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SARFAESI

Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002

In the event of default by a borrower, a **secured creditor** will have the following powers under SARFAESI:

- Take possession, sell or lease the secured assets
- Take over the management of the business
- Appoint a manager (powers vested with chief manager in banks)
- Recover money payable by 3rd parties to the borrower

Consortium Accounts

In case of Consortium financing or multiple lending arrangement, if 60% of the secured creditors in value, agree to initiate recovery action, the same shall be binding on all the secured creditors

Loans which are **not eligible** under SARFAESI Act

- Loan with outstanding balance up to Rs 100000-
- Where the amount due is less than 20% of the principal and interest.
- Loan secured by pledge, lien and by security of deposits.
- Where limitation is expired.
- Agriculture land cannot be sold.
- Where security is not charged to the bank or charge not registered with CERSAI.

Bank after giving **60 days demand notice**, in writing, can take the possession of the assets. (Sec 13-2 or Sec 13-2)

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If the borrower makes an objection, the bank to give the reply within 15 days.

- **Borrower can also make an application** along with such fee as prescribed by the debt recovery Tribunal, within a period of 45 days.
- **DRTs would have to dispose - of cases within 60 days** of any application being filed before it by borrowers whose assets are taken possession of by lenders. **If the DRTs fails to take a decision** within 4 months, the bank or the borrower can prefer an appeal to the DRAT.
- And further **appeal against the debt recovery Tribunal** can be made within 30 days when the borrower has deposited with appellate Tribunal 50% of the amount of the debt due from him.
- The appellate may reduce this amount to not less than 25% of debt

SALE OF ASSETS

- **Publication in 2 newspapers** (one regional and one national): TWICE i.e, first time, within 7 days after taking possession and second time: 30 days sale notice.
- The **Chief metropolitan magistrate or District Magistrates** shall pass suitable orders in an application for **assistance for taking possession** of the secured assets, under new Sec. 14, within 30 days.
- This can be extended by another 30 days after recording the reasons thereof.
- Bank will give **minimum 30-day notice before selling** the assets.
- **Proper valuation** is to be made in all assets, prior to sale and reserve price will be arrived at only after proper valuation process.
- If offer price at the **reserve price cannot be obtained**, the asset can be disposed of at a lower price but only with the consent of the borrower and lender.

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- **Sale is confirmed** by Bank on receipt of 25% amount immediately and balance in 15 days.

Notice before possession	60 days
Reply to objection of borrower	15 days
Borrower can approach the DRT against possession notice	45 days
Appeal to DRAT against decision of DRT	30 days
Notice before sale	30 days
Period of balance payment 75% by the buyer of assets	15 days

AMENDMENT WEF 26.10.07

- **Rights of Creditor:** To take possession, takeover management, Appoint manager, recovery money receivable from third parties.
- **DRT pending case:** Bank can make use of SARFAESI Act for sale of security for such cases.
- The property shall be **sold either by inviting tender or by holding public auction** for obtaining quotations **or by private treaty**.
- At least one attempt should be made to sell the property through public auction/ auction by inviting tenders and at least two attempts should be made to sell the property through public auction/ auction by inviting tender, before opting for sale through private treaty.

ENFORCEMENT OF SECURITY INTEREST & RECOVERY OF DEBTS LAWS & MISC PROVISIONS (AMENDMENT) BILL, 2016

In view of the difficulties faced by banks and financial institutions in recovering loans and enforcing securities charged with them, a need was felt to amend the existing debt laws.

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Accordingly, the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Bill 2016 has been passed in August 2016.

Following four Laws have been amended:

- a) Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act 2002.
- b) Recovery of Debts due to Banks & Financial institutions Act (RDDBFI), 1993.
- c) Depositories Act, 1996 and
- d) Indian Stamp Act, 1899

AMENDMENTS TO THE SARFAESI ACT, 2002

- The SARFAESI Act **allows secured creditors to take possession** over a collateral, against which a loan had been provided, upon a default in repayment.
- This **process is undertaken with the assistance of the District Magistrate** and does not require the intervention of courts or tribunals.
- The Bill provides that this process will have to be completed within 30 days by the District Magistrate.
- In addition, the **Bill empowers the District Magistrate to assist banks in taking over the management of a company**, in case the company is unable to repay loans.
- The **Act creates a central registry** to maintain records of transactions related to secured assets.

