Finance and secured lending in India

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Trends and regulatory climate

Trends

What is the current state of the lending market in your jurisdiction and have any new trends emerged over the last 12 months?

India is the fastest growing large economy in the world. Although the lending market has waivered in this regard over the past several years, there seems to have been some hope over the past year for the lending market to do justice to this label. Banks have seen an overall reduction in provisioning against deteriorating assets and an increase in credit growth. The industry seems to be recovering from the overnight de-monetisation of the Rs500 and Rs1,000 notes in circulation on 8 November 2016 and the implementation of the Goods and Services Tax. High-profile controversies have affected both public and private sector banks, which have raised eyebrows in regard to the overall conviction of the industry. However, stern measures from regulators and enforcement agencies should help to clear these blemishes on the industry.

There has been an influx of external commercial borrowing transactions, where foreign lenders lend to Indian borrowers, as the external commercial borrowing guidelines have been substantially liberalised and the interest rates of foreign lenders are traditionally lower compared to the Indian market. The past year has also seen significant activity in the financial technology space. This is evidenced by sizeable growth in peer-to-peer lending in the industry – although the Reserve Bank of India (RBI) has imposed strict limitations on the peer-to-peer lending industry.

The country's inflation rate being lower than expected and stable over the past few years has allowed regulators to periodically reduce interest rates. These are expected to drop further in the coming year, fuelling demand and liquidity in the market.

Masala bonds or rupee-denominated bonds issued overseas have not been a game-changer in the bonds space; however, there have been a few sizeable rupee-denominated bond issuances over the past year.

Regulatory activity

Is secured lending a regulated activity in your jurisdiction?

Yes, secured lending is a regulated activity in India. Various types of institution are entitled to engage in lending activities. These include:

- scheduled and non-scheduled commercial banks;
- non-banking finance companies (NBFCs);
- cooperative society banks;
- small finance banks;
- microfinance institutions; and
- money lenders.

Regulations require lending agencies to maintain standards relating to capital adequacy, prudential norms, cash reserve ratio, statutory liquidity ratio, credit ceiling and know-your-customer guidelines – although each of these norms would apply to each category of lending agency in a different manner. Each agency plays a different role in terms of the type of lending and borrower. For example, infrastructure NBFCs can extend credit facilities to entities in the transport, energy, water and sanitation and communication sectors. Loans and advances of up to Rs2.5 million are required to constitute at least 50% of the loan portfolio of small finance banks. A security interest over the assets of the borrower or third party can be created to secure any regulated lending activity. However, if a loan is provided for financing the purchase of a vehicle, it is common for a security interest to be created only over the vehicle which is purchased through the financing and no additional asset is provided as security, although the security is a depreciating asset.

Are there any specific regulatory issues which a prospective borrower should consider when arranging or entering into a secured loan facility?

An Indian company may borrow funds in compliance with the Companies Act 2013. A public limited company in India would need the approval of 75% of its shareholders if the proposed borrowing, together with the money already borrowed by the company, would exceed the aggregate of its paid-up share capital and free reserves. This provision excludes temporary loans which are repayable on demand or within six months of the date of disbursement, such as short-term, cash credit arrangements or bill discounting facilities obtained in the ordinary course of business. Appropriate corporate authorisations must be passed along with statutory filings.

Are there any specific regulatory issues which a prospective lender should consider when arranging or entering into a secured loan facility?

Prospective lenders should be registered with the RBI as a bank or NBFC. The RBI regulates the banking sector by issuing various regulations, guidelines, notifications and policies from time to time. However, certain intercompany loans are permitted without the company being recognised as a bank or NBFC by the RBI.

The lender should conduct due diligence on the assets provided as security to ensure the security provider's absolute title over the same. A lender should ensure that the borrower, third-party security provider and/or guarantor has the due capacity to enter into the financing documents and that these are enforceable under their respective governing laws.

Are there plans or proposals for reform or significant changes to the regulatory landscape in this area?

There have been significant changes to the regulatory landscape in this area.

