

Heralding Change - Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Bill, 2016

The Banking sector in India is in a crisis with continuous increase in the burden of bad loans and as a result of it, the profitability of commercial sector banks has declined. Non-performing asset, a defaulted credit facility is an important factor to identify the performance and strength of the banks. The banking performance has been categorized by the percentage level of non-performing asset as it is the indicator for the profit measurement of banking industry.

With the objective to facilitate expeditious disposal of debt issues burdening the creditors including banks and financial institutions, the SARFEASI Act, 2002 has been amended and the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Bill, 2016 (the "**Bill**") has been introduced. It was passed by the Lok Sabha on August 1, 2016 and by the Rajya Sabha on August 9, 2016. The bill seeks to amend four acts viz. the SARFAESI Act, 2002, ("**SARFEASI Act**"), the Recovery of Debts due to Banks and Financial Institutions Act, 1993, ("**RDDDBFI Act**") the Indian Stamp Act, 1899 and the Depositories Act, 1996. The amendments are aimed at faster recovery and resolution of bad debts by banks and financial institutions, thereby making it easier for asset reconstruction companies (ARCs) to function. Along with the new bankruptcy law which came into effect earlier this year, the amendments will put in place an enabling infrastructure to effectively deal with non-performing assets in the Indian banking system.

In the amendment, the sponsors of the ARCs are allowed to maintain 100% stake in the ARC. The Secured Creditors will no longer be able to take possession of the collateral unless it is registered with the Central Registry. However, after registration with the Central Registry of Security Interest, these creditors will have priority over all other debts, revenues, taxes, cesses and other rates payable to the Central Government, State Government or local authority.

Another important change brought about by the Bill is the amendment in the definition of "Debt Securities", which is now defined as debt securities listed on the Indian Stock Exchanges and the definition of "Secured Creditor" have been amended to include debenture trustee registered with the Board for secured debt securities. The Bill allows a debenture trustee to enforce security with respect to listed debt securities in the event of non-payment of debt after notice period of 90 days to the borrower.

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. This will be done in case the banks convert their outstanding debt into equity shares, and consequently hold a stake of 51% or more in the company.

The powers of the Reserve Bank of India (RBI) are also proposed to be widened by allowing RBI to carry out audit and inspection of ARCs. The ARCs can be penalised if it fails to comply with any directions issued by the RBI. Where upon inspection/audit or otherwise, RBI is satisfied that business of asset reconstruction is conducted by the ARC in a manner detrimental to public interest; RBI may remove

the Chairman or any Director and appoint Central Bank officials to its Board. To promote assignment/transfer of financial assets in favour of ARCs the stamp duty on such assignment/ transfer has been exempted.

Once implemented, the Act enables the banks to take over the management of the defaulting company.

The provisions of the Bill also seek to amend the RDDBFI Act, and allows Banks and Financial Institutions to file cases in tribunals having jurisdiction over the area of Bank branch where the debt is pending. This provision has replaced the earlier provision of the SARFAESI Act, where the bank and financial institution were required to file cases in Tribunals having jurisdiction over the defendant's area of residence or business.

Given the vast number of pending cases and to fast track the disposal mechanism, it has called for online filing of applications as well as upload of all rulings. Section 19A has been introduced, where filing of recovery applications, documents and written statements can be facilitated in electronic form and authenticated with digital signature of the applicant, defendant or any other petitioner. Any summons, notice or communication or intimation as may be required to be served or delivered under this Act, may be served or delivered by transmission of pleadings and documents by electronic form. Similarly, any interim or final order passed by the Tribunal or Appellate Tribunal displayed on the website of such Tribunal or Appellate Tribunal shall be deemed to be a public notice of such order and transmission of such order by electronic mail to the registered address of the parties to the proceeding shall be deemed to be served on such party.

To ensure the creditor's interest, the Bill also empowers the Debt Recovery Tribunals to issue a summon within 30 days of an application, directing the defendant to disclose the particulars of properties and assets and also pass an interim ex-parte order restraining the defendant from disposing them. Furthermore, the defendant will also be expected to deposit at least 25 per cent of the debt due while filing for an appeal.

Given the inadequacy of the infrastructure to deal with recovery, the implementation of the changes will be critical. The SARFAESI Act should also include the manner in which each action thereunder can be taken in reference to resolution and liquidation under the Bankruptcy code. It could further be clarified that the transfer of a financial asset from a bank or financial institution to an ARC during the moratorium under Bankruptcy Code would be permitted.

The Act creates a central registry to maintain records of transactions related to secured assets. The Bill creates a central database to integrate records of property registered under various registration systems with this central registry. This includes integration of registrations made under Companies Act, 2013, Registration Act, 1908 and Motor Vehicles Act, 1988.

Together with the new Insolvency and Bankruptcy Code (2016) that has been passed by the Government earlier this year, the Government is putting in place critical building blocks to provide an enabling infrastructure to deal with burgeoning bad debts at bank and to minimize losses incurred. Flaws in the exiting recovery system have contributed to the problem of bad debt. The Bill seeks to sync the SARFEASI Act, with the Bankruptcy Code, besides giving more power to the

Central Bank. The government is hopeful that these amendments along with the Bankruptcy code will provide for a time bound framework to deal with stressed assets and loan recovery.