

Act set to boost recovery of non-performing assets

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The Indian financial sector recently received a fillip with the enactment of the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act, 2012. The act aims to remove some bottlenecks observed in the existing regulatory framework for recovery of non-performing assets (NPAs), namely the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDB Act), and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act).

This article describes some of the key measures introduced by the 2012 act.

Co-operative gains

The act includes multi-state co-operative banks (MSCBs) within the ambit of "bank" as defined by the RDB and the SARFAESI acts. This amendment was required in light of a contrary ruling by the Supreme Court of India in *Greater Bombay Co-operative Bank Limited v MS United Yarn Textiles Private Limited*.

In addition to the remedies available under the Multi-State Co-operative Societies Act, 2002, MSCBs now have the option of initiating recovery proceedings before the Debt Recovery Tribunal (DRT), a tribunal constituted under the RDB Act especially for recovery of debt, as well as proceedings under the SARFAESI Act. This measure could also provide a stimulus to asset reconstruction, as MSCBs may now assign NPAs to asset reconstruction companies (ARCs).

Conversion option

ARCs are now permitted to convert any portion of acquired debt component into shares of the borrower

company. This measure could permit ARCs to have a greater say in the borrower's management, and allow a profitable exit in the event of a successful turnaround. Borrowers are also likely to benefit from being freed from the burden of debt servicing, enabling them to devote resources for productive purposes. The rules governing the nitty-gritty details of such conversion are currently awaited.

However, such a recovery strategy entails belief in the fundamentals of the borrower, as conversion may, in the short term, result in a plunge in the market value of the borrower's equity. Further, the conversion of the entire debt amount into equity would result in the loss of the status of a secured creditor and the accompanying rights and privileges, including no longer having a first charge in the event of liquidation or asset sale of the company.

Property rights

Secured creditors seeking recovery of NPAs through public auction of secured assets are sometimes frustrated due to failure to obtain the reserve price from bidders. The 2012 act enables the creditor to acquire the property in its own name in this event, with the outstanding debt duly adjusted to the extent of the acquisition price. This would particularly aid creditors in situations where there is a possibility that the auction process may have been compromised by parties acting in collusion with, or at the behest of, the borrower.

This change is a permitted exception to the general restriction that prevents banks from acquiring immovable property. However, the amendment is subject to the terms of the Banking Regulation Act, 1949, which requires that such property, acquired otherwise than for a bank's own use, be disposed of within seven

years or such extended period as permitted by the Reserve Bank of India.

Ironing out creases

Over the years, certain procedural bottlenecks were observed in the RDB and SARFAESI acts, which the legislature has sought to redress in the 2012 act. For example, the process for substitution of the original debtor by the acquiring party in any matters pending before the DRT or the Debt Recovery Appellate Tribunal (DRAT) has been streamlined by providing for an application mechanism, to be filed by the acquirer before the applicable tribunal.

Dilatory tactics of borrowers are also sought to be curbed by limiting the number of adjournments which may be sought by parties during recovery proceedings to three each. Additionally, the borrower's written statement in defence is now required to be submitted within 30 days, which may only be relaxed in exceptional circumstances.

To clamp down on *ex parte* orders in favour of borrowers, the 2012 act contemplates the lodging of caveats by secured creditors so as to ensure that they have an adequate opportunity to represent themselves in proceedings before the DRT, the DRAT, or district and high courts of India.

The act also provides for the registration of securitization transactions under a central registry, which would help ensure a comprehensive database accessible to financial institutions and facilitate the detection of fraud. Thus, the act has introduced several commendable measures to aid the efficient recovery of loans and lower NPAs.

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