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## **ANALYSIS OF SARFAESI ACT: PRACTICAL APPROACH**

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### **I. ABSTRACT:**

This article is the hook that grabs the reader's attention towards the practical approach of implementation of SARFAESI Act (The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002) legislation in India. This article takes within its fold the international scenario of securitisation law and the Indian perspective of securitisation law. This article also provides for brief analysis of (The Securitisation and Reconstruction of Financial Assets and enforcement of Security Interest Act, 2002) which is a step to ensure legislation in securitisation arena. The research work is concluded by giving suggestions by the researcher to contribute to the field of securitisation law in India.

## **II. Introduction:**

Law is primarily needed to maintain peace, harmony and to eradicate the illegal practices in the society. There is a comprehensive legislative framework laid down by the legislators to combat illegal activities and for smooth the functioning of the specific field. Hence it is not wrong to say that today in each and every field, law is a necessity.

One such arena is of securitization of assets law. It is natural for a human being to crave for a good life. However when this craving takes form of greed, it make a person do anything for satisfying the greed. The person in a bid to lead a good and “luxurious” life takes the unlawful means. These means lead to nothing else but “white color crimes”. The fugitive offenders who generally belong to upper strata of the society tend to take huge loans from banks and flee the country instead of repaying the loans, leaving the banks and depositors in crunch. They settle in the country where there is no extradition treaty with their home country, thereby saving themselves from the clutches of law. This often leads to white color crimes in the country.

One of the important players in India's efforts to succeed in successfully accelerating its economic development has been the finance industry. The legal structure governing business transactions lagged behind changes in the financial industry and in business practices. It increased the amount of non-performing assets held by banks and other financial institutions and reduced the rate of recovery of defaulted loans<sup>1</sup>. A robust law was required to ensure repayment to the Bank. The SARFAESI Act (The Securitisation and Reconstruction of Financial Assets and enforcement of Security Interest Act, 2002) was enacted in 2002 in India and came into force on 17/12/2002. The Act was made with the aim to regulate securitisation and reconstruction of financial assets and enforcement of security interest and for matters connected therewith and incidental thereto. The Act provides for setting up of Debt Recovery tribunal which is a helping arm in enforcing the security interest and for matters connected thereto. This article helps to analyze the said Act and to highlight its practical approach.

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<sup>1</sup>Sarfaesi Act, 2002, applicability, objectives, process, documentation, cleartax.in, available at: <https://cleartax.in/s/sarfaesi-act-2002>, last seen on 25/04/2022.

### III. SARFAESI Act, 2002:

As stated earlier, SARFAESI Act (The Securitisation and Reconstruction of Financial Assets and enforcement of Security Interest Act, 2002) was enacted for recovery of debts and for enforcing security interests and to make perform assets that are not performing and are bad in eyes of law.

#### *Role of SARFAESI Act:*

1. Issuing Security Receipts and Securitizing Financial Assets: Invest in financial assets by purchasing bonds, debentures, or contracts. The security receipts issued to the QBs will also be collected.
2. Rebuilding Financial Assets: acquire appropriate steps to sell, manage, settle, restructure debt, or acquire control of financial assets in accordance with evolving RBI rules.
3. Security Interest Enforcement: The secured creditor may pursue the enforcement of its security interest without the help of the court<sup>2</sup>.

Following diagram helps us to understand the scheme of the SARFAESI Act (The Securitisation and Reconstruction of Financial Assets and enforcement of Security Interest Act, 2002):

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<sup>2</sup>SARFAESI Act 2002: Applicability, Features, Role and Procedure, godigit.com, available at: <https://www.godigit.com/guides/legal/sarfaesi-act-2002>, last seen on: 25/04/2023

# SARFAESI ACT

Chapter I Preliminary

Chapter II: Regulation of Securitisation And Reconstruction of Financial Assets of Banks and Fincial Institutions.

