

# [Andhyarujina much substance in the submission made on](https://assignbuster.com/andhyarujina-much-substance-in-the-submission-made-on/)

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ANDHYARUJINA COMMITTEEThiswas a committee on Legal Reforms. This Committee, being a ten-member Committeeunder the Chairmanship of Shri. T. R. Andhyarujina, former Solicitor General ofIndia, had been set-up in February, 1999 to formulate specific proposals forgiving effect to the suggestions as made by the Narasimham Committee. Thereport of this Committee was submitted in May, 2000 and as regards legalreforms in banking sector, had highlighted the following points as regardsbringing about the present Securitisation and Reconstruction of FinancialAssets and Enforcement of Security Interest Act:                   i)       Banks must bevested with power of taking possession and sale of securities withoutintervention of court as regards mortgaged properties;                 ii)       The existingRecovery of Debts Due to Banks and Financial Institutions Act, 1993 should beamended to make its provisions more effective; and               iii)       Amendment shouldalso be made in the Contract Act, 1872, by making provision of giving more timeto Banks and Financial Institutions to enforce their claims under Guarantee.

Inview of what has been stated above, there is not much substance in thesubmission made on behalf of the petitioners that while the Recovery of DebtsDue to Banks and Financial Institutions Act was in operation, it was uncalledfor to have yet another legislation for the recovery of the mounting dues. Considering the totality of circumstances and the financial climate world over, if it was thought as a matter of policy to have yet speedier legal method torecover the dues, such a policy decision cannot be faulted with nor is it amatter to be gone into by the courts to test the legitimacy of such a measurerelating to financial policy1. In1999, the Reserve Bank of India had also set-up a Working Group on Developmentof the Market for Asset Securitisation which had submitted its report inDecember, 1999, identifying several impediments in the matter of securitizationand making certain suggestions.

This Working Group was followed by itssuccessor which virtually prepared a draft Bill on Securitisation, and the samewas submitted to the Government for its consideration. Otherpolicy decisions taken conterminously by the Reserve Bank of India include-     i)       One Time Settlement Scheme- This Scheme was introduced in 1999; and in pursuanceof this Scheme, mainly covering small borrowers, the Public Sector Banks hadrecovered a total sum of Rs. 2, 192 crores pertaining to 5. 23 lakh accounts ason 30. 06. 2001. Although the Scheme was not extended yet  banks had the liberty to frame their ownpolicies both for recovery and for writing off, including compromise andnegotiated settlements conforming to Reserve Bank Guidelines issued in 1995, and a Scheme in the name of Mid-term Monetary and Credit Policy had beenfurther announced on 22.

10. 2001, by Dr. Bimal Jalan, Governor of the ReserveBank of India.    ii)       Corporate Debt Reconstruction Scheme- This Scheme was announced in the year 2001 and had itsapplication only to multi-banking accounts having an outstanding exposure ofRs. 20 crore and above with banks and financial institutions.   iii)       Policy Norms for Non-Performing Assets- Stricter norms had been adopted in this policy and theReserve Bank of India, through its matter circular of 4. 7. 2000, revised itsprudential norms on Asset classification.

iv)       Monetary and Credit Policy for 2002-03- This Policy was announced by Dr. Bimal Jalan, Governorof the Reserve Bank of India on 29. 4. 2002, stating that-    “ Consistent with the recommendations ofNarasimham Committee II, and with a view to moving closer to international bestpractices, it is proposed that with effect from March 31, 2005, an asset wouldbe classified as doubtful if it remained in the sub-standard category for 12months. Banks are permitted to phase the consequent additional provisioningover a four-year period with a minimum of 20% each year.” Subsequently a mid-termreview of this policy was announced on 29.

10. 2002, stating that-     “ There has been some improvement withregard to NPAs, operating expenses and cost of funds of commercial banks. GrossNPAs of public sector banks as a percentage of gross advances declined from12. 4% in March 2001 to 11. 1% in March 2002. The net NPAs as a percentage ofadvances also declined from 6. 7% to 5. 8% during the same period.

With a view tomoving towards international best practices and to ensure greater transparency, commercial banks were advised to adopt 90 days norm for recognition of loanimpairment from the year ending March 31, 2004. The 90 days norm has also beenmade applicable to Urban Co-operative Banks and regional rural banks, w. e. f. March 31, 2004. In order to facilitate adoption of 90 days norm for negotiationof loan impairment from the year ending March 31, 2004, banks were advised toswitch to charging interest on advances at monthly rests with effect from April1, 2002.

