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Analysing the Effectiveness of Debt Recovery Mechanisms for Banks in India: A Special Focus on the SARFAESI Act, 2002

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ABSTRACT

The effectiveness of bank debt recovery systems is crucial to a country's financial stability and economic progress. In India, where non-performing assets (NPAs) have been a persistent challenge for the banking sector, the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act of 2002 is a critical legislative intervention aimed at addressing this issue. This research study presents a comprehensive review of the efficiency of debt collection methods for Indian banks, with a special emphasis on the SARFAESI Act of 2002. The paper opens with an overview of debt collection processes in India, including their historical development, regulatory frameworks, and institutional mechanisms. It then gets into the provisions and aims of The SARFAESI Act, analysing how it permits banks to recover NPAs and enforce security interests through mechanisms like as asset reconstruction and security interest enforcement without court intervention. Furthermore, the report assesses the SARFAESI Act's influence on debt recovery, asset quality, and bank financial health. It examines the issues and constraints that banks encounter when implementing the SARFAESI Act, such as legal obstacles, procedural delays, and borrower opposition. Furthermore, the article investigates current modifications, court interpretations, and regulatory actions affecting the SARFAESI Act, providing insights into its changing landscape. Based on comparative analysis and practical insights, the report closes with recommendations for improving the effectiveness of debt collection systems in India, including proposed modifications to the SARFAESI Act policy ramifications for regulators, policymakers, and the banking industry. Overall, this study contributes to the continuing discussion about debt settlement and financial stability, providing useful insights for stakeholders in India's banking and financial environment.

***Keywords**: Debt Recovery Mechanisms, Financial Stability, Non-Performing Assets (NPAs), Economic Growth.*

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I. Introduction

The efficient management of debt is critical to the stability and prosperity of any economy, with the banking sector functioning as a pillar in this regard. Non-performing assets (NPAs) have long been a major worry for Indian banks, limiting their ability to lend and catalyse economic development. In response to this difficulty, the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act of 2002 was enacted as a historic legislative move to strengthen banks' debt collection methods. The financial sector has significantly contributed to India's rapid economic growth. The current legal framework for commercial transactions is outdated and does not reflect evolving practices in the banking industry. Banks and financial institutions can expect more nonperforming assets and low loan recovery rates. The federal government established the Narasimham Committees I and II, as well as the Andhyarujina Committee, to overhaul the banking industry. The committees assessed the need to modify the legal system in various sectors. The SARFAESI Act of 2002 was formed based on committee suggestions for new laws. Securitization allows financial firms to keep and quickly sell securities without court interference. Under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002, banks in India can purchase and sell defaulting borrower's security to recover losses without court intervention. This allows banks to significantly reduce their non-performing assets (NPAs). The statute is known as the SARFAESI Act (or simply SARFAESI). Banks can seize and auction loan security if the borrower defaults. The SARFAESI Act, implemented in 2002, helps banks and financial institutions quickly recover bad loans. The act has multiple applications for dealing with non-performing assets. Only secured loans are eligible for this. Banks should file a civil case for defaulting on unsecured loans. The statute removes the necessity for court participation in secured loan instances. This act formed ARCIL, India's first asset reconstruction corporation (ARC). Section 13 of the SARFAESI Act grants secured creditors (banks and financial institutions) many rights to enforce security interests. If a beneficiary receiving financial aid defaults.[2]

India has long been regarded as a viable destination for green-field investment and competition due to its strong investment and competition regulations, which have been in place for some time and provide it an advantage over its developing competitors. The financial industry has played a critical part in India's rapid economic growth, but it has not been without obstacles.

[2] "Debt Recovery in India" :In -Depth study of the legal framework & effectiveness of debt recovery tribunal available at https://www.brillopedia.net/post/debt-recovery-india-in-depth-study-of-the-legal-framework-effectiveness-of-debt-recovery-tribunals accessed March 10th, 2024

One major challenge that banks and financial institutions have encountered is the recovery of loans made to individual borrowers and commercial organisations. This has resulted in a decrease in loan disbursements as banks and financial institutions become more cautious about lending. To solve this issue, the government established Debt Recovery Tribunals (DRTs) in 1993 under the "Recovery of Debts Due to Banks" and Financial Institutions Act (RDDBFI)", which has provided a robust framework for banks to initiate speedy debt recovery proceedings.

"Debt Recovery Tribunals (DRTs)" have been critical in facilitating the timely resolution of debt collection cases and speeding up recovery proceedings. With 39 DRTs and 5 Debt Recovery Appellate Tribunals (DRATs) in operation around the country, the tribunals have played an important role in relieving the burden on banks and financial institutions by allowing for rapid loan recovery. The prompt resolution of debt recovery issues has greatly decreased the backlog of cases and guaranteed the whole recovery process runs smoothly. The legal structure has struggled to keep up with the enforcement of securities interests. [3]

To address this issue, the government enacted the "Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI)" to facilitate the efficient recovery of "non-performing assets (NPAs)" of banks and financial institutions. The major goal of SARFAESI is to establish a strong legal framework for the prompt recovery of NPAs, which may be utilised as collateral for loans made by banks and financial institutions. Despite the government's actions, the financial industry continues to face substantial issues. This research paper will examine the existing legal framework governing commercial transactions, as well as the efficiency, functions, and composition of DRT, and how it might be strengthened to better meet the financial sector's concerns. The essay will specifically look at how DRTs and SARFAESI affect loan recovery and highlight areas where the legal framework might be improved to encourage effective debt recovery while protecting the interests of all stakeholders.

