Securitisation & Reconstruction of Financial Assets

A critical Analysis

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Critical Evaluation of the Securitisation Law

1. **Regulation of Securitisation And Reconstruction Of Financial Assets Of Banks And Financial Institution**

- **Registration of securitisation companies or reconstruction companies**

  No securitisation company or reconstruction company shall commerce carry on the business of securitisation or asset reconstruction without------

  a. obtaining a certificate of registration granted under this section; and

  b. having the owned fund of not less than two crore rupees or such other amount not exceeding fifteen per cent of total financial assets acquired or to be acquired by the securitisation company or reconstruction company as the Reserve Bank may, by notification, specify:

  Provided that the Reserve Bank may, by notification, specify different amount of owned fund for different class or classes of securitisation companies or reconstruction companies:

  Provided further that securitisation company or reconstruction company, existing on the commencement of this Ordinance, shall make an application for registration to the Reserve Bank before the expiry of six months from such commencement

- **Cancellation of certificates of regulation.** The Reserve Bank may cancel a certificate of registration granted to a securitisation company or a reconstruction company, if such company -

  a. cases to carry on the business of securitisation or asset reconstruction; or

b. cases to receive or hold any investment from a qualified institutional buyer; or

c. has failed to comply with any conditions subject to which the certificate of registration has been granted to it; or

d. at any fails to fulfill any of the conditions referred to it in clause (a) to (g) of sub-section (3) of section 3; or

e. fails to----

(i) comply with any direction issued by the Reserve Bank under the provisions of this Ordinance; or

(ii) Maintain account in accordance with the requirement of any law or any direction or order issued by the Reserve Bank under the provisions of this Ordinance; or

(iii) submit or offer for inspection its books of account or other relevant document when so documended by the Reserve Bank; or

(iv) obtain prior approval of the Reserve Bank required under sub-section (6) of section 3:

- **Acquisition of right or interest in financial assets .**Notwithstanding anything contained in any agreement or any other law for the time being in force, any securitisation company or reconstruction company may acquire financial asset of any bank or financial institution-------

a. by issuing a debenture or bond or any other security in the nature of the debenture, for consideration agreed upon between such company and the bank; or

b. by entering into an agreement with such bank or financial institution for the transfer of such financial asset to such company on such terms and conditions as may be agreed upon between them.

If the bank or financial institution is a lender in relation to any financial asset acquired under sub-section(1) by the securitisation company or the reconstruction company, such securitisation company or reconstruction company shall, on such acquisition be deemed to be the lender and all right of such bank or financial institution shall vest in such company in relation to such financial assets.

- Issues with regard to Stamp Duty chargeable for transfer of assets from the originators to the Asset Reconstruction Company (ARC), has not been addressed in the Act. The Stamp Duty is a state subject; it would require initiatives from the respective state governments. As a matter of fact, these banking assets should be exempted from the levy of Stamp Duty.
- The transfer of assets mortgaged by a borrower attracted high stamp duty, varying from 7 per cent in some states to even 12 per cent. The stamp duty will be imposed at two stages- firstly, while transferring the assets from the ARCs and secondly, from ARCs to final buyer. If this happens, the basic objective of setting up ARCs would then be defeated. There is a need to clarify this issue. Also there is a need to reduce stamp duty rates and make it uniform across all states.

- **Issue of security by rising of receipt or funds by securitisation company or reconstruction company**

Any securitisation company or reconstruction company, may, after acquisition any financial asset under sub-section (1) of section 5, offer security receipts to qualified institutional buyers (other than by offer to public) for subscription in accordance with the provisions of those Acts.

A securitisation company or reconstruction company may rise funds from the qualified institutional buyers by formulating schemes for acquiring financial asset and shall keep maintain separate and distinct accounts in respect of each such scheme for every financial asset acquired out of investment made by a qualified institutional buyer and ensure that realisation of such financial asset held and applied towards redemption of investments and payment of returns assured on such investments under the relevant scheme.

2. Enforcement Of Security Interest

Any security interest created in favour of any secured creditor may be enforced, without the intervention of court or tribunal

Where any borrower, who is under a liability to a secured creditor under a security arrangement, makes any default in repayment of secured debt or any instalment thereof, and his account in respect of such debt is classified by the secured creditor as non-performing asset ,then, the secured creditor may require the borrower by notice in writing to discharge in full his liabilities to the secured creditor shall be entitled within sixty days from the date of notice failing which the secured creditor shall entitled to exercise all or any of the rights

The notice shall give details of the amount payable by the borrower and the secured assets intended to be enforced by the secured creditor in the event of non payment of secured debts by the borrower.

In case the borrower fails to discharge his liability in full within the period specified, the secured creditor may take recourse to one or more the following the measures to recover his secured debt namely: -

a. take procession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset;

b. take over the management of secured asset of the borrower including right to transfer by way of lease assignment or sale and realise the secured asset;

c. appoint any person, to managed the secured asset the possession of which has been taken over by the secured asset;

d. require at any time by notice in writing any person who has acquired any of the secured asset from the borrower and from whom any money is due or may become due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.

Where any action has been taken against a borrower, all costs, charge and expenses which, in the opinion of the secured creditors, have been properly incurred by him or any expenses incidental thereto, shall be recoverable from that borrower and the money which is received by the secured creditor shall, in the absence of any contract to the contrary , be held by him in trust to be applied, firstly, in payment of such costs, charges and expenses and secondly, in discharge of the dues of the secured creditor and the reduced the money so received shall be paid to the person entitled thereto in accordance with his rights and interests.

If the dues of the secured creditor together with all costs, charge and expensed incurred by him are tendered to the secured creditor at any time before the date fixed for sale or transfer, the secured asset shall not be sold or transferred by the secured creditor, and no further step shall be taken by him for transfer by him for transfer or sale of that secure asset.

In the case of financing of a financial asset by more than one secured creditors or joint financing of a financial asset by secured creditors. No secured creditor shall be entitled to excise any or all of the right unless exercise of such right agreed upon by the secured creditors, representing not less than three- fourth in value of the amount outstanding as on all the secured creditors:

In the case of a company in liquidation, the realised from the sale of secured asset shall be distributed in accordance with the provisions of section 529 A of the Companies Act, 1956. The secured creditor of such company, who opts to realise his security instead of relinquishing his security and proving his debt under provision to sub-section (1) of section 529 of the companies Act, 1956, may retain the sale proceeds of his secured asset after depositing the workmen's dues with the liquidator in accordance with the provisions of section 529A of that Act:

Where dues of the secured creditor are not fully satisfied with the sale proceeds of the secured asset, the secured creditor may file an application in the form and manner as may be prescribed to the Debts Recovery Tribunal having jurisdiction or a competent court, as the case may be, for recovery of the balance amount from the borrower.

Without prejudice to the right conferred on the secured creditor under or any this section, secured creditor shall be entitled to process against the guarantors or sell the pledged asset without first taking any of the measured specified in clause (a) to (d) of sub-section (4) in relation to the secured asset.

No borrower shall after receipt of notice , transfer by way of sale, lease or otherwise (other than in the ordinary course of his business) any of his secured asset referred to in the notice, without prior written consent of secured creditor.

- According to RBIs definition, an asset is considered as:
  1. 'Non-Performing' in case if interest or installments of principal or both remain unpaid for more than 180 days.
  2. An advance is to be classified as 'Substandard' if it remains an NPA up to a period of 18 months.
  3. It will be classified as 'Doubtful' if it remains NPA for more than 18 months.
  4. An account is classified as 'Loss', without any waiting period, where the dues are considered uncollectible or only marginally collectible.

  All three categories cannot and should not be treated at par. The Act gives an impression that as soon as the asset becomes Non-Performing, irrespective of the category it falls under, would get similar treatment.

- **C**
  hief Metropolitan Magistrate or District Magistrate to assist secured creditor in talking possession

Where the procession of any secured asset is required to be taken by the secured creditor or if any of the secured assets is required to be sold or transferred by the secured creditor under the provisions of this ordinance, the secured creditor may, for the purpose of taking procession or control of any such secured asset, request, in writing, the Chief Metropolitan Magistrate, or the District Magistrate within whose jurisdiction any such secured asset or other asset or the documents relating thereto may be situated or found to take procession thereof and the Chief Metropolitan Magistrate or as the case may be the District Magistrate shall, on such request being made to him -

a. take possession of such asset and documents relating thereto; and

b. forward such asset and documents to the secured creditor.

- **Manner and effect of takeover of management**

When the management of business of a borrower is taken over by the secured creditor, the secured creditor may, by publishing a notice in a news paper published in English language and in a newspaper published in an Indian language in circulation in the place where the principal office of the borrower is situated, appoint as many person as it think fit -

(a) in case where the borrower is a company as defined in the Companies Act, 1956, to be the directors of that borrower in accordance with the provisions of that Act; or

(b) in any other case, to be the administrator of the business of the borrower.

On publication of a notice,-

a. in any case where the borrower is a company as defined in the Companies Act, 1956, all person holding offices as directors of the company and in any other case, all person holding any offices having powered of superintendence, direction and control of the business of the borrower immediately before the publication of the notice, shall be deemed to have vacated their offices as such;

b. any contract of management between the borrower and any director or manager thereof holding offices as such immediately before publication of the notice, shall be deemed to be terminated;

c. the director or the administrators appointed under this section shall take such steps as may be necessary to take into their custody or under their control all the property and effects and actionable claims to which the business of the borrower is, or appears to be, entitled and all the property and effect of the business of the borrower shall be deemed to be in the custody of the directors or administrators, as the case may be as form the date of the publication of the notice;

d. the directors appointed under this section shall, for all purpose, be the directors of the company of the borrower and such directors or as the case may be, the administrators appointed under this section, shall alone be entitled to exercise all the powers of the directors or as the case may be, of the persons exercising powers of superintendence, director and control, of the business of the borrower whether such powers are derived from the memorandum or articles of association of the company of the borrower or form any other source whatsoever.

Where the management of the business of a borrower, being a company as defined in the Companies Act, 1956, is taken over by secured creditor, then notwithstanding anything contained in the said Act, or in the memorandum or articles of association of such borrower, ---

a. it shall not be lawful for the shareholders of such company or any other person to nominate or appoint any person to be a director of the company;

b. no resolution passed at any meeting of the shareholders of such company shall be given effect to unless approved by the secured creditor;

c. no proceeding for the winding up of such company or for the appointment of a receiver in respect thereof shall lie in any court, except with the consent of the secured creditor.

Where the management of the business of a borrower had been taken over by the secured creditor shall, on relation of his debt in full restore the management of the business of the borrower to him.

- **No compensation to directors for loss of office.** Notwithstanding anything to the contrary contained in any contract or in any other law for the time being in force, no managing director or any other director or a manager or any person in charge of management of the business of the borrower shall be entitled to any compensation for the loss of office or for the premature termination under this Ordinance of any contract of management of entered into by him with the borrower.

  Nothing contained in sub-section (1) shall affect the right of any such managing director or any other director or manager of any such person in charge of management to recover from the business of the borrower moneys recoverable otherwise than by way of such compensation.

- **Right to appeal**

  Any person (including borrower) aggrieved by any of the measures referred to in sub-section (4) of section 13 taken by the secured creditor or his authorised officer under this chapter, may prefer an appeal to the Debts Recovery Tribunal having jurisdiction in the matter within forty-five days from the date on which such measures had been taken.

  Where a borrower prefers an appeal, such appeal shall not be entertained by the Debts Recovery Tribunal unless the borrower has deposited with the debts Recovery Tribunal seventy-five per cent. of the amount claimed in the notice provided that the Debts Recovery Tribunal may, for reasons to be recorded in writing waive or reduce the amount to be deposited under this section.

- **Appeal to appellate Tribunal**

  Any person aggrieved by any order by the Debts Recovery Tribunal may prefer an appeal to an Appellate Tribunal within thirty days from the date of receipt of the order of Debts Recovery Tribunal.

- **Right of borrower to receive compensation and costs in certain cases**

  If the debts Recovery Tribunal or the Appellate Tribunal as the case may be, on an appeal filed under section 17 or section 18, holds possession of secured asset by the secured creditor as wrongful and directs the secured creditor to return such secured asset to the concerned borrower, such borrower shall be entitled to payment of such compensation and costs as may be determined by such Tribunal or Appellate Tribunal.

3. **<u>Central Registry</u>**

- The Central Government may by notification, set up or cause to be set up from such date as it may specify in such notification, a registry to be non as the central Registry with its own seal for the purpose of registration of transaction of securitisation or reconstruction of financial asset and creation of security interest under this Ordinance.

The head office of the central registry shall be such place as the Central Government may specify and for the purpose of facilitating registration of transaction to in sub-section (1), there may be established at such other places as the Central Government may think fit, branch offices of the Central Registry.

The Central Government may, by notification, appoint a person for the purpose of registration of transactions relating to securitisation, reconstruction financial asset, and security interest created over properties, to be known as the Central Registrar.

- **Register of securitisation, reconstruction and security interest, transaction .** For the purpose of this Ordinance, a record called the Central Register shall be kept at the head office of the Central Registry for entering the particulars of the transaction relating to---

    a. securitisation of financial asset;

    b. reconstruction of financial asset; and.

    c. Creation of security interest

  The register shall be kept under the control and management of the Central Registrar

- **Filling of transaction of securitisation, reconstruction and creation of security interest**

  The particular of every transaction of securitisation, asset reconstruction or creation of security interest shall be filed, with the Central Registrar in the manner and on payment of such fees as may be prescribed, within thirty days after the case of such transaction or creation of security, by the securitisation company or reconstruction company or the secured creditor, as the case may be:

  Provided that the Central Registrar may allow the filling of the particulars of such transaction or creation of security within thirty days next following the expiry of the said period of thirty days on payment of such additional fees not exceeding ten times the amount of such fee.

- The Act provides for creating a central registry to record the particulars of transactions related to Securitisation and Reconstruction of Financial Assets and creation of Security Interest including electronic record of the same. It has not been clarified whether this registration would exempt ARCs and securitization companies for filing particulars with State Registry simultaneously.

4. Offences and Penalties

- **Penalties.** If a default is made -

  a. in filling under section 23, the particulars of every transaction of any securitisation or asset reconstruction or security interest created by a securitisation or reconstruction company or secured creditors; or

  b. in sending under section 24, the particulars of the modification referred to in that section; or

  c. in giving intimation under section 25,

  every company and every officer of the company or the secured creditor and every officer of the secured creditor who is default shall be punishable with fine which may extend to five thousand rupees for every day during which default countries.

5. Miscellaneous

- **Provisions of this Ordinance not to apply in certain cases.** The provisions of this ordinance shall not apply to—

a. a lien on any goods, money or security given or under the Indian Contract Act, 1872 or the sale of goods Act,1930, or any other law for the time being in force;

b. a pledge of movable within the meaning of section 172 of the Indian Contract Act, 1872;

c. creation of any security in any as defined in clause (1) of section 2 of the Aircraft Act, 1934;

d. creation of security interest in any vessel as defined in clause (55) of section 3 of the Merchant Shipping Act, 1958;

e. any conditional sale, hire-purchased or lease or any other contract in which no security interest has been created;

f. any right of unpaid seller under section 47 of the Sale of Goods Act, 1930;

g. any properties not liable to attachment or sale under the proviso to sub-section (1) of section 60 of the code of Civil Procedure, 1908;

h. any security interest for securing repayment of any financial asset not extending one lakh rupees;

i. any security interest created in agricultural land;

j. any case in which the amount due is less than twenty per cent of the principal amount and interest thereon .

- **The provisions of this ordinance to override other laws.** The Provisions of this Ordinance shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law.

- There seems to be no logic for exempting borrowers u/s 31 of the Act, when amount due is less than 20% of principal and interest due thereon, is not understandable.

- The scope of the act is limited. The provisions of the act do not cover small loans up to Rs1,00,000 and unsecured loans. Security interest of the banks in agricultural lands is also not covered. The secured loans are estimated to be just 30-35% of the banking industry.