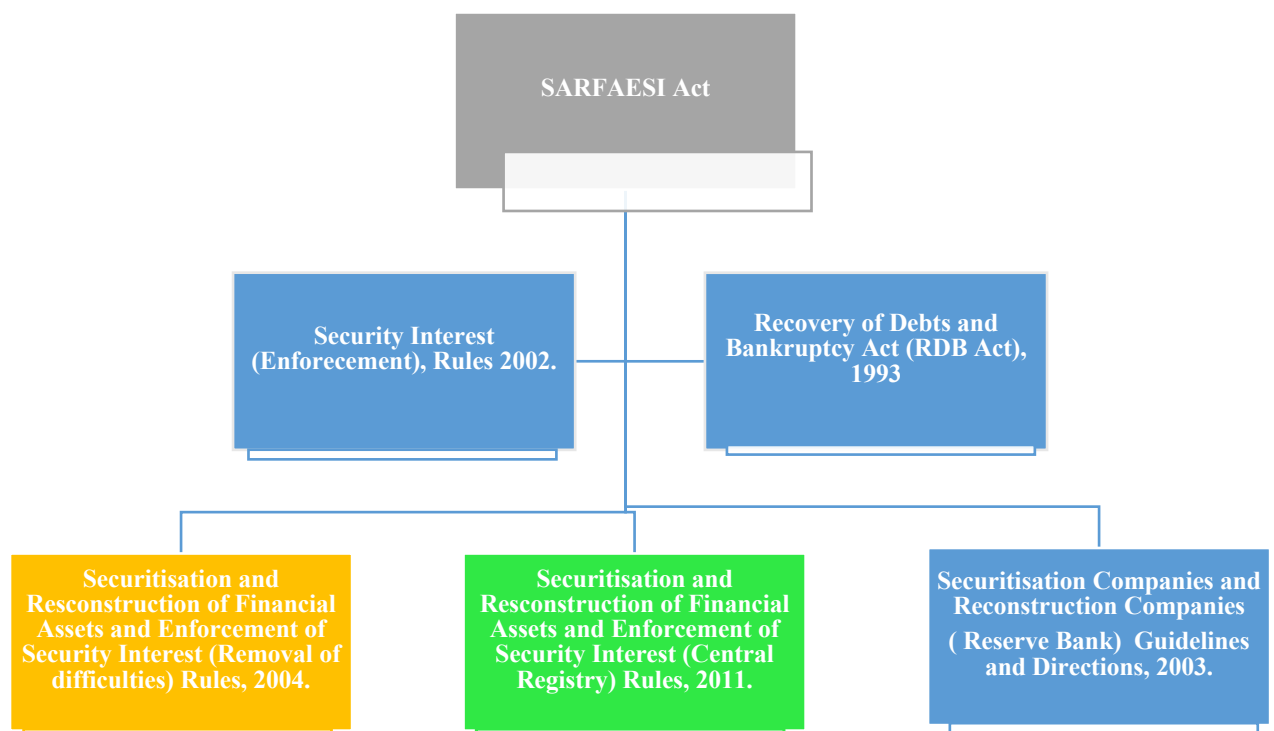
Chapter III: Enforcement of Security Interest.

Chapter IV: Central Registry.

Chapter V: Offences and Penalties.

Chapter VI: Miscellaneous

The SARFAESI ACT, 2002 is supplemented with other rules which can be understood with help of following diagram:



## *Some important features:*

The Securitisation and Reconstruction of Financial Assets and enforcement of Security Interest Act, is pretty self-explanatory the researcher has attempted to highlight certain notable features that are the very heart of the Act.

***Definitions:***

The Act has some important definitions that help us to understand and interpret the complex terms:

i. Asset reconstruction: means acquisition by any securitisation company or reconstruction company of any right or interest of any bank or financial institution in any financial assistance for the purpose of realisation of such financial assistance;

ii. Borrower: means any person who has been granted financial assistance by any bank or financial institution or who has given any guarantee or created any mortgage or pledge as security for the financial assistance granted by any bank or financial institution and includes a person who becomes borrower of a securitisation company or reconstruction company consequent upon acquisition by it of any rights or interest of any bank or financial institution in relation to such financial assistance;

iii. Default: means non-payment of any principal debt or interest thereon or any other amount payable by a borrower to any secured creditor consequent upon which the account of such borrower is classified as non-performing asset in the books of account of the secured creditor.

iv. Non-performing asset: means an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset:

(a) in case such bank or financial institution is administered or regulated by any authority or body established, constituted or appointed by any law for the time being in force, in accordance with the directions or guidelines relating to assets classifications issued by such authority or body;

(b) In any other case, in accordance with the directions or guidelines relating to assets classifications issued by the Reserve Bank.

