

# SARFAESI Act for NBFCs: Frequently Asked Questions

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The Union Budget, 2020<sup>1</sup> had proposed to amend the eligibility criteria of NBFCs for recovery under SARFAESI Act, 2002. In furtherance to the said proposal, the Ministry of Finance (MoF) vide its notification dated 24<sup>th</sup> February, 2020<sup>2</sup>, in exercise of its powers under section 2(1)(m)(iv) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests Act, 2002 (SARFAESI Act), notified the eligibility criteria for NBFCs to be considered as financial institution for the purpose of SARFAESI Act.

This is a major change in enabling framework for NBFCs, especially the manner in which recovery actions were taken by the NBFCs before this notification. This notification brings the NBFCs closer to the banks in terms of level playing field.

Earlier, MoF had released a notification<sup>3</sup> pinpointing around 196 NBFCs and notifying them as financial institutions for the purposes of SARFAESI Act. Until the publication of notification on 24<sup>th</sup> February, 2020, these 196 NBFCs only were eligible to enforce security interest under the SARFAESI Act. Now, several other NBFCs which fulfil the eligibility criteria will be considered as financial institutions for the purposes of SARFAESI Act, and would be eligible to enforce security interest. There are ambiguities with respect to the applicability of various aspects of the law, which has encouraged us to prepare this document which address these queries in question-answer form.

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<sup>1</sup> Our Budget Booklet 2020 maybe referred here- <http://vinodkothari.com/wp-content/uploads/2020/02/Budget-Booklet-2020.pdf>

<sup>2</sup> <http://egazette.nic.in/WriteReadData/2020/216392.pdf>

<sup>3</sup> <http://egazette.nic.in/WriteReadData/2016/171157.pdf>

# Section 1- Eligibility criteria for NBFCs to be defined as Financial Institutions

## 1. Is SARFAESI Act applicable to all NBFCs?

The Ministry of Finance vide its notification dated 24<sup>th</sup> February, 2020, in exercise of its powers under section 2(1)(m)(iv) of the SARFAESI Act, notified NBFCs having asset size of Rs. 100 crores or more ('eligible NBFCs') as financial institution for the purpose of SARFAESI Act, for enforcement of security interest on debts amounting to atleast Rs. 50 lacs.

In this regard, following are the cases of applicability/inapplicability of SARFAESI Act to NBFCs:

- (i) **An NBFC having asset size of Rs. 100 crores or more, and the amount of debt less than Rs. 50 lacs:** The NBFC is eligible to be considered as a financial institution under SARFAESI Act. However, security interest on the particular debt which amounts to less than Rs. 50 lacs, cannot be enforced.

Further, security interest on other debts of the same NBFC, which amount to Rs. 50 lacs or more, may be enforced.

- (ii) **An NBFC having an asset size of less than Rs. 100 crores and the amount of debt is more than Rs. 50 lacs:** The NBFC is not eligible to be classified as a financial institution under the SARFAESI Act. Thus, security interest on any of the debts of such NBFC cannot be enforced, irrespective of the amount of debt.

- (iii) **An NBFC having an asset size of Rs. 100 crores or more and the amount of debt is more than Rs. 50 lacs:** The NBFC is a financial institution under SARFAESI Act and the amount of debt is above the benchmark of Rs. 50 lacs. Thus, the NBFC can enforce security interest on such debt.

## 2. Is there a threshold for applicability of SARFAESI Act on NBFCs?

Yes, eligible NBFCs are allowed to enforce security interest in cases where the security interest was created in their favour to secure a financial assistance having a debt (as defined under SARFAESI Act) amounting to Rs. 50 lacs.

Though the limits prescribed for other classes of secured creditors under the SARFAESI Act is Rs. 1 lac, the limit for NBFCs is Rs. 50 lacs.

## 3. On what date will the asset size of Rs. 100 crores be reckoned?

The notification issued by the MoF is silent about the date on which the asset size of Rs. 100 crores will be reckoned. However, the earlier notification which notified 196 NBFCs as financial institutions expressly provided that the asset size of Rs. 500 crores as per last audited balance sheet of the NBFC.

Further, audited balance sheets are the only publically available financials of an entity and thus, widely acceptable. A concern that might arise here is that if an NBFC is not eligible as per its latest audited financial statements, but on the date of enforcement, expects that its asset size has crossed Rs. 100 crores, will it be ineligible to enforce security interest?

Naturally, no borrower, court or any other entity will accept the asset size revealed in the unaudited financial statements. Thus, the last audited financial statements would be the only reliable source.

Hence, the asset size has to be determined on the date of last audited financial statements.

#### **4. Which assets will be considered for determining the asset size of Rs. 100 crores?**

For the purposes of RBI regulations, total assets of NBFCs are considered for determining the asset size. On the lines of RBI directions, the total assets of the NBFC as depicted in the last audited financial statements should be considered.