- The extent to which a secured creditor can proceed against a third party acquirer of Secured Assets from the borrower has not been adequately addressed in the Act. It may lead to legal complexities with third parties and the Secured Creditors.
- The pricing of NPAs is a critical issue. There are just two ways in which one can fix the price at which an NPA gets sold to an ARC: at book value, or according to what the market can bear. The former is good for the bank but could mean huge losses for the ARC. By and large no ARC would be willing to take bad debts at book value. Book value transfers would shift losses from the banks to the ARCs. The other option of transferring at realistic market prices which are discounts to book value- though sounds good are difficult for banks to accede to. The experience of Malaysia shows that for the bulk of the NPAs, the average discount rate applied by Danaharta (an ARC) has been almost 48%. The sale of NPAs by some of our financial institutions to the proposed ARC at such discounts will create a hole in their balance sheet. Banks will have to bear the burden of losses on the sale of these assets.
- so. As a result, there will be vacuum resulting in loss/hardship to employees, government and the economy as a whole. The value and quality of secured assets may also suffer due to compulsory shut down of units in such circumstances.
- The requirement of depositing 75% of the claim amount with the DRT along with the appeal is unreasonable and unjustified. In case, the management had such funds with them, they would have paid the same to the secured creditors and settled the claim there itself.

- Section 13(4) provides for management of Secured Assets only. Where a company has hundreds of assets, the management of isolated assets is how far feasible is difficult to decide and the Act is silent on this point.
- In case of sale of seized assets, the seller and the beneficiary will be the same. The sale of secured assets by banks at value enough to cover their dues would be adequately self serving, but may appear to be unfair to the stakeholders.
- In case of management control over the business of the defaulters, the Secured creditor will have effective control over the unsecured assets of the borrower as well, which contravenes the stipulated intent of the Act.
- It will be difficult for banks to sell distressed assets as there might be few takers for such assets. Auctions may turn out to be a farce.
- In case of certain specific industries where an industrial license, specific government approval or permission or special rights like mining lease etc., is issued in the name of the borrowing company, will such license/approval/permission be automatically transferred to the name of the buyer/bank or not?
- Will intangible assets like patents, brands, goodwill be deemed to be automatically transferred to the banks/buyers and defaulter won't have any right, title or interest in such assets, once he has been divested of the secured assets charged to the bank.
- There seems to be no logic for exempting borrowers u/s 31 of the Act, when amount due is less than 20% of principal and interest due thereon, is not understandable.

THE SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST LAW, 2002 (Act # 54 of '02)

Statement of Objects and Reasons

The financial sector has been one of the key drivers in India's efforts to achieve success in rapidly developing its economy. While the banking industry in India is progressively complying with the international prudential norms and accounting practices, there are certain areas in which the banking and financial sector do not have a level playing field as compared to other participants in the financial markets in the world. There is no legal provision for facilitating securitisation of financial assets of banks and financial institutions. Further, unlike international banks, the banks and financial institutions in India do not have power to take possession of securities and sell them. Our existing legal framework relating to commercial transactions has not kept pace with the changing commercial practices and financial sector reforms. This has resulted in slow pace of recovery of defaulting loans and mounting levels of non-performing assets of banks and financial institutions. Narasimham Committee I and II and Andhyarujina Committee constituted by the Central Government for the purpose of examining banking sector reforms have considered the need for changes in the legal system in respect of these areas. These Committees, inter alia, have suggested enactment of a new legislation for securitisation and empowering banks and financial institutions to take possession of the securities and to sell them without the intervention of the court. Acting on these suggestions, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Law, 2002 was promulgated on the 21st June, 2002 to regulate securitisation and reconstruction of financial assets and enforcement of security interest and for matters connected therewith or incidental thereto. The provisions of the Law would enable banks and financial institutions to realise long-term assets, manage problem of liquidity, asset liability mismatches and improve recovery by exercising powers to take possession of securities, sell them and reduce non-performing assets by adopting measures for recovery or reconstruction.

2. It is now proposed to replace the Law by a Bill, which, inter alia, contains provisions of the Law to provide for--

(a) Registration and regulation of securitisation companies or reconstruction companies by the Reserve Bank of India;

(b) Facilitating securitisation of financial assets of banks and financial institutions with or without the benefit of underlying securities,

(c) Facilitating easy transferability of financial assets by the Securitisation Company or Reconstruction Company to acquire financial assets of banks and financial institutions by issue of debentures or bonds or any other security in the nature of a debenture,

(d) Empowering securitisation companies' or reconstruction companies to raise funds by issue of security receipts to qualified institutional buyers;

(e) Facilitating reconstruction of financial assets acquired by 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;

(f) Declaration of any securitisation company or reconstruction company regis-tered with the Reserve Bank of India as a public financial institution for the purpose of section 4A of the Companies Act, 1956;

(g) Defining 'security interest' as any type of security including mortgage and change on immovable properties given for due repayment of any financial assistance given by any bank or financial institution;

(h) Empowering banks and financial institutions to take possession of securities given for financial assistance and sell or lease the same or take over management in the event of default, i.e. classification of the borrower's account as non-performing asset in accordance with the directions given or under guidelines issued by the Reserve Bank of India from time to time;

(i) The rights of a secured creditor to be exercised by one or more of its officers authorised in this behalf in accordance with the rules made by the Central Government;

(j) 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;

(k) Setting up or causing to be set up a Central Registry by the Central Government for the purpose of registration of transactions relating to securitisation, asset reconstruction and creation of security interest;

(l) Application of the proposed legislation initially to banks and financial institutions and empowerment of the Central Government to extend the application of the proposed legislation to non-banking financial companies and other entities;

(m) Non-application of the proposed legislation to security interests in agricultural lands, loans not exceeding rupees one lakh and cases where eighty per cent, of the loans are repaid by the borrower.

2. The Bill seeks to achieve the above objects.

Preamble

AN ACT to regulate securitisation and reconstruction of financial assets and enforcement of security interest and for matters connected therewith or incidental thereto, be it enacted by Parliament in the Fifty-third Year of the Republic of India as follows:

NOW THEREFORE, in exercise of the powers conferred by clause (1) of article 123 of the Constitution, the president is pleased to promulgate the following Law: -

Chapter I

PRELIMINARY

1. Short title extent and commencement:
(1) This Law may be called the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Law, 2002
(2) It extends to the whole of India.
(3) It shall come in to force at once. (21st June 2002)

2. Definition (1) In this Law, unless the context otherwise requires, -

(a) "Appellate Tribunal" means a Debts Recovery Appellate Tribunal established under sub-section (1) of section 8 of the Recovery of debts Due to Banks and Financial Institution Act. 1993;

(b)"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;

(c)"bank" means-
A banking company; or
A corresponding new bank; or
The State Bank of India; or
A subsidiary bank; or
Such other bank, which the Central Government may be notification, specify for the purpose of this Law;

(d) "Banking company" shall have the meaning assigned to it in clause (c) of section 5 of the Banking Regulation Act, 1949;

(e) "Board" means the Securities and Exchange Board of India Established under section 3 of the Securities and Exchange Board of India Act, 1992

(f) "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 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;

(g) "Central Registry" means the registry set up or cause to be set up under sub-section (1) of section 20;

(h) "Corresponding new bank" shall have the meaning assigned to it in clause (da) of section 5 of the Banking Regulation Act, 1949;

(i) "Debts Recovery Tribunal" means the Tribunal established under sub-section (1) of section 3 of the Recovery of Debts due to Banks and Financial Institution Act, 1993;

(j) "Default" means non-payment of any principal debt or interest thereon or any other 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 in accordance with the directions or guidelines issued by the Reserve Bank;

(k) "Financial assistance" means any loan or advance guaranteed or any debentures or bonds subscribed or any guarantees given or letters of credit established or any other credit facility extends by any bank or financial institution;

(l) "Financial asset" means debt or receivables and includes;
A claim to any debt or receivables or part thereof whether secured or unsecured; or
Any debt or receivables secured by, mortgage of, or charge on, immovable property; or
A mortgage, charge hypothecation or pledge of movable property; or
Any right or interest in the security, whether full or part underlying such debt or receivables; or
Any beneficial interest in property whether movable or immovable, or in such debt, receivables, whether such interest is existing, future, accruing, conditional or contingent; or
Any financial assistance;

(m) "Financial institution" means-
A public financial institution within the meaning of section 4A of the Companies Act, 1956;
Any institution specified by the Central Government under sub-clause (ii) of clause (h) of section 2 of the Recovery of Debts Due to Banks and financial Institution Act, 1993;
International Finance Corporation established under the International Finance Corporation (Status, Immunities and Privileges) Act, 1958
Any other institution or non-banking financial company as defined in clause (f) of section 45-1 of the Reserve Bank of India Act, 1934, which the Central Government may, by notification, specify as financial institution for the purpose of this Law;

(n) "Hypothecation" means a change or in or upon any movable property, existing or future, created by a borrower in favour of secured creditor without delivery of procession of the movable property to such creditor, as a security for financial assistance and includes floating charge and crystallization of such charge into fixed charge on movable property;

(o) "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, in accordance with the direction or guidelines relating to asset classification issued by the Reserve Bank;

(p) "Notification" means a notification Published in the Official Gazette;

(q) " Obligor" means a person liable to the originator, whether under a contractor otherwise, to pay a financial asset or to discharge any obligation in respect of a financial asset, whether existing future, conditional or contingent and include the borrower;

(r) "Originator" means the owner of the financial asset, which is acquired by a securitisation company or reconstruction company for the purpose securitisation or asset reconstruction;

(s) "Prescribed" means prescribed by rules made under this Law;

(t) "Property" means-
Immovable property;
Movable property;
Any debt or any right to receive payment of money whether secured or unsecured;
Receivables, whether existing or future;
Intangible assets, being know-how patent copyright trademarks, license, franchise or any other business or commercial right of similar nature;

(u)"qualified institutional buyer" means a financial institution, insurance company, bank, state financial corporation, state industrial development corporation, trustee or any asset management company making investment on behalf of mutual fund or provident fund or gratuity fund or pension fund or a foreign industrial investor registered under the securities and Exchange Board of India Act, 1992 or regulation made there under, or any other body corporate as may be specified by the Board;

(v) “Reconstruction Company” means a company formed any registered under the companies Act, 1956 for the purpose of asset reconstruction;

(w) ‘Register of Companies" means the Register defined in clause (40) of section 2 of the Companies Act, 1956;

(x) "Reserve Bank" means the Reserve Bank of India constituted under section 3 of the Reserve Bank of India Act, 1934;

(y) "Scheme" means a scheme inviting subscription to security receipts proposed to be issued by a securitisation company under the scheme;

(z) "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;

(za) “Securitisation Company” means any company formed and registered under the Companies Act, 1956 for the purpose of securitisation;

(zb) "Security agreement" means an agreement, instrument or any other document or agreement under which security interest is created in favoured of the secured creditor including the creation of mortgage by deposit of title deeds with secured creditor;

(zc) "Secured asset" means the property on which securities interest is created;

(zd) "Secured creditor" means any bank or financial institution or any consortium or group of banks or financial institutions and includes-
Debenture trustee appointed by any bank or financial institution; or
Securitisation company or reconstruction company; or
Any other trustee holding securities on behalf on a bank or financial institution, in whose favour security interest is created for due repayment by any borrower of any financial assistance;

(ze) "Secured debt" means a debt, which is secured by any security interest;

(zf) "Security interest" means right title and interest of any kind whatsoever upon property created in favour of any secured creditor and includes any mortgage, charge, hypothecation, assignment other than those specified in section 31;

(zg) "security receipt" means a receipt or other security, issued by a security, issued by a securitisation company or reconstruction company to any qualified institutional buyer pursuant to a scheme, evidencing the purchase or acquisition by the holder thereof, an undivided right, title or interest in the financial asset involved in securitisation;

(zh) "sponsor" means any person holding not less than ten per cent of the paid up equity capital of a securitisation or reconstruction company;

(zi) "State Bank of India" means the State Bank of India constituted under section 3 of the state Bank of India Act, 1955;

(zj) "subsidiary bank" means shall have the meaning assigned to it in clause (k) of section 2 of the State Bank of India (Subsidiary Banks) Act, 1959;

(2) Words and expressions used and not defined in this Law but defined in the Indian Contract Act, 1872 or the transfer of property Act, 1882 or the Companies Act, 1956 or the securities and Exchange Board of India Act, 1992 shall have the same meaning respectively assigned to them in those Acts.

CHAPTER II

REGULATION OF SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS OF BANKS AND FINANCIAL INSTITUTION

3. (1) Registration of securitisation companies or reconstruction companies.

No securitisation company or reconstruction company shall commerce carry on the business of securitisation or asset reconstruction without------

obtaining a certificate of registration granted under this section; and
having the owned fund of not less than two crore rupees or such other amount not exceeding fifteen per cent of total financial assets acquired or to be acquired by the securitisation company or reconstruction company as the Reserve Bank may, by notification, specify:
Provided that the Reserve Bank may, by notification, specify different amount of owned fund for different class or classes of securitisation companies or reconstruction companies:

Provided further that securitisation company or reconstruction company, existing on the commencement of this Law, shall make an application for registration to the Reserve Bank before the expiry of six months from such commencement and notwithstanding anything contained in this sub-section may continue to carry on the business securitisation or asset reconstruction until a certificate of registration is granted to it or, as the case may be, rejection of application for registration is communicated to it.

(2) Every securitisation company or reconstruction company shall make an application for registration to the Reserve Bank in such form and manner as it may specify.

(3) The Reserve Bank may, for the purpose of considering the application for registration of a securitisation company or reconstruction company to carry on the business of securitisation or asset reconstruction, as the case may be require to satisfied, an inspection of records or books of such securitisation company or reconstruction company, or otherwise, that the following condition are fulfilled, namely:-
that the Securitisation Company or reconstruction company has not incurred losses in any of the three preceding financial years;
that such securitisation or reconstruction company has made adequate arrangement for realisation of the financial asset acquired for the purpose of securitisation or asset reconstruction and shall be able to pay periodical returns and redeem on respective due dates on the inv4estments made in the company by the qualified institutional buyers or other person;
that the directors of Securitisation Company or Reconstruction Company have adequate professional Experience in matters related to finance, securitisation and reconstruction;
that the board of directors of such securitisation company or reconstruction company does not consist of more than half of its total number of directors who are either nominees of any

sponsor or associated in any manner with the sponsor or associated in any manner with the sponsor or any of is subsidiaries;
that any of its directors has not been convicted of any offends involving moral turpitude;
that a sponsor of its directors is not holding company of the securitisation company or reconstruction company as the case may be, or does not otherwise hold any controlling interest in such securitisation company or reconstruction company;
that securitisation company or re construction company has complied with or is in a position to comply with the prudential norms specified by the Reserve Bank.

(4) The Reserve Bank may, after being satisfied that the condition specified in sub section (3) are fulfilled, grant certificate of registration to the securitisation company or the reconstruction company to carry on or commerce business of securitisation or asset reconstruction, subject to such conditions, which it may consider, fit to impose

(5) The Reserve Bank may reject the application made under sub-section (2) if it is satisfied that the condition specified in sub-section (3) are not fulfilled:
provided that before rejecting the application the applicant shall obtain prior a reasonable opportunity of being heard.

(6) Every Securitisation Company or reconstruction company shall obtain prior approval of the Reserve Bank for any substantial change in its management or change of location of its registered or change in its name:
Provided that the decision of the Reserve Bank, whether the change in management of a securitisation company or a reconstruction company is a substantial change in its management or not shall be final

Explanation- For the purpose of this section, the expression "substantial change in management by way of transfer of share or amalgamation or transfer of the business of the company.

