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☞ INTRODUCTION

Before the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (**"the Securitization Act"**) was passed banks[1] and Financial Institutions (**"FIs"**) were grappling with the growing number of Non-Performing Assets[2] (**"NPAs"**) which were more of a liability than an asset. The Securitization Act has been enacted with the aim to realize long-term assets, manage problem of liquidity, asset liability mismatches and improve recovery by handing powers to secured creditors[3] to take possession of these NPAs and adopt measures for their recovery and reconstruction. It was essential to enact the Securitization Act because the lenders had inadequate powers to take control of the securities and sell them even though another legislation - Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (**"the Act"**) existed. The recognized lending institutions were unable to realize their dues against the secured assets in their NPA accounts without the intervention of the court.

Although the Securitization Act and the Act have been enacted for the purpose of recovery of monies due to the secured creditors, a fine procedural distinction exists between the two legislations. In the former, the lender can take charge of the secured assets of a borrower by giving a notice whereas under the latter legislation a lender must proceed only through Debt Recovery Tribunals (**"DRT"**) established under the Act. This newsletter highlights the powers conferred upon the lenders under the Securitization Act to recover their monies from a borrower and relying upon a Supreme Court judgment explains the co-relation between the aforesaid two legislations for recovery of dues from a secured debtor.

1. The Securitization Act

1.1 Powers of the lenders

The Securitization Act proceeds on the premise that the liability of the borrower to repay has crystallized and a right, in the secured asset, is created in the favor of banks/FIs. The provisions of section 13 of the Securitization Act provide the procedure for a lender to recover its debt. The lenders are under a primary obligation to serve a written notice to the borrower to pay debts within sixty days from the date of receipt of the notice[4]. The notice must contain the details of the amount payable and the secured assets which can be disposed[5] in case of non-payment. In case the debtor fails to repay then the secured creditor has the power to exercise its rights by taking over the possession and management of the assets including the right to transfer by way of lease, assignment and appoint any person to manage those secured assets. However, a borrower can raise an objection to the notice for repayment by the creditor and the lender is under an obligation to inform the debtor, within one week of receipt of the objections if the objections are unacceptable and the reasons for

[1] Section 2 (c) of the Securitization Act defines "bank" as a banking company, a corresponding bank, State Bank of India, a subsidiary bank or any other bank notified by the Central Government vide its notification.

[2] Under section 2 (o) of the Securitization Act these are assets or account of a borrower declared as a doubtful or loss asset by a bank or a FI.

[3] Under section 2 (zd) of the Securitization Act secured creditor includes any bank/FI/consortium of banks or FIs and securitization or reconstruction companies.

[4] Section 13 (2) of the Securitization Act.

[5] Section 13 (4) of the Securitization Act outlines the different means that a secured creditor may adopt to recover its secured debts.

the same[6]. Contravention of the provisions can lead to both penal and monetary sanctions[7].

1.2 Asset Reconstruction Companies

Another objective of the Securitization Act is to facilitate securitization and asset reconstruction[8] of secured assets through Asset Reconstruction Companies (**"ARCs"**). The ARCs have the right to acquire financial assets of a bank/FI. In case of such an acquisition, an ARC steps into the shoes of a bank/FI[9]. Further, if the asset of a borrower is acquired by an ARC, the bank/FI has the discretion to notify the borrower. A bank/FI may decide against notifying the borrower about acquisition of financial asset by an ARC because a borrower may transfer the assets overnight[10]. The ARCs are under a statutory obligation to report transactions to the Central Government. Failure to report attracts a monetary fine for the company and the officer in default[11]. According to the latest guidelines issued by the Reserve Bank of India on July 2, 2007[12] the asset acquisition policy of an ARC must ensure that the transactions take place in a transparent manner and at a 'fair price[13]'.

2. Co-relation between the Securitization Act and the Act

All secured, unsecured, and assigned debts come within the ambit of the Act and the Securitization Act[14]. The Government initially enacted the Act whereby the DRT were established to adjudicate the recovery matters of the banks through a fast-track method critical for the successful implementation of financial sector reforms. The Act provides an entire procedure whereby a bank/FI can make an application to the DRT for the recovery of any debt.[15] In 2004, amendments were made in the Act and provisos to section 19 (1) were inserted. One of the provisos states that a bank, with the prior permission of the DRT, can withdraw its application filed under the Act to take action against the secured debtor under the Securitization Act. The proviso further states that the DRT must dispose a withdrawal application within thirty days from the date of its receipt. In case of refusal, the DRT must give a reasoned order[16]. Thus, this amendment in the Act gave an option to a lender to choose its course of action for recovery.

