

Enforcement of loans, guarantees and security documentation in India

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Enforcement

Criteria for enforcement

What are the common enforcement triggers for loans, guarantees and security documents?

The common enforcement trigger for loans, guarantees and security is default in repayment of the loan. Lenders usually avoid accelerating loans upon the occurrence of non-payment defaults.

Process for enforcement

What are the most common procedures for enforcement? Are there any specific requirements with which lenders must comply?

The Reserve Bank of India (RBI) has directed banks to initiate insolvency proceedings against certain identified specified accounts. On 12 February 2018 the RBI controversially issued a notification to all banks and financial institutions to commence insolvency proceedings against certain defaulting entities if a resolution plan was not implemented within 180 days of a default. The notification also withdrew all other types of resolution and restructuring mechanism laid down previously. However, the Supreme Court of India recently struck down the notification. The RBI is yet to issue fresh resolution and restructuring guidelines for stressed assets.

Asset classification norms by the RBI mandate banks to classify a loan as a non-performing asset and provision for it accordingly if the loan has been in default for a continuous period of 90 days. Banks and specific financial institutions have the right to enforce their security interest without court intervention once the account is classified as a non-performing asset. The procedure for these lenders to enforce without court intervention is laid down under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002. A notice must be provided to the defaulting entity to repay all dues within 60 days of the date of the notice. If the defaulting party fails to make such payment and does not contest the notice, the lenders have the right to take possession of the secured property and auction it to realise its dues. This right of the lenders also extends to third-party security providers.

Lenders not covered under the act must initiate action in accordance with the dispute resolution mechanism laid down in the financing documents.

Security interest created by a hypothecation or pledge has contractual remedies where the lenders may dispose of the assets without intervention of courts. This is usually practically difficult for hypothecation, as the lenders do not have possession of the secured assets.

Ranking in insolvency

In what order do creditors rank in case of the insolvency of a borrower?

The statutory priority of distribution among different classes of creditor is as follows:

- costs incurred for insolvency;
- workmen's dues for 24 months and payments due to secured creditors who have opted to relinquish their security interest;

- payments to employees (who are not workmen) in the preceding 12 months;
- dues to unsecured financial creditors (excluding operational or trade creditors);
- government dues and payments to secured creditors who have opted not to relinquish their security interest and have unpaid amounts following the enforcement of their security interest;
- all remaining debts and dues (including operational or trade creditors);
- preference shareholders, if any; and
- equity shareholders or partners, as the case maybe.

Operational or trade creditors have not been included under the ambit of unsecured financial creditors, as dues to the government would be paid only after clearing the dues of unsecured financial creditors.

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