

# Securitisation And Reconstruction Of Financial Assets And Enforcement Of Security Interest Act 2002

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## INTRODUCTION

- 1.1** The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 has come into force with effect from 21<sup>st</sup> June 2002, the date on which the ordinance was first promulgated. The Central Government has notified the Securities Interest (Enforcement) Rules 2002, in accordance with the powers conferred by sub-section (1) and clause (b) of sub-section (2) of section 38 read with sub-section (4), (10) and (12) of section 13 of the said Act. The Act aims to regulate securitisation and reconstruction of financial assets and enforcement of security interest and for the matters connected therewith or incidental thereto.
- 1.2** This new legislation gives certain powers to secured creditors such as Bank and Financial Institutions (FIs), and applies to Non-Performing Assets (NPAs), duly classified as per the Reserve Bank of India (RBI) norms. It gives to the secured creditor, the option to either (a) transfer security interest to a Securitisation or Reconstruction Company, or (b) to enforce the provisions on its own. Under section 13 (4), the secured creditors may, after 60 days notice, either take possession of the assets and dispose them of, or take over the management of the assets, or claim an amount from the acquirer of the security who owes a sum on that account to the borrower. Thus sweeping powers have been granted

for the recovery of the dues.

## 2.0 THE NPA MENANCE

- 2.1** The prudential norms on income recognition issued by the RBI on 4-7-2002 define NPA as:
- 2.1.1** Interest and/or installment of principal remain overdue for a period of more than 180 days in respect of a Term Loan,
- 2.1.2** The account remains out of order for a period of more than 180 days, in respect of an Overdraft/Cash Credit (OD/CC),
- 2.1.3** The bill remains overdue for a period of more than 180 days in the case of bills purchased and discounted,
- 2.1.4** Interest and/or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purpose, and
- 2.1.5** Any amount to be received remains overdue for a period of more than 180 days in respect of other accounts.

With a view to move towards international best practices and to ensure greater transparency, it has been decided by the RBI to adopt the '90 days' overdue' norm for identification of NPAs, from the year ending March 31, 2004. As a result of this, with effect from 31<sup>st</sup> March, 2004, the time period of 180 days as mentioned in para 2.1.1, 2.1.2, 2.1.3 & 2.1.5 above shall be replaced with a time period of 90 days, other conditions in the definition shall remain the same.

- 2.2** As of March 2001 net NPAs at Rs 64,000 crores accounted for 11.8 per cent of the advances in the

*The author is a member of ICAI. The views expressed herein are the personal views of the author and do not necessarily represent the views of the Institute.*

banking sector. Till now banks could do little about recovering this money, as defaulters took refuge in an overburdened legal system and the lack of foreclosure laws. But the Securitisation Law promises to change all that, much to the discomfiture of defaulters. Now, it is no longer necessary for banks to fight in court. They can simply seize the assets of the company and sell them to the highest bidder. According to news reports, banks have already issued defaulters with notice to the tune of several thousand crores, which has brought many of them to the table.

- 2.3** This is great news for banks, and will help them convert bad loans into cash. Lower NPAs improve capital adequacy and make future lending less risky. It's also good for the economy as whole, as idle or non-productive assets can one be churned and their value unlocked.

**3.0 TRANSACTION TO WHICH THE ACT IS NOT APPLICABLE:**

- 3.1** The provision of this Act shall not apply to:-
- 3.1.1** A lien on any goods, money or security given by or under the Indian Contract Act, 1872 (9 of 1872) or the Sale of Goods Act, 1930 (3 of 1930) or any other law for the time being in force;
  - 3.1.2** A pledge of movables within the meaning of section 172 of the Indian Contract Act, 1872 (9 of 1872);
  - 3.1.3** Creation of any security in any aircraft as defined in clause (1) of section 2 of the Aircraft Act, 1934 (24 of 1934);
  - 3.1.4** Creation of security interest in any vessel as defined in clause (55) of section 3 of the Merchant Shipping Act, 1958 (44 of 1958);
  - 3.1.5** Any conditional sale, hire-purchase or lease or any other contract in which no security interest has been created;
  - 3.1.6** Any rights of unpaid seller under section 47 of the Sale of Goods Act, 1930 (3 of 1930);
  - 3.1.7** Any properties not liable to attachment or sale under the first proviso to sub-section (1) of section 60 of the Code of Civil Procedure, 1908 (5 of 1908);
  - 3.1.8** Any security interest for securing repayment of any financial asset not exceeding one lakh rupees;

