Comments on the Enforcement of Security Interest and Recovery of Debt Laws and Miscellaneous Provisions (Amendment) Bill, 2016 (Bill)

Pratik Datta (NIPFP), Shubho Roy (NIPFP),
Renuka Sane (ISI Delhi), Rajeswari Sengupta (IGIDR),
Anjali Sharma (IGIDR), Ajay Shah (NIPFP),
Susan Thomas (IGIDR), Bhargavi Zaveri (NIPFP)

10 July 2016

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1 Summary of comments

The laws covered in the Bill are those that strengthen creditors rights in recovery under insolvency. These are the *RDDBFI Act* (1993), *SARFAESI Act* (2003), along with certain provisions of the Indian Stamp Act (1899) and the *Depositories Act* that are relevant for recovery from stressed assets.

The scheme of *SARFAESI Act* can be divided into three parts: (a) the creation and regulation of Asset Reconstruction Companies (ARCs) as entities that purchase and manages stressed assets; (b) to allow banks, financial institutions and ARCs to enforce their security without intervention of the court; and (c) the creation of a Central Registry to record the details of all securitisation transactions and security interest created in favour of banks and the financial institutions covered under the Act. The *RDDBFI Act* allows banks and these financial institutions to recover their dues through a specialised tribunal.

In this document, we present an analysis of the Bill. The document is divided into two sections, as under:

- a strategic perspective of amendments required to reform *SARFAESI Act*;
- a clause-by-clause analysis of the Bill. This part presents (a) the clause, (b) our suggestion on how the clause should be modified or whether it should be removed outright, and lastly, (c) the rationale for our suggestion.

1.1 Strategic reform to *SARFAESI Act*

Since the *RDDBFI Act* and *SARFAESI Act* cover the process of how an individual secured creditor can enforce collateral during default, we recommend that the consequent amendments of the *RDDBFI Act* and *SARFAESI Act* must do the following:

1. **Expand the *SARFAESI Act* and the *RDDBFI Act* to include all secured creditors**

   The Bill must be revised to allow all secured creditors to take the benefit of *SARFAESI Act* and *RDDBFI Act* and not restrict the benefit of these legislations only to banks, a limited set of financial institutions and ARCs.

SARFAESI Act and *RDDBFI Act* were originally enacted to allow all secured creditors to realise their security efficiently and without having to go through the hassle of regular civil courts. However, the benefits of these laws have been long restricted to banks and certain kinds of financial institutuions. This leaves a large section of the secured creditors such as Non-Banking Financial Companies (NBFCs) and Multilateral Financial Institutions (MFIs) to the mercy of the civil courts. This has removed the scope of having a level playing field between secured creditors.

For example, a private equity fund that has given secured credit must be able to enforce its security with the same efficiency as a bank and an ARC is, under *SARFAESI Act*.

2. **Bring the regulation of ARCs at par with the regulation of other funds in India**

   The Bill must be revised to ensure that ARCs in the same manner as any other pooled vehicle is regulated in India.

   ARC is a financial firm (a pooled vehicle) that manages stressed assets. Like any other fund, such as a private equity fund or a mutual fund, it pools money from investors and invests it in stressed assets.

   Globally, financial firms are regulated from two points of view: consumer protection (including micro-prudential regulation) and systemic risk regulation. When viewed from this perspective, two features of the ARCs must be considered:

   - ARCs have no small household customers. Investors in ARC are sophisticated investors. ARCs do not accept deposits. Hence, the question of consumer protection does not arise. This feature also removes the need for micro-prudential regulation.
   - ARCs tend to be small organisations, with assets of well below 1% of GDP (which is $20 billion). Hence, there are no systemic risk concerns associated with ARCs.

   These observations suggest that there is no case to regulate ARCss. However, *SARFAESI Act* originally took a different approach toward regulation of ARCs. It conferred jurisdiction on Reserve Bank of India (RBI) to regulate these funds, which (a) mandated higher capital adequacy requirements than other regulated funds in India, (b) allowed a limited set of investors to invest in Security Receipts (SRs) issued by ARCs, (c) empowered RBI to issue directions on income recognition, deployment of funds, control board composition, among other constraints. The Bill, which proposes to increase the regulatory powers of RBI over ARCs, will further stifle the ARC industry in India.

To allow the ARC industry to flourish and take over the bad assets from banks, ARCs must be viewed as they are, that is, they are essentially private equity funds which specialise in distressed debt. Private equity funds are well established entities in India today and they are regulated by Securities and Exchange Board of India (SEBI) under the *AIF Regulations*. Instruments or units issued by private equity funds are regulated like securities. Similar to the regulatory framework under the *AIF Regulations*, ARC also require no or light-touch regulation.

If our submission on reforming the manner in which ARCs are regulated in India is not accepted, then we have suggested alternative provisions in each case which will incrementally improve the regulation of ARCs in India.

3. **Bring consistency between the *SARFAESI Act*, the *RDDBFI Act* and the *Insolvency and Bankruptcy Code***

The Bill must harmonise the provisions of the *SARFAESI Act* and the *RDDBFI Act* with the provisions of the *Insolvency and Bankruptcy Code*.

The *Insolvency and Bankruptcy Code* is a paradigm shift that focuses on consensual re-organisation of creditors' and debtors' rights. It provides for efficient processes and allows private industry to drive the resolution processes. This amendment must use the opportunity to rationalise and update *SARFAESI Act* and *RDDBFI Act*, such that each of these laws work in sync with each other. Only then will one see better debt recovery outcomes.

For example, *SARFAESI Act* must be amended to widen the set of entities who can act as the registry of information about security interest created in favour of the secured creditors for all secured credit transactions, not just CERSAI. This amendment is essential to ensure consistency between *Insolvency and Bankruptcy Code* and *SARFAESI Act*, in the context of who can store information on credit-related information. The *Insolvency and Bankruptcy Code* envisages a regulated industry of Information Utilities (IUs) for performing this function. *SARFAESI Act*, on the other hand, seeks to perpetuate a State monopoly in the form of a Central Registry or Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI).

Each of the strategic amendments suggested above is indispensable to harmonising the collective enforcement processes envisaged under the *Insolvency and Bankruptcy Code* and individual credit-enforcement laws such as *SARFAESI Act* and *RDDBFI Act*.

4. **Incorporate principles of good regulatory governance in administration of *SARFAESI Act***

   The Bill must ensure that the principles of good regulatory governance are followed in the administration of *SARFAESI Act* and *RDDBFI Act*. For example, Section 30C proposed under the Bill, provides that an appellate authority against an order levying a penalty on an ARC, will comprise of officers of the RBI.

   This is fundamentally contrary to the principles of natural justice. An appellate body must necessarily be independent and outside of the body against whose orders an appeal is preferred. One cannot appeal to a regulator against penalties imposed by the same regulator.

   It is suggested that appeals against penalties imposed by RBI under *SARFAESI Act* must be preferred to the National Company Law Tribunal (NCLT) which this note proposes as the appellate forum.

2 Amendments to ***SARFAESI Act***

2.1 Regulation of ARCs

Clause of the Bill: This comment does not apply to any specific provision in the Bill.

Comment: SARFAESI Act must be appropriately revised to bring the regulation of ARCs at par with the regulation of other funds in India. Under the current Indian regulatory framework, SEBI regulates all investment vehicles such as private equity funds, hedge funds and venture capital funds, under the *AIF Regulations*. Further, the units issued by these funds are treated as securities under the *SCRA*. Bringing the regulation of ARCs at par with the regulation of other similar funds in India, will require amendments to the *SARFAESI Act* and the *AIF Regulations*. Please see Box 1 for a list of the key amendments required to *SARFAESI Act* for this purpose.

Rationale: Please see our rationale for de-regulating ARCs in section 1 of this note.

2.2 Expanding the enforcement rights under ***SARFAESI Act***

We wish to make two alternative submissions here:

2.2.1 Allowing all secured creditors to enforce their security interest under ***SARFAESI Act***

Clause of the Bill: This comment does not apply to any specific provision in the Bill.

