



Finance Industry Development Council

(A Representative Body of Assets and Loan Financing NBFCs)

101/103, Sunflower, 1st Floor, Rajawadi Road No.2, Ghatkopar (East), Mumbai – 400 077

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FIDC PRESENTATION TO RBI COMMITTEE ON FUNCTIONING OF ASSET RECONSTRUCTION COMPANIES (ARCs) & REVIEW OF REGULATORY GUIDELINES APPLICABLE TO THEM

Madam/Sir,

At the outset, we at FIDC **thank** the RBI and the Committee for Review of Legal and Regulatory Framework applicable to ARCs and Related Matters (“the Committee”) for giving the NBFC sector an opportunity to place its views, perspective and suggestions on legal and regulatory issues on ARCs on 8th May 2021.

We believe this initiative is a step in the right direction and trust it would help in enhancing the role played by ARCs in resolution of impaired loans (both retail and wholesale).

We place below our suggestions and views as follows:

1. Providing a level playing field for NBFCs in the sale of impaired assets:

NBFCs are allowed to sell their impaired assets to ARCs and also voluntarily subscribe to Security Receipts (“SR”) issued by the ARCs in terms of the provisions of the SARFAESI Act. In a logical course, the loans sold by the NBFCs would get derecognised on their Balance Sheets and the SR subscribed to by them be recognised as an Investment and be subject to impairment provision and income



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recognition norms as per the Act. However, all systemically important NBFCs (which command a market share of more than 80% among NBFCs) are mandated to follow the new Indian Accounting Standards (“Ind-AS”), where a test of “Control” and a test of “risk and rewards” need to be applied to transferred financial assets. Under the provisions of Ind-AS such loans sold by NBFCs continue to be recognised on balance sheet while SRs subscribed by them cannot be recognised as Investments and be subject to fair valuation as per norms under the SARFAESI Act. Banks, however, can continue to derecognise such loans and account for SR investments as Investments on their balance sheets. This anomaly of the accounting standard overriding the law of land needs to be removed and a level playing field ensured between banks and NBFCs.

2. Allow NBFCs to purchase delinquent pools with modified Accounting norms:

As far as retail loans are concerned, most ARCs have not been able to develop the requisite capabilities to resolve delinquent accounts and therefore the market for sale of impaired loans has largely been restricted to large value wholesale loans. Many NBFCs have built up significant capabilities to resolve impaired retail loans and given the heterogeneity of retail loans, specialised collection capabilities are imperative to resolve them. In view of the tremendous growth in penetration of retail loans and MSME loans, resolution capabilities are a desideratum. NBFCs are better placed than ARCs (at the present moment) in this respect. While NBFCs can even now technically buy impaired assets, they have to account for the pools as



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loans on their balance sheet and make impairment provision as if these were originated by them. They do not get the preferential accounting treatment as ARCs. If NBFCs could be allowed to account for pools of retail impaired loans and account for them on a fair value basis, it would lead to a significant boost to the market for delinquent retail and MSME loans and help the economy in realising substantial value.

3. Widening the scope of dealing and trading in SRs:

ARCs issue SR created out of the loans purchased by them as a principal method of refinance and these can be purchased by “Qualified Institutional Buyers” including banks, insurance companies and financial institutions, including in most cases, the seller of the underlying pool. The marketability of the SR is therefore limited. In order to assist ARCs in raising resources better, we would request the Committee to consider allowing high net worth individuals, family offices and other informed investors to purchase SR from the primary or secondary market. Mandatory listing of SR would also deepen and widen the market and would enable more efficient ARCs to raise funds at competitive rates.

4. Incentive Structure to encourage ARCs for quick resolution:

Currently as a market practice, ARCs levy a management fee based on the size of the pool of delinquent assets purchased by them. They do not have any incentive structure which could encourage expeditious resolution of cases. Since under the SR structure where



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only 15% SRs are held by the ARCs, the bulk of the risk of downgrading of the SR gets passed on to the third party investors. We would suggest that the fee should be split between management fee and a collection-based incentive so that there is more urgency in actual resolution of cases.

