Introduction

The SARFAESI Act has been enacted to regulate securitization and to provide reconstruction of financial assets. The act provides for enforcement of security interest. The act enabled the banks and financial institution to realize term assets, manage problems of liquidity, asset liability mismatches and improve recovery by exercising powers to take possession of securities, sell them and reduce non-performing assets by adopting measures for recovery or reconstruction.

• When did Securitization and Reconstruction of Financial Assets and Enforcement of Financial Interest, 2002 came into force?
Ans. The SARFAESI Act was enacted on 21st June 2002.

• What are the objectives of the SARFAESI Act?
Ans. The objective is to facilitate recovery of dues of banks and financial institution by Non-adjudicatory body. The act enables the bank and financial institutions to enforce their security interests expeditiously without being required to move to a court or tribunal.

• What is the Constitutional validity of the SARFAESI Act?
Ans. The Supreme Court in the landmark case of Mardia chemicals Ltd Vs Union of India upheld the Constitutional validity of the SARFAESI Act.

• What is the applicability of the SARFAESI Act?
Ans. The Act is only applicable for NPA loans with outstanding above Rs. 1 lac, where the amount should not be less than 20% of the principal loan amount and interest. NPA should be backed by secured assets. Only secured assets can be attached by Banks and Financial Institutions for recovery of loans.

• What are the conditions required to enforce the rights of the creditors?
Ans. For enforcing the rights of creditors (Banks) the following conditions has to be satisfied -
1. The debt should have secured assets;
2. The debt has been classified as an Non-Performing Asset by the banks;
3. The loan are of Rs. 1 Lakh and above and more than 20% of the principal loan amount and interest;
4. The security for loans should not be an Agricultural land.

**What is Non-Performing Asset?**
Ans. NPA is defined under Section 2 (o) of the Act. Non Performing Asset means an asset or account of a borrower which has been classified by the bank or financial institution as sub-standard doubtful or loss asset or any other guidelines relating to assets classification issued by Reserve Bank of India.

Non Performing Asset is such a loan or advance given by a bank where the interest or installment of the principal sum remains overdue for more than 90 days.

**What are the methods to recover Non-performing Asset?**
Ans. The SARFAESI Act provided for 3 methods of recovery of Non performing assets:

1. Securitization-
2. Asset Reconstruction
3. Enforcement of Security without the intervention of the Court

**How are Security interest enforced by secured creditor?**
Ans. The secured creditor has to enforce secured interest in his favor without the intervention of the Court or tribunal. When there is default in repayment of loan or interest and the account is classified as NPA the secured creditor issue notice to the borrower to repay the amount in 60 days. The borrower has right to appeal against the notice. The borrower can discharge the amount or raise objection to the notice. The secured creditor has to consider the objections raised by the borrower. The secured creditor has to communicate the non acceptance of the objections with reasons within 15 days to the borrower.

If the borrower fails to comply with the notice the secured creditor can take the recourse to one or more following measures to recover his secured debt without the intervention of the Court or tribunal:

1. Take possession of the security.
2. Sale or lease or assign right over the security.
3. Manage the same or appoint any person to manage the same.

**Explain the process of securitisation.**
Ans. Securitisation is the process of issuing marketable securities backed by the secured assets. After assets are converted into securities they are sold. This process involves 3 steps-

1. Identification Process- The Banks and financial Institutions that decided to go for securitisation are called ‘Originators’. The process of selecting various loans and receivable from asset portfolio to convert them into securities is called Indentification Process.

2. Transfer Process- The originators after selecting pool of assets pass it on to the Special Purpose Vehicle or the trust. This is by the way of sale agreement. After transferring the assets the originators removing it from balance sheets.

3. Issuing Securities- The SPV then convertors the assets to securities. They will issue it to the investors.

• **What are Asset Reconstruction Company?**

Ans. Asset Reconstruction Company is a specialized financial institution that buys the NPAs or bad assets from banks and financial institutions and convert them into good loans. Asset reconstruction company buy bad assets from the banks at mutually agreed rate.

Asset Reconstruction Company helps in cleaning up of the balance sheets of banks when the latter sells these to the ARCs.

