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THE ROLE OF SARFAESI ACT IN RESOLVING NPA'S

Comparative Study of Secured Creditors and Borrowers

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Abstract

Non-performing assets have continued to be the key challenge for the Indian banking sector. The problem of default in the payment of loans creates problems in terms of liquidity, profitability, and financial stability of banks and financial institutions. Before the passage of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act), the recovery of debts had always been based on judicial processes and hearings conducted by the Debt Recovery Tribunals, a process that often led to loss of time and money.

The SARFAESI Act came into being in order to provide a quick and non-judicial system of debt recovery. This new act enabled banks and financial institutions to enforce their security interests without requiring the intervention of the courts of law. This law brought in many changes into the recovery of debts, as under this new act, the secured creditors were allowed to take possession of and manage their assets.

This research paper examines the role of the SARFAESI Act in dealing with NPAs in India. The research paper focuses on how the SARFAESI Act was implemented by public sector banks, private sector banks, non-banking financial companies (NBFCs) and housing finance companies (HFCs). In addition, the research paper evaluates the relative status of secured creditors and debtors as per the SARFAESI Act and evaluates whether the Act successfully achieves a balance between the two parties.

Furthermore, the research paper analyzes the processes involved in the SARFAESI Act,

judicial interpretations of the Act, problems associated with the implementation of the Act, and relevant court judgments on the SARFAESI Act in India. The study is a doctrine and analysis of statutory provisions, judicial precedents, guidelines by the RBI, and other secondary sources. From the study, it can be concluded that despite improvements in the recovery process, there are still problems in the SARFAESI Act. Therefore, there remains a need for reforms, clarity, and proper implementation of the Act to achieve efficient recovery while at the same time protecting the rights of borrowers.

Keywords: SARFAESI Act, Non-Performing Assets, Secured Creditors, Borrowers, Banks, NBFCs, Recovery Proceedings, Debt Recovery Tribuna.

1. Introduction

The banking and finance sector is one of the key sectors in the Indian economy. The banking and finance institutions are providing funds to enterprises, industries, and individuals. But in the past few years, there is a problem of high NPAs in the financial sector.

Non-Performing Asset means those accounts in which the borrower has failed to repay the installment or the entire principal amount before the due date. With an increase in NPAs, the profit-making capacity of the banks becomes very difficult and also hinders the ability of the banks to offer new loans.

Prior to the implementation of the SARFAESI Act, the banks used to resort to the court of law or debt recovery tribunals for recovering the principal amount. Due to lengthy procedures, the banks faced huge financial losses as a result of the delay.

In order to solve this issue, the Government passed the SARFAESI Act, 2002. This act aimed at providing a quick mechanism for securing the rights of the secured creditors. Under this act, the banks and financial institutions can take possession of the secured assets directly without the need to file a case in court initially.

From a practical standpoint, the SARFAESI Act is now seen as an essential instrument for recovery purposes within India. On the other hand, there have been some issues relating to the use of such provisions in certain cases.

2. Scope and Applicability of SARFAESI Act

SARFAESI is primarily used for secured loans where the banks/financial institutions have a lien on the borrower's property/assets. The Act is usually used when: Home loans, Mortgage loans, Property loans, Commercial secured loans, Industrial secured borrowings.

Who can use the Act? Public Sector Banks, Private Sector Banks, NBFCs, Housing Finance Companies.

However, the Act cannot be used in specific instances such as unsecured loans, small loan amounts, and agricultural lands in many cases. **Recovery Process under SARFAESI Act**

The recovery process under the SARFAESI Act is as below stage wise:

Stage	Core Objective
Phase 1 NPA Classification	The process begins when the borrower's loan account is classified as a Non-Performing Asset according to RBI guidelines.
Phase 2: Section 13(2) Notice / Demand Notice	The secured creditor issues a demand notice under Section 13(2) demanding repayment of the outstanding amount within sixty days. The borrower is provided an opportunity to make repayment or raise objections.
Phase 3: Section 13(3A) Response	The borrower may submit objections or representations against the notice. The secured creditor is required to consider such objections and communicate reasons if objections are rejected.
Phase 4: Section 13(4) Measures	If the borrower fails to comply with the demand notice, the secured creditor may take measures under Section 13(4), including Creditor assumes "Symbolic" or "Physical" possession of assets.

Stage	Core Objective
	Taking possession of secured assets Taking over management of business Appointing a manager for secured assets Recovering dues through sale or auction
Phase 5: Liquidation / Public Auction/Sale	The secured assets are valued and auctioned according to the Security Interest (Enforcement) Rules, 2002. Assets are valued and sold under Security Interest Rules, 2002.
Phase 6: Sale proceeds	The sale proceeds are appropriated towards recovery of dues. The SARFAESI framework significantly reduces dependence upon ordinary civil litigation and enables quicker recovery proceedings. Sale proceeds are applied to the debt; surplus is returned to the borrower.

The Act was introduced to reduce delay and improve efficiency in recovery proceedings.

