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LEGAL FRAMEWORK OF SECURITISATION IN INDIA

AUTHORED BY - NEETI GOYAL¹

Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act, 2002)

The said act has played a vital role in regulating the financial sector in India. The need of this act was felt when large amount of the bank loans were converting into NPA's and there was no appropriate regulation for the banks to recover their loan. The problem has been faced in earlier decades of "directed control" policies of the Indian government. Such policies and the financial support for the preferred sector was given with the aim to develop the country.²

After the Asian crisis the need for the proper legislation was felt. Recommendations given by the Narasimham Committee in 1991, in effect of which the Parliament had enacted Recovery of Debts Due to Banks and Financial Institutions Act, 1993. The Act created a separate tribunal for the Debt Recovery which were known as the debt recovery Tribunals they were appointed with the responsibility of taking the cognizance of the disputes due to non-payment of debts and for encouraging speedy recovery proceeding by banks. However this system was not proved satisfactory as the convulsion of those real estates and translation into liquid assets seemed impossible because of the legal complexities as well as the sloth of our judicial system. It meant that bad debt of the banks and financial institutions ran into huge bulk of rupees which would not be recovered easily due to delays in the conventional legal system. It took years for the banks to liquefy the security assets and appreciate the sum of deficiency. This resulted in blockade of huge amounts causing unhealthy economic imbalances in the functioning of banks and financial institutions.

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² India's financial system in its latter half of the last century was dependent on the financial institutions which provides credit to the small ventures. SIDBI was created in 1989 to facilitate financial assistance leading to the promotion, financing, and development of small-scale projects and microenterprises."

Be that as it may, the execution of DRTS was exceedingly unacceptable on account of different hindrances. One of the hurdles was the Sick Industrial Companies (Special Provisions) Act 1985 (SICA). The banks discovered it to a great degree hard to sue for recovery of cash against a modern substance enlisted as "wiped out" under SICA. Aside from that, assent was additionally required from the Board for Industrial and Financial Reconstruction (BIFR), made under article 4 of SICA, for the procedure of recovery. These remnants of the "license raj" period of communist India at that time was in hurry to change its economy but by the defaulting companies. Luckily, the Government understood that some important steps has to be taken to assist the recuperation of NPAs, in furtherance of this a bill was presented to abrogate SICA, the Sick Industrial Companies (Special Provisions) Repeal Bill was presented in the Lok Sabha on August 30, 2001. What's more, another bill the Companies (Amendment) Bill of 2001 was likewise acquainted in the Lok Sabha with achieves changes important to assist the recuperation of awful advances. In spite of the fact that the bills were displayed in the midst of much ballyhoo, just the Companies (Amendment) Act was gone in 2001; the other grieved in the parliamentary framework until 2003 when the Sick Industrial Companies (Special Provisions) Repeal Act at long last got to be law. In the midst of this, execution of Public Sector Banks kept on being antagonistically influenced, incompletely as a consequence of the fragile political financial structure of India, mostly in light of rivalry from foreign banks, and somewhat in because of structural inadequacies. This developed a feeling of earnestness in the Indian bureaucratic and political circles. All the excited movement and open civil argument over NPAs brought about a somewhat exceptional step, the declaration of "The Securitisation, Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002" (SARFAESI), by the Government of India. Suddenly, there was an enhancement of creditors' rights, which empowered "banks and financial institutions to take possession of the securities and sell them without going through the protracted judicial process."

Securitisation and its present situation in India

Securitisation is one of the latest financial innovations in Indian markets.. In December 2002, a legal frame work was provided for securitization through the "securitization and reconstruction of financial assets and enforcement of security interest Act", 2002 which became effective from June 21, 2002. The development in the Indian securitisation market has been to a great extent fuelled by the repackaging of retail assets and private home mortgages of banks and FIs. This business sector has been in presence since the mid 1990s, however has developed fundamentally just post-2000 with a built up limited band of financial specialist group and standard guarantors.

As per Industry assesses, the organized issuance volumes have become extensively in the most recent couple of years; however still little contrasted with universal volumes. Asset backed securitisation (ABS) is the biggest item class driven by the developing retail credit arrangement of banks and different FIs, investors nature with the hidden resources and the short development time of these advances. The mortgaged backed securities (MBS) market has been fairly moderate in taking off notwithstanding a developing lodging fund market because of the long development periods, absence of optional business sector liquidity and the danger emerging from prepayment/repeating of the fundamental advance.