4.(1) Cancellation of certificates of regulation. The Reserve Bank may cancel a certificate of registration granted to a securitisation company or a reconstruction company, if such company -
cases to carry on the business of securitisation or asset reconstruction; or
cases to receive or hold any investment from a qualified institutional buyer; or
has failed to comply with any conditions subject to which the certificate of registration has been granted to it; or
at any fails to fulfil any of the conditions referred to it in clause (a) to (g) of sub-section (3) of section 3; or
fails to----

(i) comply with any direction issued by the Reserve Bank under the provisions of this Law; or

(ii) Maintain account in accordance with the requirement of any law or any direction or order issued by the Reserve Bank under the provisions of this Law; or

(iii) submit or offer for inspection its books of account or other relevant document when so documented by the Reserve Bank; or

(iv) Obtain prior approval of the Reserve Bank required under sub-section (6) of section 3:

Provided that before cancelling a certificate of registration on the ground that the securitisation company or reconstruction company has to failed to comply with the provisions of clause (e) or has failed to fulfil any of the conditions referred to in clause (d) or sub-clause (iv) of clause (e), the Reserve Bank unless it is of the opinion delay in cancelling the certificate of registration granted under sub-section (4) of section 3 shall be Prejudicial to the public interest or the interest of the investor of the securitisation company or reconstruction company, shall give opportunity to such company on such terms as reserve bank may specify for talking necessary steps to comply with such provisions or fulfilment of such conditions.

(2) A securitisation company or reconstruction company aggrieved by the order of rejection of application for registration or conciliation of certificate of registration may prefer an appeal within a period of thirty days from date of on which such order rejection or cancellation is communicated to it, to the Central Government
Provided that before rejecting an appeal such company shall be given a reasonable opportunity of being heard.

(3) A securitisation company or reconstruction company, which is holding investment of qualified institutional buyers and whose application for grant of certificate of registration has been rejected or certificate of registration has been cancelled shall, notwithstanding such rejection or cancellation of certificate of registration, be deemed to be a securitisation company or reconstruction company until it repays entire investments held by it (together with interest, if any) within such period as the Reserve Bank may direct.

5. (1) Acquisition of right or interest in financial assets .Notwithstanding anything contained in any agreement or any other law for the time being in force, any securitisation company or reconstruction company may acquire financial asset of any bank or financial institution-------
by issuing a debenture or bond or any other security in the nature of the debenture, for consideration agreed upon between such company and the bank or financial institution incorporating therein such terms and conditions as may be agreed upon between them; or
by entering into an agreement with such bank or financial institution for the transfer of such financial asset to such company on such terms and conditions as may be agreed upon between them.

(2) If the bank or financial institution is a lender in relation to any financial asset acquired under sub-section(1) by the securitisation company or the reconstruction company, such securitisation company or reconstruction company shall, on such acquisition be deemed to be the lender and all right of such bank or financial institution shall vest in such company in relation to such financial assets.

(3) Unless otherwise expressly provided by this Law, all contracts, deeds, approval, consents or no-objection under any law or otherwise and other instruments of whatever nature and

which relate to the said financial asset and which subsisting or having effect immediately before the acquisition or financial asset under sub-section (1) and to which the concerned bank or financial institution is a party or which are in favour of such bank or financial institution shall, after the acquisition of the financial asset, be of as full force and effect against or in favour of the securitisation company or reconstruction company, as the case may be, and may be enforced or acted upon as fully and effectually as if in the place of the said bank or financial institution, securitisation company or reconstruction company, as the case may be, had been a party thereto or as if they had been issued in favour of securitisation company or reconstruction company, as the case may be.

(4) If, on the date of acquisition of financial asset under sub-section (1) any suit appeal or order proceeding f whatever nature relating to the said financial asset is pending by or against the bank or financial institution, save as provided in the third provision to sub-section (1) of section 15 of the Sick Industrial Companies (special Provisions) Act, 1985 the same shall not a ------ or be discontinued or be any way prejudicially affected by reason of the acquisition of financial asset by the securitisation company or re construction company, as the case may be, but the suit, appeal or the proceeding ma be continued, prosecuted and enforced by or against the securitisation company or reconstruction company, as the case may be.

6. (1) Notice to obligor and discharge of obligation of such obligor. the bank or financial institution may if it considers appropriate, give a notice of acquisition of financial asset by any securitisation company or reconstruction company, to concerned to the concerned obligor and any other concerned person and to the concerned registering authority in whose jurisdiction the mortgage, charge, hypothecation, assignment or other interest created on the financial asset had been registered.

(2) Where a notice of acquisition of financial asset under sub-section (1) is given by a bank or financial institution, the obligor, on receipt of such notice, shall make payment to the concerned securitisation company or reconstruction company, as the case may be, and payment made to such company in discharge of any obligation in relation to the financial asset specified in the notice shall be a full discharge to the obligor making the payment from all liability in respect of such payment.

(3) Where no notice of acquisition of financial asset under sub-section (1) is given by any bank or financial institution any money or other properties subsequently received by the bank or financial institution, shall constitute monies or properties held in trust for the benefit of and behalf of the securitisation company or reconstruction company, as the case may be, and such bank or financial institution shall hold such payment or properties which shall forthwith be made over or delivered to such securitisation company reconstruction company as the case may be, or its agent duly authorised in this behalf.

7. (1) Issue of security by rising of receipt or funds by Securitisation Company or Reconstruction Company. Without prejudice to the provisions contained in the Companies Act, 1956, Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992, any securitisation company or reconstruction company, may, after acquisition any financial asset under sub-section (1) of section 5, offer security receipts to qualified

institutional buyers (other than by offer to public) for subscription in accordance with the provisions of those Acts.

(2) A securitisation company or reconstruction company may rise funds from the qualified institutional buyers by formulating schemes for acquiring financial asset and shall keep maintain separate and distinct accounts in respect of each such scheme for every financial asset acquired out of investment made by a qualified institutional buyer and ensure that realisation of such financial asset held and applied towards redemption of investments and payment of returns assured on such investments under the relevant scheme.

(3) In the event non-realisation under sub-section (2) of financial asset, the qualified institutional buyers of a securitisation company or reconstruction company, holding security receipts of not less than seventy-five percent. Of the total value of the security receipts issued by such company, shall be entitled to call a meetings of all the qualified institutional buyers and every resolution passed in such meeting shall be binding on the company.

(4) The qualified institutional buyers shall, at a meeting called under sub-section (3) follow the same procedure, as nearly as possible as is followed at meeting of the board of directors of the securitisation company or reconstruction company, as the case may be.

8. Exemption from registration of security receipt. Notwithstanding any thing contained in sub-section (1) of section 17 of the Registration Act, 1908, -
any security receipt issued by the Securitisation Company or Reconstruction Company, as the case may be, under sub-section

(1) of section 7, and not creating, declaring, assigning, limiting or extinguishing any right, title or interest, to or in immovable property except in so far as it entitles the holder of security receipt to an undivided interest afforded by a registered instrument; or
any transfer of security of security receipts,
shall not require compulsory registration

9. Measures for assets reconstruction. Without prejudice to the provisions contained in any other law for the time being in force, a securitisation or reconstruction company may, for the purpose of asset reconstruction, having regard to the guidelines framed by the Reserve Bank in this behalf, provide for any one or more of the following measures, namely: -
the proper management of the business of the borrower, by change in, or take over of, the management of the business of the borrower;
the sale or lease of a part or whole of the business of the borrower;
rescheduling of payment of debts payable by the borrower;
enforcement of security interest in accordance with the provisions of this Law;
settlement of dues payable by the borrower;
taking profession of secured asset in accordance with the provisions of this Law.

10. (1) Other function of Securitisation Company or Reconstruction Company or Reconstruction Company. Any securitisation company or reconstruction company registered under section 3 may -

act as an agent for any bank or financial institution for the purpose of recovering their dues from the borrower on payment such fees or charge as may be mutually agreed upon between the parties;
act as a manager referred to in clause (c) of sub-section 13 on such fee as may be mutually agreed upon between the parties;
act as receiver if appointed by any court or tribunal:
Provided that no securitisation company or reconstruction company shall act as a manager if acting as such gives rise to any pecuniary liability.

(2) Save as otherwise provided in sub-section (1), no securitisation company or reconstruction company, which has been, granted a certificate of registration under sub-section (4) of section 3, shall commence carry on, without prior approval of the Reserve Bank, any business other than that of securitisation or asset reconstruction:
Provided that a securitisation company or reconstruction company which is carrying on, on or the before the commencement of this Law, any business other than the business of securitisation or asset reconstruction or business referred to on sub-section (1), shall case to carry on any such business within one year from the date of commencement of this Law.

Explanation - For the purpose of this section, "Securitisation Company "or Reconstruction Company" does not include its subsidiary.

11. 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, a securitisation company or reconstruction company or qualified institutional buyers, such dispute shall be settled by conciliation or arbitration as provided in the Arbitration and Cancellation Act, 1996, as if the parties to the dispute have consented in writing for the determination of such dispute by conciliation or arbitration and the provisions of that Act shall apply accordingly

12. (1) Power of Reserve Bank to determine policy and issue directions. If the Reserve Bank is satisfied that in the public interest or to regulate financial system of the country to its advantage or to prevent the affairs of any securitisation company or reconstruction from being conducted in a manner detrimental to the interest of investors or in any manner prejudicial to the interest of such securitisation company or reconstruction company, it is necessary or expedient so to do it may determine the policy and give directors to all or any securitisation company or reconstruction company in matters relating to income recognition accounting standards, making provisions for bad and doubtful debts, capital adequacy based on risk weight for asset and also relating to deployment of funds by the securitisation company or reconstruction company, as the case may be bound to follow the policy so determined and the directions so issued .

(2) Without prejudice to generality of the power vested under sub-section (1) the Reserve Bank may give directions to any securitisation company or reconstruction company generally or to a class of securitisation companies or Reconstruction Company or to any securitisation company or reconstruction company in particular as to--------

the type of financial assets of a bank or financial institutions, which can be acquired, and procedure for acquisition of such asset and valuation thereof;
the aggregate value of financial asset, which may be acquired by any securitisation company or reconstruction company.

CHAPTER III

ENFORCEMENT OF SECURITY INTEREST

13. (1) Enforcement of security interest. Notwithstanding anything contained in section 69 or section 69 A of the Transfer of Property Act, 1882, any security interest created in favour of any secured creditor may be enforced, without the intervention of court or tribunal, such creditor in accordance with the provisions of this Law.

(2) Where any borrower, who is under a liability to a secured creditor under a security arrangement, makes any default in repayment of secured debt or any instalment thereof, and his account in respect of such debt is classified by the secured creditor as non-performing asset ,then, the secured creditor may require the borrower by notice in writing to discharge in full his liabilities to the secured creditor shall be entitled within sixty days from the date of notice failing which the secured creditor shall entitled to exercise all or any of the right under sub-section (4)

(3) The notice referred to in sub-section (2) shall give details of the amount payable by the borrower and the secured assets intended to be enforced by the secured creditor in the event of non payment of secured debts by the borrower.

(4) In case the borrower fails to discharge his liability in full within the period specified in sub-section (2), the secured creditor may take recourse to one or more the following the measures to recover his secured debt namely: -
take procession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset;
take over the management of secured asset of the borrower including right to transfer by way of lease assignment or sale and realise the secured asset;
appoint any person (hereafter referred to as the manager), to manage the secured asset the possession of which has been taken over by the secured asset;
require at any time by notice in writing any person who has acquired any of the secured asset from the borrower and from whom any money is due or may become due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.

(5) Any payment made by any person referred to in clause (d) of sub-section (4)to the secured creditor shall give such person a valid discharge as if he has made payment to the borrower.

(6) Any transfer of secured asset after talking procession thereof or take over of management under sub-section (4), by the secured creditor or by the manager on behalf the secured creditors

shall vest in the transferee in or in relation to the secured asset transferred if the transferred on if the transfer had been made by the owner of the secured asset

(7) Where any action has been taken against a borrower under the provisions of sub-section (4), all costs, charge and expenses which, in the opinion of the secured creditors, have been properly incurred by him or any expenses incidental thereto, shall be recoverable from that borrower and the money which is received by the secured creditor shall, in the absence of any contract to the contrary , be held by him in trust to be applied, firstly, in payment of such costs, charges and expenses and secondly, in discharge of the dues of the secured creditor and the reduced the money so received shall be paid to the person entitled thereto in accordance with his rights and interests.

(8) If the dues of the secured creditor together with all costs, charge and expensed incurred by him are tendered to the secured creditor at any time before the date fixed for sale or transfer, the secured asset shall not be sold or transferred by the secured creditor, and no further step shall be taken by him for transfer by him for transfer or sale of that secure asset.

(9) In the case of financing of a financial asset by more than one secured creditors or joint financing of a financial asset by secured creditors. No secured creditor shall be entitled to excise any or all of the right conferred on him under or pursuant to sub-section (4) unless exercise of such right agreed upon by the secured creditors, representing not less than tree-fourth in value of the amount outstanding as on all the secured creditors:

Provided that in the case of a company in liquidation, the realised from the sale of secured asset shall be distributed in accordance with the provisions of section 529 A of the Companies Act, 1956:

Provided further that in the case of a company being wound up on or after the commencement of this Law, the secured creditor of such company, who opts to realise his security instead of relinquishing his security and proving his debt under provision to sub-section (1) of section 529 of the companies Act, 1956, may retain the sale proceeds of his secured asset after depositing the workmen’s dues with the liquidator in accordance with the provisions of section 529A of that Act:

Provided also that liquidator referred to second provision shall intimate that secured creditors the workmen’s dues in accordance with the provisions of section 529A of the Companies Act, 1956, and in case such workmen’s dues under that section to the secured creditor may retain the sale proceeds of the secured asset after depositing the amount such estimated dues with the liquidator:

Provided also that in case the secured creditor deposits the estimate amount of workmen’s dues, such creditor shall be liable to pay the balance of the workmen’s dues or entitled to receive the excess amount, if any deposited by the secured creditor with the liquidator:

Provided also that the secured creditor shall furnish undertaking t the liquidator to pay the balance of the workmen’s dues, if any.

Explanation -For the purpose of this sub-section,---

"record date" means the date agreed by the secured creditors representing not less than three fourth in value of the amount outstanding on such date;
"amount outstanding" shall include principal, interest and any other dues payable by the borrower to the secured creditor in respect of secured asset as per the books of account of the secured creditor.

(10) Where dues of the secured creditor are not fully satisfied with the sale proceeds of the secured asset, the secured creditor may file an application in the form and manner as may be prescribed to the Debts Recovery Tribunal having jurisdiction or a competent court, as the case may be, for recovery of the balance amount from the borrower.

(11) Without prejudice to the right conferred on the secured creditor under or any this section, secured creditor shall be entitled to process against the guarantors or sell the pledged asset without first taking any of the measured specified in clause (a) to (d) of sub-section (4) in relation to the secured asset under this Law.

(12) The right of secured creditor under this Law may be exercised by one or more his officers authorized in this behalf in such manner as may be prescribed.

(13) No borrower shall after receipt of notice refereed to in sub-section (12), transfer by way of sale, lease or otherwise (other than in the ordinary course of his business) any of his secured asset referred to in the notice, without prior written consent of secured creditor.

14. (1) Chief Metropolitan Magistrate or District Magistrate to assist secured creditor in talking possession. Where the procession of any secured asset is required to be taken by the secured creditor or if any of the secured assets is required to be sold or transferred by the secured creditor under the provisions of this Law, the secured creditor may, for the purpose of taking procession or control of any such secured asset, request, in writing, the Chief Metropolitan Magistrate, or the District Magistrate within whose jurisdiction any such secured asset or other asset or the documents relating thereto may be situated or found to take procession thereof and the Chief Metropolitan Magistrate or as the case may be the District Magistrate shall, on such request being made to him -
take possession of such asset and documents relating thereto; and
forward such asset and documents to the secured creditor.

(2) For the purpose of securing compliance with the provision of sub-section (1), the Chief Metropolitan Magistrate of the District Magistrate make take or cause to be taken such steps and use, or cause to be used such force, as may, in his opinion, be necessary.

(3) No act of the Chief Metropolitan Magistrate or the District Magistrate done in pursuance of this section shall be called in question in any court or before any authority.

