

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

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< EXECUTIVE SUMMARY >

◆ While the banking industry in India is progressively complying with the international prudential norms and accounting practices, there are certain areas in which the banking and financial sector do not have a level playing field as compared to other participants in the financial markets in the world.

Acting on the suggestions of Narasimham Committee I and II and Andhyarujina Committee constituted by the Central Government for the purpose of examining banking sector reforms, 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, was enacted. The

Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Ordinance, 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. The Ordinance, which enables banks and financial institutions to realise long-term assets, manage problem of liquidity, asset liability mismatches and improve recovery by exercising powers to take possession of securities, sell them and reduce non-performing assets by adopting measures for recovery or reconstruction, has now been replaced by an Act.



The Central Government had promulgated an Ordinance called "The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Ordinance, 2002" (Securitisation Ordinance) on 21.06.2002. The Government had also introduced a Bill to this effect in the Parliament during the last Monsoon Session but the same could not be taken up for discussion due to several factors including disturbances in the Parliament Proceedings. Thereafter to keep its continuity, the Government had to re-promulgate this Ordinance, which has since been passed by the Parliament. It received the assent of the President on 17.12.2002 and has now become an Act.

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BACKGROUND

The Securitisation Ordinance was brought in to speed up the debt recovery process of Banks and Financial Institutions by attachment of their assets without having to obtain a decree through normal legal process from a competent Court of Law. Although the trade and industry had a mixed reaction after the promulgation of this Ordinance, one of the reasons for which they felt insecure with the Ordinance was that the Ordinance did not make any difference between the willful defaulters and the normal business defaulters. They felt that due to various factors including the economic slow down in the country for the last couple of years most of the loans of Banks and Financial Institutions became bad for reasons beyond their control but as per the Central Government an estimated amount of about Rs. 1 lac crore was locked into Non-Performing Assets (NPA) with different Banks

and Financial Institutions and Committees after Committees have recommended introduction of some such kind of law which will provide faster mechanism to the lenders to recover their dues and to be able to not only attach the assets of the defaulters but also to encash them. The present law does not provide such a relief and it was taking a very long time in realization of dues, which was detrimental to public interest and affected national growth. With this back-ground, the Central Government has brought in the Securitisation Law and this has sent right signals not only to the defaulters concerned but also to the borrowers in general.

DEFINITIONS

The Act has defined some of the key terms in the following manner: -

- (a) **Borrower** has been defined to mean any person who has been granted financial assistance by a 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. A borrower 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/ Financial Institution in relation to such financial assistance.
- (b) **Default** means non-payment of any principal debt or interest thereon or any other amount payable by a borrower to any secured creditor consequent upon which the account of such borrower is classified as Non-Performing Asset in the books of accounts of the secured creditor in accordance with the directions or guidelines issued by the Reserve Bank of India (RBI).
- (c) **Financial assistance** will mean 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.
- (d) The Act covers different Bank and Financial Institutions. While the definition of the Bank is normal, the Financial Institution has been defined to mean not only public financial institutions within the meaning of Section 4A of the Companies Act, 1956 but also other institutions or non-banking financial companies as defined u/s 45-I (f) of the Reserve Bank of India Act, 1934 which the Central Government may specify for the purposes of this Act.
- RBI has registered many private non-banking financial companies during the last two years and there is a possibility of these private financial institutions also getting advantage of this Act for recovery of their debts.
- (e) **'Property'** has been defined to mean all types of properties including immovable, movable, secured or unsecured debts, right to receive payment of money, existing and future receivables and other intangible assets including know-how, patent, copy right, trade mark, licence and other commercial rights of similar nature.
This definition is too wide and there will be difficulty in enforcing the security rights on movable properties in particular.
- (f) There is a concept of formation of "Asset Reconstruction Companies" for the purpose of reconstruction of financial assets, which may also be called 'Securitisation Companies'. Chapter II of the Act deals with the regulation of these companies.
- (g) **Securitisation** has been defined to mean acquisition of financial assets by a Securitisation or Reconstruction company from any originator. This acquisition may be either by raising of funds by these companies from qualified Institutional buyers, as defined in the Act, by issue of security receipts representing undivided interest in such financial assets or otherwise.
- (h) **Security receipt** has been defined to be a receipt or other security issued by a Securitisation Company/ Reconstruction Company to any qualified Institutional buyer pursuant to a scheme evidencing the purchase or acquisition by the holder thereof of an un-divided right, title or interest in the financial asset involved in the securitisation.

SECURITISATION/ RECONSTRUCTION COMPANIES

- (a) Elaborate provisions have been made for registration and other activities of these companies.
- (b) One of the important provisions contained for these companies is that any Security Receipt issued by these companies and any transfer of such Security Receipts shall not require compulsory registration u/s 17(1) of the Registration Act, 1908. The Securitisation/ Re-construction Company may take

following measures for assets reconstruction within the guidelines of the Reserve Bank of India: -

- (i) Change in or take-over of the management of the business of the borrower and proper management thereof;
- (ii) Sale or lease of a part or whole of the business of the borrower;
- (iii) Re-scheduling of payment of debts payable by the borrower;
- (iv) Enforcement of security interest in accordance with the provisions of this Act;
- (v) Settlement of dues payable by the borrower;
- (vi) Taking possession of secured assets in accordance with the provisions of the Act.

It may be mentioned here that although the wording of the Act may suggest otherwise, the management of the business of the borrower should mean the management of the asset in question and not the whole management of the borrower company as a re-construction company should have nothing to do with the other business of the company and its right should relate only to the asset in question.

