

PROVISIONS AND PROCEEDINGS FOR THE BANK AND OTHER FINANCIAL INSTITUTIONS UNDER SARFAESI ACT 2005

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INTRODUCTION

Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (hereinafter referred to as SARFAESI Act)

WHAT IS SARFAESI ACT 2002?

SARFAESI Act is an Indian law enacted to secure the rights of Banking Companies¹ and other Financial Institutions² to recover their Non-Performing Assets³ (hereinafter referred to as NPA) when borrowers, co-borrowers, and guarantors fail to repay the amount lent to them and the bank recovers the same under this act without any intervention of the court. Hereinafter the security interest of the banks and other financial institutions or creditors does arise, only when the account is declared as NPA as per the guidelines of the Reserve Bank of India. There are two approaches specified under this act, for the recovery of NPAs accounts. This includes either obtaining the possession of the borrower including the powers of the lease, assigning or reselling the secured assets, or taking over the management of the borrower or company until the NPA account is regularized. The act is applicable when the borrower account is classified as NPA and the account must hold the outstanding amount of more than Rs.1,00,000/-

WHAT IS THE OBJECT OF THE ACT?

The main objective of the SARFAESI Act is to get expeditious and efficient recovery from NPA by allowing banks and other financial institutions and Non-Banking Financial Companies⁴ to auction commercial and residential properties to Asset Reconstruction Companies (ARCs)⁵ in compliance with Reserve Bank of India's norms and recommendations and to set off the consideration amount received from the auction against the NPA as a

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¹ Section 5(c) of Banking Regulation Act 1949 https://legislative.gov.in/sites/default/files/A1949-10_0.pdf

² Section 2(h) of The Recovery of Debts Due to Banks And Financial Institutions Act 1993

https://legislative.gov.in/sites/default/files/A1993-51_0.pdf

³ Section 2(1)(o) <http://arcindia.co.in/assets/img/SARFAESI-2002.pdf>

⁴ NBFC's are also covered under the SARFAESI Act through the notification release by the Ministry of Finance dated <https://www.azbpartners.com/bank/sarfaesi-notification-widens-applicability-for-nbfc/>

⁵ Section 2(ba) of SARFAESI Act <http://arcindia.co.in/assets/img/SARFAESI-2002.pdf>

recovery. Yet the amount is not settled and the account shows the outstanding balance the bank and financial institution shall opt for the Debt Recovery Tribunal⁶ (DRT) or the applicable court to recover the unsettled amount.

WHAT IS A SECURED ASSET UNDER THE ACT?

The definition defined under the Act is; “Secured Asset” which means the property on which security interest is created.⁷ In casual terms, the security interest is a lien created by the creditor on the asset which has been pledged as collateral on a loan by a borrower or a debtor. This lien on an asset can be enforced by the debtor or banks and other financial institutions by auctioning the said secured assets when the account goes bad.

A security interest reduces the risk for a creditor and also allows them to charge a lesser rate of interest on the loan lent by them. Due to this, the debtor got benefitted as the lesser rate of interest will ultimately reduce the cost of capital of the borrower. A transaction in which the security interest is granted is called a Security Transaction.

WHICH ARE THE ASSETS NOT COVERED UNDER THIS ACT?

Following are the assets which do not cover under section 31⁸ of the SARFAESI Act are as follows:-

- Any hire purchase, lease, conditional sale, or any other contract where no security interest has been charged.
- Any security interest created for securing the repayment of any financial asset not exceeding One Lac.
- In case the amount is less than 20% of the principal amount and Interest due thereon.
- Under section 47⁹ of the Sale of goods of Act, any right of an Unpaid Seller.
- Any properties which cannot be attached for sale, under section 60¹⁰ of the Civil Procedure Code, 1908.

⁶ section 2(1)(i) <http://arcindia.co.in/assets/img/SARFAESI-2002.pdf>

⁷ Section 2(1)(zc) of the SARFAESI Act 2002 <http://arcindia.co.in/assets/img/SARFAESI-2002.pdf>

⁸ Section 31; of SARFAESI Act provision of this act not apply in certain cases
<http://arcindia.co.in/assets/img/SARFAESI-2002.pdf>

⁹ Section 47 of Sale of Goods Act; Seller's lien <https://vdocument.in/bare-act-sale-of-goods-act-1930.html?page=15>

¹⁰ Section 60 Civil Procedure Code; Property liable to attachment and sale in execution of decree
https://www.indiacode.nic.in/show-data?actid=AC_CEN_3_20_00051_190805_1523340333624§ionId=33397§ionno=60&orderno=64

- A pledge of movables under the meaning of section 172¹¹ of the Indian contract act.
- Creation of any security under the definition of clause (1) of section 2¹² of the Aircraft Act, 1934.
- Creation of security against agricultural land.

RECOVERY OF DEBTS UNDER THE SARFAESI ACT:

The act has made provisions to recover the NPA, which include:

- Securitization.¹³
- Asset Reconstruction.
- Enforcement of Security interests without the intervention of the court.

