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## **REVISITING THE SARFAESI ACT, 2002: STRENGTHENING BORROWER PROTECTIONS AND THE ROAD TO REFORM**

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### **ABSTRACT**

The SARFAESI Act, 2002, was coined as a significant reform to streamline the process of debtors and lenders relationship while bypassing the slow-moving and overburdened judicial process. However, over the years, its implementation has led to serious concerns regarding the borrower rights and the unfair recovery practices, and socio-economic repercussions practised by the lenders. The Act, while empowering lenders, has often been criticized this process for inadequate borrower protections and the lack of transparent methods which they follow while being disproportionate in enforcement practices. This leads to monetary and psychological distress and even displacement of the economically weaker borrowers.

This research will assist in critically examining the legal drawbacks of the SARFAESI Act, highlighting its loopholes in grievance redressal forums, misuse by fraudulent Asset Reconstruction Companies (ARCs) and even violations of certain fundamental rights including but not limited to Right to Appeal. It also assesses the judicial interpretations that attempts to balance the lender interests with borrower safeguard practices and compares this Act with other debt recovery laws to identify, analyse and implement more equitable models. By focusing on reforms that ensure ethical recovery practices, judicial oversight, and socio-economic considerations, this study will assist in providing policy-driven solutions that are not coercive in nature and are in the benefit of both the parties. This will eventually rectify the Act's existing flaws and establish a fairer debt recovery system for the parties included in this sector.

**Keywords:** Debt Recovery, Borrower Rights, Judicial Interpretation, Grievance Redressal, Right to Appeal, Inhumane Activities

## **1. Introduction**

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002, is a landmark legislation enacted in India to address the growing problem of non-performing assets (NPAs) in the banking sector. By empowering financial institutions to recover dues without court intervention, the Act has streamlined the process of asset recovery. However, its implementation has often sparked debates about its impact on economically vulnerable borrowers, particularly small and poor borrowers.

This study seeks to comprehensively analyse the SARFAESI Act, focusing on its implications for poor borrowers. The Act provides banks with significant powers, including the right to seize secured assets in the event of default. While this mechanism improves creditor confidence and reduces recovery timelines, but at the same time it disproportionately affects borrowers' interest who have with limited financial resources, who may be pushed further into economic distress due to the aggressive recovery measures.

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 was enacted by the Parliament of India in December 2002. It was introduced by the Atal Bihari Vajpayee-led NDA government to help banks recover bad loans efficiently without court intervention. The Act came into effect on June 21, 2002, after receiving the President's assent on December 17, 2002.

## **2. Impact on Consumers**

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 was enacted to empower financial institutions to efficiently recover non-performing assets (NPAs). Although this Act has streamlined the recovery process for lenders, its impact on consumers, particularly borrowers from the economically weaker section has been significantly endangered.

The provisions of the Act enable the banks and financial institutions to realize long-term assets, manage problems of liquidity and asset liability disparities and to improve recovery by exercising powers to take possession of securities, sell them and reduce non-performing assets

by adopting measures for recovery or reconstruction.<sup>1</sup>

### **A. Legal Hardships and Borrower Rights**

Section 13(2) of the SARFAESI Act grants significant powers to secured creditors. It enables them to issue a notice to the borrower demanding repayment of the outstanding loan amount along with interest within 60 days from the date of notice. This section serves as the initial step towards the recovery process and sets the stage for further actions under the Act.<sup>2</sup>

However, the delay in notifications majorly in the rural areas where there is little or no use of internet connectivity poses a problem to pass on this message creating a major gap for economically weaker section to gather funds at an even shorter notice.

### **B. Socio-Economic Impact**

The SARFAESI Act, 2002, while aimed at optimising debt recovery, has now led to a range of socio-economic issues majorly for borrowers, particularly to those who belong to the economically weaker sections of the society. Financial illiteracy and lack of access to legal aid leaves are major reasons for this to happen which makes them vulnerable to forced evictions. Rise in the sales of properties falling under this category is often undervalued in bank auctions which is nothing but a tactic to draw as much as possible from the already underprivileged.

Strict policy reforms to ensure fair valuation of seized assets and improved borrower protections are crucial to ensure that debt recovery aligns isn't inhumane in nature.

