

***THE SECURITISATION AND RECONSTRUCTION OF
FINANCIAL ASSETS AND ENFORCEMENT OF
SECURITY INTEREST ACT, 2002***

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INTRODUCTION

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest act extends to the whole of India.

Under section 69 of Transfer of Property Act, mortgagee can take possession of mortgaged property and sale the same without intervention of Court only in case of English mortgage. (English Mortgage is where mortgagor binds himself to repay the mortgaged money on a certain date, and transfers the mortgaged property absolutely to the mortgagee, but subject to a proviso that he will re-transfer the property to the mortgagor upon payment of the mortgage money as agreed). In addition mortgagee can take possession of mortgaged property where there is a specific provision in mortgage deed and the mortgaged property is situated in towns of Kolkata, Chennai or Mumbai. In other cases possession can be taken only with the intervention of court.

Therefore till now Banks/Financial Institutions had to enforce their security through court. This was a very slow and time-consuming process. There was also no provision in any of the present law in respect of hypothecation, though hypothecation is one of the major security interest taken by the Bank/Financial Institution.

Keeping in mind the above factors among many other the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act was enacted with effect from 21.6. 2002.

The Act deals with three aspects.

1. Enforcement of Security Interest by secured creditor (Banks/Financial Institutions)
2. Transfer of non- performing assets to asset Reconstruction Company, which will then dispose of those assets and realize the proceeds.
3. To provide a legal framework for securitisation of assets.

WHAT IS SECURITY INTEREST, PROPERTY, HYPOTHECATION

Security Interest means right, title and interest of any kind whatsoever upon property, created in favour of any secured creditor and includes any charge, hypothecation, and assignment other than those specified below.

Property means

- i. Immovable property
- ii. Movable property
- iii. Any debt or any right to receive payment of money, whether secured or unsecured
- iv. Receivables, whether existing or future
- v. Intangible assets, being know-how, patent, trade mark, license, franchise or any other business or commercial right of similar nature.

Hypothecation means a charge in or upon any movable property, existing or future, created by a borrower in favour of a secured creditor without delivery of possession of the movable property to such creditor, as a security for financial assistance, and includes floating charge and crystallization into fixed charge on movable property.

Exclusions from 'security interest'

Exclusions from 'Security interest' - Provision of the Act shall not apply to the following:

1. A lien on any goods, money or security given by or under the Indian Contract Act, 1872 or the Sale of Goods Act, or any other law for the time being in force.
2. A pledge of movables within the meaning of section 172 of Indian Contract Act,
3. Creation of any security in any aircraft as defined u/s 2(1) of Aircraft Act,
4. Creation of any security interest in any vessel as defined in section 3 (35) of Merchant Shipping Act.
5. Any conditional sale, hire -purchase or lease or any other contract in which no security interest has been created.
6. Any right of unpaid seller u/s 47 of Sale of Goods Act.
7. Any properties not liable to attachment or sale under first provision to section 60(1) of Code of Civil Procedures.
8. Any security interest for securing repayment of any financial asset not exceeding one lakh Rupees.
9. Any security interest creating in agricultural land.
10. Any case in which the amount due to less than 20% of the principal amount and interest thereon (i.e. where borrower has repaid more than 80% of principal amount and interest.)

WHO IS A SECURED CREDITOR & WHEN CAN SECURITY BE ENFORCED

A secured creditor means any bank or financial institution or any consortium or groups of banks or financial institutions and includes -

- i. Debenture trustee appointed by bank or financial institution
- ii. Securitisation company or reconstruction company
- iii. Any other trustee holding securities in whose favour security interest is created for due repayment by any borrower of any financial assistance.

WHEN CAN SECURITY BE ENFORCED

Any security interest can be enforced by a secured creditor without intervention of Court or Tribunal in accordance with the provisions of the Act.

Such action can only be taken any borrower, who is under liability to a secured creditor under a security agreement, makes any default in repayment of secured debt or any installment thereof and the account is classified as NPA. (Non Performing Asset by the secured creditor)

No action can be taken if:

- a. It is agricultural land
- b. When amount due is less than Rs. one Lakh
- c. When amount due is less than 20% of the principal amount and interest thereon, i.e. the borrower has repaid more than 80% of the principle amount and interest.

No action can be taken if the debt is time barred under the Limitation Act.

