Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002

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The act is basically divided into three chapters: -

- Enforcement of Security Interest, without protracted legal battle.
- Securitisation of Financial Assets, to provide legal framework for Securitisation of Standard Assets
- Reconstruction of Financial Assets & formation of Asset Reconstruction company

- ❖ **INTRODUCTION**

RAJAN MEETS PM AND FM

18.09.2013

RBI, Finmin to Stem Rising Bad Loans

Reserve Bank of India Governor Raghuram Rajan after his meeting with Finance Minister P Chidambaram at North Block in New Delhi on Tuesday

- ➢ The Reserve Bank of India (RBI) governor Raghuram Rajan and the finance ministry will work out measures to stem the rising bad loans and ways to strengthen the banking sector.

- The meeting also set stage for more financial and managerial autonomy for bank boards, and additional powers to recover bad loans through the Debt Recovery Tribunals or SARFESI Act. The non-performing accounts or bad loans of state run banks rose to 3.84% of advances at the end of March from 2.32% in March 2011, forcing the ministry to look into the issue.

  The finance ministry has been pushing banks to focus on their top 30 non-performing assets or NPAs. As on March 2013, top 30 NPAs of state-run banks are worth Rs. 61,123 crores and constitute for 39.7% of their gross NPAs.

  (C.E.T. Report dated 18/09/2013)

- Inspite of various checks/balances/controls/Basel II & III norms, The Banking sector is still in highly volatile situation. To face all these reforms, banks wanted some reforms in controlling their Non performing Assets or recovery of their dues.
- In DRT Act many problems are still persisting as being Tribunal it has to follow civil Procedure Code necessitating long legal procedures, adjournments, vacations etc. Also numbers of courts are less as compared to pending cases, and when matter becomes sub-judice, no Banks or Institutions can take any action.

❖ SALIENT FEATURES OF ACT ENFORCEMENT OF SECURITY INTEREST

- The new Act is effective from 21.06.2002 – it allows secured lenders to take Possession or assign sell, lease assets which are charged with them by a defaulting borrower (classified as NPA) without a protracted legal tussle. Section 13(1)
- 'Non Performing Asset' means an asset or account of a borrower, which has been classified by a bank or financial institution and sub-standard, doubtful or loss asset.
- This Act requires 60 days Notice to be given to the defaulter.
- If the borrower thereafter fails to respond to the notice by offering payment, the secured lender at his discretion can take any of the following actions: Section 13(4)
  - i) Take possession of the assets mortgaged and transfer the same either by selling or by leasing.
  - ii) Takeover the management of the secured assets of the defaulting borrower.
  - iii) Can appoint manager to take charge of secured assets taken into Possession.
  - iv) Ask any person from whom the moneys are due to the borrower to pay directly to secured creditors.
- If there are more than one secured creditors, the decision to make the provision of this Act will be made applicable only when 60% of them are agreeable. Section 13 (9).
- In the event of any expected resistance Chief Metropolitan Magistrate or District Magistrate help can be sought who will assist secured creditors on request being made to them. (Section 14).
- In the event total dues of the secured creditors are not recovered from sale of secured assets, they will have the right of approaching DRT for recovery of balance amount from the borrowers and / or guarantors. Section 13 (10).

❖ OTHER IMPACTS / FACTS

- On receiving the notice, no borrower can sell, lease or transfer the secured assets mentioned in the notice, without the lenders consent. Section 13 (13).
- This Act overrides some of the provisions of Companies Act, 1956 as well as section 69 & 69(A) of the Transfer of Property Act.
- Bankers can act even on those cases which are pending with the BIFR or even with official liquidator provided more than 60% of such secured creditors agree to the same.
- No injunction shall be granted by any civil court or other authority in respect of action taken under this Act. (Section 34).
- Secured lender can parallel/independently, take action against guarantor's security & can take possession/dispose of & recover their dues. The guarantor in that case will step into shoes of secured lenders and can proceed against principal borrowers & receiver amount paid/value borrower. Surety's liability is co-extensive with that of the principal debtor.
- 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 secured creditor, to bid for the immovable property at any subsequent sale and the amount of the purchase price shall be adjusted towards the amount of the claim of the secured creditor Section 13(5a).