3. Comparative Study of Secured Creditors and Borrowers

It is important to note that the SARFAESI Act, 2002, mainly emphasizes on improving the recovery process for banks and financial institutions but at the same time gives certain safeguards to the borrowers. Thus, it is necessary to understand the role of the SARFAESI Act in determining the status of the secured creditors and the borrowers since both the groups have certain distinct rights and obligations during the recovery process.

One of the important facts about the SARFAESI Act is that the position of the secured creditors has been made comparatively better than the borrowers as the main objective of passing the SARFAESI Act was reducing NPAs in order to improve the financial performance of banks and financial institutions. Prior to this Act, banks and financial institutions had to solely depend on judicial process for recovery of loans due to them but that would often lead to financial losses for banks and financial institutions due to delayed recovery of loans.

Thus, the SARFAESI Act empowered secured creditors to recover loans without resorting to any judicial process.

Nonetheless, most procedural rights apply to the borrowers under this law. Although they lack the recovery powers that the secured creditors hold, they are still entitled to some legal rights. For instance, borrowers have the legal right to be notified before the enforcement of such recovery measures. The borrowers may make an objection or representation to the demand notice issued to them, and also contest the actions of the banks before the DRT under Section 17 of the Act.

Redemption is another crucial right provided by the Act for borrowers. After the process of possession is complete, the borrower has the right to pay off the dues and recover their property before completion of the sale process. Courts have consistently found that banks must follow due legal procedures and not act arbitrarily during the process of taking possession or sale.

In practice, the secured creditors usually have more financial muscle power, legal infrastructure and technical expertise. Most banks and financial institutions have departments that deal exclusively with the recovery process, have legal experts and officials who carry out the recovery process under SARFAESI. The debtor on the other hand faces problems related to lack of finance, lack of legal awareness and difficulty in procuring finances. Due to such disparity, it becomes difficult for the borrower to safeguard his interests.

There are also differences in the concerns of the two sides. The creditors' primary concern is fast recovery of loans, reduction in NPAs and financial stability. For secured creditors, delays in the process of acquiring possession, lawsuits filed by the debtors, lack of cooperation in the process of auctioning and decline in the value of the securities are the major problems.

The main worries of the debtors are protecting their properties, ensuring fair recovery process and preventing the abuse of powers by the financial institutions. The main problem faced by the debtors in most cases relates to the attachment and auctioning of their business and residential properties when recovering loans from them.

The judicial interpretation of the law has been crucial in finding a balance between the rights of the secured creditors and the borrowers. The Indian courts have always maintained that the

objective of quick recovery under the SARFAESI Act is to be upheld at all costs without resorting to any illegal and arbitrary means of recovering money from borrowers. In the case of *Mardia Chemicals Ltd. v. Union of India*, it was held that the constitutionality of the Act is valid and also acknowledged the right of the borrower to seek legal remedy for unjust recovery methods.

Hence, based on the comparison between secured creditors and borrowers under the SARFAESI Act, it can be seen that the law has primarily benefited the secured creditors to ensure that there is financial discipline and minimum NPAs in the country. At the same time, it cannot be overlooked that borrower rights are also very essential in such cases.

4. Challenges in Implementation

Despite the improvement in recovery procedures through the SARFAESI Act, 2002, a number of problems can occur during the process. There are many practical and legal problems that secured creditors and debtors experience during recovery proceedings. These problems may have an impact on the effectiveness of the process.

Challenges Experiences by Secured Creditors

One of the most significant problems experienced by creditors in India is that of delays in physical possession of their secured properties. Banks often find difficulty in acquiring physical possession of the property after issuing notices and performing legal formalities. At times, even help from local administrations and the police takes time in arriving.

Lengthy legal proceedings is yet another problem that a secured creditor has to face in India. Debtor resists the recovery proceedings initiated by the secured creditor at various places like DRTs, high courts, and others. It can be said that this problem is one of the significant ones since the whole intention behind SARFAESI was to protect themselves from any interference from the court in recovery proceedings.

Practical problems that the secured creditor has to encounter during the auction and sale proceedings can be stated. Lack of adequate number of bidders for the property being sold in an auction or a reduction in the market value of the property can prove to be a serious challenge. The asset may not find any takers for months together and lead to losses for the concerned institution.

It has been seen that procedural compliance becomes yet another significant problem for the secured creditors. The procedure laid down in the SARFAESI Act and Security Interest

(Enforcement) Rules, 2002 must be strictly followed else the entire proceedings would stand cancelled.

Operating difficulties such as shortage of trained recovery officers or non-coordination between departments or rise in NPA accounts become important problems for financial institutions.

Challenges Faced by Borrowers

There are also a number of challenges that borrowers encounter while undergoing the process of SARFAESI Act. One of the major problems faced by the borrowers is that of losing their residential and/or commercial properties because of default on loans. The power accorded to secured creditors in the Act is very strong, and, consequently, borrowers experience financial and psychological distress during the course of recovery process.