SCHEME OF THE ACT

It consists of 41 sections which are divide in 6 Chapters, 1 Schedule. Chapter 1 talks about the applicability of the act and contains all the definitions of the said Act. Chapter 2 consists of 10 sections which gives details for regulation of securitisation and reconstruction of financial assets of banks and financial institutions, setting up of securitisation and reconstruction companies and matters related thereto. Chapter 3 consists of 9 sections gives details for the procedure of the enforcement of security interest and incidental matters. Chapter 4 consists of 7 sections giving the procedure for the establishment of a Central Registry, registration of securitisation, reconstruction and security interest transactions and matters related thereto. Chapter 5 contains 4 sections. providing for offences, penalties and punishments. Chapter 6 contains 10 sections providing for routine legal issues.

*"The main purpose of the SARFAESI Act is to enable and empower the secured creditors to take possession of their securities and to deal with them without the intervention of the court and also alternatively to authorise any securitisation or reconstruction company to acquire financial assets of any bank or financial institution."*³

The salient features of the act are:-

- Securitisation of financial assets

The term 'securitisation is defined under definition clause which says "acquisition of financial

³ ICSI, Corporate Restructuring, Valuation And Insolvency, available at: www.icsi.edu/docs/webmodules/Publications/Full%20Book%20of%20PP-CRVI-2014.pdf (Last Modified on: 02/04/2016).

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, S.2(1)(z)

assets by any securitisation company or reconstruction company from any originator, whether by raising of funds by such securitisation company reconstruction company from qualified institutional buyers by issue of security receipts representing undivided interest in such financial assets or otherwise."⁴

Under this act banking companies and the financial institution can only securitize their financial assets due to the non performing loans or assets with the securitisation company and through asset reconstruction. The funds required for the acquisition of the assets can be raised from the QIB's⁵ (qualified institution buyers) or by issuing the security receipts representing undivided interest in such asset or otherwise.

"Financial Asset" ⁶

Debt or receivables and includes-

- a claim to any debt or receivables or part thereof, whether secured or unsecured; or any debt or receivables secured by, mortgage of, or charge on, immovable property; or a mortgage, charge, hypothecation or pledge of movable property; or any right or interest in the security, whether full or part underlying such debt or receivables; or any beneficial interest in property, whether movable or immovable, or in such debt, receivables, whether such interest is existing, future, accruing, conditional or contingent; or any financial assistance;

The act has emerged to be the significant change for the lenders to secure their future cash flow from the secured assets and to their blocked funds for the purpose of lending further.

Incorporation & Registration of Special Purpose Companies

"Securitisation company" and "asset reconstruction company" are the two main vehicle (special purpose vehicle) for securitising and reconstructing the financial assets. Securitization company"

⁴ The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, S.2(1)(z)

⁵ Any financial institution, banks, insurance company, State Financial Corporation, Trustee, State Industrial Development Corporation, or any AMC on behalf of any mutual fund, provident fund, gratuity fund or pension fund, FIIs registered with SEBI or any other body corporate specified by SEBI".

⁶ The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, S.2(1)(I)
15 The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, S.2(1)(za),

16 The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, S.2(1)(v),

17 The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, S.2(1)(b),

means any company formed and registered under the Companies Act, 1956 (1 of 1956) for the purpose of securitisation;(in common parlance called Special Purpose Vehicle (SPV);

Reconstruction company means a company formed and registered under the Companies Act, 1956 for the purpose of asset reconstruction.

Asset reconstruction means acquisition by any securitisation company or reconstruction company of any right or interest of any bank or financial institution in any financial assistance for the purpose of realisation of such financial assistance. These are the company registered under the companies act 2013.the main objective of the company is to securitize the assets and asset reconstruction.

The act requires the mandatory registration of the companies with the minimum requirement of the funds owned by these companies. Minimum 2 crores or fifteen percent of the total financial assets should be possessed by the companies. RBI has power to alter the fund requirement time to time. It is mandatory for the existing SCO and RCO to get registered under the securitisation act. These companies except their core business may perform other functions:-

To act as an recovery agent on behalf of banking companies and financial institution.