❖ RIGHTS OF BORROWERS

- On receipt of notice the borrower can raise objections and / or make representations about contents of the notice. The secured creditors must respond within 15 days about acceptance/non acceptance in writing.
- A borrower can object to the measures taken under this Act within 45 days without depositing any amount with DRT. (Section 17).
- If not satisfied with outcome of the Appeal, either of the parties can prefer second appeal with Debt Recovery Appellate Tribunal where if the borrower is objecting, he has to deposit 50% of the amount outstanding which can also be reduced to 25% at the discretion of the Appellate Tribunal.
- If at any of the Appeal level, it can be established that the possession of secured assets by the secured creditor was wrongful then DRT/Appellate Tribunal will direct the secured creditor to return such secured assets to the concerned borrower. (Section 19)
- Limitation as prescribed under Limitation Act 1963 will be applicable even to this Act. (Section 36)

❖ WHERE IT IS NOT APPLICABLE (Sec 31)

The Provision of this Act shall not apply to

- A lien on any goods – Indian Contract Act, 1872
- A pledge of movables - 1872
- Creation of any security in any aircraft – Aircraft Act,1934
- Creation of security interest in any vessel – Merchant Shipping Act 1958
- Any conditional sale, hire purchase or lease or any other contract in which no security interest has been created.
- Any right of unpaid seller under section 47 of the sale of Goods. Act 1930
- Any security interest for securing repayment of any financial asset not exceeding one lakh rupees.
- Any security interest created in agricultural land
- Any case in which the amount due is less than twenty percent of the principal amount and interest thereon.

❖ THE SECURITISATION OF FINANCIAL ASSETS

- In India, securitization as financial tool has come in to vogue since last couple of years. It has been mainly utilized by private and foreign banks and financial institutions to create additional liquidity out of long-term loan/assets. Most of the vehicle financing leasing entities, white goods financing entities and housing finance companies have already raised funds by way of Asset Based Securitization.

- Securitization is the method of creating new financial instrument, which allows lenders to sell their particular loan portfolio by way of issue of security instruments, which are backed by the rights to receive payment from original borrowers.

- The Process of Securitization can be summarized as follows –

- Lender sells various types of loans to borrowers. It has to be an Arms Length “true sale” and of Standard Assets only.

- Out of these loans, he packs certain loans together and sells these to Securitization Company/SPV at discounted value.

- The Securitization Company makes payment to original lender for loans purchased, OR

- SPV will issue securities to investors collect money to be paid to ORIGINATOR.

- These loans are converted into a pool of securities by the Securitization Company for purpose of issuing Pass Through or Pay Through Certificates (PTC)

- These PTCs are sold to individual investors or qualified institutional buyers.(QIBs)

- The recoveries from original borrowers are obtained by original lender (in case of Pass Through Certificates) or by Securitization company (in case of Pay Through Certificates).

- The Securitization Company passes on these amounts to individual investors.

- The Securitization Company will earn out of spread between purchase price of bundle of loan assets and difference in coupon rate of P.T.C.

- In case of a default, securitization company will take action against the borrower and if there are losses, same will be divided amongst investors.

❖ WHO CAN DO SECURITISATION

- The Securitisation will be done through new/ existing company, which must have minimum Net worth as prescribed by RBI / Government**.**

- Securitisation company is not allowed to carry on any other business activities except that of Securitisation & Reconstruction of Assets.

- Securitisation Companies who are registered with RBI cannot make substantial change in the management or location etc. without prior approval of RBI.

- ***Regulatory Provisions***:- SEBI has now come out with SEBI (Public Offer and Listing of Securitized Debt Instruments) Regulation, 2008 (SDI Regulations) notified in 2008. SEBI has now classified the players into different categories and have made it mandatory to get ratings from 2 different rating agencies before public offerings & listing.

❖ BENEFITS OF SECURITISATION:-

- ***LIQUIDITY***: Selling of a portfolio results in availability of ready cash.

- ***RAISE CHEAPER FUNDS:*** Experience in USA & EU shows that securitization is a cheaper form of raising finance for the originator than the traditional forms of debt financing.

- ***CONVERSION OF MARKETABLE SECURITIES***: Assets such as personal loans, residential mortgages, credit card receivables, lease/hire receivables and trade receivables which are not always marketable in their original forms are converted into marketable securities.

- ***TRANSFER OF RISKS***: Transfer of assets to an SPV results in transfer of all associated risks such as default risk, currency risk & interest risk.

- ***MAINTAIN CAPITAL ADEQVACY RATIO***: Balancing of Capital Adequacy Ratio as the capital is freed for further business.

- ***GENERATE INCOME:*** Steady & safe income for investors like Pension & Gratuity Funds/ Trusts etc.

