

Draft Regulatory Guidelines

DNBS/PD (SC/RC) No. /10.30.000/2008-09

December....., 2008

Draft Guidelines on Change in or Take Over of the Management of the Business of the Borrower by Securitisation Companies or Reconstruction Companies (Reserve Bank) Guidelines, 200....

The Reserve Bank of India hereby notifies these guidelines, framed under Section 9(a) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests Act, 2002 (SARFAESI Act) to provide for the proper management of the business of the borrower, by change in or take over of the management of the business of the borrower and for other related matters.

1. Short Title and Commencement

(a) These guidelines shall be known as the Change in or Take Over of the Management of the Business of the Borrower by Securitisation Companies or Reconstruction Companies (Reserve Bank) Guidelines, 200...

(b) These guidelines shall come into force with effect from

2. Object and Applicability of Guidelines

The object of these guidelines is to ensure fairness and transparency, and to build in a system of checks and balances while effecting change in or take

over of the management of the business of the borrower by the Securitisation Companies or Reconstruction Companies (SCs/RCs) under Section 9(a) of the SARFAESI Act. The Securitisation Companies and Reconstruction Companies (SC/RC) shall have regard to these guidelines while exercising the powers conferred on them under Section 9(a) of the SARFAESI Act and shall act in a fair, reasonable and transparent manner, and not be arbitrary or discriminatory in the exercise of these powers.

3. Powers of SC/RC and Scope of the Guidelines

A SC/RC may resort to change in or take over of the management of the business of the borrower for the purpose of realization of its dues from the borrower subject to the provisions of these guidelines. On realization of its dues in full or within a period of 5 years from the date of acquisition of assets or such extension thereof as may be permitted by the Reserve Bank, whichever is earlier, the SC/RC shall restore the management of the business to the borrower as provided in Section 15(4) of the SARFAESI Act.

4. Grounds for change in or take over of management

(1) A SC/RC may resort to change in or take over of the management of the business of the borrower, when the amount due to it from the borrower is not less than 25% of the total assets owned by the borrower; and

(2) Where the borrower is financed by more than one secured creditor (including SC/RC), secured creditors (including SC/RC) representing not less than 75% of the total secured debt agree to such action:

Provided one or more of the following circumstances exist:-

- (a) the borrower makes a willful default in repayment of the amount due under the relevant loan agreement/s;
- (b) the SC/RC is satisfied that the management of the borrower is acting in a manner adversely affecting the interest of the creditors (including SC/RC) or is failing to take necessary action to avoid any events which would adversely affect the interest of the creditors;
- (c) SC/RC is satisfied that the management of the borrower is incompetent to run the business or there is a lack of professional management of the borrower or the key managerial personnel of the borrower have not been appointed for a long time which circumstances would adversely affect the financial health of the borrower or the interests of the SC/RC as a secured creditor;
- (d) the borrower has without the prior approval of the secured creditors (including SC/RC), sold, disposed of, charged, encumbered or alienated a significant part of its assets secured to the SC/RC;

(e) there are reasonable grounds to believe that the borrower would be unable to pay its debts;

(f) the borrower has entered into any arrangement or composition with creditors without the consent of the SC/RC which adversely affects the interest of the SC/RC or the borrower has committed any act of insolvency;

(g) the borrower discontinues or threatens to discontinue any of its businesses or gives notice of its intention to do so or if all or any part of the assets of the borrower required for or essential for its business or operations are damaged, or there occurs any change in the general nature or scope of its business, operations, management, control or ownership, which circumstances in the opinion of the SC/RC could materially affect the ability of the borrower to repay the loan;

(h) the SC/RC is satisfied that serious disputes have arisen among the promoters and directors of the borrower, which could materially affect the ability of the borrower to repay the loan.

Explanation A: For the purpose of this paragraph, willful default includes -

(a) non-payment of dues despite adequate cash flow and good net worth, or

(b) non-payment of dues accompanied by one or more of the following circumstances:

(i) Siphoning off funds to the detriment of the defaulting unit.

(ii) Failure to acquire the financial assets and utilization of the funds borrowed for other purposes or disposal of the financed assets and misutilisation of the proceeds.

(iii) Misrepresentation / falsification of records pertaining to the transactions with the SC/RC.

(iv) Disposing of or otherwise dealing with the secured assets without the approval of SC/RC.

(v) Fraudulent transactions by the borrower in respect of the assets secured to the creditor/s.

Explanation B: The decision as to whether the borrower is a willful defaulter or not, may be made by the SC/RC keeping in view the track record of the borrower and shall not be made on the basis of an isolated transaction/incident which is not material. The default to be categorized as willful must be intentional, deliberate and calculated.

5. Policy regarding change in or take over of management

The take over of the management of the business of the borrower by the SC/RC may be undertaken only if the effort for change in the management of the business of the borrower has failed. Every SC or RC shall frame its policy regarding change in or take over of the management of the business of the borrower, with the approval of its Board of Directors and make it available to the borrowers. The policy shall provide for the following:

(i) The change in or take over of the management of the business of the borrower should be done only after the proposal is examined by an Independent Advisory Committee to be appointed by the SC/RC consisting of an independent valuer and technical / finance / legal professionals who after assessment of the situation of the borrower, time frame available for recovery of the debt from the borrower and other relevant aspects have recommended to the SC/RC that it should resort to change in or take over of the management of the business of the borrower and that such action would be necessary for effective running of the business leading to recovery;

(ii) The Board of Directors including at least two independent directors of the SC/RC should deliberate on the recommendations of the Independent Advisory Committee and consider the various options available for the recovery of dues before deciding whether under the existing circumstances the change in or take over of the management of the business of the borrower is necessary and the decision shall be specifically included in the minutes.

(iii) The SC/RC shall carry out due diligence exercise and record the details of the exercise, including the findings on the circumstances which had led to default in repayment of the dues by the borrower and why the decision to change in or take over of the management of the business of the borrower has become necessary.

(iv) The SC/RC shall identify suitable personnel / agencies, who can take over the management of the business of the borrower by formulating a plan for operating and managing the business of the borrower effectively, so that the dues of the SC/RC may be realized from the borrower within the time frame.

6. Procedure for 'change in' or 'take over' of management

(a) The SC/RC shall give a notice of 60 days to the borrower indicating its intention to effect change in or take over the management of the business of the borrower and calling for objections, if any.

(b) The objections, if any, submitted by the borrower shall be considered by the Board of Directors of the SC/RC and a reasoned order shall be passed by the SC/RC within a period of 15 days from the date of expiry of the notice period, indicating the decision of the SC/RC regarding the change in or take over of the management of the business of the borrower which shall be communicated to the borrower.