” Hithertofore, Section 69of the Transfer of Property Act permitted a mortgagee to take possession ofmortgaged property and sell the same without intervention of court only in caseof English Mortgage, which is a transaction where the mortgagor binds himselfto repay the mortgage money on a certain day and transfers the mortgagedproperty, absolutely to the mortgagee but subject to proviso that he willretransfer it to the mortgagor upon payment of the mortgage money as agreed2.    That apart, the mortgagee could takepossession of mortgaged property where there existed specific provision in themortgage deed and the mortgaged property were situated in specified towns likeKolkata, Chennai or Mumbai, but in other cases possession of property could betaken only by intervention of court.     Taking possession of the mortgaged propertythrough intervention of courts for enforcement of the security interest of themortgagee was, of course, a slow process with the result that by the time thesecured creditor could in any case get possession of the asset, the asset hadeither withered away or become of no value. There was, however, no provisioneither in the Contract Act or in the law relating to hypothecation, with regardto hypothecated asset which is equally a major security interest created infavour of the secured creditor.

The predominant suggestions made, therefore, in the Reports of the Narasimham Committee was to empower the banksand financial institutions to take possession of the securities and to sellthem or their part without the intervention of courts; and this recommendationwas given effect to in the text of section 13 of the Draft Bill which openedwith a non-obstante clause, thereby giving this section an overriding effectover anything contained in section 69 or 69A of the Transfer of Property Act, 1882.      TheGovernment on its part, consolidated, the reports of the aforesaid NarasimhamCommittee as also the draft bill prepared and proposed by the AndhyarujinaCommittee; and without losing time, an Ordinance with the title as that of theAct, was promulgated by the President, in exercise of his powers under Article123(1) of the Constitution of India, since the Parliament was not then insession and the President was satisfied that circumstances did exist renderingit necessary for him to take immediate action.     The Ordinance being Ordinance 2 of 2002, was thus, promulgated on June 21, 2002 and had come into force at once.

With a view to replacing the Ordinance byan Act of the same name, a Bill was introduced, on July 9, 2002, but the samecould not be passed in the Monsoon Session of the Parliament in August 2002. Normally, therefore, the life of the Ordinance had to be extended by a freshOrdinance, issued again, in August, 2002, so as to replace the formerOrdinance. Finally, the Ordinance came to culminate into an Act in the wintersession of the Parliament in December, 2002 which was deemed to have come intoforce on the 21st of June, 2002 i. e., the date of promulgation ofthe first Ordinance.     The Bill as such having been passed by bothHouses of Parliament received the assent of the President on 17thDecember, 2002 and came on the statute Book with its name as the Securitisation and Reconstruction ofFinancial Assets and Enforcement of Security Interest Act, 2002 (54 of2002).    Taking cue from certain implications of theSupreme Court judgement in MardiaChemicals Ltd. v Union of India3, the Act came to be amended through the Enforcement of Security Interest andRecovery of Debts Laws (Amendment) Ordinance, 2004 (5 of 2004), which wasenacted by the Parliament as Enforcement of Security Interest and Recovery ofDebts Laws (Amendment) Act, 2004 (30 of 2004).

Statement of Objects and Reasons ofthe Principal Act (54 of 2002)The financial sector hasbeen one of the key drivers in India`s efforts to achieve success in rapidlydeveloping its economy. While the banking industry in India is progressivelycomplying with the international prudential norms and accounting practices, there are certain areas in which the banking and financial sectors do not havea level playing field as compared to other participants in the financialmarkets in the world. There is no legal provision for facilitatingsecuritization of financial assets of banks and financial institutions.

Further, unlike international banks, the banks and financial institutions inIndia do not have power to take possession of securities and sell them. Ourexisting legal framework relating to commercial transactions has not kept pacewith the changing commercial practices and financial sector reforms. This hasresulted in slow pace of recovery of defaulting loans and mounting levels ofnon-performing assets of banks and financial institutions. Narasimham CommitteeI and II and Andhyarujina Committee constituted by the Central Government forthe purpose of examining banking sector reforms have considered the need forchanges in the legal system in respect of these areas. These Committees, interalia, have suggested enactment of a new legislation for securitization andempowering banks and financial institutions to take possession of thesecurities and to sell them without the intervention of the court. Acting onthese suggestions, the Securitisation and Reconstruction of Financial Assetsand Enforcement of Security Interest Ordinance, 2002, was promulgated on the 21stJune, 2002, to regulate securitisation and reconstruction of financial assetsand enforcement of security interest and for matters connected therewith orincidental thereto. The provisions of the Ordinance would enable banks andfinancial institutions to realise long-term assets, manage problem ofliquidity, asset liability mismatches and improve recovery by exercising powersto take possession of securities, sell them and reduce non-performing assets byadopting measures for recovery or reconstruction.