#### **5. What constitutes the amount of debt?**

For the purpose of determining the amount of debt, the definition of debt provided under SARFAESI Act shall be considered. According to the definition, the amount of debt shall be mean any liability (inclusive of interest) which is claimed as due from any person by the secured creditor and legally recoverable on the date of the application (enforcement).

Thus, the amount of debt would include:

- Principal amount
- Interest
- Penal interest or charges
- Any other costs or charges that the borrower is liable to pay to the secured creditor pursuant to agreement between both the parties.

#### **6. The debt amount of Rs. 50 lacs should be considered on which date?**

The amount of debt may increase or decrease over the tenure of the debt. Thus, it would be prudent to consider the amount of debt on the date of enforcement of security interest.

In this regard, following examples may be considered:

- (a) Debt amounting to less than Rs. 45 lacs at the time of origination but over time, due to accumulation of interest, amounts to Rs. 55 lacs at the time of enforcement** –Yes, the eligibility of a debt for enforcement will be considered at the time of enforcement only. Thus, if the amount of debt exceeds Rs. 50 lacs at the time of enforcement, security interest can be enforced on the same.
- (b) Debt amounting to more than Rs. 50 lacs at the time of origination, but due to repayments being made or any arrangement between the secured creditor and the borrower has reduced to Rs. 30 lacs at the time of enforcement** – No, since, at the time of enforcement, the amount of debt is less than Rs. 50 lacs. Amount at the time of origination is of no relevance.

#### **7. Examine the applicability of the SARFAESI in the following cases –**

Based on the discussion above, let us examine each of the above scenarios to understand the applicability of SARFAESI Act.

- (a) Single facility of more than Rs. 50 lacs with a security interest on an asset** – Yes.
- (b) More than one facility, each less than Rs. 50 lacs but in aggregate exceeding Rs. 50 lacs, secured by a single asset** – The threshold of Rs. 50 lacs is for the amount of debt. Here, debt would mean a single loan facility only. Thus, even if security interest is created on an aggregate debt of more than Rs. 50 lacs, for the purpose of determining applicability of the Act, each loan facility has to be considered separately.
- (c) More than one facility secured by different assets with cross default clause** – No, since different assets are used for securing different facilities, the same cannot be clubbed together.
- (d) A single facility amounting to more than Rs. 50 lacs, secured by 6 assets valuing to Rs. 10 lacs each.**

The eligibility for enforcement of Security Interest is based on the amount of debt and not on the value of security. Thus, the debt amounts to more than Rs. 50 lacs, SARFAESI Act shall be applicable.

**(e) A single facility amounting to Rs. 40 lacs, secured by an asset valuing Rs. 55 lacs.**

As discussed above, the base for enforcement is the amount of debt. Hence, if the amount of debt is less than Rs. 50 lacs, security cannot be enforced. The value of security is of no relevance for this purpose.

**(f) More than one facility secured by different assets without cross default clause** – No, since different assets are used for securing different facilities, the same cannot be clubbed together.

**8. Whether benefits under the SARFAESI Act can be availed by the NBFCs for cases originated before 24<sup>th</sup> February, 2020?**

SARFAESI Act provides for a mode of enforcement of security interests by a secured creditor. So, if on the date on which the secured creditor decides to enforce the security interest, the secured creditor is entitled to use the powers under SARFAESI, then it can do so irrespective of whether the facilities were originated before or after the date of notification or date on which the powers under the Act are bestowed upon the secured creditor.

Therefore, the eligible NBFCs shall be able to exercise the powers under SARFAESI Act even where the origination of the financial assistance took place before the date of notification.

## Section 2- Registration of charge

### **9. Are all NBFCs required to file particulars of transactions of creation, modification or satisfaction of any security interest with the CERSAI?**

Section 26B of the SARFAESI Act lays a compulsion on every authority or officer of the Central Government or any State Government or local authority, entrusted with the function of recovery of tax or other Government dues to file particulars of creation of security interest with CERSAI. However, no such compulsion is laid on secured creditors or other creditors covered under the Act.

Accordingly, the requirement of filing particulars of creation of security interest is mandatorily applicable only on government, local authorities or their officers. Thus, eligible NBFCs are not mandatorily required to file particulars of creation of security interest with CERSAI. However, see Q10.

### **10. Can security interest be enforced if registration with CERSAI is not done?**

As per section 26D of the SARFAESI Act no secured creditors shall be able to enforce security interest unless the same has been registered with the CERSAI.

Non-registration of security interest would impact the right of enforcement under SARFAESI Act only. The right of secured creditor under other laws such as IBC or under common law are still preserved.