Comment: SARFAESI Act must be appropriately revised to expand the enforcement rights created in favour of ARCs to all secured creditors. Please see Box 2 for the key amendment required to *SARFAESI Act* for this purpose.

Rationale: The *SARFAESI Act* was originally intended for speeding up the recovery process for *all* secured creditors. However, the benefits of these laws have been largely restricted to banks and financial institutions. A large swathe of non-bank financial entities like NBFCs and MFIs could not avail

Box 1: Key amendments to *SARFAESI Act* for bringing the regulation of ARCs at par with other funds in India

1. The following clauses must be added in section 2(1) of *SARFAESI Act*:

   "(a) "Alternative Investment Fund" has the meaning attributed to it in the Alternative Investment Fund Regulations;
   (aa) "Alternative Investment Fund Regulations" means the Securities and Exchange Board of India (Alternative Investment Fund) Regulations, 2012;"

2. Sections 3-5 of *SARFAESI Act* must be substituted with the following provision:

   "3A. Regulation of entities engaged in asset reconstruction:

   (1) On and from such date as the Central Government may, by notification in the official gazette, specify, -

   (a) an entity registered as an asset reconstruction company under this Act shall be deemed to be an Alternative Investment Fund belonging to such category as may be specified by the Board under the Alternative Investment Fund Regulations;

   (b) an entity which proposes to engage in the business of securitisation shall apply to the Board to be registered as an Alternative Investment Fund under the Alternative Investment Fund Regulations; and

   (c) all security receipts and other instruments of a like nature issued by an asset reconstruction company registered under this Act, shall be deemed to be securities as defined under the Securities Contracts (Regulation) Act, 1958.

   (3) All rules, directions, guidelines, instructions, circulars, or any like instrument issued by the Reserve Bank under this Act shall continue to be applicable for a period of one year from the date on which this provision is notified, or till such time as notified by the Board, whichever is earlier."

3. The following provisions of *SARFAESI Act* must be deleted:

   - Section 7 dealing with Issue of security by raising of receipts or funds by securitisation company or reconstruction company;
   - Section 8 dealing with exemption from registration of security receipts
   - Section 10 deakubg with Other Functions of Securitisation Company or Reconstruction Company

- Section 11 dealing with Resolution of Disputes
- Section 12 dealing with Power of Reserve Bank to determine policy and issue directions
- Section 12A dealing with Power of Reserve Bank to call for statements and information.

Box 2: Key amendments to expand the benefit of *SARFAESI Act* to all secured creditors

1. Section 2(1)(zd) of *SARFAESI Act* shall be substituted with the following:

   "'secured creditor' means any person in whose favour security interest is created for due repayment by any borrower of any financial assistance, and includes:
   (i) debenture trustee appointed by any body corporate to represent the interests of holders of secured debt issued by such body corporate;
   (ii) asset reconstruction company, whether acting as such or managing a trust set up by it for securitisation; and
   (iii) any other trustee holding securities on behalf of any body corporate."

Box 3: Proposed formulation of the definition of financial institutions

Sub-clause (iv) of clause (m) of section 2(1) of *SARFAESI Act* must be substituted with the following sub-clause:
"(iv) any other non-banking financial company as defined in clause (f) of section 45-I of the Reserve Bank of India Act, 1934 (2 of 1934);"

of the efficient recovery mechanisms that *SARFAESI Act* contemplated. Expanding the definition of secured creditor" would imply that all kinds of secured creditors, including banks, financial institutions as well as non-financial institutions which have advanced a secured loan as well as holders of secured bonds, would be entitled to enforce their security interest without court intervention.

2.2.2 Allowing all financial institutions to enforce their security interest under *SARFAESI Act*

Clause: This does not pertain to any specific clause of the Bill.

Comment: If our submission to expand the scope of *SARFAESI Act* to all secured creditors (as detailed in section 2.2.1) is not accepted, the definition of financial institutions must be expanded to include all financial entities engaged in the business of lending. Please see Box 3 for a proposed formulation of the definition of financial institutions.

Rationale: Expanding the definition of financial institutions" which are secured creditors would be entitled to enforce their security interest without court intervention

2.3 Amendment of section 2 of *SARFAESI Act*

2.3.1 Concept of default

Clause 4(v) of the Bill: Clause 4(v) of the Bill proposes to substitute the existing definition of "default" with the following definition:

> (j) " default" means -
>
> (i) non-payment of any debt or any other amount payable by the borrower to any secured creditor consequent upon which the

Box 4: Proposed formulation for definition of default under *SARFAESI Act*

Section 2(1)(j) of *SARFAESI Act* must be substituted with the following clause:

> "default" means non-payment of debt, when the whole or any part or instalment of the amount of debt has become due and payable and is not repaid to the secured creditor;

account of such borrower is classified as non-performing asset in the books of account of the secured creditor; or

(ii) non-payment of any debt by the borrower with respect to debt securities after notice of ninety days, demanding payment of dues served upon such borrower, by the debenture trustee or by any other authority in whose favour security interest is created for the benefit of holders of such debt securities.

Comment: The definition of "default" must be conceptual and must not be linked to the classification as a non-performing asset. Please see Box 4 for a proposed formulation of the definition of default.

Rationale: This amendment must be made for two reasons:

1. The current and proposed definition of default link it to the asset being classified as a Non-Performing Asset (NPA) in the books of the bank or financial institution. As per the norms specified by RBI, a bank or financial institution may classify an account of a borrower as a NPA *only upon completion of 90 days from the date of default*. This would mean that a secured creditor cannot avail of the recovery mechanisms under *SARFAESI Act* until the 90th day from the date of actual default. The purpose of *SARFAESI Act* is to allow secured creditors to enforce their claims efficiently. This right must be available from day 1 of non-payment of dues. The secured creditor need not have to wait for 90 days from the date of default.

2. The proposed definition is not aligned with *Insolvency and Bankruptcy Code*. Under the *Insolvency and Bankruptcy Code*, a creditor whose claim has been defaulted upon may trigger a resolution process on the day on which the default occurs, and need not wait until the account is actually classified as a NPA. The recovery mechanisms under *SARFAESI Act* must similarly be available from the date on which default

Box 5: Proposed formulation for definition of debt securities under *SARFAESI Act*

Section 2(1)(ia) of *SARFAESI Act* must be substituted with the following clause:

> "debt security" means a security which is in the nature of a secured debt:

occurs.

2.3.2 Concept of debt securities

Clause 4(iv) of the Bill: This clause proposes to insert the following definition of debt securities:

> (ia) "debt securities" means debt securities listed in accordance with the regulations made by the Board under the Securities and Exchange Board of India Act, 1992;

Comment: The term debt securities is proposed to be used in the definition of "debt". The definition of debt securities must be expanded to include all secured debt security structures, not just listed bonds and debentures. Please see Box 5 for a proposed formulation of the definition of debt securities.

Rationale: The definition of "debt securities" should be aligned across both *SARFAESI Act* and *RDDBFI Act* to clarify that debt includes not only plain bonds but also cover secured complex debt securities such as Pass Through Certificates or PTCs, security receipts or SRs, debt securities issued by InvITs or REITs, or any such instrument that may be issued in the future. This will ensure that holders of all debt securities which are secured, will have recourse to *SARFAESI Act* if the issuer of such securities defaults.

2.3.3 Concept of debenture trustee

Clause 4(xiv)(a) of the Bill: This clause proposes to include a debenture trustee *appointed by any company* in the definition of a secured creditor.

Comment: In clause 4(xiv)(a) of the Bill, the words *appointed by any company* must be replaced with 'appointed by any body corporate'.

Rationale: Under the current law, only a company is required to appoint a debenture trustee under the *Companies Act*. However, potentially, a debenture trustee can be appointed by any entity that issues bonds. For instance, the current formulation of debenture trustee excludes debenture trustees appointed for debt securities by statutory entities like NHAI.

2.4 Amendment of section 3 of *SARFAESI Act*

2.4.1 Net owned fund requirement

Clause 5(i) of the Bill: Clause 5(i) of the Bill proposes to amend section 3(1)(b) of *SARFAESI Act* to require an ARC to have a net owned fund of not less than two crore rupees or such other amount as the RBI may notify.