- 3.1.9** Any security interest created in agricultural land;
- 3.1.10** Any case in which the amount due is less than twenty percent of the principal amount and interest thereon.

**4.0 RIGHTS OF SECURED CREDITOR**

- 4.1** The Secured Creditor has been defined to mean any bank or financial institution or any consortium or group of banks or financial institutions and includes: -
- 4.1.1** Debenture trustee appointed by any bank or financial institution; or
  - 4.1.2** Securitisation company or reconstruction company; or
  - 4.1.3** Any other trustee holding securities on behalf of a bank or financial institution, in whose favour security interest is created for due repayment by any borrower of any financial assistance;
- 4.2** The secured creditor has two options. It can either transfer the assets to a securitisation or reconstruction company or exercise the powers under the Act.
- 4.3** Section 13 (4) of the Act empowers the recourse to one more of the following measures, after giving proper notice, for the recovery of the secured debts, namely: -
- 4.3.1** Take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realizing the secured asset;
  - 4.3.2** Take over the management of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale and realize the secured asset;
  - 4.3.3** 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;
  - 4.3.4** Require at any time by notice in writing, any person who has acquired any of the secured assets from the borrower and from whom any money is due or may become due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.
- 4.4** Thus where a credit facility is out of order for two quarters, or more the banks can initiate action under this Act. The wide powers given to the banks are better equipped to recover their dues.

- 4.5 In cases of joint financing under Consortium or Multiple lending arrangements if 75% of the secured creditors in the value agree to initiate recovery action the same is binding on all secured creditors.
- 4.5 In case of a company under liquidation, the amount realized from the sale of the secured assets are to be distributed in accordance with the provisions of section 529 A of the Companies Act, 1956. If the company is being wound up after the commencement of this Act, the secured creditor of such company, who opts to realize its security instead of relinquishing its security and proving its debts under proviso to sub-section (1) of section 529 of the Companies Act, may retain the sale proceeds of its secured assets after depositing the workmen's dues with the liquidator in accordance with the provisions of section 529 A of that Act.
- 4.7 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.
- 4.8 Secured creditor is entitled to proceed against the guarantors or sell the pledged assets without first taking any of the measures specified in clause (a) to (d) of sub-section (4) in relation to the secured assets under this Act.

## 5.0 TAKE OVER OF MANAGEMENT

- 5.1 When the management of business of a borrower is taken over by a secured creditor it can appoint as many persons as it thinks fit to be the directors, where the borrower is a company, or the administrators of the business of the borrower, in any other case.
- 5.2 The secured creditor is required to publish 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.
- 5.3 On the publication of the notice all persons who were directors of the company or administrators of the business, as the case may be, are deemed to have vacated their office. It also has the effect of termination of all contracts entered into by the borrower with such directors or administrators. No compensation is payable to such a director or manager whose services are terminated.
- 5.4 Where the management of the business of a borrower, being a company as defined in the Companies Act, 1956 (1 of 1956), is taken over by the secured creditor, then, notwithstanding anything contained in the said Act or in the memorandum or articles of association of such borrower: -
- 5.4.1 It shall not be lawful for the shareholders of such company or any other person to nominate or appoint any person to be director of the company;
- 5.4.2 No resolution passed at any meeting of the shareholders of such company shall be given effect to unless approved by the secured creditor;
- 5.4.3 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;
- 5.4.4 Where the management of the business of a borrower had been taken over by the secured creditor, the secured creditor shall, on realization of his debt in full, restore the management of the business of the borrower to him.

