secured creditor, have
  been properly incurred by him or any expenses incidental thereto, shall be recoverable from
  the borrower and the money which is received by the secured creditor shall, in the absence of
  any contract to the contrary, be held by him in trust, to be applied-
  
  (a) firstly, in payment of such costs, charges and expenses and
  
  (b) secondly, in discharge of the dues of the secured creditor and the residue of the money
      so received shall be paid to the person entitled thereto in accordance with his rights and
      interests.

- **Payment of dues of the secured creditors:** Where the amount of dues of the secured
  creditor together with all costs, charges and expenses incurred by him is tendered to the
  secured creditor at any time before the date of publication of notice for public auction or
  inviting quotations or tender from public or private treaty for transfer by way of lease,
  assignment or sale of the secured assets,—
  
  (a) the secured assets shall not be transferred by way of lease assignment or sale by the
      secured creditor; and
  
  (b) in case, any step has been taken by the secured creditor for transfer by way of lease or
      assignment or sale of the assets before tendering of such amount under this
      subsection, no further step shall be taken by such secured creditor for transfer by way
      of lease or assignment or sale of such secured assets .

- **Joint Financing:** Subject to the provisions of the Insolvency and Bankruptcy Code, 2016,
in the case of financing of a financial asset by more than one secured creditors or joint financing
of a financial asset by secured creditors, no secured creditor shall be entitled to exercise any
or all of the rights conferred on him under or pursuant to sub-section (4) unless exercise of
such right is agreed upon by the secured creditors representing not less than sixty per cent in
value of the amount outstanding as on a record date and such action shall be binding on all
the secured creditors. [Section 13(9)]. But in case of a company in liquidation, the amount
realised from the sale of secured assets shall be distributed in accordance with the provisions
Secured creditors may retain the sale proceeds of his secured assets: Provided further that in the case of a company being wound up on or after the commencement of this Act, the secured creditor of such company, who opts to realise his security instead of relinquishing his security and proving his debt under proviso to sub-section (1) of section 529 of the Companies Act, 1956 (Corresponding section 325 of the Companies Act, 2013), may retain the sale-proceeds of his secured assets after depositing the workmen's dues with the liquidator in accordance with the provisions of section 529A (Corresponding section 326 of the Companies Act, 2013) of that Act:

Role of liquidator with respect to workmen dues: Provided also that liquidator referred to in the second proviso shall intimate the secured creditor the workmen's dues in accordance with the provisions of section 529A of the Companies Act, 1956 (Corresponding section 326 of the Companies Act, 2013) and in case such workmen's dues cannot be ascertained, the liquidator shall intimate the estimated amount of workmen's dues under that section to the secured creditor and in such case the secured creditor may retain the sale proceeds of the secured assets after depositing the amount of such estimate dues with the liquidator:

In case of deposits of amount of workmen dues by secured creditor: Provided also that in case the secured creditor deposits the estimated amount of workmen's dues, such creditor shall be liable to pay the balance of the workmen's dues or entitled to receive the excess amount, if any, deposited by the secured creditor with the liquidator:

Furnishing of undertaking by secured creditor: Provided also that the secured creditor shall furnish an undertaking to the liquidator to pay the balance of the workmen's dues, if any.

Explanation- For the purposes of this sub-section,-
(a) "record date" means the date agreed upon by the secured creditors representing not less than three-fourth in value of the amount outstanding on such date;
(b) "amount outstanding" shall include principal, interest and any other dues payable by the borrower to the secured creditor in respect of secured asset as per the books of account of the secured creditor.

Filing of an application by secured creditor: Where dues of the secured creditor are not fully satisfied with the sale proceeds of the secured assets, the secured creditor may file an application in the form and manner as may be prescribed to the Debts Recovery Tribunal having jurisdiction or a competent court, as the case may be, for recovery of the balance amount from the borrower.

Rights of secured creditors in relation to secured assets: Without prejudice to the rights conferred on the secured creditor under or by this section, secured creditor shall be entitled to proceed against the guarantors or sell the pledged assets without first taking any of the
measured specifies in clause (a) to (d) of sub-section (4) in relation to the secured assets under this Act.

- The rights of a secured creditor under this Act may be exercised by one or more of his officers authorised in this behalf in such manner as may be prescribed.

- **No transfer of secured assets by borrower:** No borrower shall, after receipt of notice, transfer by way of sale, lease or otherwise (other than in the ordinary course of his business) any of his secured assets referred to in the notice, without prior written consent of the secured creditor.

(II) **Chief Metropolitan Magistrate or District Magistrate to assist secured creditor in taking possession of secured asset (Section 14)**

The secured creditor may, for the purpose of taking possession or control of secured asset, request, in writing, the Chief Metropolitan Magistrate or the District Magistrate within whose jurisdiction any such secured asset or other documents relating thereto may be situated or found, to take possession thereof, and the Chief Metropolitan Magistrate or, as the case may be, the District Magistrate shall, on such request being made to him--

(a) take possession of such asset and documents relating thereto; and

(b) forward such asset and documents to the secured creditor within a period of thirty days from the date of application.

Provided further that if no order is passed by the Chief Metropolitan Magistrate or District Magistrate within the said period of thirty days for reasons beyond his control, he may, after recording reasons in writing for the same, pass the order within such further period but not exceeding in aggregate sixty days.

(III) **Manner and effect of takeover of management (Section 15)**

- **Appointment of persons by secured creditors:** When the management of business of a borrower is taken over by an ARC under section 9(a) or, by a secured creditor under section 13(4)(b) as the case may be, the secured creditor may, by publishing a notice in a newspaper published in English language and in a newspaper published in an Indian language in circulation in the place where the principal office of the borrower is situated, appoint as many persons as it thinks fit-

(a) in a case in which the borrower is a company under the Companies Act, 1956, to be the directors of that borrower in accordance with the provisions of that Act; or

(b) in any other case, to be the administrator of the business of the borrower
Manner and effect of takeover of management

On publication notice: All persons holding office as directors of the company (if the borrower is a company) and in any other case, all persons holding any office having power of superintendence, direction and control of the business of the borrower immediately before the publication of the above notice, shall be deemed to have vacated their offices.

