

RJA

Rajput Jain & Associates
Chartered Accountants

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

About Us

- Rajput Jain & Associates is a Chartered Accountants firm, with its headquarter situated at New Delhi (the capital of India). The firm has been set up by a group of young, enthusiastic, highly skilled and motivated professionals who have taken experience from top consulting firms and are extensively experienced in their chosen fields has providing a wide array of Accounting, Auditing, Taxation, Assurance and Business advisory services to various clients and their stakeholders. focus at providing tailor made solutions to challenging problems of our clients, and perform with high quality and timely service.
- Rajput Jain & Associates, a professional firm, offers its clients a full range of services, To serve better and to bring bucket of services under one roof, the firm has merged with its various Chartered Accountancy firms pioneer in diversified fields
- Our main office is located at Delhi. Incidentally, Delhi is the Capital of India. Our other offices are in Mankapur & Moradabad (U.P.). We have associates all over India in big cities. All our offices are well equipped with latest technological support with updated reference materials. We have a large team of professionals other than our Core Team members to meet the requirements of our prospective clients including the existing ones. However, considering our commitment towards high quality services to our clients, our team keeps on growing with more and more associates having strong professional background with good exposure in the related areas of responsibility. Further to meet the growing demands of the fiercely competitive market we are constantly looking forward for team of associates comprising of highly skilled professionals to cater the needs ever increasing clientele.

PRIOR TO SARFESI

- Prior to this Act a special legislation called 'The Recovery of Debts due to Banks and Financial Institution Act, 1993' was enacted creating a Special Tribunal called 'Debt Recovery Tribunal'.
- Under the Act, the Banks are entitled to approach the Tribunal by filing an 'Original Application' which is similar to filing a suit in Civil Court proceedings. However, unlike the 'Civil Court' which is supposed to follow the 'Civil Procedure Code', a special and simple procedure was prescribed in RDBI, Act.
- The term "debt" shall have the meaning assigned to it under Recovery of Debts Due to Banks and Financial Institutions Act, 1993.

NEED FOR SARFESI

- The object of reducing 'Non-performing Assets' could not be achieved even after enacting 'RDBI, Act1993' and as a result, another legislation on the similar field was enacted and called 'SARFAESI Act'.
- Under SARFAESI Act, 2002, the Bank can determine the outstanding due after noting the objections from the borrower/guarantor if any proceed against the 'secured asset' by taking physical possession of the same and initiating auction proceedings in accordance with the provisions and the SARFAESI rules.
- An 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 is **Securitization**.
- A receipt or other security, issued by an asset reconstruction company to any qualified buyer pursuant to a scheme, evidencing purchase or acquisition by the holder thereof, of an undivided right, title or interest in the financial asset involved in securitisation is called **Security of Receipt**

OBJECT, EXTENT & NEED

- An Act to regulate securitization and reconstruction of the financial assets and enforcement of the security interest and matter connected therewith or incidental thereto.
- "Financial assistance" means any loan or advance granted or any debentures or bonds subscribed or any guarantees given
- **The Central Registrar** are Securitisation company required to report satisfaction of security interest.
- **Within 30 days** which the Report of Satisfaction of Security Interest is to be registered
- Enforcement of Security Interest Act, 2002 is an Act to Regulate securitisation and reconstruction of financial assets and enforcement of security interest

CONSTITUTIONAL VALIDITY OF SARFESI, 2002

MARDIA CHEMICALS VS UNION OF INDIA (AIR 2004 SC 2371)

- Since these already existed a RDBI, Act 1993. There was no need for draconian legislation like SARFESI.
- The mechanism provided for recovery of the debt under S.13 does not provide for any adjudicatory forum.
- NPA is declared on whims and fancies.
- That remedy of appeal under S.17 of the Act is also illusory since appeal is entertainable only when 75% of amount claimed, is deposited by the borrower.