Comment: As mentioned in section 2.1 of this note, this section must be deleted to bring the regulation of ARCs in line with the regulation of other funds in India. However, if the argument in section 2.1 is not accepted, the amendment proposed under Clause 5(i) must be deleted.

Rationale: Section 3(1)(b) of *SARFAESI Act*, as currently worded, provides that an ARC must have a net owned fund of not less than two crore rupees or such other amount *not exceeding fifteen percent* of the financial assets acquired to be acquired by the ARC, as the RBI may notify. Thus, the law imposes a cap on the minimum net owned fund that an ARC will require to have at any given point in time. Clause 5(i) of the Bill proposes to delete this cap. This cap must be retained to ensure that the net owned funds requirement is (i) capped; and (ii) that the cap is relative to the financial assets that the ARC proposes to acquire. By removing the cap on the net owned fund requirement, the ARC business may become unviable. The Notes on Clauses attached to the Bill also do not contain any justification for removal of the cap on the net owned fund requirement for an ARC.

2.4.2 Sponsor

Clause 5(ii) of the Bill: Clause 5(ii) of the Bill proposes to amend section 3(3)(f) of *SARFAESI Act* to provide that a sponsor of an ARC is a fit and proper person in accordance with the criteria specified by RBI.

Comment: As mentioned in section 2.1 of this note, this section must be deleted to bring the regulation of ARCs in line with the regulation of other

Box 6: Proposed formulation of section 3(3)(f) of *SARFAESI Act*

1. Clause 3(3)(f) of *SARFAESI Act* should be substituted with the following:
   "(f) that the sponsor is not a banking company;"

2. The following clause should be added as sub-clause (a) of section 3(3)(f):

   "(fa) that the sponsor is a fit and proper person;"

3. The following clause should be added as clause (ma) of section 2(1):

   "(ma) "fit and proper person" means a person satsifying such criteria as the Reserve Bank may specify;"

funds in India. However, if the argument in section 2.1 is not accepted, Clause 5(ii) of the Bill must be revised to state that the fit and proper person proposing to be a sponsor must not be a bank. Please see Box 6 for our proposed fomulation of section 3(3)(f) of *SARFAESI Act*.

Rationale: Section 3(3)(f) of *SARFAESI Act*, as currently worded, restricts a sponsor from holding a controlling stake in an ARC. Clause 5(ii) of the Bill proposes to remove this restriction on sponsors. This is a positive development. However, if a bank were to be allowed to hold a controlling stake in an ARC, it may lead to a conflict of interests, to the extent that a bank may simply sell an asset at a discount to an ARC controlled by it, at the cost of its depositors, to benefit the bank's shareholders. Such conflicts of interests are avoidable and will prejudice the interests of depositors.

2.4.3 Prior RBI approval for any change on the board of an ARC

Clause 5(iii) of the Bill: Clause 5(iii) of the Bill proposes to amend section 3(6) of *SARFAESI Act* to provide that an ARC will require prior approval of RBI for the following matters:

1. appointment of any director on the board of an ARC;
2. change in the managing director of an ARC; and
3. change in chief executive officer of an ARC.

Comment: As mentioned in section 2.1 of this note, this section must be deleted to bring the regulation of ARCs in line with the regulation of other funds in India. However, if the argument in section 2.1 is not accepted, Clause 5(iii) of the Bill must be deleted.

Rationale: Section 3(6) of *SARFAESI Act*, as currently worded, requires an ARC to obtain approval of the RBI only where there is a substantial change in the management of an ARC *as a result of the transfer of shares or transfer of business of the ARC*. Clause 5(iii) of the Bill proposes to expand this requirement of obtaining approval for *any* change in the board of an ARC. The requirement for obtaining RBI approval for any change in the board of an ARC leads to over-regulation of ARCs and is not supported with reasons.

ARCs are specialised firms that have skills in dealing with distressed assets. Hence, the primary law must lay down the definition of fit and proper persons who will be eligible to be appointed as directors on the board of an ARC. The board members of ARC must comply with the fit and proper criteria under *SARFAESI Act*. The ARC must not be required to seek the prior approval of RBI for every single change in the board structure, so long as the board members comply with the fit and proper criteria.

To draw a parallel, entities regulated by the SEBI are required to obtain prior approval of SEBI only where there is a *change in control* of the regulated entity. The principle is that where a regulator has granted a license to a particular entity to engage in a business, the license cannot be assigned without prior approval of the regulator, by changing the controlling shareholder of the licensee or the licensee transferring its business. Hence, while change in controlling shareholders of the licensed entity or transfer of business by the licensed entity, may warrant approval of the regulator, mandating prior RBI approval for any change in the board composition of an ARC is not supported by any reason and amounts to over-regulation of an under-developed industry. Further, this requirement is contrary to the stated object of augmenting ease of doing business in the Statement of Objects and Reasons.

2.5 Amendment of section 5 of *SARFAESI Act*

2.5.1 Exemption from stamp duty

Clause 6(i) of the Bill: Clause 6(i) of the Bill proposes to add a provision in section 5 of *SARFAESI Act* exempting all documents between a bank or a financial institution and an ARC transferring a financial asset to the ARC, from stamp duty.

Comment: Clause 6(i) of the Bill must be deleted.

Rationale: This clause must be deleted because:

1. The power to legislate in relation to stamp duty in respect of the following instruments lies with the Union under List I of the Seventh Schedule: bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts.
2. The power to legislate in relation to stamp duty in respect of all other instruments lies with the States under List II of the Seventh Schedule.

2.5.2 Financial assets which ARCs may acquire

Clause 6(i) of the Bill: Clause 6(i) of the Bill proposes to add a new sub-section (1B) in section 5 of *SARFAESI Act* stating that an ARC may acquire the financial asset of any bank or financial institution for the purpose of asset reconstruction, where a borrower has failed to pay the secured debt or any instalment thereof on due date, *whether or not the account of such borrower is classified as non-performing.*

Comment: The portion of clause 6(i) referring to section (1B) must be deleted for the reasons mentioned below.

Rationale:

As mentioned in section 2.1 of this note, this section must be deleted to bring the regulation of ARCs in line with the regulation of other funds in India. Once ARCs are regulated like other funds, there is no requirement to have specific provisions in *SARFAESI Act* delineating the assets they may or may not acquire. Like all other funds in India, ARCs will have a portfolio of assets and a large part of them may be distressed assets acquired from secured creditors.

In the alternative, if our submission under section 2.1 is not accepted, the portion of clause 6(i) proposing to insert sub-section (1B) in section 5 must be deleted. It runs contrary to section 5(1) of *SARFAESI Act* which provides that an ARC may acquire financial assets of a bank or financial institution. The term financial asset has been defined to mean "debt or receivables". There is no reference to default in this definition, which would imply that ARCs may purchase a financial asset, even if it has not been defaulted upon. The proposed sub-section (1B) adds a reference to default, which seems to make it conditional that ARCs may only purchase debt which has been defaulted upon. Banks and financial institutions must be allowed to transfer debts or receivables to ARCs even there is an impending default, but no actual default. This will incentivise banks to detect early warnings of financial distress, and take suitable precautionary measures including by transferring such debt or receivables to the distressed funds industry, like the ARCs.

2.5.3 Securitisation model for distressed assets

Clause: This does not relate to any specific clause of the Bill.

Comment: As mentioned in section 2.1 of this note, section 5 must be deleted to bring the regulation of ARCs in line with the regulation of other funds in India. Once ARCs are regulated like other funds, there is no requirement to have specific provisions in *SARFAESI Act* delineating the assets they may or may not acquire. Like all other funds in India, ARCs will have a portfolio of assets and a large part of them may be distressed assets acquired from secured creditors.

In the alternative, if our submission in section **de-regulation** is not accepted, we propose the following changes to section 5(1) of *SARFAESI Act*:

1. The words "or any other body corporate" must be added after the words financial institution in section 5(1) of *SARFAESI Act*.
2. Transfer of a financial asset from a bank to an ARC must be for cash consideration (and not SRs or other like instruments).

Please see Box 7 for a proposed formulation of section 5(1).

