

## THE SECURITIZATION ACT, 2002 IN MANAGEMENT OF NON-PERFORMING ASSETS: OPPORTUNITIES V/S THREATS

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### ABSTRACT

Non-performing Assets (NPA) has emerged since over a long period as an alarming threat to the Indian banking industry. Banking reforms by the Government of India and Reserve Bank of India (RBI) in terms of the two Narasimhan Committee Reports have been neutralized by the ill effects of this surging threat. Despite various correctional steps administered to solve and end this problem, concrete results are eluding the severity of the problem is however acutely suffered by almost all the branches of commercial banks. The curative measures are reactionary in nature and focused on recovering from NPAs accounts. It includes measures initiated by RBI such as setting up Asset Reconstruction Companies (ARCs), Debt Recovery Tribunals (DRTs), Securitization Act, 2002, Lok adalats, Compromise Settlement Schemes, etc. The review of literature clearly indicates that among these measures Securitization Act 2002 is most significant to solve the problem of NPAs. But still the level of NPAs has not pulled down to standard level (2%), especially in Public Sector Banks. So it is necessary to evaluate the opportunities and threats related to implementation of The Securitization Act 2002 in NPAs management with the help of Bankers' & Borrowers' perspective. The present research paper emphasizes on exploring Opportunities and threats related to application of provisions of The Securitization Act, 2002 in NPAs management of Public Sector Banks. The study is based on secondary data collected from research papers, articles, news papers, publications related to Bare Act of the Act.

**Keywords:** The Securitization Act, 2002, NPAs, Opportunities, Threats.

### INTRODUCTION

Indian banks' gross non-performing assets (NPAs), or bad loans, stood at Rs 10.25 lakh crore as on 31 March 2018. On quarter, the pile has grown by Rs 1.39 lakh crore or 16 percent from Rs 8.86 lakh crore as on 31 December 2017. This chunk now accounts for 11.8 percent of the total loans given by the banking industry. For financial year 2018, the total bad loans of these banks rose by a whopping Rs 3.13 lakh crore.

Taking note of the alarming bad loans situation, the Narendra Modi-led government, last year, announced an Rs 2.11 lakh crore bank recapitalisation plan to pull out state-run banks from the mess. As much as 90 percent of the above-mentioned sticky assets are on the books of government-owned banks.

Before 1993, the section 137 of comp. Act, 1956 was the only option, the banks & FIs have to recover debt, which used to take years to resolve the problem of NPA. Then in 1993 recovery of debt due to banks & FI Act was introduced to give a pace to NPA recovery procedure. But soon lots of cases got piled up for resolution and again the recovery procedures started getting delayed to solve. In 2002, The SARFAESI Act was promulgated to recover the NPA of banking & FI sector. This Act was result oriented and at the same time gives super power to Banks & FIs to fight with increasing NPAs.

### REVIEW OF LITERATURE

**Ajith P R (2016)** in "SARFAESI Act 2002: An effective tool for NPAs recovery" tried to describe the NPAs, its classification, provisioning for NPAs, impact of NPAs in banks. The paper also concentrated on describing SARFAESI Act and action under the Act. The study infers if the provisions of the act are used for recovery of NPAs with consideration to genuine borrowers the level of NPAs can be reduced considerably.

**Dr. Manas Chakrabarti (2015)** attempted an in-depth analysis on the role of ARCs in the Indian Banking Sector in respect of Stressed Assets Management (including NPAs); this study also travel around on the various problems which hinder smooth functioning of ARCs and try to explore prospects of ARCs in the Indian economy. This is an exploratory study on the basis of secondary data.

**Dr. Archana Makker Bhatia (2014)** has attempted to analysis the benefits of enforcement of security interest aspect of the act in recovering dues from the borrowers in public sector banks by using questionnaire from officers working in the various capacities in public sector banks. The study is conducted Bank wise and region wise.

**Ujjwal Bajaj (2013)** in Securitisation in India: A Bumpy ride has discussed several aspects of Indian securitization market, elaborating the process, discussing the fluctuating performance in response to global events and significant changes in regulations.

**Nibedita Roy (2012)** in her research paper "Securitisation – A Risk Management Tool in Indian Banking Industry" Has aimed at examining different parameters that are influenced as a result of introduction of the securitisation mechanism and to understand

the impact of this innovative financing mechanism on the performance as well as risk management factors of the institutions of the banking industry in India.

### OBJECTIVES OF STUDY

The objectives of the study are:

- 1) To explore the Opportunities and threats to Bankers while applying provisions of the securitization Act, 2002 to recover NPAs.
- 2) To explore the Opportunities and threats to customers while applying provisions of the securitization Act, 2002 to recover NPAs.

### RESEARCH METHODOLOGY

On basis of mode of objectives perspective this study is **descriptive in nature**. Secondary data is used for quantitative approach and secondary data collection sources are:

- ✓ Research Papers;
- ✓ Articles on website;
- ✓ Banks reports, publications;
- ✓ News papers;
- ✓ Bare act of the Act etc.