Insolvency and Bankruptcy Code 2016 Parliament has passed an iconic legislation in the form of the Insolvency and Bankruptcy Code 2016. The code provides comprehensive insolvency and bankruptcy procedures for companies, partnership firms, limited liability partnerships and individuals. It also provides for insolvency professionals to act as liquidators. The code established the Insolvency and Bankruptcy Board of India, which will function as the regulator for insolvency and bankruptcy matters and will oversee insolvency professionals and other bodies established by the code. Any creditor (eg, secured or unsecured, financial or operational, and domestic or foreign) of the debtor may initiate insolvency proceedings on a payment default by the debtor. Insolvency proceedings against companies and limited liability partnerships are heard before the National Company Law Tribunal.

Most provisions of the code have been notified, other than voluntary liquidation and insolvency proceedings against partnership firms and individuals. The Companies Act 2013 also lays down a process for winding up; however, creditors are required to file an insolvency proceeding under the code.

The code provides for a moratorium during the insolvency proceeding, at which time all pending actions against the debtor, including arbitration proceedings, are stayed and no new actions may be initiated. Disposal of the debtor's assets, other than out of the ordinary course of business, is prohibited during the moratorium. The entire insolvency proceeding must be completed within 180 days (extendable by 90 days) from the date of admission of the insolvency application.

A resolution plan must be submitted by the committee of creditors, which should be approved by 66% of the value of both secured and unsecured financial creditors. If no resolution plan is submitted, or such a plan is rejected by the tribunal, or the creditors vote to put the debtor into liquidation, the tribunal is required to pass a liquidation order. On passing the order, the moratorium is lifted and the secured creditors may enforce their respective security interests against the debtor independent of the liquidation process. The code provides a secured creditor with two choices under liquidation:

- to relinquish its security interest, be part of the liquidation process and receive its dues in accordance with the statutory priority of distribution; or
- to enforce its security interest on its own, where the secured creditor will lose its priority in the distribution of assets with respect to any portion of its debt that it could not recover on enforcement of its own security interest.

The code deals with limited provisions related to cross-border insolvency (ie, when the debtor has assets in a country outside India). The code states that the central government may enter into bilateral agreements with the government of any other country to deal with cross-border insolvency issues.

External commercial borrowing overhaul The RBI occasionally issues regulations dealing with the permitted borrowing of Indian corporates from overseas entities. Before December 2018 the regulations were quite stringent for Indian corporates to borrow from foreign entities. The RBI's revised external commercial borrowing framework has opened doors for all Indian entities that are eligible to raise foreign investment to raise external commercial borrowing and for any foreign entity to be an eligible lender hailing from a Financial Action Taskforce or International Organisation of Securities Commissions-compliant country. Overseas lenders typically include:

- foreign banks;
- export credit agencies;
- equipment suppliers;
- foreign equity holders;
- pension funds;
- insurers;
- sovereign wealth funds; and
- overseas branches of Indian banks.

External commercial borrowing can be used for any purpose other than a few restricted activities, which include real estate activities, equity investments and capital market investments. The revised framework is much more lenient towards Indian start-ups raising foreign debt. The regulations also permit Indian entities to raise money from overseas markets through the issuance of rupee-denominated bonds overseas (colloquially referred to as 'Masala bonds'). Under the automatic route, each entity (excluding start-ups) is permitted to raise external commercial borrowing equalling up to $750 million per financial year. However, the RBI has placed an overall limit of 6.5% of India's gross domestic product on all outstanding stock of external commercial borrowing per financial year.

Change in calculation of interest rate for banks In March 2016 the RBI issued directions to banks to revise their computation of interest rates and link the same to the marginal cost of funds based lending rates (MCLR). The calculation of interest rates using the new formula provided by the RBI ensures:

- improvement to transmission of policy rates into the lending rates of banks;
- transparency in the methodology followed by banks for determining interest rates on advances; and
- availability of bank credit at interest rates which are fair to borrowers as well as banks.

However, the RBI recently issued directions to banks to link external benchmarks to determine floating interest rates for retail loans. This will soon be implemented in a phased manner.