As India's economy evolves and grows, the effectiveness of debt collection processes becomes increasingly important in ensuring the financial sector's stability and vitality. The SARFAESI Act of 2002 was enacted in response to the compelling need for a more robust framework to address the growing problem of NPAs, which were impeding banks' lending capacity and profitability. The Act aims to create better discipline in credit transactions, encourage cautious lending practices, and speed up the resolution of distressed assets by empowering banks to take

[3] Jyoti Sharma and Kamal Vagrecha, Effectiveness of Debt recovery tribunals in resolving NPAs of banks in India: A Critical Analysis,43 OJC 75, 76 (2022).

rapid action against defaulting borrowers and enforce their security interests. However, the real application of the SARFAESI Act has been scrutinised and debated. While the Act gives banks substantial options for recovering debts, its efficacy is dependent on a variety of factors, including the efficiency of enforcement agencies, legal infrastructure, and current economic conditions. For example, the efficiency of asset reconstruction and securitization is dependent on the marketability of distressed assets and investor demand for such securities. Furthermore, the success of debt collection initiatives frequently necessitates collaboration among numerous stakeholders, including banks, borrowers, regulatory organisations, and court bodies.

II. Overview of debt recovery mechanisms in India

(A) The Recovery of Debts Due to Banks and Financial Institutions (RDBFI) Act

The Recovery of Debts Due to Banks and Financial Institutions (RDBFI) Act The Recovery of Debts Due to Banks and Financial Institutions (RDBFI) Act of 1993 is a major piece of legislation that aims to speed up the debt recovery process for Indian banks and financial institutions. It establishes Debt Recovery Tribunals (DRTs) across the country to adjudicate matters concerning the recovery of debts that surpass a certain level. These tribunals provide creditors with a specialised platform for pursuing debt collection without having to go through extensive and often time-consuming civil court proceedings. The RDBFI Act authorises DRTs to summon parties, examine witnesses, and issue debt collection orders, thereby simplifying the dispute settlement process. Furthermore, the Act enhances the implementation of DRT orders using methods such as attachment and sale of properties, garnishee orders, and arrest. The number of defaulters. By providing a specialised legal framework for debt collection, the RDBFI Act helps to improve the efficiency and effectiveness of India's financial system while protecting creditors' interests.[4]

(B) Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act)

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) is a key piece of law in India's financial framework, allowing banks and financial institutions to efficiently recover non-performing assets (NPAs). The SARFAESI Act, enacted to address the growing problem of nonperforming assets (NPAs), gives lenders the right to seize and sell assets pledged as security by defaulting borrowers without court intervention. This streamlined procedure accelerates debt recovery, allowing creditors to

[4] "Legal Framework for the Recovery of Debts in India" available https://www.ahlawatassociates.com/blog/legal-framework-for-debt-recovery-in-india accessed on March 12th, 2024.

mitigate losses while maintaining liquidity. While providing lenders with this formidable tool, the statute also includes safeguards to protect borrowers' interests, such as possibilities for representation and appeal of the lender's conduct. The SARFAESI Act promotes financial stability by making it easier to quickly resolve problematic loans. Stability and improved general health for India's financial system.

In other words The SARFAESI Act empowers lenders to take proactive actions for debt recovery without the intervention of the courts, thereby speeding up the process and minimising financial losses. This act addresses a wide spectrum of secured loans and provides a variety of enforcement tools, such as asset seizure, auction, and management takeover. Furthermore, the SARFAESI Act establishes procedural safeguards to protect borrowers' rights, including fair treatment and opportunity for counsel. While the SARFAESI Act has considerably improved the recovery situation for creditors, it has also received legal challenges and criticism for its execution and impact on borrowers' rights. Nonetheless, it is an important weapon in India's efforts to maintain financial stability and foster a healthy lending environment.

(C) Insolvency and Bankruptcy Code, 2016

The bankruptcy and Bankruptcy Code of 2016 (IBC) is a historic legislation in India that aims to consolidate and streamline the bankruptcy resolution process. The IBC establishes a comprehensive framework for the resolution of insolvency proceedings, including a time-bound and creditor-driven mechanism for the revival or liquidation of financially challenged companies. Under this legislation, the insolvency resolution process begins with the admission of a corporate debtor into insolvency proceedings, which is followed by the appointment of insolvency experts to manage the debtor's affairs. The IBC's principal goal is to maximise asset value while ensuring fair distribution to creditors, prioritising resolution over liquidation whenever possible. Through the formation of the Insolvency and Bankruptcy Board of India (IBBI) and the National Company Law Tribunal (NCLT), the IBC intends to improve openness, efficiency, and accountability in the resolution process, ultimately leading to a healthier business environment and increased investor confidence in the Indian economy.