### **11. Why should NBFCs register particulars of creation of security interest with CERSAI?**

- (i) First and foremost reason is enforcement of security interest. No secured creditors can enforce security interest under SARFAESI Act, unless the security interest created in its favour has been registered with CERSAI.
- (ii) Any registration of transactions of creation, modification or satisfaction of security interest by a secured creditor or other creditor is deemed to constitute a public notice from the date and time of filing of particulars of such transaction with CERSAI.
- (iii) In case of corporate borrowers, the registration of charge with the Registrar of Companies (RoC) is a notice to the public of creation of such charge. However, in case of unincorporated borrowers, registration of charge is not done with the RoC and hence, there is no actual notice of charge creation to the public. If the security interest is registered with CERSAI, Doctrine of Constructive Notice comes into application, and thus, anyone dealing with the property cannot claim to be ignorant about the existence of such security interest.

- (iv) The claim of such secured creditor or other creditor, who has registered the security interest or in whose favour the security interest has been registered shall have priority over any subsequent security interest created upon such property and any transfer by way of sale, lease or assignment or licence of such property or attachment order subsequent to such registration.
- (v) Also, the debts due to such secured creditor shall be paid in priority over all other debts and all revenues, taxes, cesses and other rates payable to the Central Government or State Government or local authority.

### **12. What is the time limit for registration of a security interest after its creation?**

There is no time limit specified for registration of security interest with CERSAI. Clearly, for the purpose of enforcement, the security interest must be registered. Thus, it must be registered any time before enforcement.

### **13. Are there any penal consequences for non-registration of security interest?**

No, there are no penal consequence for non-registration of security interest. However, due to non-registration:

- (a) The security interest remains unenforceable.
- (b) The secured creditor does not get priority over other charges over the security.

### **14. Analyse the following scenarios with respect to registration:**

- (a) **Eligible NBFC with debt amounting to more than Rs. 50 lacs-** Since, the debt amount is above the threshold (security interest can be enforced) and the NBFC falls under the definition of financial institution, the NBFC must register the security interest.
- (b) **Eligible NBFC with debt amounting to less than Rs. 50 lacs-** The NBFC falls under the definition of financial institution but the security interest on debt is not enforceable. Thus, it is not mandatory to register the security interest. However, registration is recommendatory since, as discussed above it will amount to a public notice and would have priority over other security interest created subsequently.
- (c) **NBFC not falling under the definition of financial institution, but the debt amounts to more than Rs. 50 lacs** – Similar to the above situation, though security interest cannot be enforced, registration of charge would provide priority over subsequent creation of security interest.
- (d) **The creditor is an operational secured creditor** – *Not mandatory*, since they do not fall under the definition of financial institutions, and thus, cannot enforce security interest.
- (e) **The borrower is not a corporate body** – *Mandatory*, since security interest can be enforced irrespective of the nature of the borrower. SARFAESI Act covers both corporate as well as non-corporate borrowers.

**15. Is registration of the mortgage deed necessary for enforcement of security interests under the SARFAESI Act?**

The benefit under SARFAESI Act cannot be availed unless the security interest is created and registered as per the relevant process of creation (documentation, deposit of title deeds, etc.). For example, in case of all corporate borrowers, registration with the RoC is mandatory. In case of documents requiring registration under the Registration Act (including state amendments – in particular, note the amendments in Maharashtra), the document cannot be received in evidence unless it is registered – (sec. 49 of Registration Act).

**16. Will registration of charge with registrar of companies be necessary even if the lender registers the security interest with the CERSAI?**

Yes. Refer answer to Q 15.

**17. In case a security interest is not registered under SARFAESI Act, can security interest be enforced under any other law?**

In case security interest is created but not registered with CERSAI, the same cannot be enforced under SARFAESI Act. However, this does not debar the secured creditor from enforcing the security under other laws such as Insolvency and Bankruptcy code.

# Section 3- Basics terms under SARFAESI Act

## **18. What is the meaning of security interest under the SARFAESI Act?**

The term “security interest” has been defined in section 2(zf) of the SARFAESI Act, 2002, as amended by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016 (Amendment Act).

Broadly, it includes the following:

### (a) Where the property is tangible in nature:

- i. Right, title or interest created on any property;
- ii. Mortgage created under section 58 of the Transfer of Property Act, 1881 conferring the right to the lender to sell the property on default;
- iii. Charge created on immovable property under section 100 of the Transfer of Property Act, 1881;
- iv. Hypothecation created on movable property – defined in section 2(1)(n) of the SARFAESI Act, 2002 and includes all forms of security interest created on movable properties except by virtue of which the possession is taken by the creditor, i.e., pledge;
- v. Assignment of rights created for the purpose of creating a security and not for the purpose of transferring.
- vi. Right or interest created by way of financial lease, hire purchase or conditional sale – Though from legal point of view, these are ownership interests, however, for the purpose of SARFAESI Act, these have been recognised as security interests.

### (b) Where the property is intangible in nature:

- i. Right, title or interest created on any property as security;
- ii. Assignment of rights created for the purpose of creating a security and not for the purpose of transferring;
- iii. License created on any intangible property for security.