When any contract of management shall be deemed to be terminated: Any contract of management between the borrower and any director or manager thereof holding office as such immediately before publication of the above notice, shall be deemed to be terminated. The directors or the administrators appointed under this section shall take such steps as may be necessary to take into their custody or under their control all the property, effects and actionable claims to which the business of the borrower is, or appears to be, entitled and all the property and effects of the business of the borrower shall be deemed to be in the custody of the directors or administrators, as the case may be, as from the date of the publication of the above notice.

Exercise of the powers of the person so appointed for the borrowers: All directors appointed in accordance with the above notice shall, for all purposes, be the directors of the company of the borrower and such directors or the administrators (if the borrower is other than a company) appointed under section 15, shall only be entitled to exercise all the powers of the directors or as the case may be, of the persons exercising powers of superintendence, direction and control, of the business of the borrower whether such powers are derived from the memorandum or articles of association of the company of the borrower or from any other source.

Management of borrower taken by the secured creditor: Where the management of the business of a borrower, being a company as defined in the Companies Act, 1956 (i.e., the Companies Act, 2013), is taken over by the secured creditor, then, notwithstanding anything contained, such borrower- in the said Act or in the memorandum or articles of association of such company -

(a) it shall not be lawful for the shareholders of such company or any other person to nominate or appoint any person to be a director of the company;
(b) no resolution passed at any meeting of the shareholders of such company shall be given effect to unless approved by the secured creditor;

(c) no proceeding for the winding up of such company or for the appointment of a receiver in respect thereof shall lie in any court, except with the consent of the secured creditor.

- **Obligation of secured creditor:** The secured creditor is under an obligation to restore the management of the business of the borrower, on realisation of his debt in full, in case of takeover of the management of the business of a borrower by such secured creditor.

- Provided that if any secured creditor jointly with other secured creditors or any asset reconstruction company or financial institution or any other assignee has converted part of its debt into shares of a borrower company and thereby acquired controlling interest in the borrower company, such secured creditors shall not be liable to restore the management of the business to such borrower.

(IV) **No compensation to directors for loss of office (Section 16)**

Irrespective of anything contained in any contract or in any other law for the time being in force, no managing director or any other director or manager or any person in charge of management of the business of the borrower shall be entitled to any compensation for the loss of office or for the premature termination under this Act. However any such managing director or any other director or manager or any such person in charge of management has the right to recover from the business of the borrower, moneys recoverable otherwise than by way of such compensation.

(V) **Application against measures to recover secured debts (Section 17)**

- **Filing of an application:** Any person (including borrower), aggrieved by any of the measures given in section 13(4) taken by the secured creditor or his authorised officer under this Chapter, may make an application along with such fee, as may be prescribed to the Debts Recovery Tribunal having jurisdiction in the matter within forty-five days from the date on which such measure had been taken.

Provided that different fees may be prescribed for making the application by the borrower and the person other than the borrower.

**Explanation:** For the removal of doubts, it is hereby declared that the communication of the reasons to the borrower by the secured creditor for not having accepted his representation or objection or the likely action of the secured creditor at the stage of communication of reasons to the borrower shall not entitle the person (including borrower) to make an application to the Debts Recovery Tribunal under this sub-section.

- **Jurisdiction:** An application under sub-section (1) shall be filed before the Debts Recovery Tribunal within the local limits of whose jurisdiction—
  
  (a) the cause of action, wholly or in part, arises;
(b) where the secured asset is located; or
(c) the branch or any other office of a bank or financial institution is maintaining an account in which debt claimed is outstanding for the time being.

- **Measures taken shall be in compliance:** The Debts Recovery Tribunal shall consider whether any of the measures referred to in section 13(4) taken by the secured creditor for enforcement of security are in accordance with the provisions of this Act and the rules made thereunder.

- If, the Debts Recovery Tribunal, after examining the facts and circumstances of the case and evidence produced by the parties, comes to the conclusion that any of the measures referred to in section 13(4), taken by the secured creditor are not in accordance with the provisions of this Act and the rules made thereunder, and require restoration of the management or restoration of possession, of the secured assets to the borrower or other aggrieved person, it may, by order,—
  
  (a) declare the recourse to any one or more measures referred to in section 13(4) taken by the secured creditor as invalid; and
  (b) restore the possession of secured assets or management of secured assets to the borrower or such other aggrieved person, who has made an application under sub-section (1), as the case may be; and
  (c) pass such other direction as it may consider appropriate and necessary in relation to any of the recourse taken by the secured creditor under sub-section (4) of section 13.

- **Remedies opted by the securities creditor:** If, the Debts Recovery Tribunal declares the recourse taken by a secured creditor under sub-section (4) of section 13, is in accordance with the provisions of this Act and the rules made thereunder, then, notwithstanding anything contained in any other law for the time being in force, the secured creditor shall be entitled to take recourse to one or more of the measures specified under sub-section (4) of section 13 to recover his secured debt.

Where—

i. any person, in an application under sub-section (1), claims any tenancy or leasehold rights upon the secured asset, the Debt Recovery Tribunal, after examining the facts of the case and evidence produced by the parties in relation to such claims shall, for the purposes of enforcement of security interest, have the jurisdiction to examine whether lease or tenancy,—
  a. has expired or stood determined; or
  b. is contrary to section 65A of the Transfer of Property Act, 1882; or
  c. is contrary to terms of mortgage; or
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d. is created after the issuance of notice of default and demand by the Bank under sub-section (2) of section 13 of the Act; and

ii. the Debt Recovery Tribunal is satisfied that tenancy right or leasehold rights claimed in secured asset falls under the sub-clause (a) or sub-clause (b) or sub-clause (c) or sub-clause (d) of clause (i), then notwithstanding anything to the contrary contained in any other law for the time being in force, the Debt Recovery Tribunal may pass such order as it deems fit in accordance with the provisions of this Act.