Rationale: There are two reasons for making these changes:

1. Currently, section 5(1) enables ARCs to acquire financial assets only from banks and financial institutions. However, the ARC industry has the potential to benefit even operational entities having receivables with low recovery potential. For example, infrastructure corporations having receivables with low recovery potential may also be able to take advantage of the securitisation model. Accordingly, expanding the kinds of entities from which ARCs may acquire financial assets, will allow operating entities in the economy to take advantage of a distressed funds industry and allow ARCs to expand the scope of their portfolio, which is currently restricted to financial assets of banks and financial institutions.
2. Where a bank or a systemically important financial institution transfers a distressed asset to an ARC, the transfer must be a clean to transfer

Box 7: Proposed formulation of section 5(1)

Section 5(1) of *SARFAESI Act* must be substituted with the following provision:
"**5. Acquisition of rights or interest in financial assets -** (1) Notwithstanding anything contained in any agreement or any other law for the time being in force, any asset reconstruction company may acquire financial assets of any body corporate, on such terms and conditions and for such consideration as may be agreed between them.
Provided that where the lender is a bank or a systemically important financial institution designated as such by any regulator in India, such transfer shall not:
(a) be on terms which are conditional such that the non-performance of any condition shall obligate such lender to buy the financial asset from the asset reconstruction company ; and
(b) be for consideration other than cash."

to ensure that the interests of the depositors and financial system are not compromised.

2.6 Amendment to section 7 of *SARFAESI Act*

2.6.1 Subscribers to security receipts

Clause 7 of the Bill: Clause 7 of the Bill proposes to amend section 7 of *SARFAESI Act* to allow ARCs to issue SRs:

1. by private placement or public offer; and
2. to categories of investors specified by RBI, in consultation with SEBI.

Comment: This clause must be deleted from the Bill. If this submission is not accepted, then there is a consequential amendment required to the definition of SRs. Please see Box 8 for a proposed formulation of the definition of SRs.

Rationale: As mentioned in section 2.1 of this note, ARCs must be regulated like any other fund in India. The securities issued by other funds (largely, units) are regulated like any other security under the *SCRA*.

If our submission in section 2.1 is not accepted and clause 7 of the Bill is retained, then a consequential amendment is required to section 2(zg) of *SARFAESI Act* which defines a SR to mean a "receipt or other security,

Box 8: Proposed definition of SRs

Clause (zg) of section 2(1) of *SARFAESI Act* must be susbtituted with the following clause:
"(zg) "security receipt" means a security or other receipt, issued by an asset reconstruction company evidencing the purchase or acquisition by the holder thereof, of an undivided rightl, title or interest in the financial asset involved in securitisation;"

issued by an ARC to any Qualified Institutional Buyer (QIB) pursuant to a scheme..." This definition will undergo a change to reflect that SRs may be issued to any category of investors as specified under section 7 (as proposed to be revised under this Bill) of *SARFAESI Act*.

2.7 Deletion of section 9 of *SARFAESI Act*

2.7.1 Measures which ARCs may take

Clause 8 of the Bill: Clause 8 of the Bill proposes to amend section 9 of *SARFAESI Act* to allow ARCs to convert their debt into shares of the borrower company.

Comment: Section 9 of *SARFAESI Act* must be deleted.

Rationale: Section 9 of *SARFAESI Act* deals with measures that an ARC may take in relation to the debtor-entity. For instance, it allows ARCs to take measures for the proper management of the business of the borrowers, including changing the management of the borrower or convert the debt into equity of the borrower, and the like. This provision must be deleted for the following reasons:

1. This runs contrary to the resolution process under the *Insolvency and Bankruptcy Code*, which is a collective enforcement proceeding that gives all creditors (secured and unsecured) a say in the management of the affairs of a debtor.

2. If this provision were retained as is in the *SARFAESI Act*, it will defeat the purpose of providing for a collective enforcement action under *Insolvency and Bankruptcy Code*, as secured creditors will seek to instead take over the management of the debtor entity under *SARFAESI Act* instead of undergoing the more tedious collective action process under

Insolvency and Bankruptcy Code, which is meant to allow all creditors to have a say in the committee of creditors.

3. After the passing of the *Insolvency and Bankruptcy Code*, *SARFAESI Act* must be restricted to allowing secured creditors the right to enforce their security, without intervention of the Court. Any right over and above this, must be in line with *Insolvency and Bankruptcy Code*.

2.8 Amendment to section 12 of *SARFAESI Act*

2.8.1 Power to issue directions on fees of ARCs and transferability of SRs

Clause 9 of the Bill: Clause 9 of the Bill proposes to amend section 12 of *SARFAESI Act* to allow RBI to issue directions to any ARC with respect to (a) the fee and other charges that ARCs may charge or incur for management of financial assets and (b) the transfer of SRs to QIBs.

Comment: As mentioned in section 2.1 of this note, section 12 of *SARFAESI Act* must be deleted to bring the regulation of ARCs in line with the regulation of other funds in India. However, if our submission in section 2.1 is not accepted, then clause 9 of the Bill must be deleted.

Rationale: Clause 9 of the Bill must be deleted for the following reasons:

1. The Notes to Clauses do not contain any explanation supporting the additional power to issue directions regarding the fees charged and expenses incurred by ARCs.

2. The expenses that an ARC may incur to obtain optimum recovery from a financial asset varies depending on several factors, including possible litigation and re-structuring costs. So long as the ARC is able to justify the expenses that it incurs for managing a given financial asset, the power to regulate the expenses that ARCs may incur is unnecessary, amounts to over-regulation and will hamper the growth of an ARC industry.

3. Free transferability of SRs amongst investors eligible to invest in them is crucial for the development of a market for SRs. Directions which hinder free transferability, such as lock-in period, etc. will hinder the development of such a market.

4. Principles of good regulatory governance require that any rule which is intended to have a legally binding effect on the citizens must be made by a statutory instrument. Even if the regulator deems it necessary to regulate the fees that ARCs may charge, such regulation must be done by a statutory instrument such as a regulation, which is made at the highest level within the regulator, is laid before the Parliament and passes through some levels of accountability. The power to issue directions to individual ARCs must not be enhanced.

2.8.2 Power to remove and appoint members on the board of ARCs

Clause 10 of the Bill: Clause 10 of the Bill proposes to add section 12B which allows:

1. RBI to audit and inspect ARCs;
2. remove the chairman or any director and appoint additional directors, on the board of an ARC, in the course of an audit or inspection.

Comment: As mentioned in section 2.1 of this note, section 12 of *SARFAESI Act* must be deleted to bring the regulation of ARCs in line with the regulation of other funds in India. However, if our submission in section 2.1 is not accepted, then the following revisions must be made to Clause 10 of the Bill:

1. Clause (a) of sub-section (3) of section 12B proposed to be added by Clause 10, which allows RBI to remove the chairman or any other director and appoint directors on the board of an ARC, must be deleted;
2. The following powers may be added to allow RBI to conduct the inspection or audit in accordance with law: (a) power to order the discovery and production of books of account and other documents; (b) power to summon and enforce the attendance of persons and examine them on oath; and (c) inspect books, registers and other documents of an ARC.

Rationale: These revisions are necessary for the following reasons:

1. The power to replace managment is an unusual power for a regulator to have, even in the context of an audit or an inspection. This is especially true, given that ARCs are merely distressed asset funds which do not deal with depositors (like banks do) or retail consumers.
2. Section 12B(3)(b) allows RBI to appoint an officer to observe the working of the board of an ARC. In light of this, the need to have the power

to appoint directors on the board of an ARC is not jusitified.

3. Instead of the power to replace management in the course of an audit or inspection, *SARFAESI Act* must confer on the RBI powers to summon witnesses, examine oaths, call for documents, etc. For example, the *SEBI Act* confers such powers on SEBI to allow SEBI to conduct effective audits and inspections of regulated entities.