Peer-to-peer lending The RBI has issued regulations on peer-to-peer (P2P) lending platforms in India, which are still in a nascent stage. P2P platforms are required to be registered with the RBI as non-banking financial companies and, among other things, must adhere to capital adequacy and prudential norms. The regulations exclude secured lending from the ambit of P2P lending platforms.

Structuring a lending transaction

General

Who are the active providers of secured finance in your jurisdiction (eg, international banks, local banks or non-bank financial institutions)?

The Indian market has a plethora of different banks engaged in secured finance. Large corporate financing transactions are mostly funded by the bigger Indian banks, international banks and institutional non-banking finance companies (NBFCs). There are different types of NBFC in India which are sector specific (eg, real estate financing, automobile financing and agriculture finance).

Is well-established market-standard facility documentation used in your jurisdiction for secured lending transactions?

The Indian Banks Association has circulated standard facility documentation for consortium lending which is followed by most public sector Indian banks. Usually, lenders follow their own individual formats for bilateral financing transactions; however, the clauses across banks are similar. Private sector banks usually prefer to follow the documentation as prescribed by the Asia Pacific Loan Market Association (APLMA) for syndicated transactions. Most sizeable corporate financing transactions are negotiated and the documentation is modified accordingly.

Syndication

Are syndicated secured loan facilities typical in your jurisdiction?

Yes. Large financing transactions are regularly syndicated. Banks resort to syndication to ensure risk mitigation and to adhere to the Reserve Bank of India's (RBI) large exposure framework.

How are syndicated facilities normally structured? Does the law in your jurisdiction allow a facility agent to be appointed to act on behalf of other banking syndicate members?

A lending consortium usually appoints the bank with the largest exposure as the lead bank. Other banks in the consortium provide the lead bank with rights to represent and manage the group of lenders. Usually the lead bank is provided with all rights for enforcement and providing directions to the obligors.

A facility agent is usually appointed for a syndicated lending transaction which adopts the APLMA-style facility documentation. Indian law does not restrict a facility agent to act on behalf of the syndicate members. Indian banks usually act in the dual capacity of facility agent and lender.

There are no specific regulations with respect to syndication or consortium lending and lenders are free to structure facilities as agreed by all parties which are within the regulatory framework for lending. However, the RBI has directed all banks engaged in consortium or multiple banking arrangements to regularly share credit information of respective borrowers with one another to ensure transparency and reduce fraud among lenders.

Does the law in your jurisdiction allow security and guarantees to be held on trust by a security trustee for the benefit of the banking syndicate?

Yes. The Indian Trust Act 1882 recognises the concept of a trust and a trust is settled in favour of the security trustee who in turn holds the security or guarantee for the benefit of the syndicate members. Appointing a security trustee is very common for syndicate financing transactions. The security documents are held in the custody of the security trustee and the security trustee acts on the directions of the syndicate lenders or facility agent (acting on the instructions of the lenders) for enforcement of the security. However, a recent Supreme Court judgment on the payment of stamp duty on security documents involving a security trustee has created issues for borrowers who are required to bear significant additional stamp duty in syndicated transactions originating in a few states in India.

Special purpose vehicle financing

Is it common in secured finance transactions for special purpose vehicles (SPVs) to be used to hold the assets being financed? Would security generally be given over the shares in the SPV or would lenders require direct asset security?

It is common for SPVs to be created for specific transactions. The SPV acts as the borrower and the assets financed are held with the SPV. It is common for lenders to take the shares and assets of the SPV as security. Lenders also insist on parent companies providing additional security to ensure due compliance with the repayment obligations of the SPV. Creation of SPVs is common in project finance transactions.

Interest

Is interest most commonly calculated by reference to a bank base rate or a market standard variable reference rate (eg, LIBOR, EURIBOR or HIBOR)? If the latter, which is the most commonly used reference rate in your jurisdiction?

The interest is calculated by reference to a bank rate. The RBI provides the formula which a bank is required to use to calculate its marginal cost of funds-based lending rates.

Are there any regulatory restrictions on the rate of interest that can be charged on bank loans?

