

# A Comparative Study of SARFAESI Act 2002 and Tools for Recovery of NPAs

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**Abstract:** *Rising Non-performing assets is growing as a cancer in a Indian Banking Sector. Almost all banks in India are affected with this death worthy disease. However, Government of India has enacted many legislatures to recover the dead amount of loan advanced by banks from time to time. Although all such laws have tried to recover the NPAs and these laws have proved successful to some extent. Still there is a need to investigate as which recovery mechanism has been more successful as compared to other tools. In this research paper, an attempt been made to analyse the effectiveness of major recovery mechanism in comparison of SARFAESI Act, 2002.*

**Keywords:** Banking Sector, Non-Performing Assets, Recovery, SARFAESI, Banks

## I. INTRODUCTION

Banking sector in India is going through a transformation since the beginning of liberalization. Interest rate has been declined considerably. The performance of banks has been improved slightly over time. However public sector banks are doing the worst among all banks. The banking sector as a whole especially the public sector banks still suffer from considerable Non-performing Assets. The Growing Non- Performing Assets have been reeling under high level of bad debts. But the situation has improved over time. In the recent past, the bank regulators have introduced a number of measures to link the regulation of commercial banks to the level of risk and financial liability of these banks. New legal developments like the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act provide new option to banks in their struggle against Non-Performing Assets.

According to section 69 of Transfer of Property Act, mortgagee can take possession of mortgaged property and sell the same without intervention of court only in case of the English mortgage. English mortgage is where mortgager binds self to repay the mortgaged money on a certain date and transfer the mortgaged property absolutely to the mortgagee, but subject to provision that he will re-transfer the property to the mortgager, upon the payment of mortgage money agreed. In addition, mortgagee can take possession of mortgaged property where there is a specific provision in mortgage deed and the mortgaged property is situated in towns of Kolkata, Chennai or Mumbai. In other cases, the possession can be taken up only with the intervention of court. Therefore, till now Bank/Financial institution had to enforce their security interest through court. This was a very slow and time-consuming process. Also there was no provision on any of the present laws in respect of hypothecation though the hypothecation is one of the major security interests taken by Banks/ Financial Institution. Keeping in mind the above factor among many other, Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act was enacted with effect from 21-6-2002.

### A. The Act deals with three aspects:

1. Enforcement of security Interest by secured creditor (Bank/Financial Institution).
2. Transfer of NPAs to Assets Reconstruction Company, which will then dispose of those assets and realize the proceeds.
3. To provide legal framework for securitization of assets.

One of the major problems faced by Banks/Financial Institutions in India is that of Bad debts termed as “Non-Performing Assets” in official terminology. There are many reasons for the sorry state of affairs, major among them are;

- a. Political interference
- b. Poor Law Enforcement
- c. Corruption at various levels
- d. Archaic Laws and Procedures
- e. Misuse of sick industrial company Act

**B. Non-performing assets:**

An asset is classified as non-performing asset (NPA) if the borrower does not pay dues in the form of principal and interest for a period of 180 days. However, with effect from March 2004, default status would be given to a borrower if dues were not paid for 90 days. If any advance or credit facilities given or granted by a bank or the financial institution to borrower become non performing, then the bank have to treat all the advances or credit facilities granted/given to that borrower as non performing without having any regard to the fact there may still exist certain advances or credit facilities having performing status. With a view to moving toward international best practices and to ensure greater transparency, it has been decided to adopt the '90days overdue' norms for identification of non-performing assets, from the year ending 31 march 2004. Thus, with effect from March 2004, a non-performing asset (NPA) shall be a loan or an advance where: -

1. Interest and/or instalment of principal remain overdue for a period of more than 90 days in respect of a Term Loan.
2. The account remains 'out of order for more than 90 days, in respect of an overdraft/cash credit.
3. The bill remains overdue for a period of more than 90 days in the case of bill purchased and discounted.
4. Interest and/or instalment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agriculture purpose and any amount to be received remains overdue for a period of more than 90days in respect of other accounts.