## **19. What are exclusions of the definition of security interest?**

- (a) Pledges, excluded under section 31 of the SARFAESI Act. Pledge is possessory security interest. Since the essence of SARFAESI is in granting right of possession, a pledge has possession with the lender from the very beginning. Right of sale is also conferred by Contracts Act. Hence, there is no need to apply SARFAESI in case of pledges.
- (b) Some specific assets – such as aircrafts, ships, agricultural land, properties not eligible for repossession under the Code of Civil Procedure.

- (c) Security interest created on properties for securing financial assistance of less than Rs. 50 lacs (in case of NBFCs).
- (d) A mere obligation to pay is not a security interest – hence, it is not applicable in case of guarantees, unless backed by a collateral.
- (e) SARFAESI does not arise unless the security interest is properly created, as per the process of creation provided in the Act (including documentation, deposit of title deeds, registration etc). For example, in case of all corporate borrowers, registration with the RoC is mandatory. In case of documents requiring registration under the Registration Act (including state amendments – in particular, note the amendments in Maharashtra), the document cannot be received in evidence unless it is registered – see sec. 49 of Registration Act.
- (f) Letter of comfort, non-disposal undertakings, etc. are not security interests.

## **20. When do we call a loan to be secured?**

Whether a loan is secured or not has to be examined from legal, regulatory and accounting viewpoints separately.

Let us first examine it from the legal viewpoint – A loan is considered as secured from where it is backed by security interest created on a property. Property here would mean any property, tangible and intangible. Therefore, a loan secured by assignment of receivables is as secured as loan extended against a mortgage created on an immovable property.

Let us now discuss it from the regulatory viewpoint – NBFCs are regulated by the RBI and as per the prudential norms issued by the RBI, a loan can be treated as secured only if the same is backed by a tangible property. Therefore, from regulatory viewpoint a loan backed by unsecured receivables will not be treated as secured loan whereas a loan backed by a mortgage created on an immovable property or other tangible property will surely do.

Lastly, let us discuss it from the accounting viewpoint. NBFCs are required to draw up their financial statements as per Schedule III of the Companies Act, 2013. The Institute of Chartered Accountants of India has issued a guidance note on preparation of financial statements as per Schedule III and the same states that a loan will be treated as secured only if it is backed by tangible property. Therefore, from accounting viewpoint as well, only those loans secured by tangible properties will be treated as secured loans.

However, for the purpose of SARFAESI Act a loan secured by both tangible and intangible properties will be treated as secured loans.

## **21. Are ownership rights also covered under the SARFAESI Act?**

Yes. Rights and interests created by way of financial lease, hire purchase and conditional sale are included in the definition of security interest, even though they are ownership interests.

## 22. What is non-performing asset (NPA)?

The term NPA has been defined to mean any asset which has been classified as sub-standard or doubtful or loss asset in the books of the lender in accordance with the guidelines and directions issued by the RBI.

As per the RBI directions, NPA treatment has to be done in the following manner:

| Classification  | Criteria  |
|---|---|
| Sub-standard  | An asset remaining non-performing for a period not exceeding –<br><br>For FY 2016-17: 14 months<br>For FY 2017-18 and onwards: 12 months<br><br>For restructured asset: Until the expiry of 1 year of satisfactory performance as per the restructuring package.  |
| Doubtful  | An asset remaining sub-standard for a period exceeding –<br><br>For FY 2016-17: 14 months<br>For FY 2017-18 and onwards: 12 months  |
| Loss  | Where the asset which has been identified as loss asset by the NBFC or its internal or external auditor or by the RBI during the inspection of the company, to the extent it is not written off by the company; and<br>Where asset which 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 due to any fraudulent act or omission on the part of the borrower. |
| <p>The term non-performing has been defined in the RBI Directions in the following manner:</p> <ol style="list-style-type: none"> <li>An asset, in respect of which, interest remains overdue for a period of 6 months or more.</li> <li>In case of a term loan which is inclusive of unpaid interest, where the instalment or interest remains overdue for a period of 6 months or more.</li> <li>In case of a demand and call loan, where the interest remains overdue or where the loan remains overdue after the demand for a period of 6 months or more.</li> <li>A bill which remains overdue for a period of 6 months or more.</li> <li>The interest in respect of a debt or the income on receivables under the head 'other current assets' in the nature of short term loans/advances, which remains overdue for a period of 6 months or more</li> <li>Any dues on account of sale of assets or services rendered or reimbursement of expenses incurred, which remained overdue for a period of 6 months or more.</li> </ol> |   |

- g. The rental arising out of a financial lease transaction or hire purchase transaction, where the rental remains overdue for a period of 6 months or more.

Where any one account of a particular borrower has been classified as NPA by virtue of any of the above, all other accounts, except in the case of financial lease or hire purchase, will have to be classified as NPA as well. The classification of financial lease and hire purchase will have to be done based on the record of recovery.