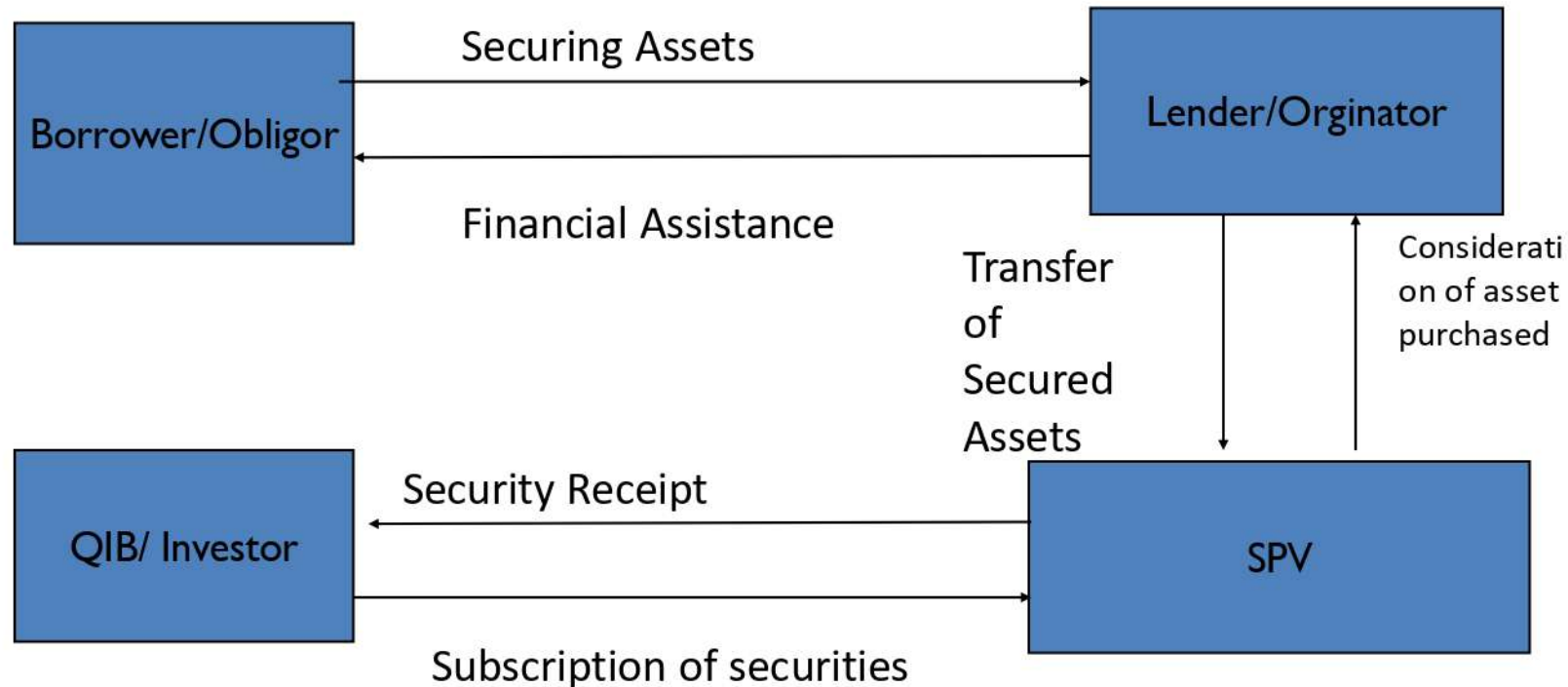
BIRD'S EYE VIEW OF SARFESI, 2002

Chapters	Contents	Section
I	Preliminary	1-2
II	Regulation of Securitisation and Reconstruction of Financial Assets of Banks and Financial Institution.	3-12A
III	Enforcement of Security Interest	13-19
IV	Central Registry	20-26
V	Offenses And Penalty	27-30
VI	Miscellaneous	31-42

PART I

ENFORCEMENT OF SECURITY INTERESTS SECURITIZATION

- Securitisation means acquisition of financial assets by any securitization company or reconstruction company. from any originator, whether by raising funds by securitization co. through QIB's by issue of security receipts representing, undivided interest in such financial asset or otherwise.



TAKING THE ASSET FOR SECURITIZATION SEC. 6(1)

When the bank or financial institution decides that the financial asset be now acquired by the securitization company or reconstruction company a notice may be given about such acquisition to the obligor i.e. borrower or any other person liable to repay to the bank.

NOTICE FOR ENFORCEMENT OF SECURITY

Section 13(2) of the SARFAESI Act speaks about the notice to be given by the secured creditor to the borrower who has defaulted in making the repayment and whose account is classified as NPA.