**II. SECURITIZATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT 2002(SARFAESI)**

SARFAESI Act provides for Enforcement of security interest for realization of the dues without the intervention of courts or Tribunals. Thus, SARFAESI is treated as one of the most effective tools for recovery of NPAs. The Securitization Act proposes to securitize and reconstructs the financial assets through two special purpose vehicles viz. 'Securitization Company ('SCO')' and 'Reconstruction Company (RCO)'. The Securitization Ordinance was brought in to speed up the debt recovery process of Banks and Financial Institutions by attachment of their assets without having to obtain a decree through normal legal process from a competent Court of Law. Although the trade and industry had a mixed reaction after the promulgation of this Ordinance, one of the reasons for which they felt unsecured with the Ordinance was that the Ordinance did not make any difference between the wilful defaulters and the normal business defaulters. They felt that, due to various factors such as the economic slowdown in the country and political interference, most of the loan of Banks and Financial Institutions became bad for reasons beyond their control but as per the Central Government an estimated amount of about Rs.4 lac crore was locked into Non -Performing Assets (NPA) with different Banks and Financial Institutions. Committees have recommended introduction of some such kind of law which will provide faster mechanism to the lenders to recover their dues and to be able to not only attach the assets of the defaulters but also to encash them. The present law does not provide such a relief and it was taking a very long time in realization of dues, which was detrimental to public interest and affected national growth. With this back - ground, the Central Government has brought in the Securitization Law and this has sent right signals not only to the defaulters concerned but also to the borrowers in general. It is needless to mention, that a lasting solution to the problem of Non Performing Assetscan be achieved only with proper credit assessment and risk management mechanism (Karunakar,2008). There is a need to investigate the effectiveness of such hard act in order to recovery of the curse i.e. NPA over other mechanism i.e. Lok Adalat and DRT's.

### III. METHODS

This research paper is based on the Doctrinal Method based on secondary data. The sources of data for this paper include the literature published by Indian Bank and the Reserve Bank of India, various magazines, Journals, Books dealing with the current banking scenario and research papers.

### IV. FINDINGS & RESULT

India's legal system has traditionally been friendly towards borrowers and famously slow and inefficient. Consequently, once a bank makes a loan to a company, it has very little bargaining power in terms of calling the loan back or getting its hands on assets that formally securitize the loan. In 1993, (DRTs) were set up precisely to avert this problem, to provide banks faster access to justice. In 2002, a major step in to empowering banks in their loan recovery efforts came in the form of the NPAs Ordinance, later turned into the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act. The Act paves the way for the establishment of Asset Reconstruction Companies (ARCs) that can take the Non-Performing Assets off the balance sheets of banks and recover them. It also allows banks and financial institutions to directly seize assets of defaulting borrowers who fails to respond within 60 days of a notice. In this section, a review of some important studies carried out on the various aspects of Non-Performing Assets is undertaken. This will help us to formulate the precise contours of the problem under study and also develop a rationale for undertaking this work. The review will also set the necessity guidelines for research and explore the possible area, which need to be studied. The level of NPA in private sector banks is lower than their nationalized counterparts. This could be due to better credit standards maintained by these private players. However, the authorities should ensure that the interest of customers is protected by the banks and they are not exceeding the limits, so as to reduce the NPA levels. The alarming thing is that all the developed and developing countries have already managed to curb the

NPA level from the high of 2008-09 at the time of global recession, where it is still rising in India. It was found that the cases get delayed inordinately in a Debt Recovery Tribunal much against the spirit and motive of its very establishment. Banks have expressed their dissatisfaction with the system that was instituted to ensure speedy recovery.

### V. CONCLUSION

The NPAs have always created a big problem for the banks in India. It is just not only problem for the banks but for the economy too. Profitability of banks is adversely affected due to growth in non-performing assets. This study shows that, to recover the amount covered under shadow of NPA, various mechanisms have been introduced by government. The study shows that Lok Adalat has not shown considerable success in recovery of NPA i.e percentage of recovered amount to total has not touched even double figures except during 2006-07 and 2011-12. SARFAESI Act and the debt recovery tribunals (DRTs) have proved to be most effective in terms of amount recovered among the various channels of recovery for dealing with bad loans. To the contrary, DRT's and SARFAESI Act has shown considerable performance in recovery of NPA. In initial years SARFAESI has performed very well. However, from 2010-11, recovery process through SARFAESI Act got slower. This may be due to high dependence of recovery shifted to SARFAESI Act than DRTs. Thus, there is need to widen the scope of SARFAESI act so that recovery mechanism could be faster. However, Indian Bank has the slippages during the period of study in controlling of NPA in the early years of the decade.

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