Securitization: Securitisation means the issuance of marketable securities by raising funds through the ARCs i.e. Asset Reconstruction Companies. The securitization company may raise the fund from Qualified Institutional Buyers¹⁴, by issuing security receipts representing the undivided interest in such financial assets. The securitisation company shall maintain a distinct account for every financial asset acquired as per the scheme. The investment made by the Qualified Institutional Buyers and the return on it should be applied for the redemption of interest and payment of returns assured on such investments under the relevant scheme.

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Asset Reconstruction Company: Asset reconstruction company means those companies who are registered with the Reserve Bank, as per Section 3¹⁵ of the act who carries out the business of asset reconstruction or securitization or both. Asset reconstruction empowers the company in India by performing the means of efficient management of the business of the borrower or by taking over the management of the business of the borrower. It may sell or lease the part or whole of the business of the borrower. It may also take possession of the secured assets in accordance with the provisions of the act.

¹¹ Section 172 of Indian Contract Act; Pledge, Pawnor and Pawnee https://www.indiacode.nic.in/show-data?actid=AC_CEN_3_20_00035_187209_1523268996428§ionId=38728§ionno=172&orderno=173

¹² Section 2(1) of Aircraft Act 1934 https://legislative.gov.in/sites/default/files/A1934-22_0.pdf

¹³ Section 2(z) of SARFAESI Act <http://arcindia.co.in/assets/img/SARFAESI-2002.pdf>

¹⁴ Section 2(u) of SARFAESI Act <http://arcindia.co.in/assets/img/SARFAESI-2002.pdf>

¹⁵ Section 3 of SARFAESI Act; Registration of Asset Reconstruction Company <http://arcindia.co.in/assets/img/SARFAESI-2002.pdf>

Enforcement of Security Interest: As per section 13¹⁶ of the act anything contained in section 69 or 69A¹⁷ of the Transfer of Property Act 1882 along with the provision of section 13 if any security is already enforced and created in favor of the secured creditor, under the provisions of this act secured creditor may sell the security interest without any interruption of the court or any tribunal.

Demand Notice u/s 13(2)¹⁸: When any borrower is under the obligation of a secured creditor under the security agreement and fails to make the payment of any installments and is declared as NPA as per the guidelines of the RBI for the default¹⁹ of financial assistance²⁰ lent to the borrower by the bank or any other financial institution for a continuous period of 90 days. Then the secured creditor gives the notice under section 13(2) of the act in writing to discharge his full liabilities amongst the secured creditor within 60 days from the receipt of such notice, failing which the secured creditor is entitled to exercise all his rights under section 13(4)

Provisions u/s 13(4)²¹: If the borrower fails to discharge the obligation within the time prescribed under section clause 2 of section 13, in that case, the secured creditor is entitled to exercise the rights u/s 13(4) of the act which are as follows:

- Take over the possession of the secured assets belonging to the borrower including the right to lease, transfer, assign, or sale.
- Take over the control or management of the business of the borrower including the right to transfer by way of lease, assignment, or sale up to the limit where such right shall be exercised only where the substantial part of the business of the borrower is held as security of debt.
- Appointment of the person named as a manager who manages the secured asset whose possession has been taken by the secured creditor.

¹⁶ Section 13 of SARFAESI ACT; Enforcement of Security Interest <http://arcindia.co.in/assets/img/SARFAESI-2002.pdf>

¹⁷ Section 69 and 69A of Transfer of Property Act <https://www.indianconstitution.in/2022/03/section-69-transfer-of-property-act-1882.html>

¹⁸ Section 13(2) provisions of Demand Notice <http://arcindia.co.in/assets/img/SARFAESI-2002.pdf>

¹⁹ Section 2(j) of SARFAESI Act <http://arcindia.co.in/assets/img/SARFAESI-2002.pdf>

²⁰ Section 2(k) of SARFAESI Act <http://arcindia.co.in/assets/img/SARFAESI-2002.pdf>

²¹ Section 13(4) provisions of Symbolic possession <http://arcindia.co.in/assets/img/SARFAESI-2002.pdf>

- May issue a notice in writing to the person who acquires the security asset from the borrower from whom any money is due or may become due to the borrower, shall be paid to the secured creditor as of the settlement of the secured debt²².

ASSISTANCE OF CHIEF METROPOLITAN MAGISTRATE OR DISTRICT MAGISTRATE TO SECURED CREDITOR IN REGARDS TO TAKING POSSESSION OF SECURED ASSET

Section 14²³ of the SARFAESI Act provides the provision that on the request of the secured creditor in writing to the District Magistrate or in metropolitan cities the District Metropolitan Magistrate in whose jurisdiction the secured asset or other documents relating thereto may be situated or found. On such application or a request the chief metropolitan Magistrate or the District Magistrate as the case may be shall:-

- Take possession of the asset or any other related documents.
- After taking the possession forward to the secured creditors.