It is very important to understand as to what is exactly non-performing asset termed as. This Act entirely revolves around the term of non-performing asset. It is the soul of the act.

v. Securitisation: means acquisition of financial assets by any securitisation company or

reconstruction company from any originator, whether by raising of funds by such securitisation company or reconstruction company from qualified institutional buyers by issue of security receipts representing undivided interest in such financial assets or otherwise; This is yet another important definition which helps us to understand as to who is authorized to carry out securitisation<sup>3</sup>.

### ***Resolution of Dispute:***

Resolution of disputes: Where any dispute relating to securitisation or reconstruction or non-payment of any amount due including interest arises amongst any of the parties, namely, the bank, or financial institution, or securitisation company or reconstruction company or qualified institutional buyer, such dispute shall be settled by conciliation or arbitration as provided in the Arbitration and Conciliation Act, 1996 (26 of 1996), as if the parties to the dispute have consented in writing for determination of such dispute by conciliation or arbitration and the provisions of that Act shall apply accordingly<sup>4</sup>.

This section promotes for alternative resolution dispute mechanisms and thereby reduces the burden on the tribunals.

### ***Powers of Reserve Bank:***

- The Reserve Bank is empowered to determine policy and issue directions.
- The Reserve Bank is empowered to call for statements and information.
- The Reserve Bank of India is empowered to carry out audit and inspection.

### ***Measures for assets reconstruction:***

Without prejudice to the provisions contained in any other law for the time being in force, a securitisation company or reconstruction company may, for the purposes of asset reconstruction, having regard to the guidelines framed by the Reserve Bank in this behalf,

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<sup>3</sup> The SARFASESI (The Securitisation and Reconstruction of Financial Assets and enforcement of Security Interest Act, 2002).

<sup>4</sup> The SARFASESI (The Securitisation and Reconstruction of Financial Assets and enforcement of Security Interest Act, 2002).

provide for any one or more of the following measures, namely:

- (a) the proper management of the business of the borrower, by change in, or takeover of, the management of the business of the borrower;
- (b) the sale or lease of a part or whole of the business of the borrower;
- (c) rescheduling of payment of debts payable by the borrower;
- (d) enforcement of security interest in accordance with the provisions of this Act;
- (e) settlement of dues payable by the borrower;
- (f) taking possession of secured assets in accordance with the provisions of this Act<sup>5</sup>.

The Act provides for the following other notable features:

- The Reserve Bank of India registers and regulates the Asset Reconstruction Companies (ARCs).
- The Chief Metropolitan Magistrate or District Magistrate are authorized to assist secured creditor in taking possession of secured asset.
- Facilitating securitization of financial assets of banks and financial institutions with or without the benefit of underlying securities.
- By issuing bonds, debentures, or any other security in the form of a debenture, the ARC encourages the seamless transferability of financial assets in order to purchase financial assets from banks and financial organisations.
- Entrusting the Asset Reconstruction Companies to sell security receipts to approved customers in order to raise money.

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<sup>5</sup> The SARFAESI (The Securitisation and Reconstruction of Financial Assets and enforcement of Security Interest Act, 2002).