## 6.0 APPELLATE MECHANISM

- 6.1 Any borrower or any other person aggrieved by the action of the secured creditors can file an appeal to the concerned Debt Recovery Tribunal (DRT). To ensure that such appeal provision is not abused to delay or defeat the proceedings for recovery section 17 (2) requires the borrower to deposit 75% of the amount claimed with the DRT. The appellate authority is given the discretion to waive or reduce the amount to be deposited for reasons to be recorded.
- 6.2 Such appeal can also be filed by any person aggrieved by the action of the secured creditor without being required to deposit any amount with the DRT. Such provisions will take care of any third party interest in the secured assets which need to be considered before sale of securities. Any person aggrieved by the order of DRT, may prefer an appeal to the Appellate Tribunal.

**7.0 Central Registry**

- 7.1 The Central Government is empowered to setup by notification a registry to known as Central Registry with its own seal for the purpose of registration of transactions of securitisation and reconstruction of financial assets and creation of security interest under this Act. The head office and the branches of the central registry shall be at such places as the Central Government may specify. The territorial limits with in which the Registry can exercise its functions shall be specified by the Central Government.
- 7.2 The Central Government will appoint a person called the Central Registrar who will exercise the powers granted to the Central Registry. Also the Central Government shall appoint other officials who shall discharge their functions under the directions of the Central Registrar.
- 7.3 A register called the Central Register will be kept at the head office of the Central Registry for entering the particulars of the transactions relating to securitisation and reconstruction of financial assets and creation of security interest under this Act. The Central Register may be maintained in electronic form in Floppies or Diskettes subject to such safe guards as may be prescribed.
- 7.4 The Register will be kept under the control and management of the Central Registrar.
- 7.5 The particulars of every transaction of securitisation asset reconstruction or creation of security interest is required to be filed with the Central Registrar in the manner and on payment of such fee as may be prescribed with in 30 days after the date of such transaction or creation of security by the securitisation/ reconstruction company or secured creditor as the case may be. The Central Registrar shall have the power to allow extension of 30 days on payment of such additional fee not exceeding 10 times the amount of such fee.
- 7.6 The particulars of any change in the terms and conditions or the extent or operation of the security interest registered under this chapter shall be sent to the Registrar by the securitisation/reconstruction company or secured creditor.
- 7.7 The Central Registrar shall be intimated of any satisfaction or payment of any security interest relating to the securitisation/ reconstruction company or secured creditors and requiring registration under this will Act with in 30 days of such payment or satisfaction.

- 7.8 On receiving the intimation the Central Registrar will issue a notice to the securitisation/ reconstruction company or secured creditors calling upon it to show cause with in time not exceeding 14 days specified in such notice as to why payment or satisfaction should not be recorded. In case no cause is shown the Central Registrar shall order that a memorandum of satisfaction shall be entered in the Central Register. If cause is shown the Central registrar shall record a note to that effect in the Central Register and shall inform the borrower that he has done so.
- 7.9 The Central register maintained by the Central Registrar (both in electronic and non electronic form) shall be open for inspection by any person during the business hours on payment of prescribed fee.

**8.0 SECURITISATION AND RECONSTRUCTION COMPANY**

A Securitisation Company can commence the business of securitisation of asset reconstruction if :-

- 8.1 It is registered under this Act.
- 8.2 Has net owned funds of at least Rs. 2.00 Crores or such other amount as may be specified by the RBI.
- 8.3 In case of an existing company it makes an application for registration with in six months from the date of commencement of the Act. An existing company may continue the business till the time application is accepted or rejected.
- 8.4 The form and manner of the application are to be prescribed by the RBI.
- 8.5 The RBI shall for the purpose of considering the application for registration shall conduct the inspection of the books and records of the company to satisfy itself about the compliance with the terms laid down in the Act.
- 8.6 The registration to the securitisation company shall be granted on such terms and conditions as RBI may deem fit. The RBI may reject the application after giving the applicant a reasonable opportunity of being heard.
- 8.7 RBIs prior approval shall be required in case of any substantial change in management of the company or change in its registered office or change in its name. Decision of the RBI in this regard shall be final. Substantial change in management means change in the management by way of transfer of shares or amalgamation or transfer of the business of the company.