The RBI prescribes the marginal cost of funds-based lending rates (MCLR), which is the minimum rate of interest that a bank may charge for lending. The spread, which is in addition to MCLR, is at the discretion of the lender. However, the RBI has required banks to have a board-approved policy delineating the components of spread charged to a customer. The policy should include principles to:

- determine the quantum of each component of spread;
- determine the range of spread for a given category of borrower or type of loan; and
- delegate powers in respect of loan pricing.

There are no restrictions to determine interest rates for lending in foreign currency. Banks are free to choose any market-determined external benchmark (eg, LIBOR, EURIBOR or HIBOR) to determine their lending rate in addition to their spread.

Banks are free to determine the default interest rate to be charged on the occurrence of an event of default. However, the RBI mandates banks to formulate a board-approved policy for charging penal interest on advances, which should be fair and transparent.

Use and creation of guarantees

Are guarantees used in your jurisdiction?

Yes. Guarantees are widely used as credit support in many financing transactions. Lenders tend to take corporate guarantees from the parent or holding company of the borrower or personal guarantees from the promoters of the borrower.

What is the procedure for their creation?

A guarantee is usually provided in the form of a deed by the guarantor in favour of the guarantee holders. A guarantee can also be provided in the form of an agreement. A guarantee is deemed created on the execution of the guarantee document. Guarantees are governed by the Indian Contract Act 1872.

Do any laws affect or restrict the granting or enforceability of guarantees in your jurisdiction (eg, upstream guarantees)?

The Companies Act 2013 restricts the issuance of guarantees by companies to guarantee the loan taken by any director of the company or any other person in whom the director is interested. However, the law provides for practical exemptions to this rule, whereby a holding company may provide a guarantee or security for a loan taken by a wholly owned subsidiary or a loan taken by a subsidiary from a bank or financial institution, provided that the loan is utilised by the wholly owned subsidiary or subsidiary for its principal business activities. The law has been further liberalised to permit companies to issue a guarantee towards a borrowing by any person in whom a director is interested by seeking approval from the company shareholders through a special resolution, provided that the loan is used for the principal business activities of the borrower. The Companies Act also prescribes limits on the guarantees that can be issued.

Guarantees provided by Indian companies as credit support towards loans taken by their overseas subsidiaries must be reported to an authorised dealer bank. These guarantees need to be capped at 400% of the net worth of the guarantor and should have a specific expiry. The approval of the RBI will be required for providing a guarantee beyond the stipulations.

Payment of stamp duty on the deed of guarantee is necessary to ensure enforceability of the guarantee document in a court in India.

Subordination and priority

Describe the most common methods of structuring the priority of debts and security.

Priority of debts is usually set by contractual arrangements between the creditors. An inter-creditor agreement is entered into between the various creditors which provides for structuring the priority of repayment obligations. Banks that have arranged the facility and taken the largest exposure usually demand priority status in an enforcement scenario. This also depends on the ranking of security interest created on the assets of the obligor. A company that has created a security interest over its assets is required to file certain forms with the Ministry of Corporate Affairs (Company Registry) in India. The filing of the security interest with the company registry determines the priority of ranking of the charge of various lenders, other than those otherwise contractually agreed.

Most lenders typically insert a clause in their facility documentation which ensures that their payment obligation would rank at least *pari passu* with the claims of all of other unsecured and unsubordinated creditors of the obligor.

Lenders can also vary any statutory dues by the obligor, as these dues take priority over a secured creditor, other than in an insolvency proceeding. A certificate from an income tax officer is usually requested, which waives the statutory lien of the Income Tax Department against the particular asset over which a security interest is created for recovery of income tax dues. This certificate is valid for 180 days from the date of issuance. Another certificate can be applied for and obtained on the expiry of the earlier certificate.

Documentary taxes and stamp duty

Are any taxes, stamp duty or other fees payable on the granting of a loan, guarantee or security interest, or on its enforcement?