### **C. Borrower Safeguards in Grievance Redressal**

The SARFAESI Act, 2002 is one of the frontier provisions providing financial institutions with extensive powers for debt recovery and still the grievance redressal mechanisms for borrowers falling under this act remain limited and largely ineffective. The primary challenge for borrowers is the Debt Recovery Tribunal (DRT) under Section 17 which interprets the

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<sup>1</sup> The impact of SARFAESI Act 2002 in recovering the non-performance assets in public sector banks: A study on recovery in SBI, CBI, CB, BOB and PNB (2008 to 2014) available at [https://www.researchgate.net/publication/316827430\\_The\\_impact\\_of\\_SARFAESI\\_Act\\_2002\\_in\\_recovering\\_the\\_non\\_performance\\_assets\\_in\\_public\\_sector\\_banks\\_A\\_study\\_on\\_recovery\\_in\\_SBI\\_CBI\\_CB\\_BOB\\_and\\_PNB\\_2008\\_to\\_2014](https://www.researchgate.net/publication/316827430_The_impact_of_SARFAESI_Act_2002_in_recovering_the_non_performance_assets_in_public_sector_banks_A_study_on_recovery_in_SBI_CBI_CB_BOB_and_PNB_2008_to_2014)

<sup>2</sup> Understanding the SARFAESI Act Section 13(2) | Bajaj Finance available at <https://www.bajajfinserv.in/understanding-sec-13-2-of-sarfaesi-act>

minimum deposit amount to be up to 50% of the outstanding dues as a precondition for filing an appeal which creates a major distress among the financially burdened borrowers. Further, the delays due to case backlogs under the judiciary for these matters makes it rather ineffective even if the rest of the process is streamlined.

The borrower can simultaneous to a pending proceeding before the DRT or DRAT try to negotiate with the bank for a settlement. This may create confusion and cause delay in filing appeal against the bank.<sup>3</sup>

#### **D. Mental Distress and the Weight of Debt**

Being in arrears may have negative consequences for the individual's mental wellbeing, as indicated by the higher prevalence of anxiety, depression and other common mental disorders among over indebted individuals.<sup>4</sup>

The psychological burden endowed by the harassment done by recovery agents and the legal complexities which needs to be followed leads to nothing but mental distress with reports of extreme cases of suicides among this category of economically weaker section. The use of unparliamentary recovery tactics which includes but not limited to harassment by bank officials or recovery agents creates a sense of helplessness amongst borrowers.

### **3. Legal Framework of the SARFAESI Act, 2002**

The SARFAESI Act was designed to ensure strengthening the financial sector and also reduce the economic burden of non-recoverable loans. Debtors have often faced inhumane activities due to the aggressive implementation of asset seizures and auctions under the name of legality. Thus, evaluating its legal framework is essential to understand its impact on both creditors as well as debtors.

#### **A. Enforcement of Security Interest**

Section 13(2) of the SARFAESI Act empowers banks and financial institutions to issue a notice to the borrower in the event of a default on a secured loan. This notice must specify the amount

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<sup>3</sup> ISSUE XI : Section 17 of SARFAESI: Is it effective for the borrowers? available at <https://www.psalegal.com/issue-xi-section-17-of-sarfesi-is-it-effective-for-the-borrowers/#>

<sup>4</sup> Debt and mental health: new insights about the relationship and the importance of the measure of mental health available at <https://pmc.ncbi.nlm.nih.gov/articles/PMC6533593/#ckz002-B6>

due and demand repayment within 60 days. The borrower has the right to make representations against this notice to the secured creditor.<sup>5</sup>

The implementation of this is highly misused at certain parts of the country where these notices are issued with engaging in proper negotiation terms creating a way for financial burden for the already poorer sections of the society.

### **B. Asset Reconstruction Companies (ARCs)**

The Asset Reconstruction Companies (ARCs) were coined under the SARFAESI Act, 2002, primarily under the provision of Section 3. This was done to manage and recover the non-performing assets (NPAs) of banks and financial institutions in order to ensure that they do not suffer losses in the process of debt recovery. While this sector has been working quite efficiently, it has also witnessed certain fraudulent companies with operate without any proper registration. These companies are a threat to borrowers as they are more likely to indulge in pressurised recovery practices as well as illegal seizures which creates nothing but just financial exploitation to the country's valued citizens.

### **C. Sale and Transfer of Secured Assets - Section 13(6) & 13(8)**

Under Section 13(6) of the SARFAESI Act, after taking possession of the borrower's asset under Section 13(4) of the act, the creditor has absolute rights of transferring these assets to recover their debts.

Section 13(8) of the SARFAESI Act enables the borrower with a right of redemption of the secured property, while maintaining the right of the creditor to dispose of the secured property.<sup>6</sup>

In multiple cases, assets were sold at a meagre value compares to its market value to the already decided buyers which deprives the borrowers of their property's full worth eventually continuing the cycle of loans and debt repayment.