THE APPLICATION MUST CONSIST OF THE FOLLOWING DETAILS AND DECLARATIONS

- The application must be filed by the authorized officer of the bank or financial institution and it shall be accompanied by an affidavit.
- The total amount of financial assistance granted by the secured creditor and the outstanding amount due as of the date of filing of the application.
- The bank or financial institution holding the security interest in the secured asset should be valid and provide a detailed description in such application and the claim should be within the limitation period prescribed in the Limitation Act.²⁴
- The borrower should be declared as NPA according to the guidelines of the RBI and the aggregate amount due to the borrower shall be stated in the application.
- The secured creditor must comply with the provisions of Section 13(2).
- In spite of serving the notice borrower did not make the payment of the financial assistance lent to him.

²² Section 2(ha) of SARFAESI Act <http://arcindia.co.in/assets/img/SARFAESI-2002.pdf>

²³ Section 14 of SARFAESI Act <http://arcindia.co.in/assets/img/SARFAESI-2002.pdf>

²⁴ Schedule of Limitation Act <https://legislative.gov.in/sites/default/files/A1963-36.pdf>

- Any other provisions and rules needed to be complied with must comply.

WHO IS ELIGIBLE TO GIVE AN APPLICATION UNDER SARFAESI ACT 2002?

Any official of the bank who is authorized, i.e. an Authorized Person of the Bank or any other Financial Institution is eligible to make an application u/s 14 of the act to the District Magistrate or in the case of Metropolitan cities the Chief Metropolitan Magistrate.

REMEDIES AVAILABLE TO THE BORROWER OR AN AGGRIEVED PERSON UNDER THE ACT

Section 17 of the act prescribes the Right to Appeal by any person including the borrower, mistreated by any of the measures of Section 13(4) taken by the authorized officer on behalf of the secured creditor as may be prescribed under the provision, may make an application along with the prescribed fee to the Debt Recovery Tribunal.

An application filed before the Debt Recovery Tribunal shall have jurisdiction: -

- The cause of action, wholly or in part arises.
- Location of the secured asset.
- The branch or any other office of a bank or financial institution maintaining an account in which debt claimed is outstanding for the time being force.²⁵

LIMITATIONS OR SHORTCOMINGS OF THE SARFAESI ACT:

Every act has its pros and cons on how far this act is advantageous, but the major drawback is that it doesn't cover how to recover dues from unsecured creditors who are declared as NPA according to the guidelines of the RBI.

Another flaw of the act is that there are no provisions that if the secured assets are not auctioned then what will be the further procedures to recover the outstanding dues? In addition to this in 2011, the amendment was made in the act that if an efficient bid is not bet by the better bidder, then the bank or any other financial institution may acquire the said secured asset. In such a case, the mortgaged property is in a remote area then there is no use of the such secured asset for the secured creditor.

²⁵ Section 17 of SARFAESI Act, <http://arcindia.co.in/assets/img/SARFAESI-2002.pdf>

CASE LAWS

*Indiabulls Finance Service Limited v/s Deccan Chronicle Holdings Limited*²⁶

In this judgment, the Apex Court has interpreted the provisions of the SARFAESI Act at their best along with the interest payable by Deccan Chronicle Holdings Limited.

In this case, the question was raised that the proceedings under the *SARFAESI Act and Recovery of Debts Due to Banks and Financial Institution Act 1993* can go hand in hand. The court held in the favor of simultaneous proceeding by considering the case of *Transcore v/s Union of India*.²⁷

In the present case, the judgment of *Mathew Varghese v/s M. Amritha Kumar*²⁸ was also discussed in detail for the interpretation of Sections 35 and 37 of the SARFAESI Act.

Section 37 of SARFAESI Act²⁹: Provisions under this act and rule are in addition to not subtraction to Recovery of Debts Due to Banks and Financial Institution and various other acts mentioned in this section for the time being in force.

Section 35 of SARFAESI Act³⁰: This section lays down the overriding effect to other laws and it is mentioned herein the section that this act shall have the provisions of overriding effect to any other law for the time being in force.

Therefore, reading Sections 35 and 37 together it has been held that if any of the provisions of the RDDB are inconsistent with the SARFAESI Act then the implementation of both acts would be complementary to each other.

CONCLUSION

SARFAESI Act has been brought to light to meet the ends of justice for the Banks and any other Financial Institutions to get the rights and remedies for the speedy recovery of the NPA's account which has been declared NPA as per the guidelines of the RBI. The presence of this act gives stability to economic growth and in economic development. The necessary amendment has also been made to safeguard not only the interest of the Secured creditor but

²⁶ <https://lawministry.in/supreme-court-explains-sarfaesi-act-in-latest-judgement/>

²⁷ Judgment <https://indiancaselaw.in/transcore-vs-union-of-india-uo-i-and-anr/>

²⁸ Judgment <https://www.casemine.com/judgement/in/56b48d62607dba348fff2a29>

²⁹ Section 37 of the SARFAESI Act <http://arcindia.co.in/assets/img/SARFAESI-2002.pdf>

³⁰ Section 35 of SARFAESI Act <http://arcindia.co.in/assets/img/SARFAESI-2002.pdf>

also of the borrower, and in addition to the wide interpretation of the supreme court in relation to the provisions of the SARFAESI Act removes the complexity of the act. Thus, this act strengthens the country's financial institutions which ultimately strengthens the development of the nation.