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- The **Bill creates a central database** to integrate records of property registered under various registration systems with this central registry. This includes integration of registration made under Co's Act, 2013, Registration Act, 1908 and Motor Vehicles Act.
- The Bill provides that **secured creditors will not be able to take possession over the collateral unless it is registered with the central registry.**
- Further, these creditors, after registration of security interest, will have priority over others in repayment of dues.
- The **Act empowered the RBI to examine the statements and any information of ARCs related to their business.**
- The Bill further **empowers the RBI to carry out audit and inspection of these co's and also penalise** a company if the company fails to comply with any directions issued by it.

AMENDMENTS TO THE RDDBFI ACT 1993 – The Recovery of Debt Due to Banks and Financial Institutions

- Expeditious adjudication of recovery applications and empowering the Govt. **to provide uniform procedural rules for conducting proceedings in DRTs and DRATs.**
- Instituting electronic filing of recovery application, documents and written statements; issuing summons by the tribunals in electronic form and display of interim and final orders of DRT and DRATs on their websites;
- **The Bill allows banks to file cases in tribunals having jurisdiction over the area of bank branch where the debt is pending.**
- The Bill provides further details of procedures that the tribunal will follow in case of debt recovery proceedings. This includes the

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requirement of applicants to specify the assets of the borrower, which have been collateralized.

- Allows PO and Chairpersons eligible for reappointment positions.

AMENDMENTS TO THE DEPOSITORY ACT 1996 AND STAMP ACT, 1899

- The amendments to exempt assignment of loans in favour of ARCs from stamp duty, and
- The Depositories Act, 1996 to facilitate the transfer of shares held in pledge or on conversion of debt into shares in favour of banks and financial institutions.

ASSET RECONSTRUCTION COMPANY (ARC)

- Registered under RBI under the provisions of the SARFAESI act and regulated under SARFAESI Act
- It is a company incorporated under companies act 1956
- Asset Reconstruction Companies (ARCs) are centralised agencies, which take over distressed assets from banks, financial institutions, credit card companies etc. Such assets are thereafter recovered, securitized or re - packaged and sold or liquidated and so on.
- It is mandatory for the ARC to be registered with the RBI and commence its business within 6 months from such registration.
- As per RBI guidelines, for commencement of business, ARC owned funds should not be less than 15% of Assets acquired or Rs. 100 crore whichever is less.
- ARCs to maintain the capital adequacy of 15% of total RWAs.

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- Asset Reconstruction Company of India Ltd. (ARCIL) is the country's first Asset Reconstruction Company has been set up with an equity base of Rs.10 crore.
- The ARCIL has eight shareholders
- ARC acquires non-performing assets or distressed assets from the banks or FIs at a discount and takes step to recover by securitization, reconstruction or the sale of the assets. (may also resort to management take over)
- Special Purpose Vehicle (SPV) issues SRs – security receipts to the investors mainly Qualified Institutional Buyers (QIBs). Investors get cash on realization of the financial assets.
- SR is basically undivided right/ interest in favour of the investors in the financial assets held by SPV.
- It is mandatory for the securitization/ reconstruction company to continue to hold atleast 15% of the SRs issued by the SPV under each scheme till the redemption of all the SRs under a particular scheme.
- 100% FDI is allowed in ARCs

**CENTRAL REGISTRY OF SECURITIZATION ASSET
RECONSTRUCTION AND SECURITY INTEREST OF INDIA**

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- Government of India has set up the **CERSAI** under the provisions of SARFAESI act.
- The majority shareholding is with the central government, public sector banks and national housing bank



Transactions to be registered

- a) Securitization and asset reconstruction
 - b) Mortgages
 - c) Hypothecation of securities
 - d) Security interest in intangible assets
 - e) Security interest in under construction buildings
- ~~Transactions to be registered~~ within 30 days of date of transaction to next 30 days permission of central registrar is required and thereafter permission of central government is required.
 - Banks can take possession of only those securities in respect of which charge has been registered with **CERSAI**

CENTRAL REGISTRY

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Central registry section 20: government to set up registry to be known as a central registry for the purpose of registration of transaction of securitisation and Reconstruction of financial assets and creation of security interest under this act.

Central registrar section 21: Central government can appoint a person for the purpose of registration of transactions relating to securitisation, reconstruction of financial assets and security interest created over properties. Central government may also appoint other officers under the superintendence and direction of the central registrars.