A number of borrowers are not well versed with their rights as defined under the Act, and due to this lack of legal knowledge, the borrowers might not raise any objections against illegal recovery measures within stipulated periods.

The problem of financial stress is also one of the major challenges faced by the borrowers. Upon becoming the Non-Performing Asset (NPA), borrowers need to find sufficient funds in a stipulated period of time in order to halt the process of recovery.

There are also issues related to valuation and subsequent auction of secured assets. There are many instances where the properties have been undervalued in order to make a sale.

Legal proceedings can also be quite costly and lengthy for borrowers in front of DRTs and courts. Many borrowers lack the requisite financial means to pursue legal battles against major financial organizations that enjoy significant legal representation.

Need for Balanced Implementation

Problems experienced by secured creditors and debtors in respect of implementation of the provisions under SARFAESI Act suggest that there is a need to have a proper balance while implementing such an Act. It is obvious that financial institutions and banks would have the power of recovery for reduction of NPAs; however, debtors too need to be protected under such provisions.

Thus, adherence to proper procedures, transparency in auction process, adequate judicial oversight, and speedy resolution of disputes are required to make this provision effective.

5. Judicial Aspects

Judicial interpretation has been a significant factor for the successful enactment of the SARFAESI Act, 2002. The judicial pronouncements made by the Supreme Court as well as High Courts in several cases have provided clarity regarding the powers of the secured creditor and rights of the borrowers as well as the process involved in the same.

1. Mardia Chemicals Ltd. v. Union of India

Citation: (2004) 4 SCC 311

This is another one of the landmark decisions involving the SARFAESI Act. In this case, the constitutional validity of the SARFAESI Act was challenged before the Supreme Court of India. The borrowers in this case contended that the Act granted too many powers to the banks and financial institutions without affording adequate protection to borrowers.

The Supreme Court upheld the constitutional validity of the SARFAESI Act but held that the Act was essential for fast recovery of bad loans and reducing NPAs. Nevertheless, the Supreme Court did protect the interest of the borrower in this decision by declaring the provision of depositing 75 percent of the amount to be deposited as being invalid.

This case assumed significance in this respect.

2. Transcore v. Union of India

Citation: (2008) 1 SCC 125

In this case, the question before the Supreme Court was whether banks could pursue a parallel process under the provisions of the SARFAESI Act as well as under the provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDDBFI Act).

The decision of the Supreme Court made it clear that both provisions were complimentary in nature, and thus could be invoked together by banks/financial institutions without withdrawing from the process before the Debt Recovery Tribunal.

3. Harshad Govardhan Sondagar v. International Assets Reconstruction Co. Ltd.

Citation: (2014) 6 SCC 1

In this case, the question was regarding the right of the tenants to the property which is secured under Section 2(1)(h) of SARFAESI Act. Whether a tenant can be dispossessed while exercising his rights under Section 13 of SARFAESI Act.

Supreme Court ruled that the legitimate tenants who have been residing in the property prior to the creation of the mortgage cannot be thrown out of the house through any illegal means.

However, the tenants whose tenancy is fictitious will not be entitled to the protection of law.

4. Indian Overseas Bank v. Ashok Saw Mill

Citation: (2009) 8 SCC 366

In this case, the Supreme Court highlighted the powers of the Debt Recovery Tribunal as per Section 17 of the SARFAESI Act.

According to the Supreme Court, the DRT possesses vast power to determine the validity of the proceedings of the secured creditor. In case there is any violation of law on the part of the bank, the DRT can restore the possession of property to the borrower.

In this way, the role of DRT as a protective body for the borrower became stronger.

5. Mathew Varghese v. M. Amritha Kumar

Citation: (2014) 5 SCC 610

This case was mainly concerned with auction and sale of security properties.

According to the Supreme Court, the banks and financial institutions are required to strictly adhere to the provisions of Rule 8 and Rule 9 of the Security Interest (Enforcement) Rules, 2002 prior to auctioning of the security property. The borrowers have the right to redemption up until such time when the sale is fully done.

This decision was very significant in matters of auctions proceedings.

6. Phoenix ARC Private Limited v. Vishwa Bharati Vidya Mandir

Citation: (2022) 5 SCC 345

In this instance, the Supreme Court pointed out that debtors must seek the help of the Debt Recovery Tribunal rather than filing petitions in the High Court.

It was said that the remedy provided under the Act is sufficient and the High Courts need to intervene only in rare circumstances.

This decision was favorable for faster recovery process and minimized judicial interference in the SARFAESI cases.

6. Conclusion

From the comparison of the secured creditors and borrowers under the SARFAESI Act, it is clear that the law favors banks and other financial institutions in recovering the amount of the loan from the borrower promptly. The creditors have been given greater legal rights to recover dues from the borrowers through the possession of the secured property and sale of the property

in case of non-payment of the loans.

However, at the same time, it should be ensured that there is an effective balance between the recovery process of loans and safeguarding the rights of the borrowers. The delay in the process of recovery will affect the financial position of the banks and lead to more NPAs. However, improper recovery processes may cause injustice to the borrowers.

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