- **Time limit for disposal of an application:** Any application made under sub-section (1) shall be dealt with by the Debts Recovery Tribunal as expeditiously as possible and disposed of within sixty days from the date of such application:

  Provided that the Debts Recovery Tribunal may, from time to time, extend the said period for reasons to be recorded in writing, so, however, that the total period of pendency of the application with the Debts Recovery Tribunal, shall not exceed four months from the date of making of such application made under sub-section (1).

- **Order by the appellate tribunal for expeditious disposal of the pending application:** If the application is not disposed of by the Debts Recovery Tribunal within the period of four months as specified in sub-section (5), any party to the application may make an application, in such form as may be prescribed, to the Appellate Tribunal for directing the Debts Recovery Tribunal for expeditious disposal of the application pending before the Debts Recovery Tribunal and the Appellate Tribunal may, on such application, make an order for expeditious disposal of the pending application by the Debts Recovery Tribunal.

- **Save as otherwise provided in this Act, the Debts Recovery Tribunal shall, as far as may be, dispose of the application in accordance with the provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and the rules made thereunder.**

(VI) **Making of application to Court of District Judge in certain cases (Section 17A)**

In the case of a borrower residing in the State of Jammu and Kashmir, the application under section 17 shall be made to the Court of District Judge in that State having jurisdiction over the borrower which shall pass an order on such application.

**Explanation:** It is hereby declared that the communication of the reasons to the borrower by the secured creditor for not having accepted his representation or objection or the likely action of the secured creditor at the stage of communication of reasons shall not entitle the person (including borrower) to make an application to the Court of District Judge under this section.

(VII) **Appeal to Appellate Tribunal (Section 18)**

- **Appeal to an order of DRT:** Any person aggrieved, by any order made by the Debts Recovery Tribunal under section 17, may prefer an appeal along with such fee, as may be
prescribed to the Appellate Tribunal within thirty days from the date of receipt of the order of Debts Recovery Tribunal.

Provided that different fees may be prescribed for filing an appeal by the borrower or by the person other than the borrower;

- **Condition for the appeal:** Provided further that no appeal shall be entertained unless the borrower has deposited with the Appellate Tribunal fifty per cent. of the amount of debt due from him, as claimed by the secured creditors or determined by the Debts Recovery Tribunal, whichever is less. Provided also that the Appellate Tribunal may, for the reasons to be recorded in writing, reduce the amount to not less than twenty-five per cent of debt referred above.

- **Dispose of appeal as per the RDDBFI Act, 1993:** Save as otherwise provided in this Act, the Debts Recovery Tribunal under section 17 or the Appellate Tribunal under section 18 shall, as far as may be, dispose of the appeal in accordance with the provisions of the Recovery of Debts Due to Banks and Financial Institutions Act(RDDBFI), 1993 and rules made thereunder.

(VIII) Validation of fees levied (Section 18A)

Any fee levied and collected for preferring an appeal to the Debts Recovery Tribunal or the Appellate Tribunal under this Act, before the commencement of the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act, 2004, shall be deemed always to have been levied and collected in accordance with law as if the amendments made to sections 17 and 18 of this Act by sections 10 and 12 of the said Act were in force at all material times.

(IX) Appeal to High Court in certain cases (Section 18B)

- **Any borrower residing in the State of Jammu and Kashmir and aggrieved by any order made by the Court of District Judge under section 17A-**
  - may prefer an appeal, to the High Court having jurisdiction over such Court, within thirty days from the date of receipt of the order of the Court of District Judge.

- **Requirement for preferring an appeal:** No appeal shall be preferred unless the borrower has deposited, with the Jammu and Kashmir High Court, fifty per cent. of the amount of the debt due from him as claimed by the secured creditor or determined by the Court of District Judge, whichever is less. Provided further that the High Court may, for the reasons to be recorded in writing, reduce the amount to not less than twenty-five per cent. of the debt referred here.

(X) Right to lodge a caveat (Section 18C)

- **Filing of a caveat:** Where an application or an appeal is expected to be made or has been made under section 17(1) or section 17A or section 18(1) or section 18B,
(a) the secured creditor, or
(b) any person claiming a right to appear before the Tribunal or the Court of District Judge or the Appellate Tribunal or the High Court, as the case may be, on the hearing of such application or appeal, may lodge a caveat in respect thereof.

- **Notice of caveat**: Where a caveat has been lodged -
  (a) the secured creditor by whom the caveat has been lodged (hereafter in this section referred to as the caveator) shall serve notice of the caveat by registered post, acknowledgement due, on the person by whom the application has been or is expected to be made.
  (b) any person by whom the caveat has been lodged (hereafter in this section referred to as the caveator) shall serve notice of the caveat by registered post, acknowledgement due, on the person by whom the application has been or is expected to be made.

- **Notice on the caveator by adjudicating authority**: Where after a caveat has been lodged, any application or appeal is filed before the Tribunal or the court of District Judge or the Appellate Tribunal or the High Court, as the case may be, the Tribunal or the District Judge or the Appellate Tribunal or the High Court, as the case may be, shall serve a notice of application or appeal filed by the applicant or the appellant on the caveator.

- **Furnishing of copy of application and documents**: Where a notice of any caveat has been served on the applicant or the Appellant, he shall periodically furnish the caveator with a copy of the application or the appeal made by him and also with copies of any paper or document which has been or may be filed by him in support of the application or the appeal.

- **Validity of period of caveat**: Where a caveat has been lodged, such caveat shall not remain in force after the expiry of the period of ninety days from the date on which it was lodged unless the application or appeal has been made before the expiry of the period.

**XI** Right of borrower to receive compensation and costs in certain cases (Section 19)

- If the Debts Recovery Tribunal or the Court of District Judge, on an application made under section 17 or section 17A or the Appellate Tribunal or the High Court on an appeal preferred under section 18 or section 18A, holds that the possession of secured assets by the secured creditor is not in accordance with the provisions of this Act and rules made thereunder, and
- directs the secured creditors to return such secured assets to concerned borrowers or any other aggrieved person, who has filed the application under section 17 or section 17A or appeal under section 18 or section 18A, as the case may be,
- the borrower or such other person shall be entitled to the payment of such compensation and costs as may be determined by such Tribunal or Court of District Judge or Appellate Tribunal or the High Court referred to in section 18B.
9. CENTRAL REGISTRY

The provisions related to Central Registry is contained in chapter IV of the Act. It covers sections 20 to 26 of the Act.