- ***DRAWBACKS:***
  1. Taxation Issues
  2. Court Battles/Litigations
  3. Stamp Duty

❖ ASSET RECONSTRUCTION COMPANY

- Assets Reconstruction has been defined as acquisition of right / interest of any Bank / Financial Institution in any loan for the purpose of realization of such loan / Credit facilities for Reconstruction purpose.

- Reconstruction Company for proper management of financial assets acquired is authorized and may take any of the following steps.

- Change or take over the business of the borrower.

- Sale or lease (Part or full) business of the borrower.

- May reschedule the repayment program.

- Go for one time or other settlement with borrower.

- Take possession of secured assets under this act.

- Can appoint manager to take charge of assets taken into possession.

- Can convert any portion of debt into shares of a borrower company.

❖ OTHER IMPORTANT PROVISIONS

- Chapter II Section 3 – Registration of Securities Companies with RBI
- Section 8 – Exemption from Registration of Security Receipt Section 9 – Measures for Assets Reconstruction
- Section 12 – Powers of RBI
- Chapter III: Section 13 – Enforcement of security interest
- Section 14 – Magistrate’s help
- Section 15 – Manner & effect of takeover of management
- Section 17– Gives the borrowers Right to Appeal
- Chapter VI: Section 31 narrates Exemption to certain category
- Section 34 – Prohibits No Injunction to certain category
- Section 35 – Empowers overriding some of the provisions of other Acts like Companies Act, Transfer of Property Act, etc.
- Section 36 – Limitation Act is still applicable
- Section 37 – Application of other laws for additional support

➢ CENTRAL REGISTRY

- Central Registry is basically intended to maintain centralized records of all Securitisation, Asset Reconstruction as well as creation of Security Interest. This will be similar to sub –Registrars office or R.O.C. where all changes are registered
- All such transactions of Securitisation Asset reconstruction's or security interest or any modification there in must be informed to such central Registrar within 30 Days of such transaction.
- Government of India has already issued notifications prescribing various rules in March, 2011.
- Though Securitization Act has proved to be very useful to financial sector, yet there are number of issues which are not yet resolved. Some of which are enumerated here below.

❖ FAQ

1. Can you continue your suit filed with DRT and also take action under Securitization Act?
2. What happens to all the reference filed with BIFR?
3. What happens to all the cases where winding up petitions have been field?
4. What if winding up order has been issued by respective state high court?
5. What happens to outstanding sales tax dues vis-à-vis secured creditors?
6. What happens to outstanding TDS / IT dues?
7. What happens to outstanding Professional Tax / works contract / Service Tax vis-à-vis secured creditors?
8. When the stamp duty will be attracted? At the time of taking possession or at the time of sale?
9. Who will bear cost of visits/valuation etc before taking possession?
10. What will happen in the event of document through mortgagee is still lying with registering authorities and the mortgagee is only holding original receipt with instruction to sub Registrars that in the event of register the same should be sent to mortgagee.
11. Is it mandatory to obtain IT Clearance U/s 281 OF Income Tax Act?
12. Is it necessary that mortgage be created by original owners or even POA can do it?

13. In the event of death of guarantor who has allowed creation of mortgage in favor of some other borrowers, can enforcement of security interest provision be applied?
14. In the case of mortgaged properties situated at MIDC/GIDC or other cooperative industrial estate will possession taking/sales etc attract transfer fees? Similarly can residential/commercial premises in any cooperative society charge for transfer fees? In some societies they collect forced donations also what will happen to that.

- **IMPORTANT CASE LAWS**

- United Bank of India Vs Satyawathi Tondon and others [5]
- Malhotra Tractors Vs Chief Manager, SBI, Faizabad [18]
- Indian Bank Vs. Blue Jaggers Estates Limited
- UCO Bank Vs Union of India
- Bank of India Vs Assistant Provident Commissioner
- Krishna Chandra Sahooo Vs Bank Of India
- M/S TRANSCORE Vs UNION OF INDIA & ANR
- IDBI Vs KAMALDEEP SYNTHETICS LIMITED IN THE HIGH COURT OF JUDICATURE AT MADRAS
- Mardia Chemicals Ltd. Vs. Union of India and Ors.
- Kalupur Commercial Co-operative Bank Ltd Vs. O.L. of Navrang Synthfab P. Ltd. & Ors [(2008) 143 COMP CAS 115 (GUJ) K.A. PUJ, J. [Decided on 20.02.2008]

THANK YOU ALL !!!