15. (1) Manner and effect of takeover of management. When the management of business of a borrower is taken over by the secured creditor, the secured creditor may, by publishing a notice in a news paper published in English language and in a newspaper published in an Indian language in circulation in the place where the principal office of the borrower is situated, appoint as many person as it think fit -
(a) in case where the borrower is a company as defined in the Companies Act, 1956, to be the directors of that borrower in accordance with the provisions of that Act; or
(b) in any other case, to be the administrator of the business of the borrower.

(2) On publication of a notice under sub-section (1),-
in any case where the borrower is a company as defined in the Companies Act, 1956, all person holding offices as directors of the company and in any other case, all person holding any offices having powered of superintendence, direction and control of the business of the borrower immediately before the publication of the notice under sub-section (1), shall be deemed to have vacated their offices as such;
any contract of management between the borrower and any director or manager thereof holding offices as such immediately before publication of the notice under sub-section (1), shall be deemed to be terminated;
the director or the administrators appointed under this section shall take such steps as may be necessary to take into their custody or under their control all the property and effects and actionable claims to which the business of the borrower is, or appears to be, entitled and all the property and effect of the business of the borrower shall be deemed to be in the custody of the directors or administrators, as the case may be as form the date of the publication of the notice;
the directors appointed under this section shall, for all purpose, be the directors of the company of the borrower and such directors or as the case may be, the administrators appointed under this section, shall alone be entitled to exercise all the powers of the directors or as the case may be, of the persons exercising powers of superintendence, director and control, of the business of the borrower whether such powers are derived from the memorandum or articles of association of the company of the borrower or form any other source whatsoever.

(3) Where the management of the business of a borrower, being a company as defined in the Companies Act, 1956, is taken over by secured creditor, then notwithstanding anything contained in the said Act, or in the memorandum or articles of association of such borrower, ---
it shall not be lawful for the shareholders of such company or any other person to nominate or appoint any person to be a director of the company;
no resolution passed at any meeting of the shareholders of such company shall be given effect to unless approved by the secured creditor;
no proceeding for the winding up of such company or for the appointment of a receiver in respect thereof shall lie in any court, except with the consent of the secured creditor.

(4) Where the management of the business of a borrower had been taken over by the secured creditor shall, on relation of his debt in full restore the management of the business of the borrower to him.

16. (1) No compensation to directors for loss of office. Notwithstanding anything to the contrary contained in any contract or in any other law for the time being in force, no managing

director or any other director or a manager or any person in charge of management of the business of the borrower shall be entitled to any compensation for the loss of office or for the premature termination under this Law of any contract of management of entered into by him with the borrower.

(2) Nothing contained in sub-section (1) shall affect the right of any such managing director or any other director or manager of any such person in charge of management to recover from the business of the borrower moneys recoverable otherwise than by way of such compensation..

17. (1) Right to appeal. Any person (including borrower) aggrieved by any of the measures referred to in sub-section (4) of section 13 taken by the secured creditor or his authorised officer under this chapter, may prefer an appeal to the Debts Recovery Tribunal having jurisdiction in the matter within forty-five days from the date on which such measures had been taken.

(2) Where a borrower prefers an appeal, such appeal shall not be entertained by the Debts Recovery Tribunal unless the borrower has deposited with the debts Recovery Tribunal seventy-five per cent. of the amount claimed in the notice referred in sub-section (2) of section 13:
Provided that the Debts Recovery Tribunal may, for reasons to be recorded in writing waive or reduce the amount to be deposited under this section.

(3) Save as otherwise provided in this Law, the Debts Recovery Tribunal shall, as far as may be, dispose of the appeal in accordance with the provisions of the Recovery of Debts Due to Bank and Financial Institutions Act, 1993 and rules made thereunder.

18. (1) Appeal to appellate Tribunal. Any person aggrieved by any order by the Debts Recovery Tribunal under section 17 may prefer an appeal to an Appellate Tribunal within thirty days from the date of receipt of the order of Debts Recovery Tribunal.

(2) Save as otherwise provided in this Law, the Appellate Tribunal shall, as far as may be dispose of the appeal in accordance with the provisions of the Recovery of Debts Due to Bank and Financial Institution Act,1993, and rules made thereunder.

19. Right of borrower to receive compensation and costs in certain cases. If the debts Recovery Tribunal or the Appellate Tribunal as the case may be, on an appeal filed under section 17 or section 18, holds possession of secured asset by the secured creditor as wrongful and directs the secured creditor to return such secured asset to the concerned borrower, such borrower shall be entitled to payment of such compensation and costs as may be determined by such Tribunal or Appellate Tribunal.

CHAPTER IV

CENTRAL REGISTRY

20. (1) Central Registry. The Central Government may by notification, set up or cause to be set up from such date as it may specify in such notification, a registry to be non as the central Registry with its own seal for the purpose of registration of transaction of securitisation or reconstruction of financial asset and creation of security interest under this Law.

(2) The head office of the central registry shall be such place as the Central Government may specify and for the purpose of facilitating registration of transaction to in sub-section (1), there may be established at such other places as the Central Government may think fit, branch offices of the Central Registry.

(3) The Central Government may, notification define the territorial limits within which an office of the Central Registry may exercise its function.

(4) The provisions of this Law pertaining of the Central Registry shall be in addition to and not in derogation of any of the provisions contained in the registration act, 1908, the Companies Act, 1956, the Merchant Shipping Act, 1958, the Patents Act, 1970,the Motor Vehicle Act, 1988, and design Act, 2000 or any other law requiring registration of charge and shall not affected the priority of charge of validity thereof under those Acts or laws.

21. (1) The Central Government may, by notification, appoint a person for the purpose of registration of transactions relating to securitisation, reconstruction financial asset, and security interest created over properties, to be known as the Central Registrar.

(2) The Central Government may appoint such other officers with such designations as it thinks fit for the purpose of discharging, under the superintendence and direction of the Central Registrar, such function of Central Registrar under this Law as he may, for time, authorise them to discharge.

22. (1) Register of securitisation, reconstruction and security interest, transaction . For the purpose of this Law, a record called the Central Register shall be kept at the head office of the Central Registry for entering the particulars of the transaction relating to---
securitisation of financial asset;
reconstruction of financial asset; and.
Creation of security interest

(2) Notwithstanding anything contained in sub-section (1), it shall be lawful for the central registered to keep records wholly or partly in computer floppies, diskettes or any other electronic from subject to such safeguards as may prescribed.

(3) Where such register is maintained wholly or partly on computer under sub-section(2) any reference in this Law to entry in the central register shall be construed as a reference to any entry as maintained on computer or in any other electronic from

(4)The register shall be kept under the control and management of the Central Registrar

23. Filling of transaction of securitisation, reconstruction and creation of security interest. The particular of every transaction of securitisation, asset reconstruction or creation of security interest shall be filed, with the Central Registrar in the manner and on payment of such fees as may be prescribed, within thirty days after the case of such transaction or creation of security, by the securitisation company or reconstruction company or the secured creditor, as the case may be:
Provided that the Central Registrar may allow the filling of the particulars of such transaction or creation of security within thirty days next following the expiry of the said period of thirty days on payment of such additional fees not exceeding ten times the amount of such fee.

24.Modification of security interest registered under this Law. Whenever the terms or conditions, or the extent or operation of any security interest registered under this Chapter are or is modified it shall be the duty of the securitisation company or the reconstruction company or the secured creditors, as the case may be, to send to the Central Registrar, the particular of a such modification, and the provisions of this Chapter as to registration of security interest shall apply to such modification of such security interest.

25. (1)Securitisation Company or Reconstruction Company or secured creditors to report satisfaction of security interest. The securitisation company or reconstruction company or the secured creditor as the case may be, shall give information to the Central Registrar of the payment or satisfaction in full, of any security interest relating to the securitisation company or reconstruction company or the secured creditor and requiring registration under this Chapter, within thirty days from the date of such of payment or satisfaction.

(2) The Central Register shall, on receipt of such information, cause a notice to be sent to the securitisation company or reconstruction company or the secured creditor calling upon it to show cause within a time not exceeding fourteen days specified in such notice, as to why payment or satisfaction should not be recorded as intimated to the Central Registrar.

(3) If no cause is shown, the Central Registrar shall order that memorandum of satisfaction shall be entered in the Central Register.

(4) If cause is shown, the Central Registrar shall record a note to that the effect in the Central Register, and shall inform the borrower that he has done so.

26. (1) Right to inspect particulars of securitisation,, reconstruction and security interest transaction. The particulars of securitisation or reconstruction or security interest entered in the Central Register, and shall inform the borrower that he has done so.

(2)The Central Register referred to in sub-section (1) maintained in electronic from, shall also be open during the business hours for the inspection of any person through electronic media on payment of such fees as may be prescribed.

CHAPTER V

OFFENCES AND PENALTIES

27. Penalties. If a default is made -
in filling under section 23, the particulars of every transaction of any securitisation or asset reconstruction or security interest created by a securitisation or reconstruction company or secured creditors; or
in sending under section 24, the particulars of the modification referred to in that section; or
in giving intimation under section 25,
every company and every officer of the company or the secured creditor and every officer of the secured creditor who is default shall be punishable with fine, which may extend to five thousand rupees for every day during which default countries.

28. Penalties for non-compliance of direction of Reserve Bank. If any securitisation company or reconstruction company fails to comply with any direction issued by the Reserve Bank under section 12, such company and every officer of the company who is in default, shall be punishable with fine which may extend to five lakh rupees and in the case of a continuing offence, with an additional fine which may extend to ten thousand rupees for every day during which default continues.

29.Offences. If any person contravenes or attempts to contravene or abets the contravention of the provisions of this Law or of any rules made thereunder, he shall be punishable with imprisonment for a term, which may extend to one year or with fine or with both.

30.Congnizance of offence. No court inferior to that of a Metropolitan Magistrate or a Judicial Magistrate of the First Class shall try an offence punishable under this Law

CHAPTER VI

MISCELLANEOUS

31. Provisions of this Law not to apply in certain cases. The provisions of this Law shall not apply to—
a lien on any goods, money or security given or under the Indian Contract Act, 1872 or the sale of goods Act,1930, or any other law for the time being in force;
a pledge of movable within the meaning of section 172 of the Indian Contract Act, 1872;
creation of any security in any as defined in clause (1) of section 2 of the Aircraft Act, 1934;
creation of security interest in any vessel as defined in clause (55) of section 3 of the Merchant Shipping Act, 1958;

any conditional sale, hire-purchased or lease or any other contract in which no security interest has been created;
any right of unpaid seller under section 47 of the Sale of Goods Act, 1930;
any properties not liable to attachment or sale under the proviso to sub-section (1) of section 60 of the code of Civil Procedure, 1908;
any security interest for securing repayment of any financial asset not extending one lakh rupees;
any security interest created in agricultural land;
any case in which the amount due is less than twenty per cent of the principal amount and interest thereon .

32.Protection of action taken in good faith. No suit, prosecution or other legal proceedings shall lie against any secured creditor or any of his officers or manager exercising any of the rights of the secured creditor or borrower for anything done or omitted to be done in good faith under this Law.

33.(1) Offences by companies. Where an offence under this Law has been committed by a company, every person who at the time the offence was committed was in charge offend was responsible to, the company, for the conduct of the business of the company as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeds against and punished accordingly:
Provided that nothing contained in this sub-section shall under any such person liable to any punishment provided in this Law, if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

(2) Notwithstanding anything contained in sub-section (1), where an offence under this Law has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of any director, manager, secretary or other officer of the company, such director manager, secretary or other officer shall also be deemed to be guilty of the offences and shall be liable to be proceeds against and punished accordingly.

Explanation - For the purpose of this section, -
"company" means any body corporate and includes a firm or other association of individuals; and
"director", in relation to a firm, means partner in the firm.

34.Civil court to have jurisdiction. No civil court shall have jurisdiction to certain any suit or proceeding in respect of any matter which a Debts Recovery Tribunal or an Appellate Tribunal is empowered by or under this Law to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Law or under the Recovery of Debts Due to Bank and Financial Institution Act, 1993.

35.The provisions of this Law to override other laws. The Provisions of this Law shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law.

36.Limitation. No secured creditor shall be entitled to take all or any of the measures under sub-section (4) of section 13, unless his claim in respect of the financial asset is made within the period of limitation prescribed under the Limitation Act, 1963.

37.Application of other laws not barred. The provisions of this Law or the rules made thereunder shall be addition to, and not in derogation of the Companies Act, 1956, the Securities Contracts (Regulation) Act, 1956, the Securities and Exchange Board of India Act, 1992, the Recovery of Debts Due to Bank and Financial Institution Act, 1993, or any other law for the time being in force.

38.(1) Power of Central Government to make rules. The Central Government may, by notification and the Electronic Gazette as defined in clause (s) of section 2 of the Information Technology Act, 2000, make rules for carrying out the provisions of this Law.

(2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely: -
the from and manner in which an application may be filed under sub-section (10) of section 22;
the manner in which the rights of secured creditor may be exercised by one or more of his officers under sub-section (12) of section 13;
the safeguards subject to which the records may, be kept under sub-section (2) of section 22;
the manner in which the particulars of every transaction of securitisation shall be filed under section 23 and fee for filing such transaction;
the fee for inspection the particulars of transaction kept under section 22 and entered in the Central Register under sub-section (1) of section 26;
the fees for inspecting the Central Register maintained in electronic from under sub-section (2) of section 26;
any other matter which is to be, or may be, prescribed, in respect of which provision is to be, or may be, made by rules .

(3) Every rule under this Law shall be laid, as soon as may be after it is made before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if before the expiry of the session immediately following the session or in two or more successive session aforesaid, both House agree in making any modification in the rule or both Houses agree that the rule should not be made, the rule shall thereafter have effect only in such modified from or be of no effect as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of any thing previously done under that rule.

39.Certain provisions of this Law to apply after registry is set up or caused to be set up. The provisions of sub-section (2), (3) and (4) of section 20 and section 21,22,23,24,25,26.and 27 shall apply after the Central Registry is set up caused to be sent up under sub-section (1) of section 20.

40.(1) Power to remove difficulties. If any difficulty arises in giving effect to the provisions of this Law, the Central Government may, by order published in the official Gazette, make such provisions not inconsistent with the provisions of this Law as may appear to be necessary for removing the difficulty:
Provided that no order shall be made under this section after the expiry of a period of two years from the commencement of this Law.

(2) Every order made under this section shall be laid, as soon as may be after it is made, before each House of Parliament.

41.The Amendments of certain enactments. The enactments specifies in the schedule shall be amended in the manner specified therein.

Year	Act No.	Short title	Amendment
1956	42	The Securities Contracts(Regulation) Act, 1956.	In section 2, in clause (h), after sub-section (ib), insert the following :- " (ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Law, 2002"
1986	1	The Sick Industrial Companies (Special Provisions) Act, 1985.	In section 15, in sub-section (1), after the Proviso, insert the following :- Provided further that no reference shall be made to the Board for Industrial and Financial Reconstruction after the commencement of the Securitisation and Reconstruction of Financial Asset and Enforcement of Security Interest Law, 2002, where financial assets have been acquired by any securitisation company or reconstruction company under sub-section (1) of section 5 of that Law Provided also that or after the commencement of the securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Law, 2002, where a reference is pending before the Board for Industrial and Financial Reconstruction, such reference shall abate if the secured creditors, representing not less than three- fourth in value of the amount outstanding against financial assistance disbursed to the borrower of such secured creditor, have taken any measures to recover their secured debt under sub-section (4) of section 13 of that Law."
1956	1	The Companies Act, 1956.	In sec. 4A, the following shall be added " (vii) the securitisation company or reconstruction company which has obtained a certificate of registration under sub-section (4) of section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Law, 2002"

Sources:
Vinod Kothari's Securitisation Website (http://www.vinodkothari.com)
Personal Website of R Kannan (http://in.geocities.com/kstability/inbank2/arc/securitisation-act.html)

State Bank of India

SBI has reported gross NPAs of Rs154,859mn for the year ended FY02. Its net NPA stood at Rs68014mn for the same period. The bank has made a provision of Rs86,844mn, translating into a provision coverage ratio of almost 56%. The bank intends to bring down the sticky assets by Rs20bn this fiscal.