(I) Central Registry (Section 20)

- **Setup of Central Registry**: The Central Government may, by notification, set up or cause to be set up from such date as it may specify in such notification, a registry to be known as the Central Registry with its own seal for the purposes of registration of transaction of securitisation and reconstruction of financial assets and creation of security interest under this Act.

  The head office of the Central Registry shall be at such place as the Central Government may specify and for the purpose of facilitating registration of transactions referred above, there may be established at such other places as the Central Government may think fit, branch offices of the Central Registry.

- **Central Government notifies territorial jurisdiction of the Central Registry**: The Central Government may, by notification, define the territorial limits within which an office of the Central Registry may exercise its functions. The provisions of this Act pertaining to the Central Registry shall be in addition to and not in derogation of any of the provisions contained in the Registration Act, 1908, the Companies Act, 1956 (i.e. Companies Act, 2013), the Merchant Shipping Act, 1958, the Patents Act, 1970, the Motor Vehicles Act, 1988 and the Designs Act, 2000 or any other law requiring registration of charges and shall not affect the priority of charges or validity thereof under those Acts or laws.

Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI) is a Government of India Company licensed under section 8 of the Companies Act, 2013 with Govt. of India having a shareholding of 51% by the Central Government and select Public Sector Banks and the National Housing Bank also being shareholders of the Company.

The object of the company is to maintain and operate a Registration System for the purpose of registration of transactions of securitisation, asset reconstruction of financial assets and creation of security interest over property, as envisaged in the SARFAESI Act.

(II) Integration of registration systems with Central Registry (Section 20A)

- The Central Government may, for the purpose of providing a Central database, in consultation with State Governments or other authorities operating registration system for recording rights over any property or creation, modification or satisfaction of any security interest on such property, integrate the registration records of such registration systems with the records of Central Registry established under section 20, in such manner as may be prescribed.
The Central Government shall after integration of records of various registration systems referred with the Central Registry, by notification, declare the date of integration of registration systems and the date from which such integrated records shall be available; and with effect from such date, security interests over properties which are registered under any registration system referred shall be deemed to be registered with the Central Registry for the purposes of this Act.

(III) Delegation of powers (Section 20B)

The Central Government may, by notification, delegate its powers and functions under this Chapter, in relation to establishment, operations and regulation of the Central Registry to the Reserve Bank, subject to such terms and conditions as may be prescribed.

(IV) Central Registrar (Section 21)

- The Central Government may, by notification, appoint a person for the purpose of registration of transactions relating to securitisation, reconstruction of financial assets and security interest created over properties, who shall be known as the Central Registrar.

- The Central Government may appoint such other officers with such designations as it thinks fit for the purpose of discharging, under the superintendence and direction of the Central Registrar, such functions of the Central Registrar under this Act as he may, from time to time, authorise them to discharge.

(V) Register of securitisation, reconstruction and security interest transactions (Section 22)

- A record called the Central Register shall be kept at the head office of the Central Registry for entering the particulars of the transactions relating to-
  (a) securitisation of financial assets;
  (b) reconstruction of financial assets;
  (c) creation of security interest

- The Central Registrar can keep the records wholly or partly in computer, floppies, diskettes or in any other electronic form subject to the prescribed safeguards. Records kept in these form shall also form a part of the Central Register. The register shall be kept under the control and management of the Central Registrar.

(VI) Filing of transactions of securitisation, reconstruction and creation of security Interest (Section 23)

- The particulars of every transaction of securitisation, asset reconstruction or creation of security interest shall be filed, with the Central Registrar in the prescribed manner and on payment of the prescribed fees., [Section 23(1)]
Provided that the Central Government may, by notification, require registration of all transactions of securitisation, or asset reconstruction or creation of security interest which are subsisting on or before the date of establishment of the Central Registry under section 20(1) within such period and on payment of such fees as may be prescribed.

- The Central Government may, by notification, require the registration of transaction relating to different types of security interest created on different kinds of property with the Central Registry [Section 23(2)]

- The Central Government may, by rules, prescribe forms for registration for different types of security interest under this section and fee to be charged for such registration.

(VII) Modification of security interest registered under this Act (Section 24)

Whenever the terms or conditions, or the extent or operation, of any security interest registered under this Chapter, are, or is, modified it shall be the duty of the ARC to send to the Central Registrar, the particulars of such modification.

(VIII) ARC or secured creditor to report satisfaction of security interest (Section 25)

- The ARC or the secured creditor as the case may be, shall give intimation to the Central Registrar of the payment or satisfaction in full, of any security interest relating to the ARC or the secured creditor and requiring registration under this Chapter, within thirty days from the date of such payment or satisfaction.

- On receipt on intimation, the Central Government shall order that a memorandum of satisfaction shall be entered in the Central Registry.

(IX) Right to inspect particulars of securitisation, reconstruction and security interest transactions (Section 26)

The particulars of securitisation or reconstruction or security interest entered in the Central Register of such transactions kept under section 22 shall be open during the business hours for inspection by any person on payment of such fee as may be prescribed.

10. RECTIFICATION BY CENTRAL GOVERNMENT IN MATTERS OF REGISTRATION, MODIFICATION AND SATISFACTION ETC. (SECTION 26A)

- The Central Government, on being satisfied-

  (a) that the omission to file with the Registrar the particulars of any transaction of securitisation, asset reconstruction or security interest or modification or satisfaction of such transaction or; the omission or mis-statement of any particular with respect to any such transaction or modification or with respect to any satisfaction or other entry made in pursuance of section 23 or section 24 or section 25 of the principal Act was accidental

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or due to inadvertence or some other sufficient cause or it is not of a nature to prejudice the position of creditors; or

(b) that on other grounds, it is just and equitable to grant relief,

may, on the application of a secured creditor or securitisation company or reconstruction company or any other person interested on such terms and conditions as it may seem to the Central Government just and expedient, direct that the time for filing of the particulars of the transaction for registration or modification or satisfaction shall be extended or, as the case may require, the omission or mis-statement shall be rectified.