To act as a manager to manage the affairs relating to the secured assets the possession of which has been taken by the secured creditor.

To act as a receiver on order given by any court or tribunal.

RBI has given wide power in relation to the registration of these companies. it can cancel the registration of these companies, in following situation:-

If the company-

- 1) ceases to receive or hold any investment from qualified institutional buyer
or
- 2) ceases to carry asset reconstruction business or
- 3) fails to comply with the conditions of registration

- 4) it Fails to fulfil the conditions of Section 3(3)⁷
- 5) it fails to comply with directions given by the RBI.
- 6) It fails to maintain accounts etc

FUNDING OF SECURITISATION

For the acquisition of the financial assets the SCO/RCO needs some funds at which they can buy the assets through a bank or financial institutions. These companies access to the qualified institutional buyers by issuing a security receipt. These securities are the "securities" within the meaning of section 2(h) (ic) of the securities contract (regulation) Act, 1956.

A Scheme of acquisition has to be formulated for every acquisition detailing therein the description of financial assets under acquisition, the quantum of investment, rate of return assured etc. Further separate and distinct accounts have to be maintained in respect of each scheme of acquisition. Realizations made from the financial assets have to be held and applied towards the redemption of investments and payment of assured returns.

In case of non-realization of financial assets, the QIB holding not less than 75% of the total value of the security receipts issued, are entitled to call a meeting of all QIB and pass resolution and every such resolution is binding on the SCO/RCO

ACQUISITION BY THE SCO AND RCO THE RIGHTS AND INTERESTS IN THE ASSETS

The company may acquire rights and interest in financial asset of the banks and financial institution by two ways given in the act⁸:-

- Either, by issuing the debenture or bond or any other security in nature of debenture, on being consideration agreed between the banker financial institution and the SCO or RCO, on their terms and conditions."

⁷ The Reserve Bank may, for the purpose of considering the application for registration of a securitisation company or reconstruction company to commence or carry on the business of securitisation or asset reconstruction, as the case may be, require to be satisfied, by an inspection of records or books of such securitisation company or reconstruction company, or otherwise, that the certain conditions are fulfilled.

⁸ The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, S.5.

- By entering into the agreement by the RCO or SCO with the bank or financial institution for transfer the financial assets on such term and condition as agreed upon.

After the company acquires the financial assets they comes into the shoes of the banks or the financial institutions and get all the rights and powers associated with the realisation of the financial assets from the obligors. It also gives the right to file any case appeal, any other proceedings against the borrower.

When the securitization company takes over the assets of the banks than they may with the consent of the origin who held the assets initially files an application to the debt recovery tribunal or any court where the case has been instituted or appeal has been instituted to change the name in place of the originator.

Assets Reconstruction

The companies may take the following steps for asset reconstruction:-

- To take over the management of the business of the obligor or the borrower.
- By selling off or by giving it on lease the part or whole of the business of the borrower.
- By rescheduling of payment of debts payable by the borrower.
- By enforcing the security interest.
- By settling down the dues [payable by the obligor.
- By taking in possession of the secured assets.
- By converting any portion of debt into share of a borrower company.⁹

NON PERFORMING ASSETS:-

In common parlance bank gives loan to the borrowers. In case of failure to repay the loan by the borrower the bank gives him notice to pay the loan on time with certain amount of interest. In case of failure the banks declares such loans as Non -Performing Assets or Bad loans. Non-performing asset means an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset,-

- (a) “in case such bank or financial institution is administered or regulated by any authority or body established, constituted or appointed by any law for the time being in force, in

⁹ The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, S.9.

accordance with the directions or guidelines relating to assets classifications issued by such authority or body”;

- (b) “in any other case, in accordance with the directions or guidelines¹⁰ relating to assets classifications issued by the Reserve Bank”.¹¹

Conclusion.

The Act is in itself is complete guide for the enforcement of security interest for individuals, However after enactment of Insolvency and Bankruptcy Code 2016, the scope of recovery and enforcement of security interest has enlarged.

So the importance of this Act becomes crucial in the sphere of Banking Law.



¹⁰ Reserve Bank Of India, "Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances", July 1, 2015, available at:

https://www.rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=9908 (Last Modified on March7, 2016)

¹¹ Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, S.2(1)(0)