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THE SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT, 2002 (SARFAESI ACT, 2002): A COMPREHENSIVE LEGAL ANALYSIS

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1. Introduction and History of the Act

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) represents a significant legislative measure undertaken by the Indian Parliament to address the critical issue of non-performing assets (NPAs) within the banking sector. The act was promulgated with the primary objective of enabling banks and financial institutions to expedite the recovery of dues without the intervention of courts, thereby facilitating the improvement of asset quality and financial stability within the system.

2. Historical Context

The SARFAESI Act's genesis can be traced to the early 1990s, a period characterized by economic liberalization and banking sector reforms in India. The rising incidence of NPAs, aggravated by inadequate legal frameworks for swift recovery, necessitated a robust mechanism to enforce security interests. The Narasimham Committee on Banking Sector Reforms (1991) and the Andhyarujina Committee on Banking Laws (2000) underscored the urgent need for a dedicated framework to address the mounting NPAs and suggested the creation of an efficient recovery mechanism. This led to the enactment of the SARFAESI Act, which received presidential assent on December 17, 2002, and came into force on June 21, 2002.

- **Important Definitions**

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The SARFAESI Act incorporates several key definitions pivotal for understanding its operative mechanisms:

Asset Reconstruction: The process of acquiring non-performing assets (NPAs) from banks and financial institutions to recover managed managing the assets effectively.

Non-Performing Asset (NPA): An asset or account of a borrower, which has been classified by a bank or financial institution as a sub-standard, doubtful, or loss asset by the directions or guidelines relating to asset classification issued by the Reserve Bank of India (RBI).

Secured Asset: Property on which a security interest is created.

Secured Creditor: Any bank or financial institution or any consortium or group of banks or financial institutions and includes debenture trustees appointed by any bank or financial institution or securitisation company or reconstruction company or any other trustee holding securities on behalf of a bank or financial institution.

Security Interest: Right, title, and interest of any kind whatsoever upon property, created in favour of any secured creditor and includes any mortgage, charge, hypothecation, or assignment other than those specified in Section 31 of the Act.

3. Authorities under the Act

The SARFAESI Act delineates various authorities vested with distinct roles and responsibilities:

Reserve Bank of India (RBI): The central regulatory authority responsible for overseeing the functioning of asset reconstruction companies (ARCs) and ensuring compliance with the norms prescribed under the Act.

Securitisation Company and Reconstruction Company (SC/RC): Entities incorporated under the Companies Act, 1956, and registered with the RBI for securitisation or asset reconstruction.

Debts Recovery Tribunal (DRT): Judicial bodies established under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, which adjudicate matters related to the enforcement of security interests and recovery of dues under the SARFAESI Act.

4. Types of Assets Dealt Under the Act

The SARFAESI Act primarily deals with the following types of assets:

Financial Assets: Includes loans, advances, debentures, bonds, and other credit facilities extended by banks and financial institutions.

Secured Assets: Tangible properties such as land, buildings, plant, and machinery, and intangible assets such as patents, copyrights, trademarks, and licenses, on which a security interest is created.

- Asset Reconstruction Company (ARC)

Asset Reconstruction Companies (ARCs) are specialized entities that play a pivotal role in the resolution of distressed assets. These entities acquire NPAs from banks and financial institutions and undertake measures for their restructuring and recovery. The SARFAESI Act provides a comprehensive framework for the establishment and operation of ARCs, which includes:

Incorporation and Registration: ARCs must be incorporated under the Companies Act, 1956, and registered with the RBI as per the provisions of the SARFAESI Act.

Functioning: ARCs acquire financial assets through an agreement with the originator (the bank or financial institution) and subsequently undertake measures for the reconstruction of such assets, including rescheduling of payment schedules, settlement of dues, and enforcement of security interests.

Powers: ARCs are empowered to take possession of secured assets, take over the management of the borrower's business, and sell or lease the assets to recover dues.

5. How Banks Give Loans and Security Interest Works

Lending Mechanism

Banks provide loans and advances to borrowers based on their creditworthiness, collateral offered, and the purpose of the loan. The lending process involves the following stages:

Credit Appraisal: Assessment of the borrower's creditworthiness, financial statements, and collateral offered.

Sanctioning and Disbursement: Approval of the loan and disbursement of funds to the borrower.

Monitoring: Continuous monitoring of the borrower's account to ensure timely repayment of dues.

Creation and Enforcement of Security Interest

Security interest is a critical aspect of lending, ensuring that banks have a legal claim over the borrower's assets in the event of default. The process involves:

Creation of Security Interest: Banks create a security interest over the borrower's assets through various means such as mortgage, hypothecation, pledge, and assignment. This is done to secure the repayment of the loan.

Registration: The security interest created must be registered with the Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI) to provide public notice and priority over other claims.

Enforcement: In the event of default, banks can enforce the security interest by taking possession of the secured assets, selling or leasing them to recover dues, or taking over the management of the borrower's business.

6. Sections of the Act

The SARFAESI Act encompasses several critical sections that delineate its operative mechanisms:

Section 13: Provisions related to enforcement of security interest, empowering secured creditors to take possession of the secured assets and sell or lease them without court intervention.

Section 17: Right to appeal to the Debts Recovery Tribunal against measures taken by the secured creditor under Section 13.

Section 18: Appeal to the Appellate Tribunal against the order of the Debts Recovery Tribunal.

Section 20: Power of the Reserve Bank of India to determine policy and issue directions to ARCs.

Section 23: Registration of transactions of securitisation, reconstruction, and creation of security interest by CERSAI.

7. Judicial Approach:

Several landmark judgments have shaped the interpretation and implementation of the SARFAESI Act. Notable among them are:

Mardia Chemicals Ltd. V. Union of India, (2004) 4 SCC 311: The Supreme Court upheld the constitutional validity of the SARFAESI Act while reading down certain provisions to ensure compliance with principles of natural justice.

Transcore v. Union of India, (2008) 1 SCC 125: The Supreme Court held that the SARFAESI Act and the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, provide parallel mechanisms for the recovery of dues, and banks can proceed under either or both statutes.

United Bank of India v. SatyawatiTondon, (2010) 8 SCC 110: The Supreme Court emphasized the primacy of the SARFAESI Act in the recovery of dues and cautioned against undue interference by courts in the enforcement of security interests.

ENDNOTES AND SOURCES

- Mardia Chemicals Ltd. V. Union of India, (2004) 4 SCC 311.
- Transcore v. Union of India, (2008) 1 SCC 125.
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