Central Register section 22: this register to be held at head office of the central registry which could be wholly or partly in computer or diskettes or in any other electronic form. This is for the purpose for entering the particulars of the transactions relating to securitisation of financial assets, Reconstruction of financial assets and creation of security interest.

Filing of transactions of securitisation, reconstruction and creation of security interest section 23:

- i. Removal of the timeline of 30 days, within which a secured creditor is required to file certain types of security interest in its favour with the Central Registry of Securitisation Asset Reconstruction and Security Interest ("**CERSAI**"); and
- ii. To provide a right to the Central Government to notify types of transactions (pertaining to creation of security interest over property) which require registration with the CERSAI.

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Modification of security interest registered Section 24: if the terms or conditions or the extent or operation of any security interest registered under section 23 came and as such modification. It will be the duty of the securitisation company or holder of such security interest to get it modified

Satisfaction of security interest section 25

Securitisation or reconstruction company or the secured creditors are to give intimation to the central registrar of the payment or satisfaction in full within 30 days from the date of such payment or satisfaction. Central registrar is to send a notice to the securitisation or reconstruction company or the secured creditors calling to show cause within a time not exceeding 14 days as to why payment of satisfaction should not be recorded as intimated to the central registrar.

And if no cause is shown, the central registrar shall order date a memorandum of satisfaction shall be entered in the central register

Right to inspection section 26: the particulars of transactions entered in the central register shall be open during the business hours for inspection by any person on payment of such fees as may be prescribed. Central register is maintained in electronic form.

Priority to registered security interests over statutory dues

Section 26E provides that after the registration of security interest, the debts due to any secured creditor shall be paid in priority over all other debts and all revenues, taxes, cesses and other rates payable to the Central Government or State Government or local authority.

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Doctrine of constructive notice for charge registered prior in time:

Section 26C (1) of SARAESI Act stipulates that registration of interests, including attachment orders, will serve as a public notification, so that anyone dealing with the property cannot claim to be ignorant about the existence of such interests.

PRIORITY TO REGISTERED CHARGES Section 26C (2)

Where there is a registered security interest, any subsequent security interest on the property will be subordinated to a pre-registered interest. While the priorities are a matter of contract and the general rule is that priorities should be as per the contract, but Section 26C (2) provides that the unregistered creditor will not be able to claim the priority available to a registered security interest.

Case 1: A extends loan to C, by creating a security interest on a Property X. Subsequently, B, who is unaware of the loan extended by A, extends loan to C, by creating a security interest in Property X. B then registers its security interest with CERSAI.

In this case, who will have priority?

Since security interest of A was not registered, B will have priority.

Case 2: A extends loan to C, by creating a security interest on a Property X and registers it's security interest with CERSAI. Subsequently, B, who is unaware of the loan extended by A, extends loan to C, by creating a security interest in Property X. B then registers it's security interest with CERSAI.

In this case, who will have priority?

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Since security interest of A is registered, B cannot take the plea that it was not aware of the interest of A in Property X. Here, A will have priority.

Penalties Provisions Omitted

Section 27 of the SARFAESI Act stipulated that if a default is made-

- in filing under Section 23, the particulars of every transaction of any securitisation or asset reconstruction or security interest created by a securitisation company or reconstruction company or secured creditor, or
- in sending under Section 24, the particulars of modification referred to in that section, or in giving intimation under Section 25,

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 Rs. 5,000/- for every day during which the default continues. The penal provisions as provided in the said section will now be deemed to be omitted pursuant to Section 19 of the Amendment Act, however, as already discussed above, the effect of non- registration has been made even more severe.

Penalties for non-compliance of directions of reserve bank of India section 28: if any securitisation or reconstruction company fails to comply with any direction issued by reserve bank of India under section 12, such company and every officer of the company who is in default shall be punishable with fine which may extend up to Rs. 5,00,000 and in

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case of continuing offence and additional fine which may extend up to Rs.10,000 for every day during which the default continues

Offences section 29: if any person contravenes or attempts to contravenes provisions of this act or of any of the rules made, he or she shall be punishable with the imprisonment for a term which may extend to one year or fine or with both. No inferior to that of metropolitan magistrate or judicial magistrate of first class shall try any offence punishable under this act.

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