**23. When can the security interest be enforced - Asset becoming NPA in the books or Asset reported as NPA in the books?**

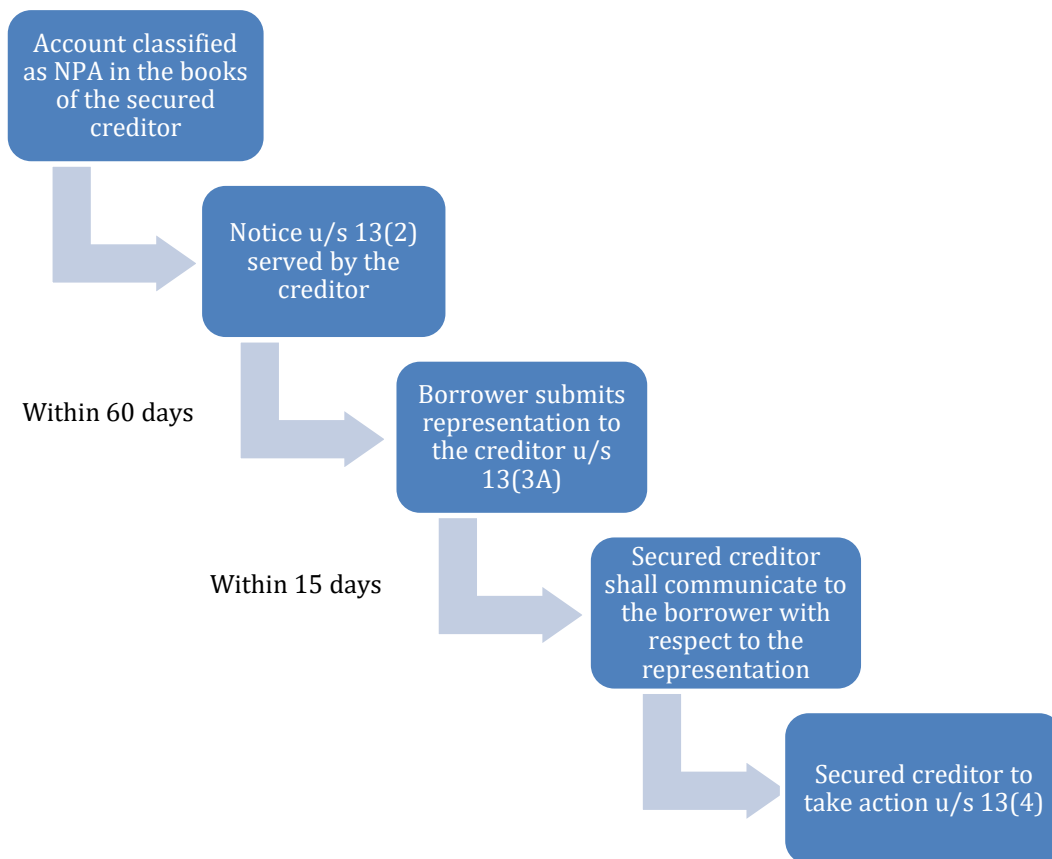
Enforcement action under SARFAESI Act can be initiated where the account becomes NPA. As per the definition provided in the Act, an account will be treated as NPA when it is classified in the books of the secured creditor as such. The secured creditor need not wait until the same is reported as NPA in the books.

**24. If the principal debtor becomes NPA in the books of the lender, does that mean even the guarantor will also have to be declared as NPA in the books of the lender?**

No, there is no such requirement under any law, which requires the secured creditor to declare the guarantor as NPA in the books based on the fact that the borrower fails to meet its obligations. Even if the guarantor is not treated as NPA in the books of the secured creditor, the secured creditor can still enforce security interest against the borrower, i.e. where the guarantor has provided any security in favour of the creditor.

**25. What is the flow of events for enforcement of security interests?**

The flow of events for enforcement of security interest under SARFAESI Act has been presented graphically below:



**26. Can the following classes of creditors vote in the resolution for enforcement of security interest –**

- (a) **Secured creditor holding first charge**
- (b) **Secured creditor holding second charge**
- (c) **Secured creditor holding sub-servient charge**
- (d) **Unsecured creditor**
- (e) **Trade creditor**

SARFAESI Act is applicable only where the creditor is a secured creditor, therefore, only secured creditors can vote in the resolution for enforcement of security interest. Further, the Act does not provide for any difference between first charge holders and subsequent charge holders. Based on this discussion, let us understand which classes of creditors can vote –

- (a) Secured creditor holding first charge - Yes
- (b) Secured creditor holding second charge - Yes
- (c) Secured creditor holding sub-servient charge - Yes
- (d) Unsecured creditor - No
- (e) Trade creditor – No. Trade creditors have the right to recover from a borrower against the good or services supplied. Usually, no seller secures trade credit. Thus, it is unsecured.

**27. A lender issues a notice under section 13(2) and receives a representation from the borrower within 60 days. After a period of 2 years the lender decides to enforce the security interest on the property. – Examine if this act of the lender is valid.**

The law is silent with respect to the maximum time period within which the secured creditor should initiate enforcement action under section 13(4) after serving the notice under section 13(2). However, the notice so served shall be subject to the *Doctrine of Laches* which talks about unreasonable delay by the plaintiff in bringing the claim and would frustrate the notice issued under section 13(2).