India is a complex jurisdiction with respect to taxes, stamp duty, registration costs and other fees. Stamp duty and other fees are payable to ensure the enforceability of a facility agreement or a security interest. Each state in India stipulates its own stamp duty payable on different types of documents for the document to be enforceable in that state. For example, the stamp duty to be paid on a facility agreement in the state of Karnataka is Rs200. The stamp duty rises to Rs400 if the agreement includes an indemnity clause. Stamp duty for creation of security interest by way of an equitable mortgage, pledge or hypothecation can rise up to Rs10 million per form of security in the state of Karnataka.

Certain states require mandatory registration over a mortgage of a property situated in that state, for which a registration fee is payable. A company is required to pay fees for filing specific forms with the company registry.

As a general rule, a document cannot be admitted as evidence in a court of law if it is stamped insufficiently or if the document is not registered where registration is mandatory. High penalties are prescribed for documents with insufficient stamp duty. The authority is also provided with the right to seize documents that are insufficiently stamped.

Given the numerous intricacies involved in this area, specific advice should be sought before execution of any document in India or which relates to enforceability of the document in India.

Cross-border lending

Governing law

Is it more common for local law to govern the terms of the facility documentation or is the law of another jurisdiction often elected by the parties (eg, English law or New York law)?

Facility documentation is usually governed by English law for cross-border lending transactions. However, security documents are governed by Indian law if the assets over which the security interest is created are situated in India. Indian law is used for wholly domestic financing transactions.

Restrictions

Are there any restrictions on the making of loans by foreign lenders or the granting of security or guarantees to foreign lenders?

Lending by foreign entities to Indian parties is governed by the Foreign Exchange Management Act 1999. The Reserve Bank of India (RBI) is the body responsible for framing regulations surrounding foreign lending. The external commercial borrowing (ECB) guidelines framed by the RBI are the primary regulations surrounding foreign lending. The main regulations in this regard are the Foreign Exchange Management (Borrowing and Lending) Regulations 2018 and the rules and regulations framed thereunder. The RBI has recently liberalised its ECB guidelines to permit multiple financing transactions. All types of Indian entity that are eligible to raise foreign investment in order to raise external commercial borrowing are eligible borrowers and any foreign entity hailing from a Financial Action Taskforce or International Organisation of Securities Commissions-compliant county will be an eligible lender under the ECB regulations. ECB can be used for any purpose other than a few restricted activities, which include real estate activities, equity investments and capital market investments. The ECB regulations are more liberalised for Indian start-ups; for example, start-ups are not restricted on the end-use of the loan. Various other regulations such as those regarding 'all-in-cost' (all-in-cost includes the rate of interest, other fees, expenses, charges and guarantee fees whether paid in foreign currency or rupees, but does not include commitment fees, pre-payment fees or charges or withholding tax payable in rupees), tenure, prepayment and currency are also prescribed. The RBI has delegated many powers to the authorised dealer bank for reporting and seeking approvals for raising ECBs.

The ECB guidelines permit the creation of security or granting of guarantees in favour of foreign lenders to extend credit support for the lending, by obtaining the approval of the authorised dealer bank. In certain cases, RBI approval is required for creation of the security or providing guarantees.

Are there any exchange controls that restrict payments to a foreign lender under a security document, guarantee or loan agreement?

On the occurrence of an event of default under the financing documents, the foreign lender will have at its disposal all the contractual remedies as prescribed in the financing documents. However, the remedies will have to be in accordance with Indian law to ensure the enforcement of rights against the borrower. For example, in case of enforcement of security interest over immovable property, the property would have to be sold only to a person resident in India and the sale proceeds would need to be repatriated to liquidate the outstanding debt. The foreign lender or security trustee is not permitted to hold the immovable property on its books as an enforcement remedy. Conversion of outstanding debt to equity requires compliance with exchange control and company law, irrespective of the rights provided under contract.

Exchange control in India is complex and specific advice should be sought.

Security – general

Security agreements

Is it possible to create a security interest over all assets of an entity? If so, would a single security agreement suffice or is a separate agreement required for each type of asset?