- Facilitating the reconstruction of financial assets which are acquired while exercising powers of enforcement of securities or change of management or other powers which are proposed to be conferred on the banks and financial institutions.
- Introducing any asset reconstruction or securitization firm that is registered as a public financial institution with the Reserve Bank of India.
- 'Security interest' is defined as any sort of security, including a mortgage and a change of ownership on real estate, offered in exchange for the timely return of financial aid provided by any bank or financial organisation.
- Designating the borrower's account as a non-performing asset in accordance with the guidelines or instructions published from time to time by the Reserve Bank of India.
- According to the guidelines established by the Central Government, the authorised officers will exercise the rights of a secured creditor in this matter.
- An appeal against the action of any bank or financial institution to the concerned Debts Recovery Tribunal and a second appeal to the Appellate Debts Recovery Tribunal.
- For the purpose of registering securitization, asset reconstruction, and security interest creation transactions, the Central Government may establish or cause the establishment of a Central Registry.
- Applicability of the proposed legislation firstly to banks and other financial institutions, with the Central Government given the authority to expand its applicability to other corporations and non-banking financial institutions.
- Non-application of the proposed legislation to security interests in agricultural lands, loans less than rupees one lakh and cases where eighty per cent, of the loans, is repaid by the borrower<sup>6</sup>.

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<sup>6</sup>Sarfaesi Act, 2002, applicability, objectives, process, documentation, cleartax.in, available at: <https://cleartax.in/s/sarfaesi-act-2002>, last seen on 25/04/2022.



Thus are the notable features of the SARFAESI (The Securitisation and Reconstruction of Financial Assets and enforcement of Security Interest Act, 2002).

### **III. Debt Recovery Tribunal:**

For the swift adjudication and recovery of debts owed to banks and financial institutions, insolvency resolution, bankruptcy of individuals and partnership firms, and related matters, the RDB Act, 1993, establishes Debts Recovery Tribunals (DRTs) with original jurisdiction and Debts Recovery Appellate Tribunals (DRATs) with appellate jurisdiction. While not discouraging borrowers, the Act seeks to protect the interests of banks and other financial institutions as lenders. Because the corresponding provisions have not yet come into effect, the Tribunals have not yet started taking on bankruptcy and insolvency resolution cases. The Act is applicable in situations where the total sum owed to any bank, financial institution, or group of banks or financial institutions as defined by the Act is Rs. 20 lakh or more. The SARFAESI Act of 2002 was intended to control the securitization, reconstruction, and enforcement of financial assets as well as to establish a central database of security interests based on property rights and related issues. The Act has made it easier for banks and other designated financial institutions to collect secured debts from borrowers without the involvement of the courts in the initial stages. The Debts Recovery Appellate Tribunals (DRATs) have appellate jurisdiction over such petitions. Borrowers may bring claims in the Debts Recovery Tribunals (DRTs) against actions taken for the enforcement of security interests under this Act. The Act is applicable in situations when a security interest is used to guarantee the repayment of any financial asset and the amount owed is 20% or more of the principle amount plus interest and exceeds Rs. 1 lakh. Any security interest created in agricultural land and in certain properties that are exempt from attachment under specific Acts is not covered by the Act<sup>7</sup>.

### **IV. Case Laws:**

#### **1. *Balkrishna Rama Tarle (Dead) thr LRS& Anr v Phoenix ARC Pvt. Ltd. and Ors.***

The Hon'ble Supreme Court upheld decision of Division Bench of Bombay High Court in which the Bench listed Do's and Don'ts for action under Section 14 of SARFAESI. Hon'ble Supreme Court held that the powers exercisable by CMM/DM under Section 14 of the

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<sup>7</sup> Debts Recovery Tribunals (DRTs), [drt.gov.in](https://drt.gov.in), available at: <https://drt.gov.in/front/actrules.php>, last seen on 25/04/2023.

SARFAESI Act are ministerial step and Section 14 does not involve any adjudicatory process qua points raised by the borrowers against the secured creditor taking possession of the secured assets. In that view of the matter once all the requirements under Section 14 of the SARFAESI Act are complied with/satisfied by the secured creditor, it is the duty cast upon the CMM/DM to assist the secured creditor in obtaining the possession as well as the documents related to the secured assets even with the help of any officer subordinate to him and/or with the help of an advocate appointed as Advocate Commissioner. At that point, the CMM/DM is not required to adjudicate any dispute regarding the secured assets between the borrower and the secured creditor, or between any other third party and the secured creditor. Instead, the aggrieved party is left to voice their concerns during the Debt Recovery Tribunal proceedings under Section 17 of the SARFAESI Act<sup>8</sup>.