8.8 The certificate of registration may be cancelled by the RBI in the following cases:

8.8.1 The company ceases to carry on the business of securitisation or asset reconstruction; or

8.8.2 Ceases to receive or hold any investment from a qualified institutional buyer; or

8.8.3 Has failed to comply with any of the conditions subject to which the certificate of registration has been granted to it; or

8.8.4 At any time fails to fulfill any of the conditions mentioned in clauses (a) to (g) of Sec. 3(3) of the Act.

8.8.5 Fails to

8.8.5.1 Comply with any of the directions issued by RBI under this act.

8.8.5.2 Maintain accounts in accordance with the requirements of any law or any direction or order issued by the RBI under this act.

8.8.5.3 Submit or offer for inspection its

books of accounts or other relevant documents when so demanded by the RBI.

8.8.5.4 Obtain prior approval of RBI u/s 3(6) of the Act.

The RBI may give the company an opportunity of complying with the aforesaid terms and conditions if the cancellation is being made on the grounds of breach of those conditions.

8.9 The securitisation company aggrieved by the order of cancellation of registration above may file an appeal with the Central Government within a period of 30 days from the date of the service of the notice. The application may be rejected but only after giving the applicant reasonable opportunity of being heard.

8.10 In case of a securitisation company where the application for the registration is cancelled or where the certificate of registration is cancelled and the company holds investments of qualified institutional buyers the company shall continue to be a securitisation company till the repayment of all the investments together with the interest thereon.

## 9.0 ISSUE OF DEMAND NOTICE AND THE PROCEDURE

- 9.1 The service of demand notices as referred to in Sub Sec. 2 of Sec 13 of the Act, shall be made by delivering or transmitting at the place where the borrower or his agent empowered to accept the notice or documents on behalf of the borrower resides or carries on business or personally works for gain. In the case of Body Corporate the notice shall be served on the registered office or any of its branches.
- 9.2 The demand notice may be served by registered post with acknowledgement due or by speed post or by couriers or by any other means like fax message, electronic mail service etc. In case where the authorized officer has reasons to believe that the borrower or his aforementioned agent is avoiding the service of the demand notice or for any other reason the service cannot be made, the service shall be affected by affixing a copy of the notice on the outer door or some other conspicuous part of the house or building in which the borrower or his agent resides or carries on business or personally works. In such case the contents of the demand notice shall also be published in two leading newspapers, one of which shall be in vernacular language.
- 9.3 Any other notice in writing to serve on the borrower or his agent by Authorized Officer shall be served in the same manner as provided above.
- 9.4 Where there are more than one borrower the Demand Notice has to be served on each borrower.
- 9.5 If the amount mentioned in the Demand Notice is not paid within the time specified there in, the Authorized Officer can proceed to realize the amount by adopting any one or more of the measures specified in Para 4.2 above. The detailed procedure to be followed and the rights and duties of the Authorized Officer are mentioned in the Rules and are summarized here under: -
- 9.5.1 Where the possession of the secured assets to be taken by the secured creditor are movable property in possession of the borrower, the authorized officer shall take possession of such movable property in the presence of 2 witnesses after a panchnama is drawn and signed by the witnesses.
- 9.5.2 After taking the possession the authorized officer or any other person on his behalf shall make an inventory of the property.
- The form of the inventory has also been provided in the rules. A copy of the inventory is also to be delivered to the borrower or any other person on his behalf.
- 9.5.3 The authorized officer is required to keep the property under possession in his own custody or in the custody of any person authorized or appointed by him.
- 9.5.4 The Authorized Officer or the person appointed is obliged to take due care of the property.
- 9.5.5 The Authorized Officer is permitted to sell the property at once in case the property is likely to decay or where the expenses associated with the keeping the property are likely to exceed its value.
- 9.5.6 The authorized officer is required to take steps for preservation and protection of secured assets and insure them if necessary till they are sold or otherwise disposed off.
- 9.5.7 In case where the secured asset is a debt not secured by negotiable instrument the authorized officer is required to obtain the possession of the asset or recover the debt by serving notice prohibiting the borrower from recovering the debt or any interest there on and the debtor from making payment there of and directing the debtor to make such payment to the authorized officer.
- 9.5.8 In the case of security being shares in body corporate the authorized officer can issue notice directing the borrower to transfer the same to the secured creditor and also the body corporate from not transferring such shares in favour of any person other than the secured creditor. A copy of such notice may also be sent to the Registrar to the Issue of the body corporate or the share transfer agent if any.
- 9.5.9 In the case of any other movable property other than debt or shares the notice is required to specify to the borrowers and the person in possession to handover the same to the authorized officer who shall take custody of such movable property.
- 9.5.10 In the case of any other movable secured assets the authorized officer is empowered to take possession of the documents evidencing title to such secured assets.
- 9.6 The Rules mandate that the Authorized Officer cannot be a person below the rank of Chief Manager.