2.9 Amendment to section 14 of *SARFAESI Act*

2.9.1 Allowing creditors who have converted to equity to invoke *SARFAESI Act*

Clause 12 of the Bill: Clause 12(ii) of the Bill provides that the following classes of secured creditors who have converted their debt into equity may apply to the District Magistrate or Chief Metropolitan Magistrate for assisting in taking possession of the secured asset:

1. two or more banks that have converted their debt to equity, thereby holding more than fifty percent of the paid-up capital of the borrower, or

2. an ARC or financial institution or an assignee holding more than fifty-one percent of the borrower.

Comment: Clause 12(ii) of the Bill must be deleted.

Rationale: The rationale of allowing secured creditors who have converted their debt into equity to take possession of the secured assets, with the help of the Magistrate, is not clear. Where a secured creditor has converted the whole or part of his debt into shares of the borrower, such secured creditor becomes a shareholder of the borrower. As a shareholder, it may vote to sell the security belonging to the borrower in accordance with due process of law. It is not clear why such a shareholder must be given special rights under *SARFAESI Act*.

2.10 Addition of chapter IVA in *SARFAESI Act*

2.10.1 Central registry

Clause 17 of the Bill: Clause 17 of the Bill proposes to add a new chapter titled 'Registration by Secured Creditors and Other Creditors' in *SARFAESI Act*.

Comment: To bring the provisions of *SARFAESI Act* relating to the Central Registry in line with the *Insolvency and Bankruptcy Code*, we suggest that the provisions relating to the Central Registry be substituted with the formulation proposed in Box 9.

Rationale: When *SARFAESI Act* was enacted in 2002, there was no single repository of all credit-related information. A statutory Central Registry was conceived to record the details of all transactions involving securitisation and creation of security interests by banks and financial institutions which were covered under the *SARFAESI Act*.

The *Insolvency and Bankruptcy Code* envisages a competitive industry of IUs to record information relating to all security interests. IUs are akin to depositories in the securities market which record the ownership of securities. This competitive industry of IUs is intended to replace the monopoly of a statutory repository of information. The competitive nature of the industry of IUs will benefit consumers of information by better service delivery and competitive rates.

Section 215(2) of the *Insolvency and Bankruptcy Code* provides that "a financial creditor shall submit financial information and information relating to assets in relation to which any security interest has been created, in such form and manner as may be specified by regulations". IUs will, thus, perform the same functions as the Central Registry. Moreover, this will be in a competitive and regulated environment.

It is clear that with the passage of the *Insolvency and Bankruptcy Code* and the introduction of an industry of IUs, the concept of a statutory Central Registry of credit-related information is redundant. For these reasons, the Central Registry envisaged under chapter IV of *SARFAESI Act* must be deleted.

The Central Government had, by a notification dated March 31, 2011, assigned the functions of the Central Registry to CERSAI, a Government company incorporated unders section 25 of the Companies Act, 1956. CERSAI must, therefore, upon notification of the relevant provisions of the *Insolvency*

Box 9: Proposed formulation to bring consistency between *SARFAESI Act* and *Insolvency and Bankruptcy Code* in relating to the Central Registry

1. Clause (g) of sub-section (1) of section 2 of *SARFAESI Act* must be replaced with the following clause:

   (g) "CERSAI" means the Central Registry of Securitisation Asset Reconstruction and Security Interest of India, a company incorporated under the Companies Act, 1956;

2. The following must be added as clauses (ma) and (mb) in sub-section (1) of section 2 of *SARFAESI Act*:

   (ma) "information utility" means an information utility as defined in clause (21) of section 3 of the Insolvency and Bankruptcy Code;
   (mb) "Insolvency and Bankruptcy Code" means the Insolvency and Bankruptcy Code, 2016.

3. Sections 20 to 26 of *SARFAESI Act* must be deleted.

4. A new provision must be added as section 26A in *SARFAESI Act* as under:

   26A. CERSAI to become information utility:

   (1) On and from such date as the Central Government may, by notification appoint,-

   (a) CERSAI shall be deemed to be an information utility and shall carry on its functions as such under the applicable provisions of the Insolvency and Bankruptcy Code:

   Provided that CERSAI shall not be required to obtain a certificate of registration under section 206 of the Insolvency and Bankruptcy Code;

   (b) save as provided in the proviso to clause (a) of this sub-section, the provisions of the Insolvency and Bankruptcy Code shall apply to CERSAI in the same manner and to the same extent as they apply to any information utility registered thereunder.

   (2) The provisions of this section shall have effect notwithstanding anything to the contrary contained in any other law for the time being in force.

   (3) All references to the Central Registry established under this Act, in any law, notification, rule, regulation or order

passed by any authority, shall be deemed to refer to and shall always be deemed to have referred to CERSAI.

5. Clause 17 of the Bill must be deleted.

and Bankruptcy Code, be deemed to be an IU. CERSAI will function like any other IU and compete with other IUs. The abovementioned consequential amendments are suggested to ensure that the industry of IUs is not frustrated by the statutory monopoly conferred upon CERSAI.

2.11 Addition of sections 30A, 30B, 30C and 30D in *SARFAESI Act*

Clause 20 of the Bill: This clause proposes to add sections 30A, 30B, 30C and 30D in *SARFAESI Act*.

Comment: These provisions must be deleted for the reasons stated in section 2.1. If our submission in section 2.1 is not accepted, then too, these provisions need to be substantial modified as they run fundamentally contrary to the principles of good regulatory governance and natural justice. Please see our proposed modifications in Box 10.

Rationale:

1. All directions which are intended to have a legally binding effect must be made by legislative instrument, namely, regulations. Empowering a regulator to issue directions to individual regulated entities (in this case, ARCs) and then impose penalties for violation of such ad-hoc directions, is fundamentally contrary to good governance. Hence, a new section 30A has been proposed empowering RBI to issue binding directions in the form of regulations.

2. The new section 30B allows RBI to penalise persons who violate regulations.

3. Further, the new section 30B provides that the penalty amount shall be determined by an Adjudicating Authority comprising of an officer or a committee of officers of the RBI that is designated as such by the central board of the RBI.

   The Adjudicating Authority must be independent of, and separate from, the officers of RBI who (a) issued the direction for the violation

Box 10: Key amendments for good regulatory governance of ARCs

Clause 20 of the Bill must be replaced with the following provisions:
"**30A. Power to make regulations**:
(1) The Reserve Bank may make delegated legisation, including for issuing binding directions, for regulating the affairs of asset reconstruction companies by issuing regulations from time to time.

(2) The Central Board of the Reserve Bank shall approve every regulation proposed to be made by it under this Act.

(3) The Central board shall approve and publish a draft of a proposed regulation, accompanied with a statement setting out, –
(a) the objectives of the proposed regulation;

(b) the problem that the proposed regulation seeks to address;

(c) how solving this problem is consistent with the objectives given to the Reserve Bank under this Act;

(d) the manner in which the proposed regulation will address this problem;

(e) the manner in which the proposed regulation complies with the provision of this Act under which the regulation is made;

(f) an analysis of costs and an analysis of benefits of the proposed regulation;

(g) the process by which any person may make a representation in relation to the proposed regulation..

(4) To make the regulation, –

(a) the board must approve the regulation; and

(b) the Reserve Bank must publish all the representations received by it and a general account of the response of the Reserve Bank to the representations.
(5) The Reserve Bank may dispense with the procedure under sub-sections (1) to (3) if the time required to comply with such procedure is detrimental to the objectives of this Act.

Provided that where the Reserve Bank dispenses with such procdure, it

shall –
(a) publish the reasons for such dispensation;

(b) submit a report to the Central Government within seven days from the date on which such regulation is notified.

(6) A regulation made under sub-section (5) shall cease to have effect after one hundred and eighty days from the date on which that regulation is notified.

(7) Every regulation shall be laid before each House of Parliament, as soon as may be possible, after it is made, for a total period of thirty working days, while it is in session.

(8) In calculating the thirty working days period under sub-section (7), no account is to be taken of any time during which the Parliament is dissolved or prorogued.

(9) A regulation shall be deemed to be approved by Parliament at the expiry of thirty working days unless, before the end of that period, both Houses of Parliament agree that such regulation –

(a) shall not be made, in which case such regulation shall be of no effect; or

(b) shall be made with certain modifications, in which case such regulation shall come into effect in the modified form.

(10) The annulment or modification of a regulation by the Parliament shall not affect the validity of anything already done under it.