The bank intends to serve notices to over 1000 defaulters in the short term. In case of failure of payment, the management will takeover the mortgaged property of these defaulters and recover a portion of its dues by selling them.

Recovery rate(%)	5	10	15	20	25	30	35
Gross NPAs (Bn)	7.7	15.5	23.2	30.9	38.7	46.5	54.2
Provisions in books (Bn)	4.3	8.7	13.0	17.4	21.7	26.1	30.4
Tax payable on write back (Bn)	1.5	3.0	4.6	6.1	7.6	9.1	10.6
Incremental profits after tax (Bn)	2.8	5.6	8.5	11.3	14.1	16.9	19.8

Assumptions:

- It has been assumed that whatever has been the proportion of sticky assets recovered, 56% of that has been provided for and will be added back in the current fiscal.
- A flat tax rate of 35% on the amount of sticky loans written back has been assumed.

Recovery rate(%)	5	10	15	20	25	30	35
Incremental (EPS)	5.4	10.7	16.1	21.5	26.8	32.2	37.5

Based on the recovery rate, the incremental earnings will be added to the bottom line in the current year. Over the last two years, SBI has moved in a P/E range of 4 to 7. Till 17th March, 2002 average price earnings ratio based on FY03 earnings stood at 4.14. The incremental price based on the average P/E ratio for the period is tabulated below:

Recovery rate(%)	5	10	15	20	25	30	35
Incremental Price per share	22.2	44.4	66.6	88.8	110.9	133.1	155.3

ARCs AROUND THE GLOBE

Specific Cases in ARC Formation around the Globe

United States

In the inflationary environment of the 1970s and early 1980s, many retail savings and loans institutions (also known as thrifts) in the United States were paying high market rates for their deposit borrowings, but earning below-market rates on their assets (mostly in the form of residential and commercial mortgages). In short, much thrift 'borrowed short to lend long'.

Most banks and thrifts were restricted to operating in certain geographical areas. When regional economies (e.g. Texas, New England) sank into recession and commercial and residential real estate markets collapsed, much thrift was faced with significant non-performing loans. At the same time, thrift industry deregulation in 1982 gave troubled thrifts the ability to take bets on risky investments with much of the risk covered by deposit insurance. In addition, at certain institutions, there was also mismanagement and fraud.

From 1980 through 1991, around 1,400 banks failed or received government assistance and during the same period, approximately 1,100 thrifts failed. The crisis led to the insolvency of the Federal Savings and Loans Insurance Corporation (FSLIC), which provided a government insurance guarantee over thrift retail deposits, and shook the solvency of the Federal Deposit Insurance Corporation (FDIC), which provided similar insurance over retail bank deposits. At the end of 1991, the Bank Insurance Fund (BIF) administered by the FDIC carried a deficit balance of US$7 billion.

The US Government seized and liquidated many institutions, and assisted others through capital contributions, asset loss coverage guarantees, yield maintenance agreements and/or regulatory forbearances. Many institutions were merged with healthy institutions, while others were sold.

Integral to the Government's response was the passing of far-reaching legislation to overhaul the banking/thrift sector and provide an effective mechanism for government intervention.

In particular, the legislation created the Resolution Trust Corporation (RTC) to resolve the problem of troubled thrifts. The RTC's brief was to take over the non-performing loans of failed thrifts, and actively manage these assets to maximise value pending eventual disposal.

Formed in 1989, the RTC had at its peak assets totaling approximately US$1 trillion. All these assets have been successfully disposed and the RTC ceased operations in 1996.

Thailand

Corporate Thailand was in 1997, as it is now, largely dependent on banks and a number of financial institutions for financing. A chicken-and-egg situation ensued whereby the companies weighed by heavy-debt burden, courtesy of wayward lending and borrowing practices of the 90s, started to collapse one by one on the one hand, and the banks collapsing over the unabated weight of Non-performing loans or NPLs, on the other hand.

NPLs as of July 2001 total Baht 615.06 billion representing 12.69% of total loans in the system. Private banks account for Baht 476.86 billion or 17.95% of total loans, while state banks account for Baht 92.53 billion or 6.39% of total loans. NPLs of foreign banks and finance companies totaled 3.55% or Baht 20.81 billion and 15.98% or Baht 24.86 billion, respectively.

The Thai government was aware that something had to be done to address the paralyzing effect of the heavy NPL situation on the Thai economy. In 1998, the Amendment to Thai Bankruptcy Act, which had been in the shelves for more than a decade at that time, was resurrected and finally given life. A year later, in 1999, another Amendment to the Bankruptcy Act was enacted to refine the 1998 Amendments. The BOT (Bank of Thailand), together with local financial institutions also took further initiatives in encouraging corporate debt restructuring by formulating a binding framework in the form of Debtor-Creditor and Inter-Creditor Agreements. The BOT's CDRAC or Corporate Debt Restructuring Advisory Committee coordinated the restructuring efforts under the DCA and the ICA by identifying the debtor and creditor groups and setting up the venue for the dialog and negotiations between these two groups. As at the end of September 2001, a total of 989 bankruptcy and business rehabilitation cases involving a total debt amount of Baht 200.95 billion were filed with the Central Bankruptcy Court, compared to 986 cases involving Baht 58.2 billion for the whole of year 2000. CDRAC, on the other hand has helped restructure 439,276 cases since its inception 2 years ago, involving debts totaling Baht 2.3 trillion.

TAMC
Declared as Thailand's last chance to clean up its NPL mess, the Emergency Decree on Thai Asset Management Corporation, or TAMC Decree came into force on June 9, 2001. With all the good intentions but crippled with hastily drafted and obscure provisions, the TAMC Act has been riddled with criticisms and even a legal suit on its constitutionality. Finally clearing its constitutional hurdles on October --, 2001, the TAMC started accepting its first lot of asset transfer on October 15, 2001.

The TAMC is a government agency owned 100% by the Financial Institutions Development Fund (FIDF). TAMC will issue Baht 170 billion (approximately US$ 3.7 billion) 10-year notes guaranteed by the FIDF to financial institutions as payment for TAMC's purchase of NPL assets form these financial institutions. A Board of Directors consisting of no more than 11 members appointed by the Minister of Finance and approved by the Council of Ministers manages the TAMC.

Mexico

During the 1980s and early 1990s, many Mexican financial institutions were privatised. In subsequent years, high economic growth rates led new, inexperienced bank owners to aggressively expand credit portfolios to compensate for high prices paid during the privatisations. Capital levels were relatively low by international standards, as were credit standards.

Prior to Mexico's 1995 economic crisis, bank asset quality had already begun to deteriorate. Mexico's balance of payments deteriorated sharply throughout 1993 and 1994, resulting in a crisis in international investor confidence, large outflows of capital and, finally, a significant devaluation of the peso in December 1994. Soaring interest rates brought on an economic recession and shook the Mexican banking and financial system. Banks' asset quality declined further as consumers and corporates struggled to survive. Liquidity problems also arose as banks found it difficult to roll over maturing certificates of deposit.

The Government received financial assistance from the United States, the World Bank and the Inter-American Development Bank. This allowed the Government to provide support to banks through the Bank Fund for Savings Support, Fondo Bancario para Proteccion del Ahorro (FOBAPROA).

FOBAPROA is a trust established by Banco de México to provide "preventive support" to problem banks. Its existence predates the 1994-1995 banking crisis. FOBAPROA's stated mission is to cover all bank liabilities, except subordinated debt. FOBAPROA has generally acted as the lead agency in resolving bank problems since the peso crisis.

One of the major FOBAPROA assistance programmes implemented was the purchase of impaired loan assets from banks at net book value (on the basis of the Mexican rating system) in exchange for a requirement for the bank in question to raise new equity. FOBAPROA instituted this programme on a case-by-case basis. In some instances, FOBAPROA purchased $2 of loans for every $1 of equity injected, while in other cases, the ratio was as high as 5 to 1.

As the Mexican economy has pulled out of recession, the sense of crisis in the banking sector has eased, although there are lingering asset quality problems, especially in mortgage loans. The role of FOBAPROA continues.

Sweden

The Swedish economy, which had expanded rapidly in the deregulated environment of the mid to late 1980s, contracted sharply between 1991 and 1993.

Real estate markets declined sharply due to high interest rates and the recessionary environment. Banks, which had a significant portion of their loan exposure in the construction and real estate sectors, felt the impact. Several banks faced insolvency concerns. Nordbanken, Sweden's third largest bank, required a capital infusion and was ultimately taken over by the government in 1992.

The Swedish government's initial step was to guarantee the safety and soundness of the banking system, stating it would stand behind the banks. The government adopted legislation creating a comprehensive programme to restructure the banking system. The Government's expressed support facilitated the private sector recapitalisation of the banks.

Two banks were taken over by the Government, which formed asset management companies to acquire the non-performing assets of these banks. The other four major banks in Sweden were encouraged to form their own similar asset workout vehicles to take over problem real estate loans. These real estate companies effectively became asset management operations for the banks' under performing real estate assets. The Government allowed the banks to deconsolidate these vehicles.

The banking sector has since recovered together with the economy, which in turn has improved overall asset quality. Several bank-owned real estate companies have been or will be spun off to shareholders.

Korea

KAMCO has bought non-performing loans from the country's financial sector and recycled them as investible assets, in the process, it planted the seeds for a liquid secondary market in distressed assets and helped nurture South Korea's fledgling asset-backed securities market. It is IFR Asia's restructuring agency of the year.

The Korea Asset Management Corp. (KAMCO) was founded in 1962 to resolve the non-performing loan (NPL) problem of the Korea Development Bank, but was reorganized in late-1997 to dispose of distressed assets that local financial institutions had become burned with as a result of the Asian financial crisis.

KAMCO's task was daunting. It was charged with purchasing and disposing of distressed loans in a country devoid of a liquid secondary market, even for performing assets. The agency also had to determine how to maximize recovery values and was faced with the tough decision of whether to quickly sell or securities the acquired assets or manage them for future sale.

KAMCO's challenge was not only to buy non-performing loans, but also to create a market for such assets and nurture a solid investor base. It also had to rapidly develop a team to assess whether recovery values would be greater if assets were disposed of through KAMCO-supervised workouts or immediate sales. To achieve its goals, KAMCO sought to create structures that would appeal to a broad investor base. Since the refocus of its charter, the agency has repackaged and sold assets directly to investors or securities them in various forms to meet a multitude of domestic and international investor needs.

In managing assets it has purchased, KAMCO sought to maximize efficiency by entering a series of joint ventures with experienced distressed-debt professionals. By retaining ownership of the assets with its patterns while farming the NPLs out to workout specialists, the agency is likely to reduce the time needed to resolve the distressed assets and prevent sharp erosions of their net-present values.

The list of houses with which KAMCO has cooperated includes some respected names in the distressed-debt business: Lehman Brothers, Goldman Sachs, Lone Star, Morgan Stanley, Deutsche Bank, Amnesco, Cerberus Capital and GE Capital.

Despite its huge scale, the first part of KAMCO's charter -; the purchase of distressed debt from local institutions-proved to be the easiest part of its mission. As of October 31, 1999, the agency had paid Won 22.7tr(US$20.2bn) for NPLs with a total face value of Won55.9tr.

At Won320bn, KAMCO's first offering was large, but represented only a fraction of the potential amount of asset-backed bonds it would issue if the initial offering proved to be a success. The bonds were backed by so-called special loans -won-denominated assets KAMCO had purchased from entities that had been placed under court receivership or were undergoing composition proceedings. Many of the loans were guaranteed by commercial banks and most were secured by real estate. The assets were assigned to an offshore SPV, thus achieving their 'trust sale", but KAMCO managed the underlying collateral to ensure smooth

GENERAL GUIDELINES

Guidelines issued by the Reserve Bank of India

The General Guidelines by RBI for all Registered Securitisation Companies / Reconstruction Companies

The Reserve Bank has framed Directions to Securitisation Companies / Reconstruction Companies relating to registration and other matters pertaining to their working, viz, Prudential Norms relating to income recognition, classification of assets, provisioning, accounting standards, capital adequacy, measures for the purpose of asset reconstruction, deployment of funds, acquisition of any type of financial assets, their valuation and aggregate value of financial assets that can be acquired.

The Bank recognizes the fact that since the asset reconstruction activity mainly centers around impaired assets, the whole process of asset reconstruction and matters related thereto has to be initiated with due diligence and care warranting the existence of a set of clear instructions which shall be complied with by all Securitisation / Reconstruction Companies so that the process of asset reconstruction proceeds on smooth and sound lines. The need for some healthy and uniform guidelines has been further necessitated by the fact that there is no prior experience as to the functioning of these companies. Accordingly, the Bank has framed a set of guidelines as detailed below, which are recommendatory in nature.

Guidelines

(1) Acquisition of Financial Assets

1. The Asset Acquisition Policy shall provide that the transactions take place in a transparent manner and at a true price in a well informed market, and the transactions are executed at arm's length in exercise of due diligence;
2. The Policy so framed should provide for checks in the matter of acquiring assets from a single Bank / FI, own sponsors and any single entity up to a desirable level of ceiling so that possible departures from desirable practices are avoided;
3. The percentage of financial assets to be acquired should be appropriately and objectively worked out keeping in view the fact that the percentage of ownership stake has a bearing on the speed with which security interest rights can be enforced in accordance with the provisions of the Ordinance;
4. For easy and faster realisability, financial assets due from a single debtor to various banks / FIs may be considered for acquisition. Similarly, financial assets having linkages to the same collateral may be considered for acquisition to ensure relatively faster and easy realisation;

5. Both fund and non-fund based financial assets may be included in the list of assets for acquisition. Standard Assets likely to face distress prospectively may also be acquired;
6. Acquisition of funded assets should not include takeover of outstanding commitments, if any, of bank / FI to lend further. Terms of acquisition of security interest in non-fund transactions, should provide for the relative commitments to continue with bank/FI, till demand for funding arises;
7. Loans not backed by proper documentation should be avoided;
8. The valuation process should be uniform for assets of same profile and a standard valuation method should be adopted to ensure that the valuation of the financial assets is done in scientific and objective manner. Valuation may be done internally and or by engaging an independent agency, depending upon the value of the assets. Ideally, valuation may be entrusted to an asset acquisition committee, which shall carry out the task in line with an Asset Acquisition Policy laid down by the Board in this regard;
9. A record indicating therein the details of deviations made from the prescriptions of the Board in the matter of asset acquisition, pricing, etc. should be maintained;
10. To ensure functioning of Securitisation Companies/ Reconstruction Companies on healthy lines, the operations and activities of such companies may be subjected to periodic audit and checks by internal / external agencies.

(2) Engagement of Outside Agency

Securitisation Companies/ Reconstruction Companies may engage the services of reputed specialised external agencies to handle the task of taking possession of secured assets in pursuance of its right to enforce security interest.

(3) Sale Committee

It is desirable that the Sale Committee authorises in case of joint / consortium financing, the secured creditor with the highest outstanding, or more preferably, the Securitisation Company/ Reconstruction Company as the designated secured creditor to arrange for the sale of secured assets.

(4) Issue of security receipts

1. The parties in question may finalise the price at which security receipt will be issued as per the mutually agreed terms and on assessment of the risks involved;
2. In cases where security receipts are issued involving transfer of risks to the full extent and rewards to a limited extent, there could be a possibility of sharing of surplus between the issuer and the investors;
3. The issuer may consider obtaining credit rating from any of the recognised credit rating agencies.
4. The matters relating to charging of 'management fee' by the Securitisation Company/ Reconstruction Company, for managing schemes floated by it, may be as per the mutually agreed terms.