(D) Civil Procedure Code, 1908

The Civil Procedure Code of 1908 (CPC) is the primary legislation that governs civil court operations in India, including debt recovery. The CPC explains the procedural aspects of bringing civil cases for debt recovery, giving creditors with a systematic framework to pursue legal action against defaulting debtors. Under the CPC, creditors commence civil actions by submitting a plaint with the proper civil court, describing the nature of the amount owing and

the relief sought. The court then issues summons to the defendant, which begins the legal process. Throughout the processes, the CPC establishes guidelines for evidence, pleadings, hearings, and judgements to ensure fair and unbiased adjudication. While the CPC allows creditors a recourse through the civil court system, it frequently involves a The legal process is longer and more complex than other tools given by specialised debt recovery statutes such as the SARFAESI Act or the Insolvency and Bankruptcy Code.

(E) Limitation Act , 1963

The Limitation Act of 1963 is a fundamental piece of legislation that governs the time limits under which legal actions, including debt recovery suits, must be filed in India. The Limitation Act specifies time periods, known as limitation periods, within which a creditor may launch a lawsuit to recover a debt. These limitation periods differ according to the nature of the debt and the applicable statute under which the claim is filed. Failure to commence legal procedures within the required limitation period may result in the debt becoming time-barred, which means that the creditor loses the legal authority to collect the debt through court action. The Limitation Act promotes efficiency and fairness in dispute settlement while also ensuring the quick beginning of legal measures. A measure of legal certainty for both creditors and debtors. Creditors must be aware of the appropriate limitation periods while pursuing debt recovery in order to avoid any claims.

III. EVOLUTION OF DEBT RECOVERY LAWS IN INDIA

The concept of ‘recovery of dues' from borrowers/guarantors comprises two stages. During the ‘soft recovery' phase, bankers use strategies such as letters, in-person meetings, and visits to borrowers' residences or places of business to collect outstanding debts. Bankers are not strictly enforcing legal rules at this time, instead focusing on borrowers and guarantors to return their debts without legal action. In the second step, bankers are pursuing legal action to collect their dues. Prior to the implementation of the SARFAESI Act in 2002, Indian banks faced severe obstacles in recovering bad debts, underscoring the vital need for debt recovery reform. One of the key issues was the lengthy and cumbersome legal process involved in debt recovery via civil courts, which resulted in delays and inefficiencies. Furthermore, the lack of specialised legislation meant that banks typically had few options for enforcing security interests and seizing collateral in the case of default. This led in enormous financial losses for banks and reduced their ability to lend further, slowing economic growth. Furthermore, the lack of a simplified structure resulted in borrowers failing to exercise credit discipline, aggravating the problem of non-performing assets (NPAs). These problems underlined the There is an urgent

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need for reform to improve the effectiveness and efficiency of debt recovery operations, which would eventually pave the way for the implementation of the SARFAESI Act.[5]

Stage 1: Before the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDDBFI)

Prior to the RDDBFI Act, there were two options for recovering debts owed to banks and financial institutions: filing a lawsuit in Civil Court using the Civil Procedure Code's Order XXXVII for summary procedure, or filing a foreclosure suit under the Transfer of Property Act. Often, it took years or decades to After a lengthy adjudication process, recovering the loan amount or selling goods/property proved challenging. To address the challenges banks and financial institutions confront in collecting loans, two committees were formed.

Stage 2 : The RDDBFI Act of 1993

In 1991, the Narasimham Committee endorsed the Tiwari Committee's findings and urged for the establishment of specialised tribunals to handle debt recovery matters. This prompted the adoption of the "Recovery of Debts Due to Banks and Financial Institutions Act (RDDBFI)" in 1993.

This Act created two sorts of agencies: "Debt Recovery Tribunals (DRTs)" and "Debt Recovery Appellate Tribunals (DRATs)". These organisations were given extraordinary authority to hear cases involving the recovery of debts due to banks and financial entities. On April 27, 1994, the first DRT began operations in Kolkata, representing a big step forward in expediting the debt recovery procedure. The Recovery of Debts Due to Banks and Financial Institutions Act (RDDBFI) was declared illegal by the High Court of Delhi in 1995, citing concerns about the judiciary's autonomy. Nonetheless, the Supreme Court authorised Debt Recovery Tribunals (DRTs) to continue, subject to the RDDBFI being modified as needed. Subsequently, the government amended the RDDBFI in 2000 and 2002, which the Supreme Court deemed constitutional. Thus, the operation of DRTs is currently regarded constitutional. Section 4 of the Recovery of Debts and Bankruptcy Act of 1993 outlines the structure of DRTs. These tribunals are led by a Presiding Officer, who is usually a District and Sessions Judge and has the only authority to hear and issue judicial orders. The Presiding Officer is backed by a team of officers from various grades who are not required to have legal competence.[6]

Section 17 of the RDDBFI Act authorises the DRT to receive applications from banks and

[5] "Debt recovery laws in India" available https://ssrana.in/litigation/criminal-litigation-india/debt-recovery/ Accessed on March 12th , 2024

[6] "Functioning of Debt Recovery Tribunals in India" available https://blog.ipleaders.in/functioning-debt-recovery-tribunals/ accessed on March 14th, 2024

financial institutions seeking to recover debts owed to them. It is critical to realise that the DRT's jurisdiction is restricted to the circumstances stated in this section of the Act, and that it cannot rule on additional issues such as property succession rights or receipt issuing.