It is now proposed to replace theOrdinance by a Bill, which, inter alia, contains provisions of the Ordinance toprovide for- a) Registration andregulation of securitisation companies or reconstruction companies by theReserve Bank of India; b)Facilitatingsecuritisation of financial assets of banks and financial institutions with orwithout the benefit of underlying securities;  c) Facilitating easytransferability of financial assets by the securitisation company orreconstruction company to acquire financial assets of banks and financialinstitutions by issue of debentures or bonds or any other security in the nameof a debenture; d)Empoweringsecuritisation companies or reconstruction companies  to raise funds by issue of security receiptsto qualified institutional buyers;  e) Facilitatingreconstruction of financial assets acquired by exercising powers of enforcementof securities or change of management or other powers which are proposed to beconferred on the banks and financial institutions; f)  Declaration of anysecuritization company or reconstruction company registered with the ReserveBank of India as a public financial institution for the purpose of section 4Aof the Companies Act, 19564;  g)Defining ‘ securityinterest’ as any type of security including mortgage and charge on immovableproperties given for due repayment of any financial assistance given by anybank or financial institution; h)Empowering banksand financial institutions to take possession of securities given for financialassistance and sell or lease the same or take over management in the event ofdefault, i. e., classification of the borrower`s account as non-performing assetin accordance with the directions given or guidelines issued by the ReserveBank of India from time to time;  i)   The right of asecured creditor to be exercised by one or more of its officers authorised inthis behalf in accordance with the rules made by the Central Government; j)  An appeal againstthe action of any bank or financial institution to the concerned Debts RecoveryTribunal and a second appeal to the Appellate Debts Recovery Tribunal; k) Setting up orcausing to be set up a Central Registry by the Central Government for thepurpose of registration of transactions relating to securitisation, assetreconstruction and creation of security interest;  l)   Application of theproposed legislation initially to banks and financial institutions andempowerment of the Central Government to extend the application of the proposedlegislation to non-banking financial companies and other entities; m)          Non-application ofthe proposed legislation to security interest in agricultural lands, loans notexceeding rupees one lakh and cases where eighty percent of the loans are repaidby the borrower.   Constitutional Validity Of ActTheconstitutional validity of the act was challenged but upheld in M.

R. Utensils v Union of India5, as also in Unique Enterprises Works vUnion of India6.   However, in Mardia Chemicals Ltd. v Union of India7, the Supreme Court struck down sub-section (2) of section 17 of the Act asarbitrary and unreasonable though the rest of the Act was declared to beconstitutionally valid8.   A DB of the Delhi High Court9also upheld the validity of the Act and its provisions except the provisionscontained in section 17(2) of the Act which have already been held ultra viresby the Supreme Court in Mardia Chemical`s case supra. Amendments In Other Acts Brought AboutBy The Act Of 2002TheAct in hand has amended certain other Acts which are:   i)       The Companies Act, 1956 by insertion of new sub-section (viia) of section 4A10;  ii)       The SecuritiesContracts (Regulation) Act, 1956 by insertion of new clause (h), after clause(ib), of section 2; andiii)       The Sick IndustrialCompanies (Special Provisions) Act, 1985 by insertion of second and thirdprovisos after the proviso to sub-section (1) of section 15. Impact of amendments in the Securities Contracts(Regulation) Act, 1956 and the Sick Industrial Companies (Special Provisions)Act, 1985 is being dealt with in the succeeding paragraphs.

Need for the Act The petitioners argued that there was “ no occasion toenact such a draconian legislation to find a short-cut to realize the dueswithout their ascertainment but which the secured creditor considered to be thedues and declare the same as non-performing assests (NPA’s)”. The petitionersfurther submitted- (a)      More than 50% ofthe projected NPA’s are concentrated in the priority sector. They furthershowed that majority of the dues are against borrowers who have dues rangingfrom Rs. 25, 000 and Rs. 10 Lakhs.