## 10.0 VALUATION OF MOVABLE SECURED ASSETS

10.1 After taking possession of the security and in any case before sale, the authorized officer has to obtain the estimated value of the movable secured assets and thereafter, if considered necessary, fix in consultation with the secured creditor, the reserve price of the assets to be sold in realization of the dues of the secured creditor.

## 11.0 SALE OF MOVABLE SECURED ASSETS

11.1 The authorized officer can sell the movable secured assets taken in possession in one or more lots by adopting any of the following methods to secure maximum sale price for the assets to be so sold:-

- (a) Obtaining quotations from parties dealing in the secured assets or otherwise interested in buying such assets; or
- (b) Inviting tenders from the public; or
- (c) Holding public auction; or
- (d) By private treaty.

11.2 The authorized officer has to serve to the borrower a notice of thirty days for sale of the movable secured assets. If the sale of such secured assets is being effected by either inviting tenders from the public or by holding public auction, the secured creditor is also obliged to publish a public notice in two leading newspapers, in vernacular language, having sufficient circulation in the locality by setting out the terms of sale, which may include,

- (a) details about the borrower and the secured creditor;
- (b) description of movable secured assets to be sold with identification marks or numbers, if any on them;
- (c) reserve price, if any, and the time and manner of payment;
- (d) time and place of public auction or time after which sale by any other mode shall be completed;
- (e) depositing earnest money as may be stipulated by the secured creditor,
- (f) any other thing which the authorized officer considers it material for purchaser to know in order to judge the nature and value of movable secured assets,

11.3 The sale by any methods other than public auction or public tender can be effected on such terms as may be settled between the parties in writing.

## 12.0 ISSUE OF CERTIFICATE OF SALE

12.1 When the movable secured assets is sold, sale price of each lot shall be paid as per the terms of the public notice or on the terms as may be settled between the parties, as the case may be, and in the event of default of payment, the movable secured assets are liable to be offered for sale again.

12.2 On payment of the sale price, the authorized officer shall issue a certificate of sale in the prescribed form specifying the movable secured assets sold, price paid and the name of the purchaser and thereafter the sale shall become absolute. The certificate of sale so issued shall *prima facie* be the evidence of title of the purchaser.

## 13.0 SALE OF IMMOVABLE SECURED ASSETS

13.1 Where the secured asset is an immovable property, the authorized officer shall take or cause to be taken possession, by delivering a possession notice prepared in the form specified in the rules, to the borrower and by affixing the possession notice on the outer door at such conspicuous place of the property.

13.2 The possession notice as mentioned above is also required to be published in two leading newspaper, one in vernacular language having sufficient circulation in that locality, by the authorized officer.