It is worth noting that the decision in the case of L Chandra Kumar established that tribunals act as an accessory to High Courts rather than a replacement for them. Section 18 of the Act specifies that other courts are not allowed to intervene in debt-related disputes except the High Court and the Supreme Court, who have the constitutional T mandates the exercise of such authority under Articles 226 and 227. The DRAT, as an appellate body, has the authority to hear appeals from orders issued by the DRT under the Act. An appeal against the DRAT's order can only be brought in the High Court or the Supreme Court.

Stage 3 : Involves enacting the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI).

In 1998, the Narsimham Committee - II and Adhyarujana Committee were formed by the central government to examine banking sector reforms and recommend changes to the legal framework. The Committees proposed new legislation that would allow banks and financial institutions to sell the securities without court interference.

The Securitization and Reconstruction of Financial Assets and Enforcement of Securities Interest Ordinance, 2002 was drafted in response to these recommendations and passed. The President assented on December 17, 2002 The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) took effect on June 21, 2002. Securitization involves converting an illiquid asset or collection of assets into a security using financial engineering. The practice of packaging and selling illiquid assets, typically debts, to investors is known as securitization.[7] Asset reconstruction refers to a securitization or reconstruction company acquiring a bank or financial institution's right or interest in a financial assistance for the goal of realising it. The SARFAESI Act allows lenders to issue notices to failing borrowers and guarantors, requiring repayment within 60 days after the notice. If a borrower fails to comply with a notice, the bank or financial institution may enforce security interests under the Act.

a) Take ownership of the security

b) Sell, lease, or assign the right to the security

[7] S. 2(z), The Securitization & Reconstruction of Financial Assets & Enforcement of Security Interest Act, 2002, No. 54, Acts of Parliament, 2002 (India).

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c) Appoint a manager to handle the security

d) Request payment from the borrower's debtors.

The Supreme Court has stated that while the Act gives one party an edge over the other, it cannot be declared unconstitutional. The rationale for this legislation is to speed up the recovery of loans classified as Non-Performing Assets (NPA), make it easier to access capital, liquidity, and resources, and promote economic growth and the well-being of the population, all of which are in the public interest. This is accomplished by allowing banks and financial institutions to take and liquidate assets supplied as collateral in order to minimise non-performing assets and improve their financial condition.

The IDBI Bank filed a notice against Mardia [8].It defaulted and filed an appeal in court, where other similar petitions were joined together and examined collectively.The Court had to decide whether it was permissible to challenge the SARFAESI Act on the grounds that it was unnecessary to enact it in the circumstances at the time, particularly when another statute was already in effect, whether Section 13 of the Act was unconstitutional, and whether Section 17, particularly Section 17(2), is unreasonable and arbitrary, and thus unconstitutional. The Supreme Court maintained the Act's constitutional legitimacy, saying that "some elements of the Act may be a bit harsh for some of the borrowers, but on the basis that the impugned parts of the Act cannot be considered illegal because the Act's purpose is to achieve speedier recovery of NPAs and to improve the availability of capital liquidity and resources to aid in the expansion of the country's economy and borrowers." The Court also allowed the debtors to submit an appeal against the lending institutions at the DRT without having to deposit 75% of the existing debt, and if the tribunal did not grant a stay order, the bank could sell the assets.

Stage 4: - Enactment of the Insolvency and Bankruptcy Code, 2016

The Government of India passed the Insolvency and Bankruptcy Code on May 28, 2016, to streamline insolvency resolution for corporations, partnerships, and individuals. The government of India passed the Enforcement of Security Laws and Recovery of Debt Laws Miscellaneous Provisions (Amendment) Act, 2016, amending the RDDBFI Act, 1993 and SARFAESI Act, 2002. The RDDBFI Act was renamed Recovery of Debts and Bankruptcy Act in 1993.The Insolvency and Bankruptcy Code was implemented in 2016 to address the failure of previous legislation and the rise of non-performing assets (NPAs) in public sector banks. IBC established a new policy framework for rehabilitation.

[8] Mardia Chemicals Ltd v Union of India & Ors, (2004) 4 S.C.C. 311.