THE RBI DIRECTIONS

The Securitisation Companies (Reserve Bank) Directions, 2002

The Reserve Bank of India, having considered it necessary in the public interest, and being satisfied that, for the purpose of enabling the Bank to regulate the financial system to the advantage of the country and to prevent the affairs of any securitisation company or reconstruction company from being conducted in a manner detrimental to the interest of investors or in any manner prejudicial to the interest of such securitisation company or reconstruction company, it is necessary to issue the directions relating to the measures of asset reconstruction and matters related thereto, as set out below hereby, in exercise of the powers conferred by Section 12(2) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (Second) Ordinance, 2002, issues to every Securitistion Company/ Reconstruction Company, the directions hereinafter specified.

Registration, Asset Acquisition and Other Matters

1. Every Securitisation Company / Reconstruction Company shall obtain a certificate of registration from the Reserve Bank
2. Every Securitisation Company / Reconstruction Company seeking the Bank's registration shall have a minimum Owned Fund of Rs. 2 crore ;
3. A Securitisation / Reconstruction Company, which has obtained a certificate of registration issued by the Bank may undertake both securitisation and asset reconstruction activities.

Operational Structure

A Securitisation Company / Reconstruction Company, which has obtained a certificate of registration issued by the Bank shall, for the purpose of raising resources as provided for, set up one or more trust/s which shall issue Security Receipts to Qualified Institutional Buyers. The trusteeship of such trust/s shall vest in the Board of Directors of the Securitisation Company/ Reconstruction Company.

Permissible Business

No Securitisation Company / Reconstruction Company shall commence / undertake any activity other than securitisation and asset reconstruction and those provided for in Section 10(1) of the Ordinance, except with the prior approval of the Bank. A Securitisation Company / Reconstruction Company, which is carrying on any other business, shall cease to do such business within one year from the commencement of the Ordinance i.e. by June 20, 2003. A Securitisation Company / Reconstruction Company, may form a different company as a joint venture with any other investor for the purpose of asset reconstruction of impaired assets. The newly formed company shall commence business only after receiving a Certificate of Registration from the Reserve Bank of India in terms of the Ordinance.

Methods of asset reconstruction

No Securitisation Company / Reconstruction Company shall change or take over the management of or sell or lease, the whole or part of the business of the borrower. They may, however, take recourse to any of the measures to recover the secured debt as provided for in sub section (4) of section 13 of the Ordinance.

Rescheduling of Debts

1. Every Securitisation Company/Reconstruction Company shall frame a policy, duly approved by the Board, in the matter of rescheduling of debts payable by the borrower;
2. A committee of the Board shall be constituted, which may approve each proposal in line with the policy laid down by the Board;
3. All proposals should be in line with and supported by an acceptable business plan, projected earnings and cash flows;
4. The proposal should not materially affect the asset liability management of the Securitisation Company/Reconstruction Company or the commitments given to investors in the schemes announced; and
5. Deviation from the policy should be made only with the approval of the Board.

Settlement of dues payable by the borrower

1. Every Securitisation Company/Reconstruction Company shall frame a policy duly approved by the Board detailing the circumstances under which settlement may be done;
2. The policy may, interalia, cover aspects such as cut-off date, formula for computation of realisable amount and settlement of account, payment terms and conditions, and borrower's capability to pay the amount settled;
3. A committee of the Board shall be constituted, which may approve each proposal in line with the policy laid down by the Board;
4. All proposals should be in line with and supported by an acceptable business plan, projected earnings and cash flows;
5. The proposal should not materially affect the asset liability management of the Securitisation Company/Reconstruction Company or the commitments given to investors in the schemes announced; and
6. Deviation from the policy should be made only with the approval of the Board.

Asset Acquisition

1. Every Securitisation Company/Reconstruction Company shall frame with the approval of its Board, a 'Financial Asset Acquisition Policy', within 90 days of grant of Certificate of Registration, which shall clearly lay down the policies and guidelines covering, inter alia,
   - norms and procedure for acquisition;
   - types and the desirable profile of the assets;

- valuation procedure ensuring that the assets acquired have realisable value which is capable of being reasonably estimated and independently valued;
- delegation of powers of various functionaries; and
- in the case of impaired Financial Assets, framing of plan for their realisation.

2. The acquisition of assets by Securitisation Company/Reconstruction Company shall be in conformity with the principles of 'true sale' whereby the risks and rewards associated with the assets stand transferred to the transferee;
3. Asset acquisition shall be made under the supervision of an Asset Acquisition Committee, which shall be a committee of the Board with independent directors (who are not nominees of the Sponsors) in majority.

Internal Control System

Every Securitisation Company / Reconstruction Company shall put in place an effective 'Internal Control System' providing for periodical check and review of the asset acquisition measures and other matters related thereto as mentioned in the above paragraph.

Bar on purchase of assets

A Securitisation Company/Reconstruction Company shall not itself purchase the secured assets put to sale in exercise of its right of enforcement of security interest through private treaty or by obtaining quotations from persons dealing with similar secured assets.

Deployment of Funds and Lending

1. A Securitisation Company/Reconstruction Company may Invest its owned funds and temporary surpluses in Government securities and deposits with scheduled commercial banks and investments in other companies formed as Joint Ventures for asset reconstruction;
2. A Securitisation Company/Reconstruction Company may not lend or invest otherwise than as specified in sub-paragraph (i) above any monies to the borrowers ;
3. No Securitisation Company/Reconstruction Company shall invest in land or building an amount exceeding 50% of its owned fund.

Issue of Security Receipts

1. A Securitisation Company/Reconstruction Company proposing to issue Security Receipts, shall formulate a policy, duly approved by their Board, within 90 days of grant of the Certificate of Registration, providing for valuation of the assets under each scheme and declaration of Net Asset Value (NAV) of Security Receipt at the end of every quarter.
2. Such policy shall provide for including in the offer document a specific clause to the effect that the security receipts issued under the Ordinance would be transferable / assignable only in favour of other Qualified Institutional Buyers.

Disclosure

Every Securitisation Company/Reconstruction Company intending to issue Security Receipts to Qualified Institutional Buyers shall make disclosures as mentioned below

Disclosure in Offer Document: Relating to the Issuer of Security Receipts

1. Name, place of Registered Office, date of incorporation, date of commencement of business;
2. Particulars of sponsors, shareholders and a brief profile of the Board of Directors of Securitisation Company/Reconstruction Company with their qualifications and experience;
3. Summary of financial information for the last three years; and
4. Details of Securitisation / Asset Reconstruction activities handled, if any, in the last three years

Disclosure in Offer Document: Terms of Offer

1. Objects of offer and proposed end use of funds;
2. Description of the instrument and extent of management fee charged by Securitisation Company/Reconstruction Company;
3. Interest rate / probable yield;
4. Due dates, if any, for payment of interest, date of maturity / redemption;
5. Details of and rationale for credit rating, if any;
6. Details of assets being securitised, changes effected to the pool, if any.
7. Geographical distribution of asset pool;
8. Residual maturity, interest rate, outstanding principal of the asset pool;
9. Nature and value of underlying security, expected cash flows, quantum and timing, credit enhancement measures;
10. Policy for acquisition of assets and valuation methodology adopted;
11. Details of terms of acquisition of assets from banks / FIs;
12. Risk profile of Financial Assets, details of performance record with the Originators;
13. Statement of risk factors and steps taken to mitigate the same;
14. Risk exposure to future cash flows, security left in Trust etc.;
15. Arrangements for implementing AR measures in case of default
16. Method of valuation of security receipts;
17. Role of Originator post acquisition;
18. Disclosure about Trustees;
19. Duties of Trustee;
20. Dispute Redressal Mechanism;

Disclosure on continuing basis

1. Declaration of NAV on quarterly basis;
2. Defaults, prepayments, losses, if any, during the period;
3. Change in credit rating, if any;
4. Change in profile of the assets by way of accretion to or realisation of assets from the existing pool;

5. Collection summary for previous corresponding period;
6. Any other material information, which has a bearing on the earning prospects affecting the QIBs;

Exemptions

The Reserve Bank may, if it considers necessary for avoiding any hardship to any Securitisation Company/Reconstruction Company or for any other just and sufficient reason, grant extension of time to comply with the directions or exempt any company or class of companies from all or any of the provisions of these directions either generally or for any specified period subject to such conditions as the Bank may impose.

PRUDENTIAL NORMS

The Prudential Norms (Reverse Bank) Directions, 2002

The Reserve Bank of India, having considered it necessary in the public interest, and being satisfied that, for the purpose of enabling the Bank to regulate the financial system to the advantage of the country and to prevent the affairs of any Securitisation Company / Reconstruction Company from being conducted in a manner detrimental to the interest of investors or in any manner prejudicial to the interest of such Securitisation Company/Reconstruction Company, it was necessary to issue the directions relating to the prudential norms as set out below.

Short Title

(1) These directions shall be known as the "Securitisation Companies/ Reconstruction Companies Prudential Norms (Reserve Bank) Directions, 2002".

(2) All the provisions of these directions shall apply to transactions relating to Securitisation / reconstruction of financial assets undertaken by Securitisation Companies/Reconstruction Companies registered with the Reserve Bank of India under Section 3(4) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (Second) Ordinance, 2002.

Definitions

1. "Date of acquisition" means the date on which all 'significant risks and rewards' of ownership of financial assets have been acquired by Securitisation Company/Reconstruction Company irrespective of whether or not physical transfer of secured assets has taken place or agreement has been entered into.
2. "Non-performing Asset" means an asset in respect of which
   a. Interest or principal (or instalment thereof) is overdue for a period of more than 180 days;
   b. Interest for principal is overdue for a period of more than 180 days from the expiry of planning period, wherever applicable;
   c. Any other receivable, if it is overdue for a period of more than 180 days.
3. "Ordinance" means the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Ordinance, 2002;
4. "Overdue" means an amount which remains unpaid beyond the due date; "Owned Fund" means aggregate of paid up equity capital, preference shares which are compulsorily convertible into equity and free reserves as reduced by accumulated balance of loss, deferred revenue expenditure, book value of intangible assets and under / short provision against NPA / diminution in value of investments, and over-recognition of income, if any; and further reduced by book value of the company's investments in shares, bonds, debentures and outstanding loans and advances made to and deposits with related parties as defined in AS 18 of Institute of Chartered

Accountants of India (ICAI), other than investments in joint ventures for asset reconstruction permitted by Reserve Bank of India ; "Planning period" means a period not exceeding 12 months from the date of acquisition of assets for reconstruction, allowed for formulating a plan for realisation of such assets; "Standard asset" means an asset in respect of which, no default in repayment of principal or payment of interest is perceived and which does not disclose any signs of impairment nor carry more than normal risk attached to the business.

Income recognition

(1) The income recognition shall be based on recognised accounting principles;
(2) All the Accounting Standards and Guidance Notes issued by the Institute of Chartered Accountants of India shall be followed in so far as they are not inconsistent with these directions;
(3) Income including interest or any other charges in respect of all the NPAs shall be recognised only when it is actually realised, i.e. `Cash' method of accounting shall be applicable for recognising the income on all the NPA. Any such income recognised before the asset became non-performing and remaining unrealised shall be reversed.

Income from investments

Income from State/Central Government Securities shall be recognised on accrual basis, provided that the interest rate on these instruments is pre-determined and interest is serviced regularly and is not in arrears for a period of 180 days.

Valuation of Investments

All investments held by the Securitisation and Reconstruction Company shall be marked to market and accounted for as per the accounting standards and guidance notes issued by the ICAI.

Asset Classification

(1) Every Securitisation / Reconstruction Company shall, after taking into account the degree of well defined credit weaknesses and extent of dependence on collateral security for realisation, classify the assets it has acquired for reconstruction and held by it, into the following categories namely, Standard assets and Non-Performing Assets
(2) The Non-Performing Assets held by the Securitisation Company/Reconstruction Company for the purpose of reconstruction shall be classified
   a. As `sub-standard asset' for a period of 12 months from the date it was classified as non-performing.
   b. As `doubtful asset' if the asset remains a substandard asset for a period exceeding 12 months.
   c. As `loss asset' if the asset is non-performing for a period exceeding 36 months or if the asset is adversely affected by a potential threat of non-recoverability due to either erosion in the value of security or non-availability of

security or if, it has been identified as loss asset by the Securitisation Company/Reconstruction Company or its internal or external auditor.

(3) Assets acquired by the Securitisation Company/Reconstruction Company for the purpose of reconstruction will be treated as standard assets during the planning period.

(4) Every registered Securitisation / Reconstruction Company may, wherever appropriate and on the basis of circumstances for the purpose of enforcement of security interest, classify an asset as non-performing within the planning period.

Plan for realisation

(1) Every Securitisation Company/Reconstruction Company shall, within the planning period, formulate a plan for realisation of assets, which may provide for one or more of the following measures namely,
   a. Rescheduling of payment of debts payable by the borrower;
   b. Enforcement of security interests in the financial assets in accordance with the provisions of the Ordinance;
   c. Settlement of dues payable by the borrower;
   d. Taking possession of secured assets in accordance with the provisions of the Ordinance.

(2) The plan for realisation shall clearly spell out the plan to reconstruct the assets and realise the same within a specified timeframe, which shall not in any case exceed five years from the date of acquisition.

Renegotiation / Reschedulment of financial assets acquired for reconstruction

(1) If the Securitisation Company/Reconstruction Company renegotiates any of the terms of the realisation plan with the borrower within a period of 6 months from the date of such an agreement / review, the asset shall be classified as substandard.

(2) The NPA may be upgraded to the category of performing asset on satisfactory performance for a period of 12 months as per the renegotiated / rescheduled terms.

Provisioning requirements

Every Securitisation Company/Reconstruction Company shall, after taking into account the time lag between an account becoming non-performing, its recognition as such, the realisation of security and erosion over time in the value of security charged, make provision there against as under:

Substandard Assets: A general provision of 10% of the outstanding;

Doubtful Assets: 100% provision to the extent the advance is not covered by the estimated realisable value of security; In addition to this, 50% of the remaining outstanding.

Loss Assets: The entire asset shall be written off. If the assets are permitted to remain in the books for any reason, 100% thereof shall be provided for.

Disclosure in the balance sheet

Every Securitisation Company/Reconstruction Company shall, in addition to the requirements of schedule VI of the Companies Act, 1956, prepare the following schedules and annex them to its balance sheet:

1. The names and addresses of the banks / FIs from whom financial assets were acquired and the value of such assets procured from each such bank / FI;
2. Dispersion of various financial assets industry wise and sponsor wise. The dispersion is to be indicated as a percentage to the total assets;
3. Names and address of all the QIBs and the amounts invested by them in the various schemes of the Company formulated in pursuance of section 7(2) of the Ordinance;
4. Calculation of Owned Fund and Capital Adequacy ratio;
5. Details of related parties as per AS-18 and the amounts due to and from them;
6. Rating obtained for its various schemes and a copy of the rating rationale made available by the rating agency;
7. A statement clearly charting therein the migration of financial assets from standard to non-performing and from thereafter to loss assets; and
8. A statement of all significant accounting policies adopted in preparation and presentation of the balance sheet and profit and loss account.

Notes

(1) The accounting policies adopted in preparation and presentation of the financial statements shall be in conformity with the applicable prudential norms prescribed by the RBI.
(2) Where any of the accounting policies is not in conformity with these directions and the particulars of departures shall be disclosed together with the reasons thereof and the financial effect thereof. Where such effect is not ascertainable, the fact shall be so disclosed.
(3) An inappropriate treatment of an item in Balance Sheet or Profit and Loss Account cannot be deemed to have been rectified either by disclosure of accounting policies used or by disclosure in notes to balance sheet and profit and loss account.

Accounting Year

Every Securitisation/Reconstruction Company shall prepare its balance sheet, and profit and loss account as on March 31 every year.