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<sup>5</sup> Understanding Section 13(2) and 13(4) of the SARFAESI Act: A Comprehensive Guide available at <https://capaa.in/understanding-section-132-and-134-of-the-sarfaesi-act-a-comprehensive-guide/>

<sup>6</sup> Right of redemption of the mortgaged property by a borrower under SARFAESI Act available at <https://www.azbpartners.com/bank/right-of-redemption-of-the-mortgaged-property-by-the-borrower-analysis-of-the-honble-supreme-courts-judgment-surinder-pal-singh-vs-vijaya-bank/>

#### **D. Penalties for Defaulting Borrowers (Section 29-30)**

The Section 29 of this Act interprets that if a borrower or any other individual fails to comply with the lawful recovery proceedings initiated under SARFAESI can face criminal penalties for non-compliance to its provisions.

Issuance of possession notice, as observed earlier, gives borrower and the public in general an intimation that the secured creditor has taken possession of the property and at that stage, it is quite possible, may be in view of resistance or if the Banks chooses to take only symbolic possession, to state that the secured creditor has taken symbolic/constructive possession and not physical possession, but that by itself would not entitle the borrower to raise challenge under Section 17(1) of the Act, as held by the Supreme Court in Noble Kumar (supra).<sup>7</sup>

#### **E. The SARFAESI (Amendment) Act, 2016**

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests Act, 2002 or SARFAESI Act Amendments have been made in 2016 because of "Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016"<sup>8</sup>

This amendment had aimed at resolving several key issues in the SARFAESI Act, 2002, such as delays in debt recovery, the inefficiency of ARCs under this provision, and even the need for optimised resolution of bad loans. It also boosted the ARCs' efficiency with added regulations and foreign investments through enabling NBFCs to recover loans and strengthen their role in financial markets.

As much as this tried to optimise the process of debt recovery it also reduced the responders time to seek legal remedies.

#### **4. Judicial Interpretations and Borrower Protections**

The SARFAESI Act, 2002 has been challenged time and time on constitutional grounds, particularly for the rights of borrowers, the principle of natural justice, and even for the role of

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<sup>7</sup> M/s. Hindon Forge Pvt. Ltd. & ANR. Vs. State of Uttar Pradesh through District Magistrate Ghaziabad & ANR. available at <https://www.advocatekhoj.com/library/judgments/announcement.php?WID=10730>

<sup>8</sup> Summary of amendments to Sarfaesi Act, 2002 available at <https://blog.ipleaders.in/summary-sarfaesi-act-amendments/>

judicial intervention in loans recovery. The Courts have played a significant role in interpreting this Act to balance the rights of financial institutions as well as the borrowers.

### **A. Constitutional Aspect and Debt Recovery**

Keshavlal Khemchand & Sons Pvt. Ltd. v. Union of India (2015)<sup>9</sup> case had challenged the right given to banks to directly take possession of secured assets without judicial intervention. The court had upheld the Sarfaesi act with the adherence of following a legal course by banks while performing this action. The right to seize assets in solely under the criteria when they follow a just process.

### **B. Right to be heard**

M/s. Mathew Varghese v. M. Amritha Kumar (2014)<sup>10</sup> case was about the borrower challenging the auction sale under the Sarfaesi Act without giving enough opportunity to settle dues before the sale. The avoidance of following the legal notifications as well as allowing the right to redeem the mortgaged property by repaying their dues before the auction process must be adhered properly.

### **C. Right to Appeal**

The case of Mardia Chemicals Ltd. v. Union of India (2004)<sup>11</sup> was about the violation of right to appeal as Section 17 of the SARFAESI Act had made them liable to deposit 75% of the outstanding dues before even being able to file an appeal with the DRT.

This is nothing but unconstitutional as all borrowers are not in the condition to pay this set of percentage in case of financial burdens.

### **D. Protection of small borrowers**

The case of Harshad Govardhan Sondagar v. International Assets Reconstruction Co. Ltd. (2014) had created a multi-faceted challenge for evaluating the tenant's right while seizure of assets under the SARFAESI Act. The judgement under this act clearly stated that banks must

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<sup>9</sup> Keshavlal Khemchand & Sons Pvt. Ltd. v. Union of India AIR 2015 SUPREME COURT 1168

<sup>10</sup> M/s. Mathew Varghese v. M. Amritha Kumar (2014) 5 SCC 610

<sup>11</sup> Mardia Chemicals Ltd. v. Union of India (2004) 4 SCC 311

recognise the rights of occupants before any such activity eventually protecting small borrowers.