Yes, it is possible to create security interest over all assets of an entity. In practice, each type of asset usually requires a different type of security interest to be created. Separate security documents would need to be executed depending on the type of security interest. For example, a security interest by way of equitable mortgage would need its own set of documents (declaration and memorandum of entry) evidencing the creation of the mortgage which will be separate from a hypothecation or pledge.

Release of security

What are the formalities for releasing security over the most common forms of assets?

Specific charge satisfaction forms must be filed with the company registry, the Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI) and information utility under the Insolvency and Bankruptcy Code, if applicable, for releasing security which was recorded with the company registry, CERSAI and information utility, respectively.

A deed of release or reconveyance is entered into between the mortgagor and mortgagee, which is subsequently registered, to release a charge created on an immovable property by way of an English mortgage.

The title deeds must be returned to the mortgagor in case of an equitable mortgage. Where the equitable mortgage is registered in a specific state, a release deed must also be registered with the relevant authority to perfect the release of security.

Pledged share certificates must be returned to the shareholder, if in physical form, upon the release of security. Requisite forms must be filed with the depository participant if the shares are held in dematerialised form.

A deed of release must be executed between the security provider and security holder and filed with the necessary authority to ensure release over IP rights.

<u>Asset classes used as collateral for security</u>

Real estate

Can security be granted over real estate? If so, what are the most common forms of security granted over real estate and what is the procedure?

Yes, security interest can be created over real estate in India. Security interest over real estate is created by way of mortgage. The Transfer of Property Act 1882 is the main statute which deals with mortgages and prescribes the various types mortgages.

The two most common forms of mortgage in India are:

1. the English mortgage – interest in the mortgaged property is transferred absolutely to the mortgagee (entity in favour of whom the mortgage is created), subject to the mortgagee reconveying the mortgaged property to the mortgagor (entity creating the mortgage) upon discharge of all payment obligations; and
2. the equitable mortgage – the mortgagor deposits the title deeds of the immovable property with the mortgagee with the express intention to create a security interest over the property.

Procedures *English mortgage* An English mortgage must be recorded in an indenture of mortgage, which must be:

- attested by at least two witnesses; and
- registered with the relevant land registry where the mortgaged immovable property is situated, within the statutory prescribed period.

Equitable mortgage The act of depositing the title deeds by the mortgagor with the mortgagee creates the security interest over the immovable property. This creation is evidenced by:

- a declaration executed by the mortgagor, specifying the intent of creating the equitable mortgage; and
- a memorandum of entry executed by the mortgagee, which records the act of the mortgagor depositing the title deeds.

Other common procedures are as follows:

- Applicable stamp duty and registration fees must be paid. Only a few states mandate the registration of an equitable mortgage.
- If the mortgagor is a company, requisite filings with the company registry and information utility under the Insolvency and Bankruptcy Code are required to record the mortgage.
- Certain lenders are required to register their mortgages with the Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI).
- Corporate authorisations of the mortgagor should be in place.

- No objection certificates should be obtained from entities which have a prior charge over the property or from the lessor if the mortgagor is mortgaging its leasehold rights over the property.

Machinery and equipment

Can security be granted over machinery and equipment? If so, what are the most common forms of security granted over this kind of property and what is the procedure?

Yes, security interest can be created over machinery and equipment. Security interest over machinery and equipment can be created by way of a mortgage or hypothecation in India:

- Mortgage – machinery and equipment are usually clubbed along with immovable properties when an English mortgage is being created.

- Hypothecation – hypothecation means a charge, floating or fixed, in or upon any movable property, existing or future, without delivery of possession of the movable property to the secured party.

Procedures *Mortgage* The procedure for the English mortgage for real estate also applies to machinery and equipment.

Hypothecation The hypothecation is created by entering into a deed of hypothecation. The terms of the security are purely contractual and the deed of hypothecation needs to capture all the rights of the secured party on enforcement, including the right to crystallise the charge and take possession of the secured assets. Other procedures are as follows:

- Stamp duty and registration fees (wherever applicable) need to be paid within the statutory period in the state where the deed of hypothecation is being executed.

- If the security provider is a company, filings with the company registry and information utility under the Insolvency and Bankruptcy Code are required to record the hypothecation.