Requirement as to capital adequacy

Every Securitisation / Reconstruction Company shall maintain, on an ongoing basis, a minimum capital adequacy ratio, which shall not be less than 15 percent of its total risk weighted financial assets. The risk weighted asset shall be calculated as the weighted aggregate of funded items as detailed hereunder:

(i) Cash and bank balances including fixed deposits and certificates of deposits with scheduled commercial banks	0

(ii) Investments	
State/Central Government securities	0
(iii) Other financial assets	100

Exemptions

The Reserve Bank of India may, if it considers it necessary for avoiding any hardship or for any other just and sufficient reason, grant extension of time to comply with or exempt all Securitisation Companies/Reconstruction Companies or a particular Securitisation Company/Reconstruction Company or class of Securitisation Companies/Reconstruction Companies, from all or any of the provisions of these directions either generally or for any specified period, subject to such conditions as the Reserve Bank of India may impose.

LENDERS OBLIGATIONS

RBI Guidelines on Fair Practices Code on Lenders Liability

While successfully piloting the "The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Bill" in the houses of the Parliament by way of moderating the possible misuse of the powers under the legislation by Banks and Financial Institutions, the Finance Minister gave an assurance to bring out a code of Fair Practices defining Lenders Liability to the borrowers in respect of loans and advances extended by them.

Such a Fair Practices Code already covers the Bankers in the USA.

According to the "fair practices code", which is at the core of the lender liability, the lenders must treat their borrowers fairly, and when they do not, they can be subject to litigation by the borrower for a variety of reasons. During the decade gone by, lender liability litigations in the US have broadly evolved into two broad categories - breach of contract and fraudulent claims. A decade-long evolution of the lender liability claims in the US has now made it a substantive segment of law. The US courts over the years have gone into innumerable areas of lender liability claims arising out of as diverse a cause as breach of contract, breach of commitment to fund or renew loans, oral commitments, bad faith, breach of fiduciary duty, fraud and misrepresentation, negligent loan processing and administration, interference with contractual affairs, interference with corporate governance, fraudulent and preferential transfers.

Consequent to the assurance by the Finance Minister, RBI during December 2002 has come out with broad guidelines for framing the Fair Practices Code with regard to lenders' liability " to be followed by commercial banks and financial institutions, emphasising on transparency and proper assessment of borrowers' credit requirements". RBI has issued a draft of the model code and has advised the individual banks to adopt model guidelines for framing their respective Fair Practices Code with the approval of their Boards.

Banks and Financial Institutions will have the freedom of drafting the Fair Practices Code enhancing the scope of the guidelines but in no way sacrificing the spirit underlying the above guidelines. For this purpose, the Boards of banks and Financial Institutions will also lay down clear policy as regards time frame, reasonableness of parameters indicated in the Fair Practices Code, etc.

The Board of Directors should also lay down the appropriate grievance redressal mechanism within the organization to resolve disputes arising in this regard. Such a mechanism should ensure that all disputes arising out of the decisions of a bank's functionary are heard and disposed of at least at the next higher level. The Board of Directors should also provide for periodical review of the compliance of the Fair Practices Code and the functioning of the grievances redressal mechanism at various levels of controlling offices with a consolidated report of such reviews submitted to the board at regular intervals as prescribed by it for this purpose.

Separate instructions would be issued by Reserve Bank of India regarding resolution of disputes between the banks/Financial Institutions and the borrowers remaining unresolved at the banks / Financial Institutions level.

Banks and Financial Institutions should take steps to have the 'Fair Practices Code' drawn so as to be in place by April 1, 2003. The adoption of the Code, printing of necessary loan application forms and circulation among the branches and controlling offices should also be completed latest by end of March 2003. The Fair Practices Code, which may be adopted by banks and Financial Institutions, should also be put on their website and given wide publicity. A copy may also be forwarded to the Reserve Bank of India.

Guidelines on Fair Practices Code

1. Loan Application forms shall be comprehensive to include information about rate of interest (fixed / floating) and manner of charging (monthly / quarterly / half-yearly / yearly rests), process fees and other charges, penal interest rates, prepayment options and any other matter which affects the interest of the borrower, so that a meaningful comparison with that of other banks can be made and informed decision can be taken by the borrower.
2. Banks and Financial Institutions should devise a system of giving acknowledgement for receipt of all loan applications. Banks / Financial Institutions should verify the loan applications within a reasonable period of time. If additional details / documents are required, they should intimate the borrowers immediately. If all the requirements are complied with by borrowers, banks / Financial Institutions should acknowledge for the same and state the specific time period from the date of acknowledgement within which a decision on the loan request will be conveyed to the borrowers.
3. Acknowledgement should also state the amount of process fees paid or to be paid and the extent to which such fees shall be refunded in the event of rejection of any application for loan.
4. In the case of rejection of any loan application, lenders should convey in writing the specific reasons thereof.
5. Lenders should ensure that there is proper assessment of credit requirement of borrowers. The credit limit, which may be sanctioned, should be mutually settled.
6. Terms and conditions and other caveats governing credit facilities given by banks/ Financial Institutions arrived at after negotiation by the lending institution and the borrower should be reduced in writing duly witnessed and certified by the authorised sanctioning authority; in respect of advances sanctioned by the Board of Directors or its committee the document of understanding should be certified by the authorised signatory preferably at Company Secretary level. A copy of such agreement should be made available to the borrowers for their record.
7. Lenders should ensure timely disbursement of loans sanctioned.
8. Stipulation of margin and security should be based on due diligence and credit worthiness of borrowers.

9. Lenders should keep the borrowers apprised of the state of their accounts from time to time and shall give notice of any change in the terms and conditions including interest rates, service charges etc. Lenders should also ensure that changes in interest rates and charges are effected only prospectively. To ensure the above, Banks / Financial Institutions should create appropriate information dissemination mechanism.
10. The loan agreement should clearly specify the liability of lenders to borrowers in regard to allowing drawings beyond the sanctioned limits, honouring the cheques issued for the purpose other than agreed, disallowing large cash withdrawals and obligation to meet further requirements of the borrowers on account of growth in business etc. without proper revision and sanction in credit limits, and disallowing drawings on a borrowal account on its classification as a non- performing asset or on account of non-compliance with the terms of sanction.
11. Lenders should give reasonable notice to borrowers before taking decision to recall / accelerate payment or performance under the agreement or seeking additional securities.
12. Lenders should release all securities on receiving payment of loan or realisation of loan subject to any legitimate right of lien for any other claim lenders may have against borrowers. If such right of set off is to be exercised, borrowers shall be given notice about the same with full particulars about the remaining claims and the documents under which lenders are entitled to retain the securities till the relevant claims are settled / paid.

Development of the Concept of ARC in India

An Asset Reconstruction Fund with adequate resources was considered as an one-time remedy for recovering and clearing the piled up NPAs of nationalised banks. The thinking first surfaced with the Second Narasimham Committee Report. To quote from the summary report of the Committee-

- **Recovery of NPAs - Creation of Asset Recovery Fund (ARF)**

  "An important aspect of the continuing reform process is thus to reduce further the high level of NPAs as a means of institutional strengthening. While there is reason to expect that with a combination of policy and institutional development, new NPAs could in future be lower than hitherto, the problem remains of the huge backlog of existing NPAs which impinges severely on banks performance and their profitability. Several approaches are possible. The earlier Committee had suggested the creation of an Assets Reconstruction Fund (ARF) to take these assets off banks books at a discount. Recapitalisation through infusion of capital is another approach and has been used in the case of some banks. In the last six years massive budgetary funds have been used for recapitalisation of public sector banks. This is costly and over time, not a sustainable option. The problem, however, remains and consideration would need to be given to revisiting the concept of an ARF."

  The Narasimham Committee, also recommended that the core NPAs of the banks would be transferred to the new entity which, in turn, would issue NPA swap bonds at the realisable value arrived at after due assessment.

<u>The basic elements of this approach consisted the following assumptions:-</u>

1. that the huge NPA burden of the industry is a one time problem, the contribution of past history of regulated banking

2. that future accrual of NPA would be streamlined and remedied through "a combination of policy and institutional development"

3. The ARC must have adequate resources to take over NPAs of commercial banks. In other words it must adequate paid-up capital to carry out a turnover of NPAs to be taken over by it, out of the piled up heap of around Rs.30000 Crores that existed before 2000

4. Once the mission is completed, the ARC would be no longer needed and it can be wound up or closed

It was estimated that a minimum of Rs.2000 Crores would be needed to float an ARC that would have the capacity to start the recovery process of NPA by taking over them from commercial banks at a discount based on the realisable value of the assets of the borrowers of these sticky borrowal accounts held by the banks. It was also suggested that the ARC should be constituted as a Private Sector enterprise.

THE Reserve Bank of India in early 2001 has suggested a maximum life-span of seven years for asset reconstruction companies (ARCs) and a minimum Rs 100-crore initial paid-up capital. The suggestion places the authorised capital of ARCs at Rs 500 crore. In a draft scheme prepared as a run-up to the constitution of ARCs, the RBI has proposed that the entities would function as private sector companies with 49 per cent holding subscribed by public sector banks and financial institutions, while the remaining 51 per cent would be offered to the public.

It also suggested that the ARCs, which are to be set up for tackling the problem of non-performing assets (NPAs) in the banking sector, should be restricted to only the past bad debt of the banks. Thus, the companies would not be allowed to nibble at the fresh NPAs added by banks on an ongoing basis after the constitution of the ARC.

The first ARC should deal with the bad debts of the three weak banks - Indian Bank, UCO Bank and United Bank of India. If the experiment proved successful, similar companies could be set up for taking up the bad debts of other banks and FIs as well.

The RBI further suggested that the realisable value of the NPAs should be a fair discounted value arrived at through a consensus between the valuers acting on behalf of the banks and the ARC.

The ARCs should be managed by a board of directors consisting of professionals from various fields such as banking, finance, law, engineering and valuation experts.

- **Other Core Issues Affecting Recovery of NPA**

Reduction/control of NPA needs a multi-pronged approach. Government of India originally set up during 1994, the Debt Recovery Tribunals in terms of *"Recovery of Debts Due to Banks and Financial Institutions Act, 1993".* The Government set up 22 DRTs and 5 DARTs. Seven more DRTs were set up after 2000. The Debt Recovery Tribunal is conferred the jurisdiction to try and entertain an application for recovery of debts of amount of Rs.10 Lacs or more due to banks and financial institutions. The Appellate Tribunal has also been constituted to entertain appeals from orders of the Debt Recovery Tribunal. The jurisdiction of the civil courts has been excluded in relation to matters falling within jurisdiction of the Tribunal except under Articles 226 and 227 of the Constitution of India. However the progress of settlement of disputes under DRTs were slow in the initial years.

To ensure the expeditious adjudication and recovery of dues, remove legal anomalies and strengthen the Recovery Tribunals, Government in the year 2000 passed The Recovery of Debts Due to Banks and Financial Institutions (Amendment) Act, 2000. The new statute allows the summary attachment of the property of the defaulting borrower at the time of filing the complaint and it also empowers Debt Recovery Tribunals (DRTs) to distribute sale proceeds among secured creditors and issue certificates for the recovery of enhanced or reduced amounts on the basis of the final order of the appellate tribunal.

The main provisions of the Act relate to set-off and counter-claims, appointment of receivers and commissioners by the Tribunal, transfer of cases from one Tribunal to another and appointment of more than one recovery officer in a Tribunal. The other provisions include empowering the Tribunals to issue certificates for recovery of enhanced or reduced amount on the basis of the final order of the Appellate Tribunal, empowering the Chairperson of the Appellate Tribunal to appraise the work of Presiding Officers of Tribunals and discharge the functions of the Chairperson of another Appellate Tribunal. The Act also allows for the transfer of recovery certificates from one Tribunal to another to facilitate recovery, and empowering the Tribunals to distribute the sales proceeds among the secured creditors in accordance with the provisions of Section 529A of the Companies Act.

- **Reports of the Andhyarujina Committee**

  The issue of NPAs is closely related to the state of legal framework. The legal framework sets standards of behaviour for market participants, details about rights and responsibilities of transacting parties, assures that completed transactions are legally binding and provides regulators with the backing to enforce standards and ensure compliance and adherence to law. The legal procedure for recovery through foreclosure of defaulted loans of banks and Financial institutions is felt too cumbersome and time consuming and there was persistent demand for provision of powers to the banks/FIs for summary take over of securities with the power to sell the same in satisfaction of the dues. To consider all these matters Government in the year 1999 appointed the Andhyarujina Committee under Chairmanship of T R Andhyarujina, senior Supreme Court advocates and former Solicitor General of India. The other members of the Committee were M Damodran, joint secretary for banking at the ministry of finance, A P Agarwal, additional legal advisor at the ministry of law and justice, V K Bhasin, additional legislative counsellor, S H Bhajani, executive director at the ICICI, N L Mitra, director at the Bangalore-based National Law School of India University, Shardul Shroff, solicitor, and N V Deshpande, legal adviser at the Reserve Bank of India.

The Committee submitted four reports.

The first is on the debt recovery tribunals.

The second is on amendment to Section 28 of the Indian Contract Act 1997.

The third is on powers for taking possession and sale of securities without intervention of court to banks and financial institutions.

The fourth is a law for securitisation.

In its report on the debt recovery tribunals or DRTs, the committee said even after the recent amendment to the recovery of debts to banks and Financial Institutions Act 1993, or DRT Act, extensive changes are required to confer larger powers on the tribunals for the expeditious disposal of claims of banks and financial institutions. The committee recognised the need for expertise in the personnel of the tribunal in view of complex transactional matters such as project financing, securitisation and new kinds of debt instruments involving high stakes, which will come up in future before these tribunals. It said the government might have to consider changing the set up of the tribunals in future to include members having expertise in such matters. The status and personnel of the tribunal should be upgraded in the meantime.

The committee has also recommended that conflicts of jurisdiction experienced between the working of the winding up court under the Companies Act and the jurisdiction of the BIFR under Sick Industrial Companies Act 1985 should be clarified. The tribunal should be given the authority to allow banks and financial institutions to serve the parties with summons for urgent orders. It further recommended that the central government should be invested with the power to make regulations for a uniform procedure to be adopted by all the tribunals in the country.

The committee has suggested that government may consider conferring the powers of contempt of court on the tribunals for effective implementation of their orders. If the tribunals are to function smoothly, it must be ensured that infrastructure requirements are expeditiously provided to them. For this purpose, the committee recommended that the DRT Act should be amended to cast an obligation on the RBI to constitute an infrastructural fund for the tribunals to ensure and facilitate and administrative and infrastructural requirements of the tribunals.

In its report on the amendment made to Section 28 of the Contract Act in 1997, the committee has stated that the banks and financial institutions have a case to have a special treatment for guarantees in the amended provisions of Section

28, particularly guarantees to government under which claims can be enforced even up to 30 years causing the banks and financial institutions to keep securities and margins for long periods. It recommended a reasonable period to be provided to the bank to enforce their rights under the guarantee after a specified event, which would extinguish or discharge the banks from their liability under a guarantee.

<u>In its report on the powers of taking possession and sale of securities without the intervention of court</u>, the committee has recognised that the right of private sale of movable and immovable property should be conferred to banks and financial institutions for speedy recovery as have been conferred upon land development banks and state finance corporations. For this purpose, a new law may incorporate power of sale without intervention of the court in cases where the mortgagees are banks and financial institutions with proper safeguards. Such a special law would also define a charge by way of hypothecation, floating charge and crystallisation of the floating charge into the rights and obligations of the hypothecator and hypothecatee with power of sale without the intervention of the court to banks and financial institutions. The law should provide for the setting up of a new registry jointly by the banks and financial institutions for registration of mortgages and hypothecation charges in place of the present obsolete and dilatory office of sub-registrar of assurance which are presently keeping records of transfers.

<u>In its report on securitisation</u>, the committee has recognised that it was time to examine the methodology of facilitating the modern concept of securitisation, which contemplates dealings in a new genre of commercial property. The committee has examined the essential ingredients of a securitisation transaction and suggested a draft bill for undertaking such transactions. It said that only with a new law there could be effective securitisation in a present dynamic field in which the development of law must assist the business world in achieving its goals. The Committee by way of Annexure to its Report enclosed a draft of a model Bill titled "Securitisation Bill 2000".