## **5. Comparative Analysis of Debt Recovery Laws**

Debt recovery laws differ globally as well as nationwide, balancing lender and borrower relationships. While the SARFAESI Act, 2002 paves the way for financial institutions to recover debts without intervention from the court. A comparative analysis will help us reveal the gaps in these provisions, highlighting the necessity for a stronger yet ethical practice for borrower safeguards.

### **A. Recovery of Debts and Bankruptcy Act, 1993**

An Act to provide for the establishment of Tribunals for expeditious adjudication and recovery of debts due to banks and financial institutions. The primary objective of this act is to provide an optimised mechanism for resolving debt recovery cases which involves banks and financial institutions.

The flexibility of the redressal tribunal to change the appeal deposit as per the borrower's financial condition paves way for quick resolutions.

### **B. Indian Contract Act, 1872**

The Indian Contract Act 1872 is a comprehensive guide that governs contracts and agreements in India. The act lays down the rules and regulations that need to be followed while entering into a contract and also provides remedies for breach of contract.

The parties that are entering in the contract must have mutual consent i.e. they should be agreeing upon the same thing in the same sense as it is. It means that there must exist consensus ad idem (i.e. meeting of minds)<sup>12</sup>

As this act is purely on a contractual basis, the borrowers who are misled can easily claim relief as done under section 19 of the Indian Contract Act whose provision is not under the

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<sup>12</sup> Analysis of Section 10 of the Indian Contract Act, 1872 available at <https://blog.ipleaders.in/analysis-section-10-indian-contract-act-1872/>



SARFAESI Act.

### **C. National Consumer Credit Protection Act, 2009**

The National Consumer Credit Protection Act 2009 (NCCPA) is an Australian law by the Australian Securities and Investments Commission (ASIC) which aims to protect consumers of the credit market to ensure that there are fair and responsible lending provisions.

The NCCPA is applied to all consumer credit providers, including banks, credit unions, and even non-banking financial institutions making it a mandatory to do an assessment of the borrower's ability of repayment before approving any kinds of loans.

Thus, focussing on ensuring that responsible lending is achieved over just credit recovery methods helps assure a reduced case list of such matters.

### **D. The Insolvency and Bankruptcy Code (IBC), 2016**

In India, the Insolvency and Bankruptcy Code, 2016 is one matured step towards settling the legal position with respect to financial failures and insolvency. To provide easy exit with a painless mechanism in cases of insolvency of individuals as well as companies, the code has significant value for all stakeholders including various Government Regulators.<sup>13</sup>

The process under the IBC is handled through the National Company Law Tribunal (NCLT) for the corporate borrowers alongside the Debt Recovery Tribunals (DRTs) for individual insolvencies. It also sets strict timelines for clear adherence while resolving insolvency cases which helps assist in optimising debt recovery.

### **E. The Negotiable Instruments Act, 1881**

The Negotiable Instruments Act, 1881 (NI Act) assists governing resources like promissory notes, bills of exchange, and cheques in India. They criminalize the act of a bounce cheque being issued to maintain accountability in financial transactions. As NI Act further allows debt recovery efficiently through provisions of summary trials in the court it mitigates the lengthy

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<sup>13</sup> Insolvency and Bankruptcy Code, 2016 available at <https://cleartax.in/s/insolvency-and-bankruptcy-code-2016>

asset recovery procedures.

### **F. The Lok Adalat (Legal Services Authorities) Act, 1987**

The Lok Adalat (Legal Services Authorities) Act, 1987 came into action to provide an alternate dispute resolution (ADR) mechanism to resolve disputes through mutual understanding.

There remains a large number of pending cases in the courts of the country. A number of measures have already been taken by the government to reduce the number of pending cases.<sup>14</sup>

The aforementioned act presents a forum for alternative dispute resolution to tackle delays of the overburdened legislature of the country through quicker settlements.

## **6. Reforms and Recommendations**

India's debt recovery framework requires an equilibrium-based approach that safeguards the borrower rights as well as ensures that financial institutions recover debts efficiently. Strengthening these regulatory oversights based on Asset Reconstruction Companies (ARCs), enforces ethical recovery methods and introduces stricter penalties for the inhumane practices will assist in mitigating the misuse of the SARFAESI Act, 2002.