5. Parity treatment of NBFCs under the Recovery of Debt & Bankruptcy Act 1993:

ARCs and banks are allowed under the Act to take proactive action to recover debt even if a delinquent customer is not an NPA. NBFCs too should be treated on par with banks/ARCs so that in case the situation warrants, they can take proactive steps for debt recovery without actually waiting for a loan to become NPA formally.

6. Review of legal and Regulatory framework applicable to ARCs and related matters

It is no doubt that enactment of SARFAESI Act and IBAC have enabled made financial creditors to realise their assets in an expeditious and effective manner by reducing the burden of an already overloaded judicial system. The success of an ARC depends upon how efficiently it is able to reconstruct or recover the loss assets. However, the above enactments have not helped much in recovery due to various practical issues concerning the working of the system under the enactments. Civil courts are also not able to meet the demands of the financial sector due to procedural complications. Going by the experience in practical working of the system under the said



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enactments, the following additional suggestions are made to improve the efficacy:

(i) Different enforcement mechanisms for movable and immovable security:

The SARFAESI Act prescribes the same mechanism for enforcement of both movable and immovable security especially in taking possession of the secured assets. As is known, even the conventional law authorizes a secured creditor in taking possession of hypothecated movable assets without notice and intervention of court whereas taking possession of immovable property can be exercised only with the intervention of courts except in exceptional circumstances that too subject to the provisions of Transfer of Property Act. However, the SARFAESI Act mandates taking over possession of even movable assets also only after various stages of notice requirements which facilitates the borrowers to secret the assets/dismantle the assets before possession. Even when the possession is taken, due to the delay in possession of movable assets in the process, the value of the assets gets depreciated. This mainly happens in case of vehicles and machinery. While immovable properties appreciate over a period of time, movable properties depreciate. As such, the secured creditors are not opting for repossession of movable assets through SARFAESI route and hence, the Act has become redundant for enforcement of standalone movable security. We would submit that the SARFAESI Act and the Security Interest (Enforcement) Rules be amended to prescribe a



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different set of rules for enforcement of movable and immovable security.

(ii) Defined guidelines for conducting a petition under Sec. 14 of SARFAESI Act:

Under the current provisions a petition under Sec. 14 of the Act for possession of the security asset can be filed either before a District Magistrate or Chief Metropolitan/Chief Judicial Magistrate. Though since there are no defined rules as to how such a petition can be disposed of by the Magistrate except for some directive guidelines by few High Courts, each magistrate exercises his own discretion in disposing of the petition. Most of the magistrates conduct the petition as a suit or a criminal trial (including issue of notice to the borrowers) thereby delaying the entire process. As such, the intention of the legislature in speedy and expeditious enforcement of security interest is defeated.

We request the Committee to recommend framing of clear rules that need to be followed by the Magistrates in dealing with petition u/s 14.



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(iii) Proposition for reduction of timelines prescribed under the SARFAESI Act, 2002

We propose that various Notice/cooling periods under the Act are bit too long and need to be reduced to half of the current requirement.

(iv) We further submit that:

- a. Clarification may be provided that SARFAESI action is possible in case of unlisted NCDs also.
- b. A Central Repository of Data for tax defaults must be Constituted for monitoring tax payments by corporates and the access of the same must be given to lenders to help in due diligence in a time efficient manner. (To substitute S.281 of Income Tax Act as a more effective tool.)
- c. Banks to be encouraged to facilitate TRA Structures (in lieu of escrow) to enable bankruptcy remote structures.
- d. NBFCs to be permitted to take interest on Security Deposits to enable obtaining better security.
- e. Assignment of loans to ARC should be permitted on any default.
- f. Cover on listed shares and timeline for top up in case of LAS transactions may be relooked, considering changed circumstances.



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- g. Rights akin to Section 71(10) & 71(11) of the Companies Act, 2013 for loans must be provided (like NCDs).

We request your kind and favourable consideration of these requests.

We once again thank you for the opportunity given to us to make presentation before the esteemed members of the Committee.

Thanking you,

Yours Faithfully,

For **FINANCE INDUSTRY DEVELOPMENT COUNCIL**

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