*The promulgation of the **"The Securitisation And Reconstruction of Financial Assets And Enforcement Of Security Interest Act, 2002"** for setting up asset reconstruction companies and for securitisation by these companies of NPAs of banks/FIs taken over by them is by way* *of implementation of the recommendations of the committee in its third and fourth reports mentioned above. The Act legislates on securitisation with particular reference to Asset Reconstruction of financial assets in the nature of NPAs of banks and financial institutions. It provides enforcement of security interest without taking recourse to civil courts.*

- **Securitisation of Assets**

Securitisation is a process through which illiquid assets are transferred into a more liquid form of assets and distributed to a broad range of investors through capital markets. The lending institution's assets are removed from its balance sheet and are instead funded by investors through a negotiable financial instrument. The security is backed by the expected cash flows from the assets.

Securitisation as a technique gained popularity in the US in the 1970. Favourable tax treatment, legislative enactment, establishment of Government-backed institutions that extend guarantees, and a pragmatic regulatory environment appear to have contributed to the successful development of this market. The market for securitisation in the US which is dominated by home mortgages has diversified to credit cards, home equity loans, student loans and small business loans.

UK is the second largest market for securitisation after the US. Areas of securitisation in the UK are broadly similar to the US and include residential mortgages, credit cards, consumer loans, commercial real estate and student loan. The Bank of England has played a leading role in evolving guidelines for banking and other authorised institutions in its loan transfers and securitisation. Now, the Financial Services Authority (FSA) sets out the policy on securitisation and loan transfers. Experience of UK is of special relevance to India, and we should liberally draw on it.

Securitisation as a form of funding (raising money by selling future revenue streams) is widely prevalent in western countries. These bonds are commonly traded in the secondary debt market as bearer bonds. The popularity of securitised bonds is on account of distinct advantages it provides to the different parties associated with it. From the perspective of the company that securitises its cash flows, the major benefits are in terms of getting immediate cash and passing the risk to the investors. Besides, for finance companies, securitisation would take the loan assets off the balance sheet, thereby relieving pressures of capital adequacy. For the investor it is a tradable security favourably rated by a Credit Rating Agency. Further, the company that wants to securitise can ask for a particular rating from a rating company and get it, by a mechanism called `credit enhancement'. This refers to shoring up investors' confidence by offering cash collateral to the SPV (Special Purpose Vehicle i.e. the agency that attends to securitisation of assets)

One major advantage of securitisation is its flexibility. A pool of receivables could be split into different `strips' and sold to different types of investors. For example, a money market mutual fund might be interested in a short-term paper (pass through certificate), whereas a pension fund might want to invest in a long-term paper. The SPV can have something to offer to both.

<u>The Process Adopted for Securitisation of Assets</u>

Assets are originated by a company, and funded on that company's balance sheet. This company is normally referred to as the " Originator".

Once a suitably large portfolio of assets has been originated, the assets are analysed as a portfolio, and then sold or assigned to a third party which is normally a special purpose vehicle company (an " SPV") formed for the specific purpose of funding the assets. The SPV is sometimes owned by a trust, or even, on occasions, by the Originator. Administration of the assets is then sub-contracted back to the Originator by the SPV.

The SPV issues tradeable "securities" to fund the purchase of the assets. The performance of these securities is directly linked to the performance of the assets - and there is no recourse (other than in the event of breach of contract) back to the Originator.

Investors purchase the securities, because they are satisfied (normally by relying upon a rating) that the securities will be paid in full and on time from the cash flows available in the asset pool. A considerable amount of time is spent considering the different likely performances of the asset pool, and the implications of defaults by borrowers on the corresponding performance of the securities. The proceeds upon the sale of the securities are used to pay the Originator.

The SPV agrees to pay any surpluses which arise during its funding of the assets back to the Originator - which means that the Originator, for all practical purposes, retains its existing relationships with the borrowers and all of the economics of funding the assets (ie: the Originator continues to administer the portfolio, and continues to receive the economic benefits (profits) of owning the assets). As cash flows arise on the assets, these are used by the SPV to repay funds to the investors in the securities.

The process in general can be described to consist of the following stages.

- The process begins when the lender (or originator) segregates loans/lease/receivables into pools which are relatively homogenous in regard to types of credit, maturity and interest rate risk.
- The pools of assets are then transferred to a Special Purpose Vehicle (SPV) usually constituted as a trust. The originator may float the SPV as a subsidiary in the form of a limited company. Another option could be for the SPV to be floated jointly by the originator/individuals/banks/institutions who are interested in the securitisation deal.
- Based on these, the SPV issues asset backed securities in the form of debt, certificates of beneficial ownership and other instruments. The securities issued may be with or without recourse.
- Interest and principal payments on the loans, leases and receivables in the underlying pool of assets are collected by the servicer (who could also be the originator) and transmitted to the investors.
- Credit enhancement can add features to boost investor confidence. This could be in the form of a provision of recourse, a guarantee requiring the originator to cover losses, a letter of credit from a bank, or over collateralisation.

There could be three basic methods of transfer of assets, viz:

- novation,
- assignment and
- sub-participation.

Novation is the clearest way of selling a loan and effectively transferring both the rights and obligations. In novation, the existing loan between originator and borrower is cancelled and a new agreement between the investor and borrower is substituted. The buyer steps into the shoes of the original lender or seller who ceases to have any obligations to the borrower. The loan, is therefore, excluded from the balance sheet of the seller.

An assignment transfers from the seller to buyer, all rights to principal and interest. Assignments for the purpose of disposing of assets may fall into two basic legal categories. The first is statutory assignment, transferring both legal and beneficial title. A statutory assignment will pass and transfer from the seller to the buyer all the legal rights to principal and interest. In most cases, it will also pass on all the legal remedies available against the borrower to ensure discharge of debt. In other words, the buyer acquires the full legal and beneficial interest in the loan. The second is equitable assignment, transferring only beneficial title. It does not transfer legal rights. Thus, a buyer may not be able to proceed directly against a borrower. The seller must be joined in action. However, the seller is not liable for debt.

Sub-participation does not transfer any of the seller's rights, remedies or obligations against the borrower to the buyer. But, it is an entirely separate, back-to-back, non-recourse funding arrangement, under which the buyer places funds with the seller. In return, the seller passes on to the buyer, payments under the underlying loan, which the borrower makes to him. But, the loan itself is not transferred.

Securitisation is designed to offer a number of advantages to the seller, investor and debt markets.

1. For seller or originator, securitisation mainly results in receivables being replaced by cash thereby improving the

liquidity position. It removes the assets from the balance sheet of the originator, thus liberating capital for other uses, and enabling restructuring of the balance sheet by reducing large exposures or sectoral concentration. It facilitates better asset liability management by reducing market risks resulting from interest rate mismatches. The process also enables the issuer to recycle assets more frequently and thereby improve earning. Finally, transparency may be improved since securitisation results in identifiable assets in the balance sheet.

2. For investor, securitisation essentially provides an avenue for relatively risk-free investment. The credit enhancement provides an opportunity to investors to acquire good quality assets and to diversify their portfolios.

3. It also provides opportunity for matching cash flows and managing ALM since a securitised instrument carries regular monthly cash flows and has varying maturities. The prevalence of secondary markets would offer liquidity.

4. From the point of view of the financial system as a whole, securitisation increases the number of debt instruments in the market, and provides additional liquidity in the market. It also facilitates unbundling, better allocation and management of project risks. It could widen the market by attracting new players on account of superior quality assets being available.

- **Asset Reconstruction**

"Asset Reconstruction" is defined as acquisition by Company of any right or interest of a bank or financial institution in respect of a financial assistance for the purpose of realisation of such financial assistance. In other words the company handles debt collection on behalf the banks and financial institutions.

In the normal course banks and financial institutions themselves handle the job of recovery for most of their lending, but in this process they are finally saddled with a left over portion of sticky debts representing willful dodgers and sunset industries. This is because no credit institution, on account of inherent risks in lending, can have 100% recovery performance. The left over or unrecovered credit represents difficult cases, which warrant special and concerted action. When such overdue credit outstanding grows large in volume, the banks and financial institutions are unable to divert attention from their core business substantially to this time-consuming job requiring concerted and continuous efforts. These can therefore be outsourced to specialised agencies i.e. Asset Reconstruction Companies, who have built-in professional expertise in this task, and who handle recovery as their core business.

Handling recovery of chronic cases and willful dodgers is the normal function of these companies and they are adequately geared and equipped for this job. In this respect the ARCs handle the function of recycling to productive and beneficial use of assets that otherwise threaten to turn as scrap or waste. In the first place Banks & FIs assign or transfer all their rights with reference to specific debts including their security rights on the collateral held by them as cover to the ARC. The ARC thus steps into the shoes of the banker and attends to recovery of the outstanding through manifold methods and devices.

The financial and banking sector in India during the past three decades is continuously witnessing burden of sick industries, failed credit and bulging non-performing assets. This posed recurring problems leading to poor capital adequacy and turning several banks weak and loss incurring. The Government of India consequently had to rush to their aid on several occasions during the past decade with doles of recapitalisation support to restore the sustainability of the ailing banking and financial institutions. This environment then should provide vast scope for ARCs to thrive with unlimited potential for roaring of business.

- **Securitisation in India**

The potential market in India for securitisation business is estimated at over a trillion of rupees. However the concept has not taken a wider application so far for various reasons.

The first widely reported securitisation deal in India dates back to 1990 when Citibank securitised auto loans and placed a paper with GIC mutual fund. Since then, a variety of deals have been undertaken

Apart from these, some innovative deals have also been struck. Earlier, in 1994-95, SBI Cap structured an innovative deal where a pool of future cash flows of high value customers of

Rajasthan State Industrial and Development Corporation was securitised. An oil monetisation deal has been structured where the future flows of oil receivables accruing to a company was securitised. Real estate developers have securitised receivables arising out of installment sales. The securitisation deal of Larsen & Toubro has opened a new vista for financing power projects. The deal was a securitisation of lease receivables even before the plant was completed. Thus, this securitisation deal financed even the asset creation.

National Housing Bank (NHB) has made efforts to structure the pilot issue of mortgage backed securities (MBS) within the existing legal, fiscal and regulatory framework. Under the proposed transaction, mortgage debt was transferred/assigned/sold to NHB by Housing Finance Companies (HFC) (originator) pursuant to an agreement/contract in the 'debt simplicitor form'. NHB acted as an issuer of pass through certificates (PTCs) and as a trustee on behalf of the investors.

A legal framework for securitisation and Asset Reconstruction is now enacted by the passing of the "The Securitisation and Reconstruction of Financial Assets And Enforcement of Security Interest Ordinance, 2002". The main purpose of the Act is to promote the setting up of asset reconstruction/securitisation companies to take over and liquidate the 70,904 Crores of NPA accumulated with the commercial banks and public financial institutions. The Act envisages Asset Reconstruction-cum-Securitisation companies to undertake Asset Reconstruction function. The Act therefore deals in detail with three distinct legal provisions for handling of dormant financial assets held by banks and FIs, namely, setting up of asset reconstruction companies to take over such assets, by exercising the powers for enforcement of security interest as vested with them in terms of the Act, and later attending to securitisation of such financial assets.

The comprehensive Act covers securitisation and asset reconstruction exclusively in respect of defaulted loans (NPAs) of Banks and Financial Institutions. It demonstrates the concern of the Government of India on the growing menace of carried forward NPAs distressing the Public Financial Institutions and Banks in the country by the provision of a comprehensive package. The Act, as a result, has brought to limelight the process of quick liquidation of accumulated overdue NPAs. Banks and Financial Institutions have already served bunches of legal notices to the defaulters under Sec.13(2) of the Act. It has awakened both lenders and borrowers to remind them of their rights and obligations.

The core issues with reference to asset reconstruction and securitisation are discussed and analysed in the series articles that follows this narrative.

The Act defines securitisation as the acquisition of financial assets by such a company from any originator, i.e., owner, of the asset for the purpose of securitisation or reconstruction as the case may be. More specifically stated securitisation is a method of funding receivables of whatever kind (mortgage debts, leases, loans, credit card balances etc...), provided they are secured defaulted "financial assets" transferred to NPA and not exempted under the Act. It involves producing asset-backed securities, which can be selectively traded to qualified institutional buyers (QIBs) secured on a portfolio of receivables.

Asset reconstruction has been defined to mean acquisition by the companies of the rights and interests of any bank or FI for realisation of the financial assistance rendered by them. The companies are really debt collectors, given sweeping powers which were so far exercised by debt recovery tribunals and civil courts and were not available to the debt recovery department of the lenders themselves.

While asset reconstruction may be deemed as the main objective or function of these bodies, securitisation and provision for enforcement of security interest are intended to enable the process of recovery of the securitised debts easier and quicker. The powers for enforcement of security enables smooth take over of the assets, and the sale proceeds of securitisation bonds will be available to take make payment for the originator for acquisition of the secured assets. They are to act as in-built facilitators for the process of Asset Reconstruction. Securitisation serves as a means of self-financing the activities of ARCs without the Government or PSBs or the Private Sector obliged to contribute huge initial equity to incorporate the Company. As per the Act ARC/SC Companies are oblige to provide for initial equity of Rs.2 Crores. Subsequently the owned capital need not exceed15% of the value of the assets acquisitioned. It is possible to conduct this business with the limited owned capital in proportion to the turnover contemplated only because the concepts of securitisation and asset reconstruction are combined.

Asset Reconstruction Company of India Limited

ICICI Bank Chairman N Vaghul is heading the country's first asset reconstruction fund ARC of India Ltd, floated by ICICI Bank, Industrial Development Bank of India, State Bank of India, Housing Development Finance Corporation (HDFC), HDFC Bank (HDBK.BO, news) and a clutch of other banks.

ARC of India Ltd, the first asset reconstruction company in the country, is planning to take off with buying out Rs 5,000 crore (Rs 50 billion) worth of bad assets from the system.

About 50 sticky accounts worth Rs 20 crore (Rs 200 million) and above have been identified which will be transferred to the ARC after it gets the licence from the Reserve Bank of India.

Most of these assets are common in the books of Industrial Development Bank of India, State Bank of India, IFCI and ICICI.

ARC of India, which has recently been incorporated, has gotten the Reserve Bank of India's licence to be kick off operations.

The other members on the board of the company, which has an equity base of Rs 10 crore, are Deepak Parekh, chairman HDFC; P P Vora, chairman IDBI (IDBI.BO, news) and P N Venkatachalam, managing director, State Bank of India.

The independent directors on the board are Ashok Ganguly, J J Irani and Y H Malegam. One more independent director is likely to join the board soon.

ICICI, IDBI and SBI hold 24.5 per cent each in the ARC, while HDFC and HDFC Bank hold 10 per cent each and the rest is being held by a clutch of banks including Federal Bank and IDBI Bank. The ARC will function as a trustee and buy distressed assets from banks.

Globally, qualified institutional buyers (QIBs) buy the distress assets. Since this market has not developed in India as yet, banks will be issued units against the assets and these units can be encashed after the assets are recovered. In essence, the ARC will act as a fund.

To start with, it will buy sticky assets of banks in small tranches. Unlike in other parts of the world, where the sticky assets are sold at a very steep discount — as much as 85 per cent — in India the stressed assets are unlikely to be sold cheap.

All assets here are backed by collaterals and most of them are productive assets. We expect them to fetch a price of around 35-40 per cent of the book value.

The ARC will be modelled on the asset management company of a mutual fund. After taking over the assets, it will bundle the assets like an MF and create asset portfolios.

At the second stage, pass through certificates against these assets will be issued to banks and institutions as there is no qualified institutional buyer in the market to buy junk bonds.

In other words, the banks and institutions which at the first stage sell sticky assets to the ARC will replace them with the PTCs which will be redeemed by the fourth year. If the net asset value of the PTCs is higher than the face value, the ARC will get 20 per cent share of that and the ARC stakeholders the rest.