WHAT IS A NPA (NON PERFORMING ASSET)

Action for enforcement of security interest can be initiated only if the secured asset is classified as Non Performing Asset.

Non Performing Asset means an asset or account of borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the directions or guidelines relating to asset classification issued by RBI.

An amount due under any credit facility is treated as "past due" when it has not been paid within 30 days from the due date. Due to the improvement in the payment and settlement systems, recovery climate, up gradation of technology in the banking system, etc., it was decided to dispense with 'past due' concept, with effect from March 31, 2001. Accordingly, as from that date, a Non performing asset (NPA) shall be an advance where

- i. Interest and /or installment of principal remain overdue for a period of more than 180 days in respect of a Term Loan,
- ii. The account remains 'out of order' for a period of more than 180 days, in respect of an overdraft/ cash Credit (OD/CC),
- iii. The bill remains overdue for a period of more than 180 days in the case of bills purchased and discounted,
- iv. 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
- v. Any amount to be received remains overdue for a period of more than 180 days in respect of other accounts.

With a view to moving towards international best practices and to ensure greater transparency, it has been decided to adopt the '90 days overdue' norm for identification of NPAs, from the year ending March 31, 2004. Accordingly, with effect from March 31, 2004, a non-performing asset (NPA) shall be a loan or an advance where;

- i. Interest and /or installment of principal remain overdue for a period of more than 90 days in respect of a Term Loan,
- ii. The account remains 'out of order' for a period of more than 90 days, in respect of an overdraft/ cash Credit(OD/CC),
- iii. The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
- iv. 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
- v. Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.

‘Out of order’

An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/ drawing power. In case where the outstanding balance in the principal operating account is less than the sanctioned limit/ drawing power, but there are no credits continuously for six months as on the date of balance sheet or credits are not enough to cover the interest debited during the same period, these account should be treated as 'out of order'.

Overdue

Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank.

PROCEDURE FOR NOTICE

If the pre-conditions for taking action to enforce security interest are satisfied, then security interest may be enforced in the following manner:

The secured creditor can send a written notice to the borrower to discharge in full his liabilities within 60 days from date of notice failing which the secured creditor shall be entitled to exercise all his rights.

The notice shall give details of amount payable by borrower and the secured asset intended to be enforced by the secured creditor in the event of non-payment of secured debts by the borrower.

MEASURES IN CASE OF NON PAYMENT

If the borrower pays within 60 days no further action is required. However if he fails to pay full amount within specified period the secured creditor can take one or more of the following measures to recover his dues.

- a. Take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset
- b. Takeover the management of secured asset of the borrower including the right to transfer by way of lease, assignment or sale and realise the secured asset.
- c. Appoint any person as manager to manage the secured assets the possession of which has been taken over by the secured creditor.
- d. 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.

RIGHTS OF FINANCIAL CORPORATION IN CASE OF DEFAULT

1. Where any industrial concern, which is under a liability to the Financial corporation under an agreement, makes any default in repayment of any loan or advance or any installment thereof or in meeting its obligations in relation to any guarantee given by the Corporation or otherwise fails to comply with the terms of its agreement with the Financial Corporation, the Financial Corporation shall have the right to takeover the management or possession or both of the industrial concern as the right to transfer by way of lease or sale and realise the property pledged, mortgaged, hypothecated or assigned to the Financial Corporation.
2. Any transfer of property made by the Financial Corporation, in exercise of its powers under sub-section (1), shall vest in the transferee all the rights in or to the property transferred as if the transfer has been made by the owner of the property.
3. The Financial Corporation shall have the same rights and powers with respect to goods manufactured or produced wholly or partly from goods forming part of the security held by it as it had with respect to the original goods.
4. Where any action has been taken against an industrial concern under the provisions of sub-section (1), all costs, charges and expenses which in the opinion of the Financial Corporation have been properly incurred by it as incidental thereto shall be recoverable from the industrial concern and the money which is received by it shall, in the absence of any contract to the contrary, be held by it in trust, to be applied firstly, in payment of such costs, charges and expenses and secondly, in discharge of the debt due to the Financial Corporation, and the residue of the money so received shall be paid to the person entitled thereto.
5. Where the Financial Corporation has taken any action against an industrial concern under the provisions of sub-section (1), the Financial Corporation shall be

deemed to be the owner of such concern, for the purpose of suits by or against the concern, and shall sue and be sued in the name of the concern.