## 2. *Bajrang Shyamsundar Agarwal v Central Bank of India Anr.*

According to the Hon'ble Supreme Court, if a secured asset is lawfully in the possession of a lessee under a valid lease instead of the borrower, the secured creditor cannot seize the asset until the lessee's lawful possession is determined. Only after the CMM/DM finds that the lease is determined can he issue an order for delivery of possession of the secured asset in favour of the secured creditor. If CMM/DM determines that no valid lease existed before or after the creation of the mortgage, he may issue an order directing the delivery of possession of secured asset. It is submitted, rightful tenants must be respected in appropriate case and cannot be compromised under SARFAESI Act proceedings. In case of unregistered or oral agreement accompanied by delivery of possession tenant is not entitled to possession of secured asset for more than period prescribed under S. 107 OF T.P. Act<sup>9</sup>.

## 3. *Phoenix Arc (P) Ltd v Vishwa Bharati Mandir:*

The maintainability of a writ suit under Article 226 of the Indian Constitution against an asset reconstruction firm and the issuance of temporary orders protecting secured creditors' rights were the issues before the Hon'ble Court. The Honourable Court ruled that temporary orders

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<sup>8</sup> Important Supreme Court and High Court Judgments of 2022 on SARFAESI Act, 2002/Recovery of Debts and Bankruptcy Act 1993, [ibclaw.in](https://ibclaw.in/important-supreme-court-and-high-court-judgments-of-2022-on-sarfaesi-act-2002-recovery-of-debts-and-bankruptcy-act-1993/), available at: <https://ibclaw.in/important-supreme-court-and-high-court-judgments-of-2022-on-sarfaesi-act-2002-recovery-of-debts-and-bankruptcy-act-1993/>, last seen on 25/04/2023.

<sup>9</sup> SARFAESI Act, [livelaw.in](https://www.livelaw.in/articles/sarfaesi-act-2002-insertion-of-section-17-4a-by-way-of-amendment-act-of-2016-its-implication-on-rights-of-tenant-under-tenancy-law-226955), available at: <https://www.livelaw.in/articles/sarfaesi-act-2002-insertion-of-section-17-4a-by-way-of-amendment-act-of-2016-its-implication-on-rights-of-tenant-under-tenancy-law-226955>, last seen on 25/04/2023.

halting or curtailing the SARFAESI Act's proceedings cannot be made, particularly where considerable sums of money are at stake. The court further ruled that because ARC is a private financial institution and cannot be created to carry out public functions that are often expected to be carried out by state authorities, writ petitions against such entities cannot be maintained. It was determined that submitting writ petitions amounted to an abuse of the legal system, and consequently, temporary orders in favour of borrowers were revoked<sup>10</sup>.

## **VI. Conclusion:**

In case of *Mardia Chemicals Ltd v UOI*, it was held that, Given the extent of indebtedness and non-performing assets (NPAs) on the balance sheets of petitioners and other industries, the length of time required for debt recovery through civil courts, the significance of liquid and solvent banks and financial institutions to economic progress, particularly in the modern global economy with a need to give up outdated and conventional methods of financing and debt recovery, and the 1993 Act's failure to bring out desired results, it could not be said that step taken towards securitisation of debts and to evolve faster recovery of NPAs was not called for. The act was enacted only after due consideration of issues<sup>11</sup>. This highlights the need of the SARFAESI Act for boosting up economy and to enable the banks with effective securitisation. In this age of commercialization and greed to maximize wealth, people turn fugitive offenders and their accounts turn non-productive assets leaving banks and economy in lurch, more stringent and robust rules should be enacted to prevent non-performance of assets!

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<sup>10</sup>Landmark judgments on banking laws 2022, [scconline.com](https://www.scconline.com), available at: <https://www.scconline.com/blog/post/2023/03/22/landmark-judgments-on-banking-laws-2022-part-i/>, last seen on 25/04/2023.

<sup>11</sup> The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, (12<sup>nd</sup> ed., 2022).

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8. The Securitisations and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, (12<sup>nd</sup> ed., 2022).