- Where the Central Government extends the time for the registration of transaction of security interest or securitisation or asset reconstruction or modification or satisfaction thereof, the order shall not prejudice any rights acquired in respect of the property concerned or financial asset before the transaction is actually registered."

### 11. REGISTRATION BY SECURED CREDITORS AND OTHER CREDITORS

The government has introduced new provisions in the form of Chapter IVA in order to encourage registration of security interest by the secured creditors, which shall facilitate uniformity, completeness and transparency in the status of security interest of the creditors over the borrower’s assets.

(I) Registration by secured creditors and other creditors (Section 26B)

- The Central Government may by notification, extend the provisions of Chapter IV relating to Central Registry to all creditors other than secured creditors as defined in clause (zd) of section 2(1), for creation, modification or satisfaction of any security interest over any property of the borrower for the purpose of securing due repayment of any financial assistance granted by such creditor to the borrower.

- From the date of notification, any creditor including the secured creditor may file particulars of transactions of creation, modification or satisfaction of any security interest with the Central Registry in such form and manner as may be prescribed.

- However, a creditor other than the secured creditor filing particulars of transactions of creation, modification and satisfaction of security interest over properties created in its favour shall not be entitled to exercise any right of enforcement of securities under this Act.

- Every authority or officer of the Central Government or any State Government or local authority, entrusted with the function of recovery of tax or other Government dues and for issuing any order for attachment of any property of any person liable to pay the tax or Government dues, shall file with the Central Registry such attachment order with particulars
of the assesse and details of tax or other Government dues from such date as may be notified by the Central Government, in such form and manner as may be prescribed.

- Also If any person, having any claim against any borrower, obtains orders for attachment of property from any court or other authority empowered to issue attachment order, such person may file particulars of such attachment orders with Central Registry in such form and manner on payment of such fee as may be prescribed.

(II) Effect of the registration of transactions, etc. (Section 26C)

- any registration of transactions of creation, modification or satisfaction of security interest by a secured creditor or other creditor or filing of attachment orders under this Chapter shall be deemed to constitute a public notice from the date and time of filing of particulars of such transaction with the Central Registry.

- Where security interest or attachment order upon any property in favour of the secured creditor or any other creditor are filed for the purpose of registration, the claim of such secured creditor or other creditor holding attachment order shall have priority over any subsequent security interest created upon such property and any transfer by way of sale, lease or assignment or licence of such property or attachment order subsequent to such registration, shall be subject to such claim:

Provided that nothing contained in this sub-section shall apply to transactions carried on by the borrower in the ordinary course of business.

(III) Right of enforcement of securities (Section 26D)

- No secured creditor shall be entitled to exercise the rights of enforcement of securities under Chapter III unless the security interest created in its favour by the borrower has been registered with the Central Registry.

(IV) Priority to secured creditors (Section 26E)

- After the registration of security interest, the debts due to any secured creditor shall be paid in priority over all other debts and all revenues, taxes, cesses and other rates payable to the Central Government or State Government or local authority.

- However such priority shall be subject to the provisions of the Insolvency and Bankruptcy Code, 2016, where insolvency or bankruptcy proceedings are pending in respect of secured assets of the borrower.

12. OFFENCES AND PENALTIES

This chapter V of the Act provides of the offences and the penalties for the commission of default in filing of particulars of every transaction of securitisation, asset reconstruction or creation of security interest with Central registry. This chapter covers section 27 to 30 of the Act.
(I) Penalties (Section 27)

If a default is made-

(a) in filing under section 23, the particulars of every transaction of any securitisation or asset reconstruction or security interest created by an ARC or secured creditors; or

(b) in sending under section 24, the particulars of the modification referred to in that section; or

(c) in giving intimation under section 25,

then, every company and every officer of the company or the secured creditors and every officer of the secured creditor who is in default shall be punishable with fine which may extend to five thousand rupees for every day during which the default continues.

Provided that provisions of this section shall be deemed to have been omitted from the date of coming into force of the provisions of this Chapter and section 23 as amended by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016

(II) Offences (Section 29)

- If any person-
  - contravenes or
  - attempts to contravene or
  - abets the contravention of the provisions of this Act or of any rules made thereunder,

he shall be punishable with imprisonment for a term which may extend to one year, or with fine, or with both.

(III) Cognizance of offence (Section 30)

- No court shall take cognizance of any offence punishable under section 27 in relation to non-compliance with the provisions of section 23, section 24 or section 25 or under section 28 or section 29 or any other provisions of the Act, except upon a complaint in writing made by an officer of the Central Registry or an officer of the Reserve Bank, generally or specially authorised in writing in this behalf by the Central Registrar or, as the case may be, the Reserve Bank.

- No court inferior to that of a Metropolitan Magistrate or a Judicial Magistrate of the first class shall try any offence punishable under this Act.

(IV) Power of adjudicating authority to impose penalty (Section 30A)

- Where any asset reconstruction company or any person fails to comply with any direction issued by the Reserve Bank under this Act the adjudicating authority may, by an order,
impose on such company or person in default, a penalty not exceeding one crore rupees or twice the amount involved in such failure where such amount is quantifiable, whichever is more, and where such failure is a continuing one, a further penalty which may extend to one lakh rupees for every day, after the first, during which such failure continues.

- The adjudicating authority shall serve a notice on the asset reconstruction company or the person in default requiring such company or person to show cause why the amount specified in the notice should not be imposed as a penalty and a reasonable opportunity of being heard shall be given to such person.

- Any penalty imposed under this section shall be payable within a period of thirty days from the date of issue of notice, failure of which adjudicating authority shall cancel its registration.

- No complaint shall be filed against any person in default in any court pertaining to any failure under sub-section (1) in respect of which any penalty has been imposed and recovered by the Reserve Bank under this section.

- Where any complaint has been filed against a person in default in the court having jurisdiction no proceeding for imposition of penalty against that person shall be taken under this section.

- "Adjudicating authority" means such officer or a committee of officers of the Reserve Bank, designated as such from time to time, by notification, by the Central Board of Reserve Bank.

