ASSET RECONSTRUCTION PROCESS AND COMPANIES

Introduction:

Internationally several models have been adopted by various countries. The Asset Management Company (AMC) or Asset Reconstruction Company (ARC) was adopted in various Asian countries with a view to separate management of Non Performing Assets of Bank.

In India, Asset Reconstruction Companies were initially sponsored by the bankers however later private sector has also been involved. Now in India, Asset Reconstruction Companies are in both public as well as private sector.

Non Performing Assets:

The prudent norms on income recognition issued by the RBI defined NPA as:

1. Interest and / or installment of principal remain overdue for a period of more than 90 days in respect of a term Loan.
2. The account remains out of order for a period of more than 90 days, in respect of an Overdraft / Cash Credit.
3. The bill remains overdue for a period of more than 90 days in case of the bill purchase and discounted.
4. Interest and / or installment of principal remain overdue for two harvest season but for a period not exceeding two half years in the case of an advance granted for agricultural purpose.
5. Any amount to be received remains over-due for a period of more than 90 days in respect of the other accounts.

Asset Reconstruction Company:

Asset Reconstructions companies are created to manage and recover Non Performing Assets acquired from the banking system. Asset Reconstruction

Companies are act as a bad bank by isolated Non Performing Assets from the balance sheet of bank/FII and facilitate the latter to concentrate in normal banking activities.

Banks and financial institutions with a large proportion of their bad loans or Non Performing Assets can sell to a separate entity i.e. Asset Reconstruction Company. Then Asset Reconstruction Companies recover a sum through attachment, liquidation etc.

The objective is to help banks in making clean books by reducing Non Performing Assets. Asset Reconstruction Companies are also making profit by buying Non Performing Assets at a lower price.

India Experience with Asset Reconstruction:

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 has come into force with effect from 21st June, 2002 for creation / operation of the Asset Reconstruction Companies.

The act aims on securitization and empowering banks and financial institutions to take the possessions of the securities and sell them without intervention of the court.

Legal Aspects:

The Act aim to regulate securitization and reconstruction of financial asset and enforcement of security interest and for the matters connected with it.

- Assets Reconstruction Companies means the company formed and registered under the Companies Act, 1956 for the purpose of asset reconstruction.
- Every Asset Reconstruction Company shall make an application for registration to the Reserve Bank of India (RBI). The forms and manner of application are to prescribe by the RBI.
- The RBI shall conduct inspection of books of accounts of the company for the purpose of considering the application for registration.

- Asset Reconstruction Company having their own fund not less than 2 crore rupees or such other amount not less than 15 % of total financial assets acquired.

- Asset Reconstruction Company shall commence their business after obtaining the certificate of registration under SARFAESI Act, 2002.

Acquisition of rights or interest in financial assets:

In accordance with the Act and Reserve Bank of India, guidelines:

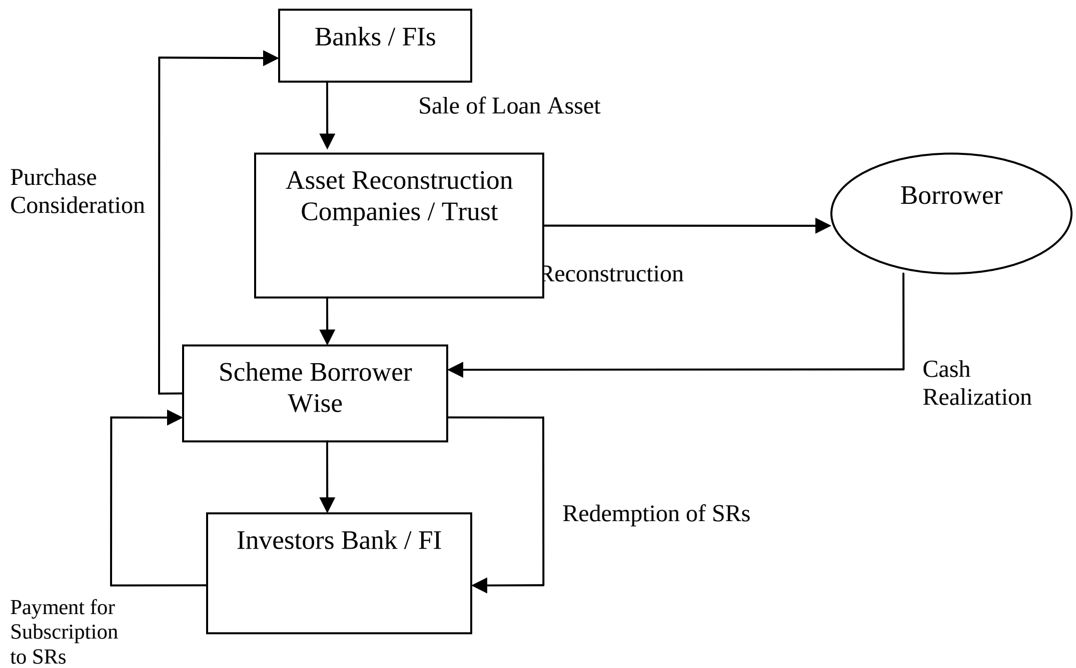
- The Asset Reconstruction Company can acquire the financial assets of non performing asset companies on their own balance sheet or through the trust structure by floatation of Schemes for raising resources through issuance of Security receipts (SRs) to Qualified Institutional buyers.
- The Asset Reconstruction Companies may issue debenture or bonds or any other security in the nature of the debenture towards acquisition of financial assets of Bank/ FIs.
- Empowering Asset Reconstruction Companies to raise funds by issue of Security receipt (SRs) to Qualified Institution buyers.
- Facilitating 'Asset Reconstruction' by exercising powers of enforcement of securities or change of management or other powers which are proposed to be conferred to the Bank/ FIs.
- Empowering bank / FIs to take possession of security given for financial assistance and sell or lease the same or take over the management in the event of default.

Measures of Asset Reconstruction:

The Asset Reconstruction Company may take following measures within the guidelines of Reserve Bank of India:

- Change in or take-over of the management of the borrower.
- Sale or lease of a part or whole of the business of the borrower.
- Re-scheduling of payment of debts payable by the borrowers.
- Enforcement of security interest in accordance with the provisions of the Act.
- Settlement of dues payable by the borrowers.
- Taking the possession of secured asset in accordance with the provision of the Act.

Transaction Structure:



Take over of Management:

Where the management of business of borrower is taken over, it can appoint as many people as it thinks fit to be the directors, where the borrower is a company or the administrators of the business of the borrower in any other cases.

Asset Reconstruction Company is required to publish a notice in a newspaper published in English language and in a newspaper published in an Indian Language in circulation in the place where the principal office of the borrower is situated.

On the publication of the notice all the persons who were directors of the company or the administrator of the business, as the case may be, are deemed to have vacated their office. It has the effect of termination of all contracts entered into by the borrower with such director or administrator.

No compensation shall be payable to such director or manager whose services are terminated.

Appellate Mechanism:

Any borrower or any other person aggrieved by the action of reconstruction can file an appeal to the concerned Debt Recovery Tribunal (DRT).The Appellate authority is given the discretion to waive or reduce the amount to be deposited for reason to be recorded.

Any person aggrieved by the order of the DRT, may prefer an appeal to the Appellate Tribunal.

Benefits of Asset Reconstruction:

- Asset Reconstruction Companies acquire and aggregate the Non Performing Assets from various lenders in order to quicken the process of corporate restructuring.
- The major objective is to acquire and rapidly liquidate Non Performing Assets.
- Clean books of accounts by reducing Non Performing Assets.
- Less to deals with Non Performing clients.
- Special legislative powers to fewer Asset Reconstruction Companies rather than to each bank.

Conclusion:

The Ordinance, which enables the bank and financial institutions to realize long term assets, manage problems of liquidity and improve recovery by exercising the power to take the possession of the securities, sell them and reduce Non Performing Assets.

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