The bankruptcy and Bankruptcy Code (IBC) process in India establishes an organised and time-bound framework for resolving bankruptcy matters. It begins with the filing of insolvency proceedings against a corporate debtor, which can be initiated by either the debtor, its creditors, or a regulator. Following acceptance of the case by the National Company Law Tribunal (NCLT), an interim resolution professional (IRP) or resolution professional (RP) is appointed to handle the debtor's affairs during the resolution process. The IRP/RP collaborates with creditors and stakeholders to develop a resolution plan within a set timeline, usually 180 days (extendable by 90). If the committee of creditors (CoC) approves a feasible resolution plan and the NCLT sanctions it, the debtor The company is restructuring and continues to operate as a going concern. If a settlement cannot be reached or the resolution plan is not approved, the debtor may be forced to liquidate its assets in order to repay creditors. The IBC procedure emphasises openness, creditor participation, and quick resolution, with the goal of maximising distressed asset value while minimising the time and cost of bankruptcy proceedings.

IV. Understanding SARFAESI Act, 2002

(A) Scope and Jurisdiction

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act of 2002 (SARFAESI Act) aims to empower banks and financial institutions to efficiently recover non-performing assets (NPAs) by enforcing security interests without the need for judicial intervention. Under this statute, lenders have the ability to seize and sell assets offered as collateral by failing borrowers, resulting in a more efficient debt collection process. The SARFAESI Act focuses on secured loans and includes a variety of enforcement tools such as asset seizure, management takeover, and auction. It also established Debt Recovery Tribunals (DRTs) to resolve debt recovery disputes, providing creditors with a specialised platform to pursue legal remedies. The SARFAESI Act provides a comprehensive framework for debt recovery The SARFAESI Act is critical to improving the efficiency and efficacy of India's financial system while also protecting creditors' interests. The Code of Civil Procedure was judged insufficient for debt recovery, thus the "Recovery of Debts Due to Banks and Financial Institutions Act, 1993" was enacted. However, experience demonstrated that it was ineffective, prompting the passage of the SARFAESI Act. This act allows banks and financial institutions to realise their long-term assets, manage liquidity concerns, and improve recovery efforts by seizing control of securities and disposing them in order to reduce "Non-Performing Assets".

The jurisdiction of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) covers the entire territory of India. This means

that the provisions of the SARFAESI Act are applicable consistently across the country, allowing banks and financial institutions to enforce security interests and recover non-performing assets (NPAs) in all states and union territories. The Act allows lenders to seize and sell assets offered as collateral by failing borrowers without the requirement for judicial involvement. Additionally, SARFAESI proceedings can be commenced against borrowers situated anywhere in India, provided that the loan agreement includes provisions allowing the lender to seek recourse under the SARFAESI Act in the event of default. The Act established Debt Recovery Tribunals (DRTs) to adjudicate debt collection cases, providing creditors with a specialised platform to pursue legal remedies throughout the country. Overall, the SARFAESI Act's authority provides consistency and efficiency in debt recovery proceedings, which contributes to India's financial system stability.

Economic indiscipline, sometimes known as financial illiteracy, is a hallmark of Indian industry. The ever-increasing Non-Performing Assets ('NPA'), a fine euphemism devised to describe bad loans, prompted the passage of the Recoveries of Debts Due to Banks and Financial Institutions Act, 1993, which established a special Debt Recovery Tribunal ('DRT'), defined under Section 2(1)(i) of the Act, to reclaim NPA. However, on the one hand, this did not hasten the recovery, and on the other, the stringent civil law requirements made the attachment and foreclosure of the assets supplied as collateral for the loan almost useless. Furthermore, banks and other financial institutions' balance sheets were turning red due to significant statutory provisions for non-performing assets (NPAs).

A "Non-Performing Asset (NPA)" is a borrower's account or asset that has been classified as a substandard, dubious, or loss asset by a bank or financial institution in accordance with the guidelines supplied by either the regulating authorities or the "Reserve Bank of India". Such classification enables the bank or financial institution to efficiently monitor and manage the borrower's financial responsibilities, ensuring that the dues are recovered and losses are minimised. Before designating an asset as an NPA, banks must follow a precise method based on evidence of recovery and cannot do so just due to a momentary shortfall. Recognising that one out of every five borrowers is a defaulter, the government was required to offer adequate debt recovery methods as well as foreclose the security. As a result, the SARFAESI Act of 2002 (the Securitisation Act) aims to achieve both of these objectives while also providing a broad legal framework for asset securitization and asset reconstruction.

(B) Applicability and Non- Applicability

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest

Act, 2002 (SARFAESI Act) primarily applies to secured loans made by banks and financial institutions in India. The Act covers a wide range of financial assets and security interests, including loans secured by immovable property (land and buildings), moveable property (machinery and equipment), and financial assets (stocks and securities). However, it is important to clarify that SARFAESI procedures apply only to secured loans that have been categorised as non-performing assets (NPAs) because the borrower has failed to meet their repayment requirements. It is not applicable to all sorts of loans and financial transactions. It often excludes unsecured loans with no collateral, agricultural advances, loans below a defined threshold value, and certain asset categories. Loans granted by government agencies or organisations may also be exempt from the SARFAESI Act's authority because they may have their own recovery procedures. While the SARFAESI Act is a powerful weapon for recovering non-performing assets (NPAs) for banks and financial institutions, its applicability is determined by the nature of the loan and the assets involved, with some exceptions and exclusions outlined in the legislation.