Also, if there have been settlement talks, partial recoveries etc. after serving the notice, preferably, lender should serve notice afresh.

Any recoveries received after notice should be received with a specific remark – received without prejudice to the Notice dated [•].

**28. Can security interest be enforced with respect to loans obtained by the NBFC by way of assignment of receivables?**

The question whether security interest on a property can be enforced in respect of loans acquired by way of assignment of receivables depends on whether the originator had the right to enforce security interest under SARFAESI. If yes, and if the right to enforce the underlying security interest is also expressly transferred by the originator to the assignee, then the security interest in respect of such loans can be enforced.

This view was also held by Bombay High Court in the case of *Kotak Mahindra Bank Ltd. vs. Trupti Sanjay Mehta*<sup>4</sup>.

**29. What powers can the DM/ CMM exercise for taking possession of assets?**

The powers of CMM/DM with respect to taking possession of assets have been laid down under section 14 of the SARFAESI Act, 2002, whereby it is allowed to pass an order of repossession of the property after duly considering the contents of the application and the affidavit submitted by the secured creditor in this regard within a period of 30 days from the date of receipt of the application and where there is sufficient cause for delay in passing the order, within 60 days from the date of receipt of the application.

Further, several rulings have dealt with the powers that can be exercised by CMM/DM and that matters concerning tenancy rights on the property in question and the same have been discussed below:

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<sup>4</sup> <https://indiankanoon.org/doc/72232507/>

(a) *Harshad Govardhan Sondagar vs. International Assets Reconstruction Co. Ltd. & Ors* -

- i. Where the possession of the secured asset by a lessee prior to the creation of mortgage and in accordance with section 65A of the Transfer of Property Act is not terminated as per section 111 of the Transfer of Property Act, then the CMM/DM cannot pass an order for taking possession of the secured asset to the secured creditor;
- ii. When the lessee voluntarily surrenders the asset to the secured creditor then even a valid lease agreement is considered to be terminated as per Section 111 (f) of Transfer of Property Act. In such circumstances, order to pass over the possession of the asset to the secured creditor may be passed by the CMM/DM;
- iii. CMM/DM by adhering to the principles of natural justice- accordingly determine the validity of a tenancy and pass orders;
- iv. To prove valid tenancy - proof of execution of a registered instrument shall have to be produced. Where the tenancy is created by unregistered/oral agreement then CMM/DM to come to a conclusion that tenant not entitled to possession from the date of instrument or the date of delivery of the possession.

(b) *Vishal N. Kalsaria v Bank of India & Ors*<sup>5</sup>

- i. Non-registration of a lease agreement does not render such tenancy nugatory
- ii. Attention must be paid to the relationship between the two parties in the lease agreement and their rights and liabilities;
- iii. Fact that there is regular payment and acceptance of rent has to be proved;
- iv. No undue advantage can be taken on the basis that the lease deed in unregistered.

### **30. Under what circumstances are tenancy rights valid under the SARFAESI Act?**

The CMM/ DM can consider the presence of tenancy rights on the property while passing an order under section 14. Let us examine the validity of tenancy rights on various circumstances.

- a. Tenancy rights acquired before creation of security interest on the property – Yes.
- b. Tenancy rights acquired after creation of security interest in compliance with the facility agreement – Yes.
- c. Tenancy rights acquired after creation of security not in compliance with the facility agreement – No.
- d. Tenancy rights acquired after enforcement action under SARFAESI Act is initiated – No.

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<sup>5</sup> [(2016) 3 SCC 762]

**31. When can a borrower get the property released after the enforcement action is initiated by the lender?**

Once the secured lender decides to proceed against the borrower under section 13(4), the borrower can get the property released only by paying all amount due, which would include, costs, charges and expenses incurred before the date of publication of the notice for public auction or inviting quotations or tender from public or private treaty for transfer of the property (section 13(8)).

**32. How is the reserve price fixed?**

As per rule 5 and 8(5) of the Security Interests (Enforcement) Rules, 2002, an AO has to carry out the valuation of the property after it is repossessed to derive the estimated value of the property and thereafter fix the reserve price of the property based on the estimated value so obtained.