### **A. Abstaining Unfair Debt Recovery Practices**

One of the primary concerns with the SARFAESI Act, 2002, and its debt recovery mechanisms in general, is its coercive and unlawful methods often employed by financial institutions to optimise debt recovery. The borrowers, particularly from the economically weaker sections, have often reported instances of inhumane activities during the enforcement of this Act. Judicial interpretations have often highlighted the need for ethical debt recovery methods to ensure that monetary institutions adhere to fair and transparent methods to ensure borrower protection.

The Fair Debt Collection Practices Act (FDCPA), U.S. has regulated debt collection methods to protect consumers from unfair debt collection tactics to ensure that no rights are violated

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<sup>14</sup> Legal Services Authority Act, 1987 available at <https://blog.ipleaders.in/legal-services-authority-act-1987/>

and the process is complete with ease.<sup>15</sup>

### **B. Deliberations on Socio-Economic Displacement**

For loan defaulters in India, banks exercise their rights under Section 13(4) and 13(8) which often results in families being evicted from their own homes with little room for legal recourse due to added liability of the family burden. The implementation of laws like the Fair Debt Collection Practices Act (FDCPA) will assist in protecting these defaulters from aggressive evictions and abrupt dispossession through a chain of methods for their collaborative work towards resolving their issue.

### **C. Optimizing the Debt Recovery Process**

In order to ensure the ease of process to tackle this problem of debt recovery, the provision of setting up dedicated DRT benches in high-load areas will assist in reducing case pendency. Further, with digitalisation peaking up introducing the e-filing and virtual hearing to resolve cases through regulations overseeing ARCs. The case between Keshavlal Khemchand & Sons Pvt. Ltd. v. Union of India (2015)<sup>16</sup> was a landmark judgement where the Gujarat high court held that banks must adhere to provisions under Section 13(2) & 13(4) of the SARFAESI Act before finally moving forward with property auctions.

### **D. Ensuring ethical recovery methods**

The Debt recovery is a necessary process for financial based institutions, but it must be conducted in a wise manner that upholds humanity. The use of inhumane and unlawful activities by some recovery agents has led to severe borrower distress. Ethical debt recovery will ensure that creditors reclaim their dues without violating fundamental rights and it also maintains the integrity of the monetary system.

A fair recovery system must include a formulated repayment method rather than resorting to coercive recovery actions towards the borrowers at the first instance of their default. Many Countries like the U.S. and the U.K. have coined "Borrower Rehabilitation Programs" to make sure that borrowers can restructure their debts instead of facing legal consequences at the very

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<sup>15</sup> Fair Debt Collection Practices Act available at <https://www.federalreserve.gov/boarddocs/supmanual/cch/fairdebt.pdf>

<sup>16</sup> Keshavlal Khemchand & Sons Pvt. Ltd. v. Union of India AIR 2015 SUPREME COURT 1168

moment of a crisis.

### **E. Effective Recovery from cross-border Laws**

While globalisation is peaking, all monetary transactions must extend beyond borders. However, recovering these debts from foreign borrowers or assets located overseas poses significant legal and procedural discrepancies. Different jurisdictions across the globe follow distinct debt recovery provision, making enforcement complex. A well-structured cross-border debt recovery mechanism is vital for financial institutions to safeguard their interests to ensure compliance with the global legal standards.

## **7. Conclusion**

The complexities surrounding the debt recovery laws in India have highlighted a delicate balance between creditor rights and borrower protections. Although legislation such as the SARFAESI Act, the IBC and the Recovery of Debts and Bankruptcy Act provides a very formulated mechanisms for financial institutions to in order to claim their dues. The system is still suffering from delays, procedural inefficiencies, and issues about fairness. Borrowers, particularly small businesses and individuals, often struggle from aggressive recovery tactics and the lack of grievance redressal which occurs due to asset seizures. Furthermore, the legal provisions must adapt to modern financial realities which includes the rise of cross-border debt cases, digital lending platforms, and increasing instances of financial fraud. Ensuring the ethical recovery methods and optimizing the dispute resolution mechanisms will strengthen judicial safeguards which will help in maintaining the process of debt recovery while maintaining debt recovery.

A comprehensive reform approach must focus on eliminating unfair recovery practices, improving borrower rights and ensuring that judicial proceedings are faster yet fair. The integration of digitalisation and transparent resolution mechanisms will assist in striking the right balance between efficiency and fairness for these practices. Finally, these methods mustn't compromise on constitutional rights, ethical standards, and socio-economic stability but also ensure that economic growth is driven by responsible lending to the ones who can actually repay it rather than coercive recovery methods for all.