(C) Methods for Recovery Under the SARFAESI Act, 2002

The SARFAESI Act allows the following three techniques of recovering non-performing assets (NPAs):

a. Securitisation

Securitization is the process of producing marketable securities backed by a pool of existing assets, such as mortgages or vehicle loans. An asset can be sold once it has been turned into a marketable security. A securitization or asset reconstruction firm can only raise capital from Qualified Institutional Buyers (QIBs) through the formation of financial asset acquisition schemes. Securitization, as defined by the SARFAESI Act, allows Indian banks and financial institutions to resolve non-performing assets (NPAs) by transforming illiquid loans into tradeable securities. This method entails transferring distressed assets to specialised companies known as Asset Reconstruction Companies (ARCs), who are responsible for recovering or reconstructing these assets. ARCs play an important part in the securitization process by purchasing non-performing assets (NPAs) from banks at a discount and striving to resolve them. Once purchased, distressed assets are securitized into Security Receipts (SRs), which reflect an undivided interest in the underlying pool of assets. These SRs are then sold to investors, allowing them to invest in distressed assets while potentially earning returns through recovery or resolution initiatives. Securitization using the SARFAESI Act serves as a tool for banks to clean up their balance sheets, increase liquidity, and focus on their core lending activities, while

simultaneously giving opportunities for investors to participate in the resolution of distressed assets.

b. Asset Reconstruction

Asset reconstruction enables asset rebuilding enterprises. It can be accomplished by managing the borrower's business through sale or acquisition, or by rescheduling the borrower's loan payments in accordance with the Act's terms. Asset Reconstruction refers to the acquisition and management of troubled assets by specialised companies known as Asset Reconstruction Companies (ARCs). These ARCs are authorised to purchase non-performing assets (NPAs) from banks and other institutions at a discount in order to resolve them through various measures. This process frequently comprises restructuring debts, reaching agreements with borrowers, or pursuing legal action for recovery. ARCs help to revitalise troubled assets by providing financial support, consultancy services, and aiding borrowers' rehabilitation efforts.

c. Enforcement of security without interruption by the court

The Act authorises banks and financial institutions to give notices to persons who have gained a secured asset from the borrower in order for them to pay the due amount, as well as to demand payment from the borrower's debtor. banks and financial organisations in India can enforce their security interests without the requirement for a judicial order. This process begins with sending a notice to the borrower seeking repayment of the outstanding loan amount within a set timeframe. If the borrower fails to comply with the repayment obligation, the lender may take possession of the secured assets and sell them to recoup the debt. The Act authorises lenders to appoint an Authorised Officer to oversee enforcement processes, such as asset seizure and sale. This streamlined system allows creditors to recover non-performing assets (NPAs) more quickly and effectively, ensuring credit discipline and financial stability in the banking industry.

V. CHALLENGES OF SARFAESI ACT

1. Classification of non-performing assets and early resolution of issues

Many borrowers believe that bank staff are harassing them unreasonably and utilising the provisions of the SARFAESI Act of 2002. They argue that they are not 'willful defaulters' and that if there is a default, they are willing to fix it and honour the agreed-upon commitments. While bank officials may have a legitimate interest in assisting borrowers within the legal framework, in some cases, bank officials act unreasonably and invoke the provisions of the SARFAESI Act, 2002 by classifying the account as a 'Non-performing Asset' even if the loan account can be regularised. Obviously, the Bank should adhere to the rules stated.

The Reserve Bank of India classifies any loan account as a 'non-performing asset'. However, it is primarily a question of interpretation and how Bank officials intend to implement the rules. Normally, the Tribunal and Courts do not address the subject of classifying an account as a 'Non-performing Asset', and they prefer to support the categorization of any loan account as NPA if payments are not made as planned. However, the Reserve Bank of India's criteria for Asset Classification are not one-sided, and it all depends on how those guidelines are interpreted in relation to a certain 'credit account' or borrower.

Many loan accounts can be settled at the time of classification as NPA provided the bank is accommodating and willing to regularise the loan accounts, the value of the asset has not decreased, and there is no difficulty with the quality of the asset mortgaged. It is well known that it is not obligatory for the bank to notify borrowers of the account's categorization as NPA and the repercussions. It is likewise incorrect to assume that the borrower is uninformed of the repercussions of default. In certain circumstances, bank officials take a friendly approach and have their accounts regularised, emphasising the importance of maintaining excellent relationships with the borrower. However, in some cases, when the Bank issues a demand notice under Section 13 (2) of the Act, they tend to take the proceedings further, though the Bank can consider the proposal for account regularisation at any stage if there are no other disputes between the Bank and the borrower in relation to that specific loan transaction or transactions.