BORROWER NOT PAYING AS PER NOTICE

Bank can **take possession** of the secured assets of the borrower including right to transfer by way of lease, assignment or sale for realising the secured asset

Take over the management of the secured asset of the borrower including the right to transfer by way of lease, assignment or sale and realize the secured asset.

Appoint any person as manager to manage the security assets the possession of which has been taken over by the secured creditor.

RULES OF NATURAL JUSTICE

In *Mahesh Chandra vs. UP Finance Corporation* 78 Comp Cas 1, SC set important rules of natural justice in repossession. The technicalities implied by these rules have been overruled by the SC in *Jagadamba Oil Mills case* but the rules of natural justice continue to apply.

The following are implicitly still applicable:

- Attempt must be made for best possible price - easiest indication is a public auction.

- Borrower must always be given a right of first refusal or improving upon the price

- The sale must not be made at the back of the borrower

JUDICIAL AUTHORITY'S HELP TO BANK FOR TAKING POSSESSION

- When the secured creditor is required to take possession or control of the secured asset or when the secured asset is required to be sold or transferred under the provisions of the SARFAESI Act, the secured creditor can take help of the Chief Metropolitan Magistrate or the District Magistrate by making request in writing.
- On such request being made the Chief Metropolitan Magistrate or the District Magistrate, as the case may be, shall take possession of security asset and documents relating thereto.
- The Metropolitan Magistrate or the District Magistrate may take or cause to be taken such steps and use or cause to be used such force as may be in his opinion necessary.
- Any act of the Metropolitan Magistrate or the District Magistrate for and while taking possession of the security shall not be called in question in any court or before any authority.
- Metropolitan Magistrate or a Judicial Magistrate of the First Class shall try any offence punishable under this Act

NOTICE ON TAKING MANAGEMENT OF THE BORROWER CONCERN

Director -if the borrower is a company as defined in the companies Act, 1956, to be the directors of such company or
Administrator -in any other case, to be the administrator of the business of borrower.

EFFECT OF NOTICE AND TAKING OVER THE MANAGEMENT

On publication of such notice, the directors of the company in case the borrower is a company and in other cases person holding any office having power of superintendence, direction and control of the business of the borrower immediately before publication of the notice, shall be deemed to have vacated their offices.

As effect of this, any contract or management between the borrower and any directors or manager thereof shall be deemed to be terminated.

CHALLENGING BEFORE DRT BANK'S ACTION TO TAKE POSSESSION (APPEAL)

The Debts Recovery Tribunal has to dispose of the application, as far as may be, in accordance with the provisions of the recovery of Debts Due to Banks and Financial Institutions Act, **1993** and rules made there under. The application has to be disposed as early as possible but within sixty days.

APPEAL TO APPELLATE DRT

No appeal can lie unless the borrower deposits 50% of the debt claimed by the secured creditor. The Tribunal has powers for reasons to be recorded to reduce this amount to 25% of the claim amount

Within 45 days of the measures taken can an aggrieved party make an appeal

Any person aggrieved, by order made by the Debts Recovery Tribunal under section 17, may prefer an appeal to an Appellate Tribunal within Thirty days from the date of receipt of the order of Debts Recovery Tribunal

DUES AFTER THE SARFAESI ACTIONS

If after sale of securities the claim is not fully satisfied and still there are any dues to be recovered from the borrower, the creditor is required to file civil suit before the Civil Court or a claim before the Debt Recovery Tribunal or the Authorities / Courts under the Co-operative Societies Act, as may be applicable within limitation period.

Therefore, the secured creditor will have to make an assessment, before taking possession of the security, whether it would be possible to sell the security and make eventual claim for shortfall within the limitation period.

EXCEPTIONS UNDER SEC. 31

- The provision of act shall not apply to
- Lien on goods, money or security under Contracts law or Sale of Goods Act:
- Pledge of movable within meaning of 172 of Indian contract act
- creation of security in any aircraft
- creation of security in vessels
- conditional sale, hire purchase or lease or any other contract in which no security interest has been created
- rights of unpaid seller
- properties not liable for attachment under CPC:
- where financial assistance not exceeding Rs 1 lac
- where dues are less than 20% of principal and interest
- agricultural land

WHEN BORROWER SUCCEEDS IN SECTION 17

Again, even if borrower succeeds in his Appeal under section 17 of the SARFAESI Act, 2002, the borrower may not be happy. It is interesting. But, it will not happen and the DRT may simply set-aside the possession notice issued by the Bank under section 13 (4) of the Act and the Bank impliedly have an opportunity to start the proceedings afresh.