### THE SECURITIZATION ACT, 2002 AND NPAs

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (also known as the SARFAESI Act) helps Banks and financial institutions to ensure asset quality in multiple ways. This means that the Act was framed to address the problem of NPAs (Non-Performing Assets) or bad assets through different processes and mechanisms. It allows banks and other financial institution to auction residential or commercial properties to recover loans.

The SARFAESI Act gives detailed provisions for the formation and activities of Asset Reconstruction Companies (ARCs). Scope of their activities, capital requirements, funding etc. are given by the Act. RBI is the regulator for these institutions.

As a legal mechanism to insulate assets, the Act addresses the interests of secured creditors (like banks). Several provisions of the Act give directives and powers to various institutions to manage the bad asset problem.

### DIFFERENT ASPECTS OF THE ACT

#### a) Methods of Recovery

Major feature of SARFAESI is that it promotes the setting up of asset reconstruction (RCs) and asset securitization companies (SCs) to deal with NPAs accumulated with the banks and financial institutions. The Act provides three methods for recovery of NPAs, viz:

#### (i) Securitization

Securitization is the process of pooling and repackaging of financial assets (like loans given) into marketable securities that can be sold to investors. In the context of bad asset management, securitization is the process of conversion of existing less liquid assets (loans) into marketable securities. The securitization company takes custody of the underlying mortgaged assets of the loan taker. It can initiate the following steps:

- a) Acquisition of financial assets from any originator (bank), and
- b) Raising of funds from qualified institutional buyers by issue of security receipts (for raising money) for acquiring the financial assets or
- c) Raising of funds in any prescribed manner, and
- d) Acquisition of financial asset may be coupled with taking custody of the mortgaged land, building etc.

#### (ii) Asset reconstruction

Asset reconstruction is the activity of converting a bad or non-performing asset into performing asset. The process of asset reconstruction involves several steps including purchasing of bad asset by a dedicated asset reconstruction company (ARC) including the underlying hypothecated asset, financing of the bad asset conversion into good asset using bonds, debentures, securities and cash, realization of returns from the hypothecated assets etc.

Reconstruction is to be done with the RBI regulations and the SARFAESI Act gives the following components for reconstruction of assets: –

- a) Taking over or changing the management of the business of the borrower,
- b) The sale or lease of a part or whole of the business of the borrower;
- c) Rescheduling of payment of debts payable by the borrower;
- d) Enforcement of security interest in accordance with the provisions of this Act;
- e) Settlement of dues payable by the borrower;

- f) Taking possession of secured assets in accordance with the provisions of this Act.

### (iii) Enforcement of security interests

The Act empowers the lender (banker), when the borrower defaults, to issue notice to the defaulting borrower and guarantor, calling to repay the debt within 60 days from the date of the notice. If the borrower fails to comply with the notice, the bank or the financial institution may enforce security interests (means interest of the bank/creditor) by following the provisions of the Act:

- a) Take possession of the security;
- b) Sale or lease or assign the right over the security;
- c) Appoint Manager to manage the security;
- d) Ask any debtors of the borrower to pay any sum due to the borrower.

If there are more than one secured creditors, the decision about the enforcement of SARFEASI provisions will be applicable only if 75% of them are agreeing.

### Opportunities to Bankers

- a) Section 4 of the Act provides provisions regarding registration and establishment of Asset reconstruction companies. Asset Reconstruction Company should have certificate of registration granted under this section and net owned fund of not less than 2 crore rupees. For getting certificate of registration asset reconstruction company required to make an application to RBI in specific manners. After getting satisfied, ARC fulfils all conditions specified to get the registration, RBI grants a certificate of registration. In case RBI, being not satisfied with the conditions specified, have power to reject the application. Every asset reconstruction company requires obtaining prior approval of RBI for any substantial change in its management. ARCs have been set-up to provide a focused approach to NPAs resolution issues of banks by isolating NPAs from the financial system and facilitating development of market for distressed assets.
- b) Section 13 'enforcement of security interest' provides power to banks to enforce the secured assets without the intervention of the court or Tribunal. According to this section of the Act if any borrower, who is under a liability to secured creditor agreement, makes any default in repayment of secured debt or any installment, and its account in respect of such debt is classified by the secured creditor as NPA, then secured creditor may give notice in writing to discharge in full his liabilities to the secured creditor within 60 days from the date of notice to the borrower. In case the borrower fails to discharge his liability in full within the specified period, the secured creditor may take possession; take over the management of the secured asset.
- c) Under section 14 of this Act, banks may, for taking possession of any secured asset is required to be taken by secured creditor or if any of the secured asset is required to be sold or transferred by the secured creditors, request, in writing the chief metropolitan magistrate or the district magistrate within whose jurisdiction any secured asset or other documents relating thereto may be found, to take possession thereof and the chief metropolitan magistrate and the district magistrate shall, on such a request being made to him-
  - a take possession of such asset and documents relating thereto, and
  - forwards such asset and documents to the secured creditor.No act of CMM and DM or any officer authorized by CMM or DM done in pursuance of this section shall be called in question in any Court or before any authority.
- d) Under section 20 of this act, the central government may by notifications set-up or cause to be set-up from such date as it may specify in the notification a registry to be known as the central registry for the purpose of registration of transaction of securitization and reconstruction of financial assets and creation of security interests the central registry shall have its own seal.
- e) Section 35 of the Act provides that the provisions of the proposed legislation shall override other laws. It provides that the provisions of the proposed legislation shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law.