30B. Power to impose penalties for violation of regulations -
(1) Where any asset reconstruction company contravenes any regulation issued under the Reserve Bank under this Act, the adjudicating authority may, by an order, impose on such person, a penalty not exceeding one crore rupees or twice the amount involved in such failure or contravention or default, where such amount is quantifiable, whichever is more, and where such failure or contravention or default is a continuing one, a further penalty which may extend to one lakh rupees for every day, after the first, during which such failure or contravention or default continues.

Provided that the adjudicating authority shall be independent of the officers of the Reserve Bank who investigated the specific violation alleged to be committed under this section.

(2) For the purpose of imposing penalty under sub-section (1), the adjudicating authority shall serve a notice on the person referred to in that sub-section requiring such person to show cause why the amount specified in the notice should not be imposed as a penalty and a reasonable opportunity of being heard shall be given to such person.

Explanation. For the purposes of this section and sections 30B, 30C and 30D, "Adjudicating authority" means such officer or a committee of officers of the Reserve Bank, designated as such from time to time, by notification, by the Central Board of Reserve Bank.

30B. Appeal to National Company Law Tribunal -
A person against whom an order is passed under section 30A, may, within a period of thirty days from the date on which such order is passed, prefer an appeal to the Tribunal:

Provided that the Tribunal may entertain an appeal after the expiry of the said period of thirty days, if it is satisfied that there was sufficient cause for not filing it within such period.

Explanation: For the purpose of this section, Tribunal means the National Company Law Tribunal.

30C. Power to recover penalties -
(1) The Reserve Bank must appoint atleast one of its employees as a Recovery Officer for the purpose of this Act.

(2) Where any person against whom an order imposing a penalty has been passed and is subsisting under section 30A, the Recovery Officer may recover such penalty in any of the following ways, in descending order of priority, namely –

(a) attachment and sale of movable property belonging to the defaulter;

(b) attachment of the bank account of the defaulter;

(c) attachment and sale of immovable property owned by the defaulter;

(d) where the defaulter is an individual, arrest and detention of such individual in prison;

(e) appointing a receiver for the management of the movable and immovable properties belonging to the defaulter.

(3) For the purpose of such recovery, the provisions of sections 220 to 227, 228A, 229, 232, the Second and Third Schedules to the Income-tax Act, 1961 (43 of 1961) and the Income-tax (Certificate Proceedings) Rules, 1962, as in force from time to time, will apply with necessary modifications as if the said provisions and rules, –

(a) were the provisions of this Act; and

(b) referred to the amount due under this Act instead of to income-tax under the Income-tax Act, 1961 (43 of 1961).

(4) In this section, the movable or immovable property or monies held in a bank account will include property or monies which meet all the following conditions, –

(a) property or monies transferred by the defaulter without adequate consideration;

(b) such transfer is made, –

(i) on or after the date on which the amount in the certificate drawn up under section 222 of the Income Tax Act, 1961 (43 of 1961) had become due;

(ii) to the defaulter's spouse, minor child, son's wife or son's minor child;

(c) such property or monies are held by, or stand in the name of, any of the persons referred to in sub-clause 2.11, including where they are so held or stand in the name of such persons after they have attained the age of majority.

30D. Transfer of penalties to the Consolidated Fund of India
The Reserve Bank shall transfer all monies collected by it from the imposition of any penalties to the Consolidated Fund of India.

of which penalty is sought to be imposed; and (b) investigate the violation. Imposing a penalty is a quasi-judicial function of the regulator. It is a basic principle of good regulatory governance that this function is separated from its quasi-legislative function (of issuing regulations/ directions) and its executive function (of conducting investigations).

4. Section 30C provides for appeal against a penalty order to an "appellate authority". Section 30C, as proposed under the Bill, provides that an appellate authority will comprise of officers of the RBI. This is fundamentally contrary to the principles of natural justice. An appellate body must necessarily be independent and outside of the body against whose orders an appeal is preferred. One cannot appeal to a regulator against penalties imposed by the same regulator. It is suggested that appeals against penalties imposed by RBI under *SARFAESI Act* must be preferred to the NCLT which this note proposes as the appellate forum.

5. Section 30D, as proposed under the Bill, provided for a detailed and unusually excessive recovery mechanism for penalties imposed by RBI, not found in any other law which contain the power to impose penalties. For instance, it allowed RBI to issue a notice requiring any person from whom any payment is due to a penalised person, to pay the RBI the amount of the penalty. This is extremely unusual as it effectively means that RBI's claim to recover penalties imposed by it *overrides* every other claim that is due from the penalised person. The provison further imposes personal liability on persons who owe money to the penalised person and do not pay the amount of the penalty to RBI.

   It is noteworthy that none of the other laws governing financial sector regulators such as SEBI, IRDA or PFRDA confer such recovery powers upon the regulators. The Notes on Clauses also do not explain the reasons underlying these unusual recovery powers conferred upon the RBI. These unsusual recovery powers must be re-visited.

6. Finally, we propose a new section 30D providing that all penalties imposed by RBI under *SARFAESI Act* must be credited to the Consolidated Fund of India.

2.12 Additional amendments to align *SARFAESI Act* with *Insolvency and Bankruptcy Code*

The *Insolvency and Bankruptcy Code* deals with collective action for enforcement of creditors' rights. It provides for a resolution process where a committee of creditors takes decisions on the affairs of the borrower, such that they can make optimum realisation as whole. While *SARFAESI Act* protects the rights of only secured creditors comprising largely of banks and financial institutions, the IBC seeks to protect the rights of all creditors without prejudicing the rights of any of them. The IBC provides a negotiating forum to all kinds of creditors, and not just the secured ones. It is important that if an application for resolution is made under the IBC, all creditors be treated equally during the resolution process. Hence, any individual enforcement right accorded to secured creditors by *SARFAESI Act* must be in abeyance when IBC is in progress as otherwise the entire resolution process will get derailed.

To illustrate this, during the moratorium period of 180 days where the committee of creditors is deliberating on the next course of action, secured creditors cannot invoke the *SARFAESI Act*. Corresponding amendments must be made to *SARFAESI Act* to avoid inconsistencies and impart clarity to the interface between rights of secured creditors vis-a-vis other creditors under *SARFAESI Act* and IBC. Some key amendments to *SARFAESI Act* have been suggested in Box 11, together with their rationales.

3 Amendments to *RDDBFI Act*

3.1 Amendment of section 2 of the *RDDBFI Act*

3.1.1 Ninety days notice

Clause 25 (i) of the Bill: Section 2(g) of *RDDBFI Act* is proposed to be amended to include liability towards debt securities, but only if they are unpaid in part or full after a notice of 90 days has been served by the debenture trustee.

Comment: The 90 days notice period for debenture trustee should be deleted from the definition of 'debt'.

Rationale: For banks and specified financial institution, the definition of

Box 11: Key amendments to align *SARFAESI Act* and *Insolvency and Bankruptcy Code* and rationales

1. The following proviso may be added to section 13(4) of *SARFAESI Act*:

    > Provided that a secured creditor shall not take any of the abovementioned measures in respect of a borrower if:
    >
    > (i) the National Company Law Tribunal, or as the case may be, the Debt Recovery Tribunal, has passed an order under the *Insolvency and Bankruptcy Code* declaring a moratorium in respect of such borrower; and
    >
    > (ii) such order of moratorium is still in force.

    Rationale: This proviso is necessary to ensure that once a resolution process is initiated under the IBC, a secured creditor does not invoke *SARFAESI Act* to the detriment of the ongoing resolution process under the IBC.

2. The following provisos must be added in section 13(9) of *SARFAESI Act* to deal with the interface between the creditors' rights under *SARFAESI Act* and the liquidation process under the IBC:

    > Provided that in case of a company being liquidated or an individual being subjected to bankruptcy proceedings under the *Insolvency and Bankruptcy Code*, the amount realised from the sale of secured assets shall be distributed in accordance with the applicable provisions of the *Insolvency and Bankruptcy Code*;
    >
    > Provided further that in case of such a company or individual, where the secured creditor chooses to realise his security instead of relinquishing his security, the rights of such secured creditor shall be dealt with in accordance with the applicable provisions of the *Insolvency and Bankruptcy Code*.