Therefore, a special legislation aimedprimarily to recover dues from the industrial and corporate bodies does notaddress the NPA problem and a knee jerk reaction. (b)     There is already alegislation namely the Recovery of Debts Due to Banks and FinancialInstitutions Act on the same issue of recovery of debts and providing anexpeditious recovery procedure through the Debts Recovery Tribunals.(c)      The NPA problem inIndia is sexed up by certain commentators. The petitioners argued that “ thepercentage of NPA of as against the GDP is only 6% in India which is much lessas compared to China, Malaysia, Thailand, Japan, South Korea and othercountries. Therefore, it is evident that resort has been taken to a drasticlegislation, under misapprehension that other ways and means have failed torecover the dues from the borrowers.” At the  very outset, the Supreme Court rejected theargument that NPA’s due from industrial units is not a serious issue.

While theCourt accepted that the Recovery of Debts Due to Banks and FinancialInstitutions Act deals essentially with the same subject-matter, the Courtstated that it is a widely accepted fact that the legislation has not been verysuccessful in dealing with the problem of NPA’s. The Court observed- “…it is to be noted thatthings in the concerned spheres are desired to move faster. In the present dayglobal economy, it may be difficult to stick to old and conventional methods offinancing and recovery of dues. Hence, in our view, it cannot be said that astep taken towards securitisation of the debts and to evolve means for fasterrecovery of the NPA’s was not called for or that it was superimposition ofundesired law since one legislation was already operating in the field namely, the Recovery of Debts Due to Banks and Financial Institutions Act”. The Court further observedthat the NPA problem is an important issue retarding the growth of the economyin general and the financial sector in particular. The Court pointed out thatthe fact that the NPA’s have reached an alarming proportion was noted byseveral committees and institutions dealing with the financial sector.

The NarasimhamCommittee which was constituted in 1991 in “ Under Chapter V of the Report underthe heading ‘ Capital Adequacy, Accounting Policies and other Related Matters’, it opined that a proper system of income recognition and provisioning isfundamental to the preservation of the strength and stability of bankingsystem. It was also observed that the assets are required to be classified; italso takes note of the fact that the Reserve Bank of India had classified theadvances of a bank, one category of which was bad debts/doubtful debts”. TheCourt also noted that the committee also recommended the setting up of a “ aseparate institution by the Government of India to be known as ‘ AssetsReconstruction Fund’ (ARF) with the express purpose of taking over such assetsfrom banks and financial institutions and subsequently following up on therecovery of dues owed to them from the primary borrowers”. The Court furthernoted that similar concerns were raised by the Second Narasimham Committee, theAndhyarujina Committee, and the Reserve Bank of India. Againstthis backdrop of rich literature, the Court rejected the contention of thepetitioners that there was no rationale for the enactment of a speciallegislation to address the concern of the growing NPA’s in banks. The Courtalso pointed out whether to draft a particular legislation or not is a matterof legislative policy and “ such a policy decision cannot be faulted with, norit is a matter to be gone into by the Courts to test the legitimacy of such ameasure relating to financial policy.” However, the Court also cautioned: “ Butcertainly, what must be kept in mind is that the law should not be inderogation of the rights which are guaranteed to the people under theConstitution. The procedure should also be fair, reasonable and valid, thoughit may vary looking to the different situations needed to be tackled and objectsought to be achieved.

” Hence, the Court proceeded to consider the Constitutionalityof the various provisions of the Act. 1Mardia Chemicals Ltd. v Union of India, AIR 2004 SC 23712Section 58(c) of the Transfer of Property Act, 18823Mardia Chemicals Ltd. v UOI, AIR 2004 SC 23714Now section 2(72) of the Companies Act, 2013, w. e.

f. 12. 9. 2013. 5M. R. Utensils v Union of India, (2002) 40 SEBI & Corporate Laws 360 (Guj.)(DB).

6Unique Enterprises Works v Union of India, 2004 (2) BC 241 (Uttaranchal) (DB). 7Mardia Chemicals Ltd. v Union of India, AIR 2004 SC 23718 Asa sequel to the observations of the Supreme Court in Mardia Chemical`s case theAct was amended by the Enforcement of Security Interest and Recovery of DebtsLaws (Amendment) Act, 2004, since brought on the statute book by Act 30 of2004. 9GABS (Group Apparel Business Services v Union of India, 2004 (20) AIC 304(Del.) (DB). 10Section 4A(viia) of the Companies Act, 1956, which was inserted by the SARFAESIAct, 2002, has been omitted by the Enforcement of Security Interest andRecovery of Debts Laws (Amendment) Act, 2004, w.

e. f. 11. 11.

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