- (c) The Securitisation/ Reconstruction Company may also have, inter-alia, the following functions: -
 - (i) To act as an agent for any Bank or Financial Institutions for the purpose of recovering their dues from the borrower on payment of a certain fee.
 - (ii) To act as a Manager to manage the secured assets, the possession whereof has been taken over by the secured creditor, in case the borrower fails to discharge his liability in full within the specified period, provided that the Company shall not act as a Manager if acting as such Manager gives rise to any pecuniary liability.
 - (iii) To act as Receiver if appointed by any Court or Tribunal.

RESOLUTION OF DISPUTES BY ARBITRATION

It has been specifically provided that where any dispute relating to securitisation or reconstruction or non-payment of any amount arises amongst the concerned parties, such dispute shall be settled by arbitration as provided in the Arbitration and Conciliation Act, 1996 and the provisions of the said Act shall apply accordingly.

ENFORCEMENT OF SECURITY INTEREST

This is one of the most important aspect of this Act which says that notwithstanding anything contained in Section 69 or Section 69A of the Transfer of Property Act, any security interest created in favour of any secured creditor may be enforced, without the intervention of any Court or Tribunal, by such creditor in accordance with the provisions of this Act. The procedure laid down, inter-alia, is as follows: -

- (a) Where any borrower, makes any default in repayment of a secured debt or any instalment thereof and his account in respect of such debt is classified by the secured creditor as a Non-Performing Asset, then, the secured creditor may require the borrower, by notice, to discharge in full his liabilities to the secured creditor within 60 days from the date of the notice failing which the secured creditor shall be entitled to exercise inter-alia all or any of the following rights: -
 - (i) Take possession of the secured assets;
 - (ii) Take over the management of the secured assets;
 - (iii) Appoint a Manager to manage the secured assets;
 - (iv) Require 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.
- (b) The 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 debt by the borrower.

As regards enforcement of security in case of financing of financial asset by more than one secured creditor, it has been provided that none of them shall be entitled to exercise any rights conferred on them, unless the same is agreed upon by secured creditors representing not less than three-fourth in value of the amount outstanding as on a Record Date and such action shall be binding on all such secured creditors.

It has also been provided that the dues of the workmen as per Section 529A of the Companies Act, 1956 will have to be paid in case the Company is in liquidation or being wound up after the commencement of this Act and the said amount will have to be deposited with the Liquidator.

- (c) Apart from other measures regarding procedure and other methods for enforcement of security, one of the clauses which is going to be harsh on the bor-

rowers is, that, if any person including the borrower is aggrieved by any of the measures taken by the secured creditor, he may prefer an appeal to the Debt Recovery Tribunal within 45 days, only on depositing 75% of the amount claimed in the notice referred to hereinabove. Although the Debt Recovery Tribunal (DRT) has been empowered to waive or reduce the amount to be deposited for reasons to be recorded in writing, practically it will be difficult for any DRT to reduce the amount at that stage without going into all the relevant facts and circumstances of the case.

PROVISIONS OF THIS ACT NOT TO APPLY IN CERTAIN CASES

This Act will not apply in some of the following cases: -

- (i) A lien on any goods, money or security given by or under the Indian Contract Act or the Sale of Goods Act or any other Law for the time being in force;
- (ii) A pledge of movables;
- (iii) Creation of any security in any aircraft and any vessel;
- (iv) Any conditional sale, hire purchase or lease or any other contract in which no security interest has been created;
- (v) Any security interest for securing repayment of any financial asset, not exceeding Rs. 1 lac;
- (vi) Any security interest created in agricultural land;
- (vii) Any case in which the amount due is less than 20% of the principal amount and interest thereon;
- (viii) Any rights of an un-paid seller and any property not liable to attachment or sale as per the Civil Procedure Code.

PROVISIONS OF THIS ACT TO OVERRIDE OTHER LAWS

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.

CIVIL COURT NOT TO HAVE JURISDICTION

It has also been provided that no Civil Court shall have jurisdiction to entertain any suit or proceedings in respect of any matter, which a DRT or an 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.

However, there should be no bar to move a Writ Petition before the High Court under Articles 226 or before the Supreme Court under Article 32 of the Constitution of India.

LIMITATION ACT TO APPLY

The limitation prescribed under the Limitation Act, 1963 will apply and the secured creditor will have to take action only within the period of limitation.

AMENDMENT TO OTHER ENACTMENTS

It may also be noted here that by amendment to other enactments the Act has made the following provisions: -

- (i) The Companies Act, 1956 has been amended to provide that Securitisation/ Re-construction Companies will also fall within the definition of 'Public Financial Institutions' under Section 4A of the said Act.
- (ii) The Sick Industrial Companies (Special Provisions) Act, 1985 has been amended to provide that no reference shall be made to the BIFR after commencement of this Act where the financial assets have been acquired by any Securitisation/ Re-construction Company. It has also been provided that after the commencement of this Act where a reference is pending before the BIFR, such reference shall abate if the secured creditors representing not less than three-fourth in value of the amount outstanding against financial assistance disbursed to the borrower of such secured creditors have taken measures to recover their secured debt under the relevant provisions of this Act.
- (iii) The Securities Contracts (Regulation) Act, 1956 has been amended to provide the definition of "security receipt" as one of the securities under the said Act.

NECESSARY RULES NOTIFIED

Detailed guidelines for implementation of the various provisions of this Act have already been notified by the Central Government and the same are contained in the Security Interest (Enforcement) Rules, 2002. ■