• **What is the process of registration of Asset Reconstruction Company?**

Ans. Securitization Company or Reconstruction Company can commence or carry on the business of Securitization or Asset Reconstruction only after complying with the following conditions:

1. It has to obtain a Certificate of Registration under this section from RBI.
2. It has to own fund of not less than two crore rupees or such other as specified by the RBI.
3. It has to maintain a capital ratio of 15% of its risk weighted assets.

• **What are the main functions of the Company?**

Ans. The Asset Reconstruction company may act as:

1. Act as an agent for any bank or FI for the purpose of recovering their dues from the borrower on payment of such fees or charges.
2. Act as a manager between the parties, without raising a financial liability for itself.
3. Act as receiver if appointed by any court or tribunal.
**How Asset reconstruction Company convert NPA to performing assets?**

Ans. The Asset reconstruction company acquire financial Assets from bank and financial institutions. This can be done by in two ways;

1. By Issuing bonds and debentures or any other security for agreed consideration.
2. By an agreement between the Banks and financial institutions for transfer of assets to such companies.

Bonds or debentures can be issued for maximum period of 6 years with rate of interest at least 1.5% above the RBI ' bank date'.

Asset Reconstruction company issue security recipients for raising funds to Qualified Institutional buyers. Qualified institutional buyers are buyers that have specialized knowledge and expertise about functions of ARC's. QIB have huge amount of capital assets. The Security Receipt gives the QIB a right, title or interest in the financial asset that is bought by the company. These Security Receipts issued are backed by impaired assets.

ARCs while restructuring the assets follow resolution strategies. SARFAESI Act stipulates various measures that can be undertaken by ARCs for asset reconstruction. These include:

a) taking over or changing the management of the business of the borrower,
b) the sale or lease of the business of the borrower
c) entering into settlements and
d) restructuring or rescheduling of debt.
e) enforcement of security interest

After when assets are reconstructed it is returned to the Banks or Financial institution according to the term and conditions of the act.

Besides restructuring, the ARCs can perform certain other functions as well. They are permitted to act as a manager of collateral assets taken over by the lenders by receiving a fee. Similarly, they can also function as a receiver, if appointed by any Court or DRT.

**What are the powers of Reserve Bank of India?**
Ans. Powers of Reserve Bank of India are given in Section 12 and 12A of the Act. The RBI give directions and issue directions in the public interest, to regulate financial system of the Country, regulate the affairs of asset reconstruction.

The RBI can give directions to asset reconstruction company in matter related to income recognition, accounting standards, making provision for bad and doubtful debts, capital adequacy based on risk weights of the assets, Deployment of funds by said companies.

In addition the RBI can also:
1. Call for statements and information as per Section 12A
2. Carry out audit and inspection as per Section 12 B
3. For securing proper management of an asset reconstruction company, by an order— remove the Chairman or any director or appoint additional directors on the board of directors of the asset reconstruction company or appoint any of its officers as an observer to observe the working of the board of directors of such asset reconstruction company.

• What is the role of Chief Metropolitan Magistrate or District Magistrate?
Ans. The Chief Metropolitan Magistrate or District Magistrate assist the secured creditors in taking the possession or control of the secured asset or selling or transfer of the secured asset. The secured creditors has to make a request in writing accompanied by required affidavit to the said authority in whose jurisdiction the secured assets or documents is situated. After being satisfied with the contents of the affidavits the authority will pass an order for purpose of taking the possession of the secured assets or documents and transferring it to the secured creditors. This act of CMM or DM cannot be called into question in any court or before any authority

• What are the rights of Borrowers?
Ans. The SARFAESI Act provides some rights to the borrower to protect them from any illegal and fraudulent act of the Banks and Financial institutions. The borrowers can remit the dues any time before the sale is concluded. The borowers are entitled for compensation for any illegal act done by authorised officers. They can also approach DRT for any grievances.

• Why is Central Registry set up?
Ans. Section 20 of The SARFAESI Act provides for setting up of Central Registry by the Central Government. It is set up to prevent frauds by Banks in loan cases involving multiple lending from different banks on the same immovable property. The head office of the Central Registry should be
as specified by the Central Government. The central Government should appoint Central registrar for the purpose of registration contemplated by the Act.

A record should be maintained at the head office of Central Registry about the transactions relating to:

1. Securitisation of financial assets
2. Reconstruction of financial assets
3. Creation of security interest.