- "person in default" means the asset reconstruction company or any person which has committed any failure, contravention or default under this Act and any person in charge of such company or such other person, as the case may be, shall be liable to be proceeded against and punished under section 33 for such failure or contravention or default committed by such company or person.

(V) Appeal against penalties (Section 30B)

- A person in default, aggrieved by an order passed in section 30A(4), may, within a period of thirty days from the date on which such order is passed, prefer an appeal to the Appellate Authority.

- Appellate Authority may entertain an appeal after the expiry of the said period of thirty days, if it is satisfied that there was sufficient cause for not filing it within such period.

(VI) Appellate Authority (Section 30C)

- The Central Board of Reserve Bank may designate such officer or committee of officers as it deems fit to exercise the power of Appellate Authority.

- The Appellate Authority shall have power to pass such order as it deems fit after providing a reasonable opportunity of being heard to the person in default.
The Appellate Authority may, by an order stay the enforcement of the order passed by the adjudicating authority under section 30A, subject to such terms and conditions, as it deems fit.

Where the person in default fails to comply with the terms and conditions imposed by order without reasonable cause, the Appellate Authority may dismiss the appeal.

(VII) Recovery of penalties (Section 30D)

Any penalty imposed under section 30A shall be recovered as a "recoverable sum" and shall be payable within a period of thirty days from the date on which notice demanding payment of the recoverable sum is served upon the person in default and, in the case of failure of payment by such person within such period, the Reserve Bank may recover the sum as per the section.

13. MISCELLANEOUS

Chapter VI of the Act comprises of miscellaneous provisions dealt under sections 31-42 of the Act.

(I) Provisions of this Act not to apply in certain cases (Section 31)

The situations in which the provisions of this Act do not apply are as follows:-

(a) a 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;

(b) a pledge of movables within the meaning of section 172 of the Indian Contract Act, 1872;

(c) creation of any security in any aircraft as defined in clause (1) of section 2 of the Aircraft Act, 1934;

(d) creation of security interest in any vessel as defined in clause (55) of section 3 of the Merchant Shipping Act, 1958;

(e) any rights of unpaid seller under section 47 of the Sale of Goods Act, 1930;

(f) any properties not liable to attachment (excluding the properties specifically charged with the debt recoverable under this Act) or sale under the first proviso to sub-section (1) of section 60 of the Code of Civil Procedure, 1908;

(g) any security interest for securing repayment of any financial asset not exceeding one lakh rupees;

(h) any security interest created in agricultural land;

(i) any case in which the amount due is less than twenty per cent of the principal amount and interest thereon

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(II) Provisions of the Act not to apply in some cases (Section 31A)

- The Central Government may, by notification in the public interest, direct that any of the provisions of this Act,-
  - shall not apply to such class or classes of banks or financial institutions; or
  - shall apply to the class or classes of banks or financial institutions with such exceptions, modifications and adaptations, as may be specified in the notification.

- A copy of every notification proposed to be issued under sub-section (1), shall be laid in draft before each House of Parliament, while it is in session, for a total period of thirty days, and if, both Houses agree in disapproving the issue of notification or both Houses agree in making any modification in the notification, the notification shall not be issued or, as the case may be, shall be issued only in such modified form as may be agreed upon by both the Houses.

- In reckoning any such period of thirty days as is referred to in sub-section (2), no account shall be taken of any period during which the House referred to in sub-section (2) is prorogued or adjourned for more than four consecutive days.

- The copies of every notification issued under this section shall, as soon as may be after it has been issued, be laid before each House of Parliament

(III) Protection of action taken in good faith (Section 32)

- No suit, prosecution or other legal proceedings shall lie against the Reserve Bank or the Central Registry or any secured creditor or any of its officers for anything done or omitted to be done in good faith under this Act.

(IV) Offences by companies (Section 33)

- Where an offence under this Act has been committed by a company, every person who at the time the offence was committed was in charge of, and was responsible to, the company, for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished in accordance with the provisions of the Act.

- But if such person is able to prove that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence, then section 33 does not apply to such person.

- It must also be noted that, where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of the offence and shall be liable to be proceeded against and punished in accordance with the provisions of the Act.
For the purposes of section 33:-

(a) "company" means any body corporate and includes a firm or other association of individuals; and

(b) "director", in relation to a firm, means a partner in the firm.

(V) Civil Court not to have jurisdiction (Section 34)

No civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which a Debts Recovery Tribunal or the Appellate Tribunal is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act or under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993.

(VI) The provisions of this Act to override other laws (Section 35)

The provisions of this Act shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law.

(VII) Limitation (Section 36)

No secured creditor shall be entitled to take all or any of the measures under sub-section (4) of section 13, unless his claim in respect of the financial asset is made within the period of limitation prescribed under the Limitation Act, 1963.

(VIII) Application of other laws not barred (Section 37)

The provisions of this Act or the rules made thereunder shall be in addition to, and not in derogation of, the Companies Act, 2013, the Securities Exchange Board of India Act, 1992, the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 or any other law for the time being in force.

(IX) Application of other laws not barred (Section 38)

The Central Government may, by notification and in the Electronic Gazette make rules for carrying out the provisions of this Act. In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely:-

(a) other business or commercial rights of similar nature under clause (t) of section 2;

aa. the form and manner in which an application may be filed under sub-section (10) of section 13;

(b) the manner in which the rights of a secured creditor may be exercised by one or more of his officers under section 13(12);

ba. the fee for making an application to the Debts Recovery Tribunal under section 17(1);
bb. the form of making an application to the Appellate Tribunal under section 17(6);
bc. the fee for preferring an appeal to the Appellate Tribunal under section 18(1);
bc.a. the manner of integration of records of various registration systems with the records of Central Registry under sub-section (1) of section 20A;
bcb. the terms and conditions of delegation of powers by the Central Government to the Reserve Bank under section 20B.*;
(c) the safeguards subject to which the records may be kept under sub-section (2) of section 22;
(d) the manner in which the particulars of every transaction of securitisation shall be filed under section 23 and fee for filing such transaction;
da. the form for registration of different types of security interests and fee thereof under sub-section (3) of section 23;*;
(e) the fee for inspecting the particulars of transactions kept under section 22 and entered in the Central Register under sub-section (1) of section 26;
(f) the fee for inspecting the Central Register maintained in electronic form under sub-section (2) of section 26;
fa. the form and the manner for filing particulars of transactions under sub-section (2) of section 26B;
fb. the form and manner of filing attachment orders with the Central Registry and the date under sub-section (4) of section 26B;
fc. the form and manner of filing particulars of attachment order with the Central Registry and the fee under sub-section (5) of section 26B.*.
(g) any other matter which is required to be, or may be, prescribed, in respect of which provision is to be, or may be, made by rules.