### Threats to Bankers

- a) Section 31 of this Act specifies the cases to which the provisions of the proposed legislation shall not apply. It provides that the provisions of the proposed legislation shall not apply to-
  - A lien on any good, money or security given by or under the Indian contract Act, 1872 or the Sale of Goods Act, 1930 or any other law for the time being in force;
  - A pledge of movable within the meaning of section 172 of the Indian Contract Act, 1872;
  - Creation of any security in any aircraft as defined in the Aircraft act,1934;
  - Creation of security interest in any vessel as defined in the Merchant Shipping Act, 1958;
  - Any rights of unpaid seller under the Sale of Goods Act, 1930;
  - Any properties not liable to attachment or sale under the code of Civil procedure, 1908;
  - Any security interest for securing repayment of any financial asset not exceeding 100000 rupees;
  - Any security interest created in agricultural land;
  - Any case in which the amount due is less than 20% of the principal amount and interest thereon.

- b) After enforcement of secured assets sometimes Banks find it difficult to sell off the attached secured asset to recover the dues because of non availability of any buyer of such asset. In that case Banks has to retain such asset with them till they find any buyer and need to bear the maintenance cost for taking care the asset.
- c) Section 5 “Acquisition of rights or interest in financial assets” of the Act provides that notwithstanding anything contained in any agreement or any other law for the time being in force, any asset reconstruction company may acquire financial assets of any Bank by issuing a debenture or bond or any other security in the nature of the debenture, for consideration agreed upon between ARC and the Bank, incorporating therein such terms and conditions as may be agreed upon between them.

#### Opportunity to Borrowers

- a) Section 17 ‘Application against measures to recover secured debts’ of this Act provides that any person, aggrieved by any of the measures taken by the secured creditor, may make an application along with prescribed fee to DRT within 45 days from the date on which measures had been taken. If DRT conclude that any of the measures taken by the secured creditor are not in accordance with the provisions of this Act of the secured assets to the aggrieved person. It may declare the recourse to measure taken by secured creditor as invalid.
- b) Section 18 “Appeal to Appellate Tribunal” provides that any person aggrieved by any order made by the DRT may prefer an appeal along with prescribed fee within 30 days from the date of receipt of the order of DRT.
- c) Section 27 “Penalties” of the Act provides that every company and every officer of the company or the secured creditor and every officer of the secured creditor who is in default shall be punishable with fine which may extend to fine thousand rupees for every day during which the default continues.

#### Threats to Borrowers

- a) Section 13 (7) provides that where any action has been taken against a borrower under the provisions of sub-section (4), all costs, charges and expenses which, in the opinion of the secured creditor, have been properly incurred by him or any expense incidental thereto, shall be recoverable from the borrower. It also provides that any money which is received by the secured creditor shall, in the absence of any contract to the contrary, be held by him in trust, and shall be applied, firstly, in payment of such cost, charges and expenses and secondly, in discharge of the dues of the secured creditor and the residue of the money so received shall be paid to the person entitled thereto in accordance with his rights and interests.
- b) Under section 14 of this Act, banks may, for taking possession of any secured asset is required to be taken by secured creditor or if any of the secured asset is required to be sold or transferred by the secured creditors, request, in writing the chief metropolitan magistrate or the district magistrate within whose jurisdiction any secured asset or other documents relating thereto may be found, to take possession thereof and the chief metropolitan magistrate and the district magistrate shall, on such a request being made to him-
  - a take possession of such asset and documents relating thereto, and
  - forwards such asset and documents to the secured creditor.

Sometimes this section is used for threatening borrower to recover the dues instead of using it as a peaceful attachment tool.

- c) Grievances of the borrowers are not settled at first place by DRTs, though it is empowered to deal with the issues related to quantum of debt and claims under the Act.

#### CONCLUSION

The present study analyses different positive and negative aspects of the Securitization Act, 2002, while applied to recover dues from borrowers. The Act provides the legal framework for activities of securitization, reconstruction and enforcement of secured assets for recovering the dues from borrowers and gives power to attach the secured asset without court intervention. Dilution of provisions of other Acts has helped banks for effective recovery of NPAs in different sectors. The provisions related to offences and penalties under the act make Banks to comply with the RBI directives in proceedings. This Act has given all self-exercise power to Banks to recover the dues from borrowers, and in enthusiasm to recover dues as soon as possible these powers are misused by banks to recover dues from genuine borrowers.

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