**33. What should be the contents of an auction notice?**

As per rules 6 and 8 of the Security Interest (Enforcement) Rules, 2002, the following should be the minimum contents of an auction notice:

| <b>Where the property is movable</b>   | <b>Where the property is immovable</b>   |
|--|--|
| <ul style="list-style-type: none"><li>a. Details about the borrower and the secured creditor;</li><li>b. description of movable secured assets to be sold with identification marks or numbers, if any, on them;</li><li>c. reserve price, if any, and the time and manner of payment;</li><li>d. time and place of public auction or the time after which sale by any other mode shall be completed;</li><li>e. depositing earnest money as may be stipulated by the secured creditor;</li><li>f. any other thing which the authorised officer considers it material for a purchaser to know in order to judge the nature and value of movable secured assets .</li></ul> | <ul style="list-style-type: none"><li>a. The description of the immovable property to be sold, including the details of the encumbrances known to the secured creditor;</li><li>b. the secured debt for recovery of which the property is to be sold;</li><li>c. reserve price, below which the property may not be sold;</li><li>d. time and place of public auction or the time after which sale by any other mode shall be completed;</li><li>e. depositing earnest money as may be stipulated by the secured creditor;</li><li>f. any other thing which the authorised officer considers it material for a purchaser to know in order to judge the nature and value of the property.</li></ul> |

**34. Can the borrower join the auction as a bidder?**

Yes. The borrower can join the auction as a bidder after fulfilling the pre-requisites laid down by the AO for joining the auction as a bidder, which would include depositing the earnest money as provided in the auction notice.

**35. SARFAESI Act is not applicable in case of agricultural land, what is the meaning of agricultural land?**

As per section 31 of the SARFAESI Act, 2002, security interests created on agricultural land cannot be enforced under this Act. The meaning of the term agricultural land has been through several case law, some of them are provided below.

- (a) Supreme Court in the case of *S P Watel vs. State of U.P*<sup>6</sup> – “Agriculture” means the science and art of cultivating the soil including the gathering in of the crops, and the rearing of livestock; farming (in the widest sense). So, agricultural area would mean an area used for cultivation or farming.
- (b) Supreme Court in the case of *Benoy Kumar Saharoy*<sup>7</sup> - Actual tilling or ploughing of land is important to understand whether the land is agricultural or not.
- (c) Kerala High Court in case of *Sosamma Abraham*<sup>8</sup> – Refused to grant a stay on a piece of land, claimed to agricultural land based on some coconut trees and some banana trees mere growing on it.
- (d) Kerala High Court in case of *Muhammed Basheer vs Kannur District Co-operative Bank Ltd.*<sup>9</sup> – Rubber plantation is not included in the term of the “agricultural land”.

### **36. Can personal household property be repossessed under the SARFAESI Act?**

Section 31 also states that security interest created on anything which is not liable for attachment as per the provisions of first proviso to section 60 of the Code of Civil Procedure, 1908 cannot be enforced under this Act, which in turn talks about household properties like wearing apparel, cooking vessels, beds and bedding etc.

Therefore, neither agricultural land, nor household property be repossessed under this Act.

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<sup>6</sup> AIR 1973 SC 1293

<sup>7</sup> AIR 1957 SC 768

<sup>8</sup> IV (2008) BC 526

<sup>9</sup> Securitisation, Asset Reconstruction and Enforcement of Security Interests, by Vinod Kothari, 4<sup>th</sup> edition page 1174.

## Section 4- Benefits under other Acts

### **37. Whether benefits under SARFAESI Act can be availed even if recovery proceedings under other frameworks have been initiated?**

Yes, where a secured creditor has already initiated recovery proceedings under other frameworks, they can still proceed against the borrower under the SARFAESI Act after obtaining leave of absence from respective authority.

### **38. Whether NBFCs can avoid SARFAESI Act and enforce security interests under common law principles?**

SARFAESI Act only provides a mode of enforcement of security interest and does not bind the secured creditor to use nothing but SARFAESI Act. Therefore, NBFCs can avoid using SARFAESI Act and enforce security interests under common law principles.

For instance it will be easier for NBFCs to take possession of movable properties under common law principles, hence, they can avoid taking the SARFAESI route in this regard.

However, enforcement of mortgages on immovable properties are cumbersome under the common law principles, therefore, in this case powers of SARFAESI Act will be comparatively beneficial for the NBFCs.

# Section 5- Proceedings, Appeals and arbitration

## **39. Whether arbitration proceedings and enforcement of security interests under the SARFAESI Act can happen simultaneously?**

There is no bar in conducting arbitration proceedings while proceeding against the borrower for enforcement action under the SARFAESI Act. Arbitration is a process or settling disputes between the parties whereas SARFAESI Act is meant for enforcement of security interest. Both the courses of action are not contradictory and can happen simultaneously. Further, where the borrower has initiated any proceeding questioning the right of the lender, and there is a stay granted by the respective authority, the lender's action will get stayed.