- **Power of Central Government to make rules** Every rule made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or both Houses agree that the rule should not be made, the rule shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule.
Examples

1. Facts
   - ABC Bank has provided term loan of 10 crores to XYZ Ltd., a steel manufacturing company at an interest rate of 10% p.a. and principal amount is to be payable in equal quarterly instalments within 5 years from the date of disbursement of loan.
   - The loan is fully secured against plant & machinery.
   - The company successfully repaid 4 instalments along with interest during the first year. From the start of second year, the EBITDA of the company fell drastically due to multiple factors including crash in steel prices, rise of coal and iron ore prices, and plant shut down. The company therefore couldn’t repay the 5th instalment but it paid the interest amount as and when due.
   - After the end of 60 days from the due date of the 5th instalment the credit manager of the bank decided to sell the loan to LMN ltd., an asset reconstruction company, along with the overdue loan of 2 crore to another textile company, which was classified as NPA six months ago, and a loan of ₹ 2 crore to a farmer Mr JKL, secured against agriculture land.
   - Please analyse and advise the manager whether he can do so?

Analysis:
   - The balance amount is 8 crore (i.e 80% of the total loan value), which is more than 20% of the total principal and interest amount (s. 31(j)). The loan is a financial asset and the bank has security interest as defined in the act.
   - For enforcement of security under this act, there has to be a default as defined u/s 2(1)(j), which requires the classification of the asset as NPA. In the immediate case of steel company, the debts are overdue by only 60 days, and is therefore still not classified as NPA (NPA classification shall happen after 90 days), unlike the loan of textile company.
   - In absence of the other facts of the case of the textile company, we cannot comment if ‘default’ exists and it can be sold to LMN ltd.
   - Further the loan given to Mr JKL being secured against agricultural land, cannot be sold as the provisions of SARFAESI act is not applicable to such assets (s. 31(j)).

2. Facts
   - XYZ Finance Ltd. is an NBFC company with total assets of 550 crore, and an NPA of 50 crore in its balance sheet.
   - The 50 crore loan consists of 9 cases of 5 crore each and 10 cases of 50 lakhs each.
The management of the company wants to sell bad loans worth 50 crore to an ARC. Of the ₹50 crore, 45 crore is secured against various properties, while one case of 5 crore is unsecured.

During detailed discussion with the in-house legal counsel, it came to light that 2 crore of the secured bad loan has not been registered with the central registry CERSAI, however this was not informed to the buyer in the preliminary discussion.

Please analyse and advise the CEO of XYZ finance ltd. how much bad loan can he sell to the ARC?

**Analysis:**

- Sarfaesi is applicable to only those notified NBFC which has an asset base of 500 crore or above, hence in this case the XYZ finance ltd. shall be able to sell the bad loans to ARCs through Sarfaesi.
- Further SARFAESI is applicable to secured loans only, therefore only 45 crore of bad loans can be sold to ARC under SARFAESI.
- As per section 26D no secured creditor shall be entitled to exercise the rights of enforcement of securities under Chapter III unless the security interest created in its favour by the borrower has been registered with the Central Registry, therefore the buyer may not be keen to take over the unregistered loan of 5 crore.
- Further NBFCs can invoke SARFAESI for only those cases which are over 1 crore, therefore the 10 cases of 50 lacs each cannot be sold to ARC under SARFAESI.
- Therefore, we are left with 8 cases of 5 crore each which can be sold to ARC subject to meeting all other conditions of the law.

**3. Facts**

- A newly formed ARC has acquired secured interest on few assets in steel sector. The sector is undergoing cyclical recession due to global meltdown and increase in raw material price.
- The management is now contemplating various options through which it can realise its assets.
- What are the measures with the ARC management under the SARFAESI law?

**Analysis:**

- Section 9 deals with measures for asset reconstruction which provides for the following measures:
  - the proper management of the business of the borrower, by change in, or take over of, the management of the business of the borrower;
  - the sale or lease of a part or whole of the business of the borrower;
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- rescheduling of payment of debts payable by the borrower;
- enforcement of security interest in accordance with the provisions of this Act;
- settlement of dues payable by the borrower;
- taking possession of secured assets in accordance with the provisions of this Act;
- conversion of any portion of debt into shares of a borrower company: Provided that conversion of any part of debt into shares of a borrower company shall be deemed always to have been valid, as if the provisions of this clause were in force at all material times.

Further Chapter III deals with the enforcement of security interest, which provides for the following modes of security enforcement:

- take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset;
- take over the management of the business of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset:
  - Provided that the right to transfer by way of lease, assignment or sale shall be exercised only where the substantial part of the business of the borrower is held as security for the debt:
  - Provided further that where the management of whole of the business or part of the business is severable, the secured creditor shall take over the management of such business of the borrower which is relatable to the security for the debt;
- appoint any person (hereafter referred to as the manager), to manage the secured assets the possession of which has been taken over by the secured creditor;
- 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.