It is felt that the **Debt Recovery Tribunal can grant no relief to the borrowers under section 17 except asking the Bank to start the proceedings afresh**

IS IT CORRECT TO SAY THAT "ONCE NPA IS ALWAYS NPA" UNDER SARFAESI ACT, 2002?

- **M/s. Sravan Dall Mill P. Limited, Rep. by its Managing Director Vs. Central Bank of India.**
- *“The right of the borrower to have a due consideration of objections is, therefore, an important right of the borrower where the bank is bound to apply its mind and inform the borrower of its reasons as to why and how the account is classified as NPA, particularly, when the borrower raises specific objections in that regard. The reply of the bank must indicate application of mind by the bank that the decision of the bank in classifying the account as NPA was fully in conformity with the prudential norms of RBI. Non-consideration of the said objection by mere statements in the reply that the bank has considered the same cannot be said to be the fulfilment of the obligation of the bank under Sections 13(2) and 13(3)(A) of the SARFAESI Act. It also cannot be disputed that even assuming that particular account had become NPA, the subsequent payments by the borrower entitles a borrower to upgrade the said account and may come out of the said classification of his account as NPA. Therefore, it is incorrect to presume that once an NPA is always an NPA and it is precisely for the said reason that the clause 4.2.4 of the prudential norms specifically states that if interest and principal are paid by the borrower in case of loans classified as NPA, the said account should no longer be treated as NPA and may be classified as sub-standard account. Consequently, therefore, the action under the SARFAESI Act with regard to the said account would not be tenable, as jurisdictional fact under Section 13(2) of the SARFAESI Act would remain unsatisfied”.*

PART II

Securitisation and Reconstruction of
Financial Assets of Banks and Financial
Institution.

APPLICATION TO BANKS

- All the Banking Companies, Nationalized Banks, the State Bank of India as well as its subsidiary Banks and Co-operative Banks are within the meaning of the word bank for the purpose of this Act
- "FINANCIAL INSTITUTION" means--
- (i) a **public financial institution** within the meaning of section 4A of the Companies Act, 1956
- (ii) any **institution specified by the Central Government** under sub-clause (ii) of clause (h) of section 2 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993.
- (iii) the International Finance Corporation established under the International Finance Corporation (Status, Immunities and Privileges) Act, 1958
- (iv) any other institution or **non-banking financial company** as defined in clause (f) of section 45-I of the Reserve Bank of India Act, 1934, **which the Central Government may, by notification, specify as financial institution for the purposes of this Act;**

ASSET RECONSTRUCTION

Acquisition of any right or interest, in the security, by any securitization company or reconstruction company for the purpose of realization of such financial assistance is called as asset reconstruction

No asset reconstruction company shall commence or carry on the business of securitization or asset reconstruction without Having the owned fund of not less than two crore rupees

In the event of non-realisation of financial assets, the qualified buyers of an asset reconstruction companies, holding security receipts of **not less than Seventy five percent of the total value of the security receipts issued by such company** shall be entitled to call a meeting of all the qualified institutional buyers and every resolution passed in such meeting shall be binding on the company.

- Any asset reconstruction company registered under section 3 may Act as an agent for any bank or financial institution for the purpose of recovering their dues or Act as a receiver, if appointed by any Court or Tribunal

NON PERFORMING ASSET

PROPERTY

SECURED ASSET

Secured Asset means the property on which security interest is created. The powers given by SARFAESI Act for enforcement of securities are against secured assets only

SECURED CREDITOR AND SECURED DEBT

Record date means the date agreed upon by the secured creditors representing **not less than sixty percent** in value of the amount outstanding on such date

In case where the management of the business is taken over by the secured creditor, the secured creditor shall, on realisation of his debt in full and Restore the management of the business of the borrower to Him

Any person aggrieved by any of the measures taken by the secured creditor may appeal to The Debts Recovery Tribunal

SECURITY INTEREST

Any right, title and interest of any kind whatsoever upon the property created in favour of any secured creditor is called as security interest

QUALIFIED INSTITUTIONAL BUYERS

- **"Qualified Institutional Buyer"** means
- a financial institution,
- Insurance company,
- bank,
- state financial corporation,
- state industrial development
- securitisation company or 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, or any other body corporate as may be specified by the Board;

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