- Certain lenders are required to register their charge with the CERSAI.

- Corporate authorisations of the security provider should be in place.

- No objection certificates should be obtained from entities which have a prior charge over the secured assets.

Receivables

Can security be granted over receivables? If so, what are the most common forms of security granted over this kind of property and what is the procedure?

Yes, security interest can be created over receivables. Security interest over receivables can be created by way of an English mortgage, hypothecation or assignment. Restrictions in the underlying contract must be studied carefully to ensure due creation over receivables. Notice to the third party is usually provided upfront on the lender's security interest over the receivables of the security provider.

The procedures for English mortgage and hypothecation also apply to receivables.

An assignment is evidenced by way of an instrument in writing. Usually, security by way of assignment is done under the deed of hypothecation. Assignments are not popular in India due to high stamp duty charges. The stamp duty is mostly *ad valorem*, ranging from 2% to 5% across different states in India.

Factoring transactions in India are governed by the Factoring Regulation Act 2011.

Financial instruments and cash

Can security be granted over financial instruments? If so, what are the most common forms of security granted over this kind of property and what is the procedure?

Yes, security interest can be created over financial instruments in India. Security interest over financial instruments is created by way of a pledge.

Pledge The bailment of goods as security for payment of a debt or performance of a promise is knowns as a 'pledge'. A pledge is primarily governed by the Contract Act 1872.

Procedures which entail a pledge are as follows:

- Execution of a pledge agreement between the pledgor (entity creating the pledge) and pledgee (entity in favour of whom the pledge is created).
- Delivery (actual or constructive) of the secured asset. In case of shares, physical share certificates must be deposited with the pledgee. If the shares are in dematerialised form, specific forms must be filed with the depository participant of the pledgor to ensure that possession of shares is transferred to the pledgee.
- Stamp duty and registration fees (wherever applicable) would need to be paid within the statutory period, in the state where the pledge agreement is being executed.
- If the pledgor is a company, filings with the company registry and information utility under the Insolvency and Bankruptcy Code are required to record the pledge.
- Certain lenders are required to register their charge with the CERSAI.
- Corporate authorisations of the pledgor should be in place.

Lenders in India do not usually include the value of shares pledged while calculating the security cover due to the volatile valuation of these instruments.

Can security be granted over cash deposits? If so, what are the most common forms of security granted over this kind of property and what is the procedure?

Yes, security interest over cash deposits can be created in India. Security interest over cash deposits can be created by way of an English mortgage or hypothecation. The procedures for an English mortgage and hypothecation outlined above also apply to cash deposits.

Intellectual property

Can security be granted over intellectual property? If so, what are the most common forms of security granted over this kind of property and what is the procedure?

Yes, security interest can be created over intellectual property in India. Intellectual property in India mostly includes patents, copyright, trademark and designs. Security interests over IP rights can be created by way of hypothecation, assignment or mortgage.

Procedures *Patents* Patents are governed by the Patents Act 1970. The following procedures must be complied with:

- The instrument must be in writing.
- The document creating the assignment, mortgage, licence or creation of any other interest needs to be registered with the relevant authority along with necessary prescribed forms.

Copyrights Copyrights are governed by the Copyright Act 1957. The following procedures must be complied with:

- An instrument in writing should record the assignment of copyright.
- Registration of the assignment instrument is not mandatory, but advisable. The assignment of copyright needs to be recorded with the relevant authority on enforcement.

Trademarks Trademarks are governed by the Trademark Act 1999. The following procedures must be complied with:

- The instrument must be in writing.
- The document creating assignment must be registered with the relevant authority.

Designs Designs are governed by the Designs Act 2000. The following procedures must be complied with:

- The instrument must be in writing.
- The document creating the assignment, mortgage, licence or any other interest needs to be registered with the relevant authority along with necessary prescribed forms.

Other procedures include the registration of the charge with the company registry. Certain lenders are required to register their charge with the CERSAI and corporate authorisations should be in place.

<u>Enforcement</u>

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 stuck 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.

Kochhar & Co - Anuj Kaila