4. Facts

- ABC limited has issued listed bonds five years ago, which is due to be redeemed in the current year worth 50 crore. Market analyst feels that the projected cash flows and profitability seems inadequate to repay the bond value.
- The single largest bond holder BH Ltd. holds bonds worth 20 crore, and wants to explore its options under SARFAESI law, in case ABC limited fails to repay the debt.
- Please advise whether BH ltd. can have recourse to the SARFAESI Act.
Analysis:

- The definition of secured creditor under section 2(zd) of SARFAESI act has been amended so as to include debenture trustee appointed in respect of debt securities, and corresponding changes have also been made in SARFAESI Act and RDDBFI Act. Hence it shall have recourse to all options available to any secured creditor under the law such as enforcement of security, sale of loans to ARC etc. Unlike NBFC for which a threshold of assets of 500 crore is put for applicability of the SARFAESI act, there is no such limit for debenture holders.
Question 1

RST Ltd. is a securitization and reconstruction company under SARFAESI Act, 2002. The certificate of registration granted to it was cancelled. State the authority which can cancel the registration and the right of RST Ltd. against such cancellation.

Answer

Cancellation of Certificate of Registration under SARFAESI Act, 2002:

The Reserve Bank of India may cancel a certificate of registration granted to a securitisation and reconstruction company for the reasons stated in Section 4 of SARFAESI Act, 2002.

RST Ltd., can prefer an appeal to the Central Government (Secretary, Ministry of Finance, Government of India) within a period of 30 days from the date on which order of cancellation was communicated to it. The Central Government must also give such company a reasonable opportunity of being heard before rejecting the appeal. If RST Ltd., is holding investments of qualified institutional buyers at the time of cancellation of certificate of registration, it shall be deemed to be a securitisation and reconstruction company until it repays the entire investments held by it, together with interest if any, within such period as may be specified by the Reserve Bank.

Question 2

Referring to the provisions of the Securitisation & Reconstruction of Financial Assets & Enforcement of Security Interest Act, 2002 state the circumstances under which the Reserve Bank of India may cancel the certificate of registration granted to a Securitisation Company.

Answer

Cancellation of Certificate of Registration (Section 4 of the securitisation & reconstruction of financial assets & enforcement of Security Interest Act, 2002)

As per the section 4 of the Securitisation & Reconstruction of Financial Assets & Enforcement of security Interest Act, 2002, the Reserve Bank may cancel a certificate of registration granted to a securitization company or a reconstruction company, if such company-

(i) ceases to carry on the business of securitisation or asset reconstruction; or
(ii) ceases to receive or hold any investment from a qualified institutional buyer; or
(iii) has failed to comply with any conditions subject to which the certificate of registration has been granted to it; or
(iv) at any time fails to fulfil any of the conditions referred to in clauses (a) to (g) of sub-section (3) of section 3; or
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(v) fails to-

(a) comply with any direction issued by the Reserve Bank under the provisions of this Act; or

(b) maintain accounts in accordance with the requirements of any law or any direction or order issued by the Reserve Bank under the provisions of this Act; or

(c) submit or offer for inspection its books of account or other relevant documents when so demanded by the Reserve Bank; or

(d) obtain prior approval of the Reserve Bank required under sub-section (6) of section 3.

Question 3

Apex Limited failed to repay the amount borrowed from the bankers, ACE Bank Limited, which is holding a charge on all the assets of the company. The bank took over management of the company in accordance with the provisions of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 by appointing four persons as directors. The company is managed by a Managing Director, Mr. X. Referring to the provisions of the said Act, examine whether Mr. X is entitled to compensation for loss of office and also explain the effect of such takeover on certain rights of the shareholders of the company.

Answer

Apex Limited failed to repay the amount borrowed from the bankers, ACE Bank Limited, which is holding a charge on all the assets of the company. The bank took over management of the company in accordance with the provisions of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 by appointing four persons as directors. The company is managed by a Managing Director, Mr. X.

Here, Apex Limited is a borrower and ACE Bank Limited is a secured creditor.

Compensation to Managing director (Mr. X) for loss of office:

According to section 16 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, irrespective of anything contained in any contract or in any other law for the time being in force, no managing director or any other director or a manager or any person in charge of management of the business of the borrower shall be entitled to any compensation for the loss of office or for the premature termination under this Act. However any such managing director or any other director or manager or any such person in charge of management has the right to recover from the business of the borrower, moneys recoverable otherwise than by way of such compensation.
Effect of takeover on rights of the shareholders:

Where the management of the business of a borrower, being a company as defined in the Companies Act is taken over by the secured creditor, then, notwithstanding anything contained, such borrower- in the said Act or in the memorandum or articles of association of such company -

(1) it shall not be lawful for the shareholders of such company or any other person to nominate or appoint any person to be a director of the company;

(2) no resolution passed at any meeting of the shareholders of such company shall be given effect to unless approved by the secured creditor;

(3) no proceeding for the winding up of such company or for the appointment of a receiver in respect thereof shall lie in any court, except with the consent of the secured creditor.

The secured creditor is under an obligation to restore the management of the business of the borrower, on realisation of his debt in full, in case of takeover of the management of the business of a borrower by such secured creditor.

Provided that if any secured creditor jointly with other secured creditors or any asset reconstruction company or financial institution or any other assignee has converted part of its debt into shares of a borrower company and thereby acquired controlling interest in the borrower company, such secured creditors shall not be liable to restore the management of the business to such borrower.

Question 4

Under Section 31 of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, certain situations have been specified in which the provisions of this Act are not applicable. You are required to mention any four of such situations.

Answer

Under Section 31 of the SARFAESI Act, 2002, the situations in which the provisions of this Act do not apply are as follows:

(i) a 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;

(ii) a pledge of movables within the meaning of section 172 of the Indian Contract Act, 1872;

(iii) Creation of any security in any aircraft as defined in clause (1) of section 2 of the Aircraft Act, 1934;

(iv) Creation of security interest in any vessel as defined in clause (55) of section 3 of the Merchant Shipping Act, 1958;

(v) Omitted

(vi) any rights of unpaid seller under section 47 of the Sale of Goods Act, 1930
(vii) any properties not liable to attachment (excluding the properties specifically charged with the
debt recoverable under this Act) or sale under the first proviso to sub section (1) section 60 of
the Code of Civil Procedure, 1908;

(viii) any security interest for securing repayment of any financial asset not exceeding one lakh
rupees;

(ix) any security interest created in agricultural land;

(x) any case in which the amount due is less than twenty percent of the principal amount and
interest thereon.