TIME LIMIT FOR TAKING ACTION AFTER NOTICE IS SERVED

The secured creditor can take action any time after the expiry of 60 days notice. There is no time limit. However action must be taken within reasonable time. The notice cannot be said to be perpetually valid. If the creditor does any act which is contrary to the intention of notice (e.g. reschedules loans or gives further time for repayment), it can be said that the notice has abated and no action can be taken against such notice.

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JURISDICTION OF CIVIL COURT BARRED

Civil court is barred from entertaining any suit or proceeding where Debt Recovery Tribunal is empowered to determine. No injunction shall be granted by any court or other authority in respect of any action taken in pursuance of any power conferred under this Act. However writ jurisdiction of the High Court remains unaffected.

MAGISTRATE SUPERVISION TO TAKE OVER POSSESSION

The secured creditor can take over possession of assets 60 days after giving notice.

Where possession of assets is required to be taken or if any asset is required to be sold or transferred and if the secured creditor expects resistance, he can request the Chief Metropolitan Magistrate or the District Magistrate within whose jurisdiction the assets are located, to take possession of the assets. The Magistrate shall then transfer these assets to secured assets.

CHANGE OF DIRECTORS / APPOINTMENT OF ADMINISTRATOR

On the management being taken over, the secured creditor can change the directors of borrower company if borrower is a company and appoint administrator if borrower is not a company. A notice to the effect is also published in the newspaper.

On publishing of such notice, the earlier directors (in case of a company) and persons holding any office of power of superintendence (if borrower is not a company) shall be deemed to have vacated their office.

Any contract of management, which borrower had with any director or manager of borrower holding office shall be deemed to be terminated.

The new directors/administrator appointed by secured creditor will take over in custody or control all the property, effects or actionable claims to which the business of the borrower is entitled. Administrator shall alone be entitled to exercise all the powers of superintendence, direction and control of business of borrower.

EFFECT OF TAKEOVER OF MANAGEMENT

The takeover of assets has following effect:

SHAREHOLDERS CANNOT APPOINT DIRECTORS - After the takeover of assets, shareholders of company cannot appoint or nominate any director of the company.

NO RESOLUTION WITHOUT CONSENT OF SECURED CREDITORS - Any resolution passed by shareholders will be effective only if approved by secured creditors.

NO PROCEEDING FOR WINDING UP - No proceeding for winding up of such company or appointment of receiver shall lie in any court, without the consent of secured creditor.

NO COMPENSATION FOR LOSS OF OFFICE - Any Managing Director or Director of the borrower shall not be entitled to any compensation for loss of office or for premature termination of any contract of agreement with the borrower. However, the MD or director or manager shall be entitled to any other money receivable, other than compensation.

APPEAL TO DEBT RECOVERY TRIBUNAL (DRT)

Any person aggrieved by any measure taken by secured creditor or his authorised officer may file an appeal to Debts Recovery Tribunal, within 45 days from date on which such measure was taken. i.e. action of taking possession of asset, takeover of management of business of borrower, appointing person to manage secured asset etc. is taken by the creditor.

When a borrower files an appeal, the appeal cannot be entertained unless; the borrower deposits 75% of the amount claimed in the notice by secured creditor. The DRT can waive or reduce the amount required to be deposited. The amount is not required to be deposited at the time of filing appeal, but appeal will not be heard till the amount is deposited. The borrower while filing the appeal should also file an application requesting the Debt Recovery Tribunal to admit the appeal without deposit of any amount. If the DRT orders partial deposit of the amount and the same is not deposited, appeal can be dismissed.

The 75% deposit is only required if the appeal is filed by the borrower. If some other aggrieved person (e.g. guarantor, shareholder) files it the deposit is not required.

DEBT RECOVERY APPELLATE TRIBUNAL

If a person is aggrieved by the order of the DRT, it can file an appeal to the Appellate Tribunal within 30 days from date of receipt of the DRT order.

If the DRT or Appellate Tribunal holds that possession of assets by the secured creditor was wrongful and directs the secured creditor to return asset to concerned borrower, the borrower shall be entitled to compensation and costs as may be determined by DRT or Appellate tribunal.

The Tribunal can also direct return of asset, if the secured creditor had already sold or transferred the asset to a third party.

THANK YOU