2. Powers of DRT

Section 17 of the SARFAESI Act of 2002 grants the right to appeal against any action taken by the Bank in accordance with the provisions of the act. The borrower or any person aggrieved may contest the possession notice issued under Section 13 (4) of the SARFAESI Act, 2002, and there is a time restriction for filing an appeal. However, as the Courts have rightly made it clear that the borrower is entitled to question all measures initiated by the Bank pursuant to the possession notice under section 13 (4), and with this interpretation, there is no much relevance to the time-limit prescribed to prefer an appeal, though it will be in the interests of the borrower to prefer an appeal as soon as possible if there is a Genuine grievance with the bank. While the rights of borrowers or people aggrieved to file an appeal under Section 17 of the SARFAESI Act, 2002 are nearly decided, the subject of the Debt Recovery Tribunal's authority under Section 17 of the Act is still being contested. With the interpretation of Courts, the scope of powers of DRT under section 17 of SARFAESI Act, 2002 has greatly grown from the stage of maintaining that 'the DRT is expected to just look into the procedural concerns', while certain

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matters still require examination.[9]

Though the Debt Recovery Tribunal is authorised to deal with issues of debt quantum and related claims under Section 17 of the SARFAESI Act, 2002, there is criticism that the Debt Recovery Tribunal avoids adjudication on certain issues and aids the Bank by allowing appeals filed by borrowers under Section 17 on technical grounds, allowing the Banks to continue dealing with the borrower. If this is the case, the borrower is required to approach the Tribunal several times and is made to run from pillar to post. Logically, the borrower might urge that the Debt Recovery Tribunal deal with the points made by him in his appeal, and if there is an observation in the decision against the Bank. For the borrower, this is equivalent to a decree unless reversed, and the observations are meaningful and binding on banks. This is what is intended to happen if the borrower has a strong case regarding the amount required by the bank, but it is extremely rare to see situations develop in this manner, as many claim. If the DRT is hesitant or ineffective in addressing all the issues raised by the borrower in his appeal under section 17, the borrower will be left with no remedy, and he cannot also approach the Civil Court in view of section 34, and even if he approaches the Civil Court, it is very difficult to convince and maintain a civil suit in relation to a loan transaction in which the bank has begun SARFAESI proceedings.

3. Sale of assets under SARFAESI Act

The sale of assets by the bank under the provisions of the SARFAESI Act of 2002 is frequently criticised by borrowers. In some situations, the auction process is rushed, making it extremely difficult for borrowers to have the transaction set aside, despite the fact that the DRT is allowed to do so under section 17. It is the Bank's job to ensure that they obtain the highest feasible price for the property at public auction because they are the trustees of the property and the balance sale consideration, after adjustments, goes to the borrower. There is a lot of difficulty in this procedure, and it is quite tough for the borrowers at times to struggle with the banks, which has something to do with The problem involves a lack of awareness of procedures and laws under the SARFAESI Act of 2002. Not only does the Bank have considerable discretion when multiple properties are available for auction under the SARFAESI Act of 2002, but the sale of a property chosen by the borrower also clears the debt. Even from the perspective of the bidder or purchaser, there may be concerns. In certain circumstances, the bidder or purchaser paid the entire sale consideration, and litigation ensued, resulting in the non-conferment of total

[9] "Sarfaesi act loopholes explained" available at https://debtindia.wordpress.com/2023/05/17/sarfaesi-act-loopholes-explained/ accessed on March 16th , 2024

ownership rights. If the delay between the payment of the sale consideration and the actual conferment of clear title is longer, the bidder or purchaser is also in danger because he will only get if the sale is finally set aside and the Bank is ordered to restore the Sale Consideration to the auction-purchaser, the will receive the bare minimum of interest on his investment. Though it is established that the Bank is required to follow the method stipulated for conducting a public auction under the SARFAESI Act of 2002, it all depends on the facts and circumstances of the case, with the underlying issue being obtaining the highest possible price for the property.

4. High Court's Jurisdiction in a proceeding under SARFAESI Act, 2002

If there is clear unfairness or arbitrariness on the part of the Bank in invoking the provisions of the SARFAESI Act or in the process, the High Court, in my opinion, should provide relief to the borrower without focusing too much on the availability of an alternative remedy under Section 17 of the SARFAESI Act of 2002. Banks are unaffected by this because the High Courts are always concerned with the public interest and will resolve Writ Petitions under Article 226 in sarfaesi cases as soon as possible on requests.