13.3 In the event of possession of immovable property is actually taken by the authorized officer, such property shall be kept in his own custody or in the custody of any person authorized or appointed by him, who shall take as much as care of the property in his custody as owner of ordinary prudence would, under the similar circumstances, take of such property.

13.4 The authorized officer shall take steps for preservation and protection of secured assets and insure them, if necessary, till they are sold or otherwise disposed off.

13.5 Before effecting sale of the immovable property the authorized officer shall obtain valuation of the property from an approved valuer and in consultation with the secured creditor, fix the reserve price of the property and may sell the whole or any

part of such immovable secured asset by any of the methods as mentioned in Para 11.1

- 13.6 The authorized officer has to serve to the borrower a notice of thirty days for sale of immovable secured assets. However if the sale of such secured asset is being effected by either inviting tenders from the public or by holding public auction, the secured creditor shall cause a public notice in two leading newspapers one in vernacular language having sufficient circulation in the locality by setting out the terms of sale which shall include:-
  - 13.6.1 the description of the immovable property to be sold, including the details of the circumstances known to the secured creditor;
  - 13.6.2 the secured debt for recovery of which the property is to be sold;
  - 13.6.3 reserve price, below which the property, may not be sold,
  - 13.6.4 time and place of the public auction or time after which sale by any other mode shall be completed;
  - 13.6.5 depositing earnest money as may stipulated by the secured creditor;
  - 13.6.6 any other thing which the authorized officer consider it material for purchaser to know in order to judge the nature and value of the property.
- 13.7 The notice of sale shall be affixed on a conspicuous part of the immovable property and way, if the authorized officer deems it fit, put on the web site of the secured creditor on the Internet.
- 13.8 The sale by any methods other than public auction or public tender shall be on such terms as may be settle between the parties in writing.

### 14.0 TIME OF SALE, ISSUE OF SALE CERTIFICATE AND DELIVERY OF POSSESSION

- 14.1 No sale of immovable property under these rules can take place before the expiry of thirty days from the date on which the public notice of sale is published in newspapers.
- 14.2 The sale shall be confirmed in favour of the purchaser who has offered the highest sale price in his bid or tender or quotation or offer to the authorized officer and shall be subject to confirmation by the secured creditor. But no sale can be confirmed, if

the amount offered by sale price is less than the reserve price. However if the authorized officer fails to obtain a price higher than the reserve price, he may, with the consent of the borrower and the secured creditor effect the sale at such price.

- 14.3 On every sale of immovable property, the purchaser shall immediately pay a deposit of twenty five percent of the amount of the sale price, to the authorized officer conducting the sale and in default of such deposit the property shall forthwith be sold again.
- 14.4 The balance amount of purchase price payable shall be paid by the purchaser to the authorized officer on or before the fifteenth day of confirmation of sale of the immovable property or such extended period as may be agreed upon in writing between the parties.
- 14.5 In default of payment within the period mentioned above, the deposit shall be forfeited and the property shall be resold and the defaulting purchaser shall forfeit all claim to the property or to any part of the sum for which it may be subsequently sold.
- 14.6 On confirmation of sale by the secured creditor and if the terms of payment have been complied with, the authorized officer exercising the power of sale shall issue a certificate of sale of the immovable property in favour of the purchaser in the prescribed form.
- 14.7 Where the immovable property sold is subject to any encumbrances, the authorized officer may issue notices to the persons interested in or entitled to the money deposited with him and take steps to make the payment accordingly.
- 14.8 The authorized officer shall deliver the property to the purchaser free from encumbrances known to the secured creditor on deposit of money.
- 14.9 The certificate of sale shall specifically mention that whether the purchaser has purchased the immovable secured asset free from any encumbrances known to the secured creditor or not.

### 15.0 CONCLUSION

Banks and FIs are commercial organizations and no longer an extension of the Government itself. In pure economic terms, such powers granted to one player will certainly be disadvantageous to the other player. But the problem of NPA is too large to be ignored. Therefore conferring such powers is justified. ■