However, over a period of time, the provisos created some ambiguity and a primary concern arose – is it essential to withdraw a pending application before electing to exercise the rights under the Securitization Act? The Supreme Court settled this issue in *Transcore v. Union of India*[17]. The Court was of the view, "the Securitization Act is an additional remedy to the Act. Together they constitute one remedy and therefore, the doctrine of election does not apply." The Court held that, "withdrawal of application pending before a tribunal under the Act is not a pre-condition for taking recourse to the Securitization Act." It is for the lender to exercise its discretion and decide in which cases they would like to take action by invoking provisions of the Securitization Act.

Briefly, the facts of Transcore case[18] are as follows. In March 1999, Indian Overseas Bank (**"the Bank"**) filed an application under the Act for recovery of dues from Transcore. This claim was disputed. In January 2003, the Bank issued a notice[19] under the Securitization Act. However, in 2004, the Act was amended and the provisos to section 19 (1) were added. Thereafter, in early January of 2005, the Bank issued possession notice to acquire the assets of Transcore and asked Transcore to repay the loan amount. The notice was sent to the guarantor, Transcore, and public at large who were directed not to deal with the immovable properties. The properties were put up for auction. However, Transcore moved

[6] Section 13 (3-A) of the Securitization Act.
[7] Section 29 of the Securitization Act.
[8] Section 2 (b) states the definition of asset reconstruction which primarily means acquisition of any right or interest of any bank/FI in any financial assistance by any asset reconstruction company for the recovery of such financial assistance.
[9] Section 5 of the Securitization Act.
[10] Section 6 of the Securitization Act.
[11] Section 27 of the Securitization Act.
[12] DNBS (PD) CC. No. 7/SCRC/10.20.000/2007-2008
[13] Section 3 (1) (v) of the Securitization Companies and Reconstruction Companies (Reserve Bank) Guidelines and Directions, 2003 defines fair value which should be mean of the earning value and the break up value of an asset.
[14] Section 2 (g) of the Act and Section 2 (ha) of the Securitization Act.
[15] Section 19 of the Act.
[16] Proviso 1 to 3 to section 19 (1) of the Act.
[17] AIR2007SC712.
[18] Supra 7.
[19] Under section 13 (2) of the Securitization Act.

the Madras High Court who passed an order in favor of the Bank. Aggrieved by this order, Transcore filed an appeal before the Supreme Court.

The main contention of Transcore, before the Supreme Court, was that the Bank could not have invoked the Securitization Act without seeking prior permission of the tribunal since the application was pending at the DRT. Transcore contented the notice issued in January 2003 was merely a show cause notice which did not constitute an action in terms of the first proviso to section 19 (1) of the Act. The Bank was duty bound to withdraw the pending application.

The Supreme Court held that both the legislations have been enacted to reduce the number of NPAs by adopting means for recovery and reconstruction. The Court observed that "the provisos to the Act align the provisions of the Act and the Securitization Act." If due to severe back log of cases in the tribunal, cases may not be disposed off expeditiously. Consequently, a bank has apprehension that by the time the DRT deals with the case, the value of the asset may depreciate. In these circumstances, it is essential to provide an alternate remedy. The lender should be permitted to invoke the Securitization Act and safeguard its interest. The entire purpose of evolving the speedy recovery methodology would be defeated if the secured creditors have to move from one forum to another for recovery of the monies. The Supreme Court held that "it is not a necessary pre-condition for the banks/FIs to withdraw their application pending under the Act before they can proceed against a borrower under the Securitization Act. The secured creditors are at liberty to decide the course of action they would prefer to take on a case-to-case basis."

☞ CONCLUSION

The Securitization Act and the Act complement each other. The purpose of both these legislations is to ensure speedy recovery of debt without going through the courts. The enactments provide for cumulative remedies to the secured creditors. The law provides an option to the secured creditor to choose from the remedies available because the Government aims to securitize credit exposures of banks and FIs which involves a transfer of outstanding loans into transferable and tradable securities. The secured creditors, however, must ensure that the valuation process is uniform and it is done on the scientific and objective manner. In the fiscal year 2007, banks could sell NPAs worth INR 40 billion[20]. Therefore, the Securitization Act has given impetus for the recovery of sums due to the banks/FIs.

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[20] www.moneycontrol.com, accessed on July 24, 2007.

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