## **40. Whether a lender can avail the benefits of SARFAESI Act in the following circumstances –**

- (a) **An insolvency application has been launched against the borrower** -Where an insolvency application is launched against the borrower, a secured lender shall not be able to exercise its powers under the SARFAESI Act during the first moratorium granted by the Adjudicating Authority under section 14(1)(c) of the Insolvency and Bankruptcy Code, 2016 for a period of 180 days from the date of admission of the application, which is extendable for another period of 90 days.
- (b) **The borrower is under BIFR** -Where the borrower in question is under BIFR, the secured lender can still proceed against the borrower under the SARFAESI Act, after obtaining leave of the said authority. Since, the SARFAESI Act deals with enforcement of security interest on specific properties, therefore, enforcement action under this Act shall override BIFR proceedings. The same can be validated from reading of section 35 of the Act, which provides that the provisions of SARFAESI Act will override all such laws, for the time being in force, having inconsistencies with this Act.
- (c) **A winding up petition has been made against the borrower** - Yes. If the lender decides not to relinquish the security interest on the property at the time of winding up of the borrower company, the lender will be able to retain the proceeds recovered from the enforcement proceedings after depositing the workmen dues with the liquidator in terms of second proviso to section 13(9) of the SARFAESI Act.
- (d) **A criminal proceeding has been launched by the lender against the borrower**- In a criminal proceeding the suit is launched by the State against the defendant whereas the SARFAESI Act empowers the secured lenders to enforce security

interests by non-judicial means, the proceedings of the two are completely different from each other. Therefore, there is no bar in pursuing both simultaneously.

**(e) Security has been attached by government authorities for recovery of government dues-**

(i) If the security interest is registered – The secured creditor will have priority above all other claims, including dues payable to the government. In such case, the registration of security interest is a notice to the public, including the government about such creation of security interest. Thus, the government cannot attach such property.

(ii) If security interest is not registered – In absence of registration, the secured creditor would not be able to enforce security interest. In case registration is done after attachment of the property by the government, but before enforcement of security interest, the secured creditor shall be allowed to enforce security interest, however, the same will be subject to release of the security by the government.

We have further examined various scenarios with respect to enforcement of security interest and impact of filing/non-filing of particulars of creation of security interest. The same maybe viewed here- <http://vinodkothari.com/2020/01/notification-of-amendments-to-sarfaesi-act/>

**41.Can SARFAESI proceedings be initiated against the guarantor to the credit facility?**

SARFAESI Act defines the term borrower in section 2(f) in the following manner –

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

As stated in the definition, the term borrower includes anyone who has extended guarantee for a financial assistance. Therefore, enforcement proceedings under the SARFAESI Act can be initiated against the guarantors as well.

Note, however, that SARFAESI is available only for enforcement of security interest. That is, only if the guarantor has granted a security interest, the same may be enforced under SARFAESI.

**42.Can proceedings against the guarantor be initiated first and then against the borrower?**

Yes, there is no specific provision in the Act which requires the secured lender to proceed first against the principal borrower and then against the guarantor.

#### **43. Who can be the Authorised Officer for the purpose of SARFAESI Act?**

The term "Authorised Officer" has been defined in rule 2(a) of the Security Interest (Enforcement) Rules, 2002 in the following manner –

*"authorised officer" means an officer not less than a chief manager of a public sector bank or equivalent, as specified by the Board of Directors or Board of Trustees of the secured creditor or any other person or authority exercising powers of superintendence, direction and control of the business or affairs of the secured creditor, as the case may be, to exercise the rights of a secured creditor under the Ordinance;*

The words used in the aforesaid definition shows that the officer should be of the rank of chief manager in case of public sector banks. Where the secured creditor is a financial institution, other than PSU bank, then AO should be such person who exercises powers which are similar to that of chief managers in case of PSU banks.

#### **44. Can the AO pass on its rights to act under the SARFAESI Act by way of power of attorney?**

No, though the Act is silent in this regard, we are of the view that the AO has to exercise its powers under the SARFAESI Act only by itself and not through any other person by executing power of attorney. The ability of the AO to act through their lawful attorney has been legally challenged several times in the past.

#### **45. Is the notice under section 13(2) appealable?**

No. The borrower can only submit its representation against the notice served by the secured creditor under section 13(2), but cannot appeal against the creditor. An appeal can be launched only against the measures taken by the secured creditor under section 13(4).

#### **46. Who can appeal under section 17?**

Any person aggrieved by the measures taken by the secured creditor can file an application with the Debt Recovery Tribunal (DRT). The words used here are any person. Thus, any person, other than the borrower, can also make an application if such person is aggrieved by the act of the creditor.

For instance a person having tenancy rights on the property which has been repossessed by the secured creditor under section 13(4) can also make an application.

#### **47. Where can an appeal be instituted?**

Section 17(1A) of the Act states that an appeal under section 17 shall have to be filed before the DRT under whose jurisdiction –

- (a) the cause of action, wholly or in part, arises; or
- (b) where the secured asset is located; or
- (c) the branch or any other office of a bank or a financial institution is maintaining an account in which the debt claimed is outstanding for the time being.

**48. What are pre-requisites of making an appeal under section 17?**

The pre-requisites for filing an appeal under section 17 are as follows –

- (d) The secured creditor must have taken measures under section 13(4) either by itself or with the help of the CMM/DM under section 14;
- (e) The plaintiff must be aggrieved by the creditor's action of enforcement of security interest;
- (f) The application must be filed within a period of 45 days from the date on which action has been taken by the creditor;
- (g) The application must be filed with the DRT having proper jurisdiction (see Q25)

The plaintiff must pay requisite fees along with the application.