3. A new provision may be added as section 13A, as under:

    > **13A. Resolution process under the *Insolvency and Bankruptcy Code***:
    >
    > Where an order of an Adjudicating Authority approving a resolution plan under the *Insolvency and Bankruptcy Code* has become final, a secured creditor shall not enforce his

security interest under section 13 of this Act, if such enforcement is inconsistent with the resolution plan so approved.

Rationale: Under the IBC, if the committee of creditors agree to a resolution plan, which is subequently approved by the adjudicating authority, such resolution plan is binding on all the creditors who were part of such committee. Accordingly, once the resolution process under the IBC is complete, secured creditors must abide by the resolution plan and cannot enforce their rights under *SARFAESI Act* contrary to the resolution plan.

4.

5. *Aligning adjudication fora*: The following amendments may be made to *SARFAESI Act*:

   (a) In section 2, in sub-section (1), clause (a) shall be replaced with the following clause:

      (a) "Appellate Tribunal" means, -

      (i) where the order to be appealed against is the Debts Recovery Tribunal, the Debts Recovery Appellate Tribunal established under sub-section (1) of section 8 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993);

      (ii) where the order to be appealed against is the National Company Law Tribunal, the National Company Law Appellate Tribunal established under section 410 of the Companies Act, 2013 (18 of 2013).

   (b) In section 2, in sub-section (1), after clause (s), the following clause shall be inserted, namely: -

      (t) "Tribunal" means:

      (i) the National Company Law Tribunal established under section 408 of the Companies Act, 2013 (18 of 2013), where the debtor is a person incorporated with limited liability under any law for the time being in force;

      (ii) the Debts Recovery Tribunal, in all other cases.

   (c) In section 17 of *SARFAESI Act*, the words Debts Recovery Tribunal shall be replaced with Tribunal.

(d) In section 18 of *SARFAESI Act*, the words Debts Recovery Tribunal shall be replaced with the word Tribunal.

Rationale: Section 17 of *SARFAESI Act* allows persons aggrieved by any measure taken by a creditor to enforce his security interest, to apply to the Debt Recovery Tribunal (DRT). Under the IBC, the adjudicating authority for corporate debtors is the NCLT and the adjudicating authority for individual debtors and partnership firms is the DRT. Given the bifurcation of jurisdiction for body corporates on the one hand, and individual and firms on the other, in matters relating to insolvency and resolution, the *SARFAESI Act* may also suitably aligned to ensure consistency of adjudication fora.

Box 12: Proposed amendments to 90 days notice

1. In clause (g) of section 2, after the words "the date of the application", the following words shall be inserted, namely:-

   "and includes any liability towards debt securities which remains unpaid in full or part after notice served upon the borrower by the debenture trustee or any other authority in whose favour security interest is created for the benefit of holders of debt securities or"

'debt' does not have the requirement of a 90 days period for which the due remains unpaid. However, when including debt securities, a 90 day requirement has been introduced.

This is inconsistent. A level playing field should be maintained by deleting the 90 days notice period for debenture trustees.

3.1.2 Definition of debt should be more comprehensive

Clause 25 (i) of the Bill: Section 2(g) of the *RDDBFI Act* defining "debt" is proposed to be amended to add debt securities. 'Debt securities' is proposed to be defined in the new clause 2(ga) as only listed debt securities.

Comment: Definition of debt should be expanded to include all secured debt security structures, not just listed bonds and debentures. The proposed clause 2(ga) should be amended to define "debt securities" as any security which is in the nature of a secured debt as defined under section 2(1)(ze) of SARFAESI Act, 2002.

Box 13: Proposed amendments to definition of debt

1. After clause (g) of section 2, the following words shall be inserted, namely:-

   " 'debt securities' mean debt securities which are in the natureof a secured debt as defined in section 2(1)(ze) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002."

Rationale: While the definition of "debt" is wide enough to have included debt securities, the Bill is specifically adding debt securities in the definition. Given that this clarification is being added to the definition of "debt", it is suggested that the *RDDBFI Act* should clarify that debt includes not only plain vanilla bonds, but also cover secured non-vanilla debt securities such as PTCs, security receipts, paper issued by InvITs or REITs or any such instrument that gets added in the future.

3.1.3 Definition of property and intangible assets

Clause 25 (v) of the Bill: The proposed clause 2(jb)(e) defines 'property' to include intangible assets "which are declared by the Reserve Bank, by notification, to be property rights over which security interest can be created in favour of banks and financial institutions".

Comment: The definition of "property" in the *RDDBFI Act* should be aligned with the same under section 2(t) of *SARFAESI Act*.

Rationale The proposed definition limits the use of intangible assets for creating security only to those against which security interests can be created in favour of banks and financial institutions. If new entities, such as debenture trustees or other regulated financial institutions such as NBFCs, are being covered under the Bill, they should be given similar rights as the existing entities. Otherwise, unnecessary differences would be created between *SARFAESI Act* and *RDDBFI Act*.

3.1.4 Security interest

Clause 25(vi) of the Bill: The proposed clause 2(lb) defines 'security interest' in a manner that restricts it to "any bank or financial institution".

Box 14: Proposed amendments to definition of property

1. After clause (ja) of section 2, the following clause shall be inserted, namely:-

   " 'property' means property as defined in section 2(t) of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;"

Box 15: Proposed amendments to definition of security interest

1. In clause (la) of section 2, the words "in favour of a banks and financial institutions" should be replaced with "in favour of secured creditors".

Comment: The words "in favour of a banks and financial institutions" should be replaced with "in favour of secured creditors".

Rationale: Restricting "security interest" to only banks and financial institutions would be inconsistent with inclusion of debenture trustees within the scope the *RDDBFI Act*.

3.2 Amendment to section 19 of *RDDBFI Act*

3.2.1 Estimated value of security

Clause 29(iv) of the Bill: The new clause 19(3A) proposed to be inserted requires every applicant filing an application for recovery of debt before a tribunal to state the estimated value of securities kept as security interest.

Comment: In the new clause 19(3A)(a), instead of "estimated value of security interest", a tighter formulation like "estimated current market or fair value of security interest certified by a valuer" should be inserted.

Rationale: Lenders are unlikely to have access to information about any other properties or assets owned by the defendants beyond the security interest created in their favour or personal guarantees or bank guarantees furnished, much less have the ability to estimate the value of such assets. This requirement may not be practical.

Box 16: Proposed amendments to estimate value of security

1. In the new clause (a) of section 19(3A), replace the words "estimated value of security interest" with "estimated current market or fair value of security interest certified by a valuer".

3.2.2 Stating particulars of the properties of a defendant

Clause 29(iv) of the Bill: The new proposed clause 19(3A)(b) requires that "if the estimated value of securities is not sufficient to satisfy the debt claimed", the applicant must "state particulars of any other properties or assets owned by any of the defendants, if any".

Comment: This clause can be deleted.

Rationale: Lenders are unlikely to have access to information about any other properties or assets owned by the defendants beyond the security interest created in their favour or personal guarantees or bank guarantees furnished, much less have the ability to estimate the value of such assets. This requirement may not be practical.

3.2.3 Seek information on encumbrances

CLause 29(iv) of the Bill: The new clause 19(3A)(c) states "if the estimated value of such other assets is not sufficient to recover the debt, seek an order directing the defendant to disclose to the Tribunal particulars of other properties or assets owned by the defendants."

Comment: The following words should be added at the end of the new clause 19(3A)(c): "and any charge or security interest or encumbrance that may have been created in such assets".

Rationale: In seeking this order, the applicant should also seek details of any encumbrances on the property created in favour of other lenders that may exist on these assets. The idea is that in enabling the recovery for one secured creditor, rights of other security owners should not be prejudiced. The law should make it clear that while enforcing a recovery certificate, only unencumbered assets (on which no other security interest has been created) which represent the equity of the borrower, may be sold. Proceeds of sale of any secured assets will only be for the benefit of the secured creditor who holds that charge. This is currently not clearly stated in the law.