5. Civil Court's jurisdiction

Section 34 of the SARFAESI Act, 2002 imposes a clear bar on civil courts dealing with SARFAESI-related issues. It is also difficult to persuade a Civil Court that it has jurisdiction to hear a particular litigation against the Bank, regardless of whether the Bank refers to the provisions of the SARFAESI Act. Civil Court jurisdiction is not totally barred, and it cannot be barred even in circumstances where the Bank has used the provisions of the SARFAESI Act of 2002. If the DRT is not clearly empowered to deal with specific issues brought by the borrower or to be addressed by the borrower or the aggrieved person, the borrower or the aggrieved person may approach Civil Court, and the matter will be resolved. But when a borrower is entitled to approach the Civil Court based on the facts of that particular case; however, it is certain that it is difficult to persuade a Civil Court that it has jurisdiction to hear a specific suit against the Bank when the Bank has invoked the provisions of the SARFAESI Act 2002. If the Civil Court is convinced that a particular suit against the Bank should be entertained, an injunction against the Bank in proceeding under the provisions of the SARFAESI Act can be issued, and there is no need to be concerned about this because only a few minor cases qualify to be maintained before a Civil Court. There is nothing to worry about for the banks in terms of civil court jurisdiction, and they If they believe that the Civil Court is exercising jurisdiction that it does not have, they have the right to seek redressel under Article 227 promptly. The Civil Court can and should decide on actual matters. However, with some borrowers attempting to obstruct

SARFAESI procedures by filing a suit in Civil Court and High Courts, it is frequently assumed that the borrower has no recourse before a Civil Court if the Bank applies the provisions of the SARFAESI Act once. It is a fallacy, and a Civil Suit against the Bank can be filed in appropriate instances regardless of whether the Bank utilised the provisions of the SARFAESI Act.[10]

VI. Recent amendments to SARFAESI Act

The Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016 was enacted on August 12, 2016 to alter the Sarfaesi Act, 2020. However, certain parts were notified on different dates. The Ministry of Finance, Department of Financial Services, notified the following parts of the Act by Notification No. SO. 4619 (E) on December 26, 2019 and they will be effective January 24, 2020.[11]

- Section 17 proposes an adjustment to Section 23 of the Sarfaesi Act, 2002
- Section 18 inserts Chapter IVA into the Sarfaesi Act, 2002. Chapter IVA covers registration, securities enforcement rights, and secured creditors' priority.
- Section 19 addresses the deletion of section 27 of Sarfaesi.

SEC 23(1) governs the filing of securities transactions, reconstitution, and creation of security interests.

1. Effective January 24, 2020, the following types of transactions must be filed with the Central Registry of Securitization, Asset Reconstruction, and Security Interests of India (CERSAI):- Transactions involving securitization, asset reconstruction, or security interest creation.

2. Transactions that occurred before or after the creation of CERSAI must be recorded by January 24, 2020.

(A) Chapter IVA of the SARFAESI ACT, 2002 addresses the filing and registration of secured and other creditors.

Creditors can now file transactions to ensure repayment of financial aid supplied to borrowers. Previously, this facility was only available to banks, FIs, Specified NBFCs, ARCs, debenture trustees, and other trustees who held securities on 50% of banks or FIs (Sec 26B).

Filing a transaction does not give the creditor the power to enforce security interests under the

[10] "Critical issues of Sarfaesi act " available https://taxguru.in/corporate-law/critical-issues-sarfaesi-act-2002.html#google_vignette accessed on March 18th , 2024

[11] "ENFORCEMENT NOTIFICATION FOR AMENDMENT OF SARFAESI ACT" available https://argus-p.com/updates/updates/enforcement-notification-for-amendment-of-sarfaesi-act/ accessed on 20th March, 2024

Sarfaesi Act, 2002, unless they are a bank, FI, Specified NBFC, ARC, Debenture Trustee, or other Secured creditor as defined in section 2(1)(zd).

1. Authorities responsible for recovering taxes, revenue, or government dues must submit an attachment transaction with CERSAI.
2. If a person receives attachment orders from a court or authority against their claim, they can register the details with CERSAI to strengthen their claim.

(B) Effect

Filing or registration by a secured creditor, government entity, or individual with an attachment order serves as public notice. Once a security interest or attachment order is lodged with CERSAI, the creditor's claim takes precedence over any later security interests created on the property. The creditor must register or file a security interest with CERSAI before selling, transferring, or leasing the property.

(C) Priority for secured creditors - Sec. 26E

1. Once a security interest is registered with CERSAI, the secured creditor's debts (banks, FIs, NBFCs, ARCs, etc.) have priority over all other debts, including revenue, taxes, cessess, and rates owed to the Central, State, or Local Government.
2. If IBC actions are continuing for secured assets, secured creditors will have priority based on IBC rules.

VII. Conclusion

In conclusion, a review of debt recovery procedures in the Indian banking sector, with a particular emphasis on the SARFAESI Act of 2002, reveals a complicated picture in which legislative reforms have greatly improved banks' ability to recover debt efficiently. The SARFAESI Act has established a strong framework for banks to address the issue of non-performing assets (NPAs) by facilitating asset seizure and sale. However, the Act's effectiveness is limited by practical problems, legal complications, and infrequent cases of abuse. Moving forward, policymakers must address these issues through continuous evaluation, stakeholder consultations, and potential amendments to ensure that the SARFAESI Act remains a powerful tool for debt recovery while upholding the principles of fairness and transparency in banking sector. Furthermore, exploring alternative approaches such as boosting financial literacy among borrowers and rewarding prompt repayments could help to prevent the growth of non-performing assets. By implementing these techniques, policymakers can create a more robust and fair debt recovery environment that balances the interests of banks, borrowers, and the

overall economy.

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