Box 17: Proposed amendments to seeking information on encumbrances

1. Add the following words at the end of the new clause 19(3A)(c): "and any charge or security interest or encumbrance that may have been created in such assets".

Box 18: Proposed amendments to ex parte order by Tribunal

1. In the new section 19(4) replace the words "under clause (c) of sub-section (3A)" with "under clause (a) of sub-section (3A)".

3.2.4 Ex parte order by Tribunal

CLause 29(v) of the Bill: The new clause 19(4) states that on an application for recovery of debt, the tribunal "shall" pass an interim ex parte order preventing the defendant from "dealing with or disposing of such assets and properties disclosed under clause (c) of sub-section (3A) pending the hearing and disposal of the application for attachment of properties".

Comment: Clause 19(3A)(c) should be changed to clause 19(3A)(a) in clause 19(4).

Rationale: Assets in clause 19(3A)(c) are those other properties/assets of the borrower over which no security interest has been given to the lender. The proposed clause 19(4) makes it mandatory for the Tribunal to restrict transfer of such property even without hearing such party. This is unfair and arbitrary. This clause should be limited to assets/properties prescribed in clause 19(3A)(a), which are assets which form the security interest.

3.2.5 Transfer of property outside security interest

Clause 29(vi) of the Bill: The proposed clause 19(4A) states that "Notwithstanding anything contained in section 65A of the Transfer of Property Act, 1882, the defendant on service of summons shall not transfer by way of sale, lease or otherwise except in the ordinary course of his business any of the assets over which security interest is created and other properties and assets specified or disclosed under sub-section (3A), without the prior approval of the Tribunal".

Comment: The words "other properties and assets specified or disclosed

Box 19: Proposed amendments to transfer of property outside security interest

1. In the new section 19(4), delete the words "and other properties and assets specified or disclosed under sub-section (3A)".

Box 20: Proposed amendments to the waterfall provisions

1. Replace the words "provided in section 326 of the Companies Act, 2013 or under any other law for the time being in force" with "provided in section 53 of the Insolvency and Bankruptcy Code, 2016".

under sub-section (3A)" should be removed. The defendant can be restricted from transferring such properties only by an interim or final order of the Tribunal in this regard.

Rationale: Preventing the defendant from transferring properties which are outside the security interest at the summons stage, without even an interim order being passed, is unfair and arbitrary.

3.2.6 Waterfall provisions

Clause 29(xvii) of the Bill: The proposed clause 19(19) states that "Where a certificate of recovery is issued against a company registered under the Companies Act, 2013 and such company is under liquidation, the Tribunal may by an order direct that the sale proceeds of secured assets of such company be distributed in the same manner as provided in section 326 of the Companies Act, 2013 or under any other law for the time being in force."

Comment: Replace the words 'provided in section 326 of the Companies Act, 2013 or under any other law for the time being in force' with 'provided in section 53 of the Insolvency and Bankruptcy Code, 2016'.

Rationale: Since the IBC has been passed, and this amendment is susbsequent to it, the waterfall provisions of the IBC should be made applicable, not section 326 of the Companies Act 2013. Moreover, section 326 of the Companies Act, 2013, has not been notified and, in fact, stands modified by the IBC.

Box 21: Proposed amendments to the reduction of deposit amounts

1. In the proviso to section 21, for the words "waive or reduce the amount", the words "in exception circumstances, reduce the amount to be deposited by such amount which shall not be less than twenty-five percent of the amount of such debt so due".

3.3 Amendment to section 21 of *RDDBFI Act*

3.3.1 Reduction of deposit amount

Clause 32 of the Bill: The proposed amendment narrows the discretion of the Debt Recovery Appellate Tribunal (DRAT) to only reduce the deposit amount and that too not below 25%.

Comment: The language should be made tighter so that such reduction of deposit amount is allowed only in exceptional circumstances.

Rationale: If this power is exercised in ordinary cases, it will dilute the effect of this provision.

3.4 Amendment to section 25 of *RDDBFI Act*

3.4.1 Recovery of debt

Clause 35 of the Bill: The proposed clause 25(aa) provides another mode for recovery by "taking possession of property over which security interest is created or any other property of the defendant and appointing receiver for such property and to sell the same."

Comment: The words "any other property" should be replaced with "any other unencumbered other property".

Rationale: If the property of the defendant is encumbered by another charge, then it cannot be taken or sold without the permission of the creditor in whose favour that charge is created.

Box 22: Proposed amendments to recovery of debt

1. In the proposed clause (aa) of section 25, the words "any other property" should be replaced by "any other unencumbered property".

Box 23: Proposed amendments to financial institution

1. Repace the definition of 'financial institutions' in section 2(h) of the *RDDBFI Act* with ""financial institution" means (a) a scheduled bank; (b) financial institution as defined in section 45-I of the Reserve Bank of India Act, 1934; (c) Public financial institution as defined in clause (72) of section 2 of the Companies Act, 2013; and (d) such other institution as the Central Government may by notification specify as a financial institution."

3.5 Additional suggested amendment to *RDDBFI Act*

3.5.1 Extending the benefit of *RDDBFI Act* to all secured creditors

To ensure that all secured creditors are able to use the benefit of the efficient processes under *RDDBFI Act*, we propose the following amendment:

Proposed amendment: The definition of financial institutions in section 2(h) of the *RDDBFI Act* must be replaced with the following definition:

> "financial institution" means (a) a scheduled bank; (b) financial institution as defined in section 45-I of the Reserve Bank of India Act, 1934; (c) Public financial institution as defined in clause (72) of section 2 of the Companies Act, 2013; and (d) such other institution as the Central Government may by notification specify as a financial institution.

Rationale: The *RDDBFI Act* was originally intended for speeding up the recovery process for *all* secured creditors. However, the benefits of these laws have been largely restricted to banks and financial institutions. A large swathe of non-bank financial entities like NBFCs and MFIs could not avail of the efficent recovery mechanisms that *SARFAESI Act* contemplated. Expanding the definition of "financial institutions" to include all financial entities engaged in the business of lending will ensure that all secured creditors get the benefit of the efficient recovery mechanisms contemplated in *RDDBFI Act*.

Box 24: Proposed amendments to jurisdictions of DRTs and NCLTs

1. Insert the following sub-section (1A) after sub-section (1) of section 17:

   "(1A) From a date as may be notified by the Central Government, the National Company Law Tribunal shall exercise, the jurisdiction, powers and authority to entertain and decide applications from the banks and financial institutions for recovery of debts due to such banks and financial institutions against corporate persons as defined under section 3(7) of the Insolvency and Bankruptcy Code, 2016.

   (1B) Any person aggrieved by an order of the National Company Law Tribunal under sub-section (1A) can appeal before the National Company Law Appellate Tribunal.

   (1C) The National Company Law Tribunal and the National Company Law Appellate Tribunal shall have the same powers vested on the Debt Recovery Tribunal and the Debt Recovery Appellate Tribunal under this Act."

3.5.2 Streamline jurisdictions of DRTs and NCLTs

To ensure that the jurisdictions of DRTs and NCLTs are aligned across *RDDBFI Act*, *SARFAESI Act* and the IBC, we propose the following amendment:

Proposed amendment: The *RDDBFI Act* and the *SARFAESI Act* should be suitably amended to ensure that NCLTs have jurisdiction over recovery actions against all "corporate persons" as defined under section 3(7) of the *Insolvency and Bankruptcy Code*, while DRTs have jurisdiction over recovery actions against individuals and partnership firms.

Rationale: Under the IBC, the NCLTs have been vested with jurisdiction over all "corporate persons" during insolvency resolution process and liquidation, while the DRTs have been vested with jurisdiction over individuals and partnership firms during insolvency resolution process and bankruptcy. The proposed amendment will align the jurisdictions of NCLTs and DRTs across *RDDBFI Act*, *SARFAESI Act* and the IBC.

4 Amendments to *Indian Stamp Act*

Please see our comment and rationale on exemption from stamp duty in paragraph 2.5.1 in section 2.5 of this note.

5 Amendments to *Depositories Act*

We agree with the changes proposed by the Bill to the *Depositories Act*.