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Co-operative Banks Under Sarfaesi Act

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Why in News

Recently, the Supreme Court held that **Co-operative banks** established under a State law and multi-State level co-operative societies come within the ambit of the **Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (Sarfaesi) Act** of 2002.

Key Points

- **Conflicting decisions by high courts:** The judgment came in view of several conflicting decisions by high courts on the issues of
 - Whether the Co-operative banks can be called 'Banks (financial Institution)' under the Banking Regulation Act of 1949 or,
 - Whether the Parliament has legislative competence to regulate financial assets of cooperative banks formed under state law.

The argument was that under **Lists I and II of the 7th Schedule**, the Constitution provides for distinct fields of legislative entries for the state legislature and Parliament and once there is already a valid law made by the state referring to its own field, there should not be a parallel parliamentary law on the same topic.

- **Supreme Court verdict:**

- Upholding the central government notification of January 28, 2003 which brought co-operative societies within the purview of the Sarfaesi Act, the Supreme court said **Co-operative banks come within the definition of “Banks”** under the Banking Regulation Act, 1949 for the purposes of the Sarfaesi Act.

The recovery procedure under the Sarfaesi Act is also applicable to co-operative banks and there is no clash with the Banking Regulation Act, 1949.

- The court also ruled that the **Parliament has legislative competence to provide procedures for recovery of loans under the Sarfaesi Act** with respect to cooperative banks.
- The court was of the opinion that **recovery of dues would be an essential function of any financial institution** and co-operative banks cannot carry on any activity without compliance of provisions of the banking Act and any other legislation applicable to such banks and the RBI Act.

Sarfaesi Act

- Banks utilize Sarfaesi Act as an **effective tool for bad loans (Non Performing Asset) recovery.**
- The Sarfaesi Act is **effective only against secured loans** where banks can enforce the underlying security.
- Following are the main objectives of the Sarfaesi Act.
 - Provides the legal framework for securitization activities in India.
 - It gives the procedures for the transfer of NPAs to asset reconstruction companies for the reconstruction of the assets.
 - Enforces the security interest without Court’s intervention.
 - Gives powers to banks and financial institutions to take over the immovable property that is pledged to enforce the recovery of debt.
- Major feature of Sarfaesi is that it **promotes the setting up of asset reconstruction companies (ARCs) and asset securitization companies (SCs)** to deal with NPAs accumulated with the banks and financial institutions.

- The Act provides three alternative methods for recovery of non-performing assets, namely:
 - **Securitisation**

Securitization is the practice of pooling together various types of debt instruments (assets) such as mortgages and other consumer loans and selling them as bonds to investors.
 - **Asset Reconstruction**

Asset reconstruction is the activity of converting a bad or non-performing asset into performing asset with the help of Asset reconstruction companies.
 - **Enforcement of Security without the intervention of the Court.**

If the borrower defaults, the bank may enforce security interests by:

 - Take possession of the security;
 - Sale or lease or assign the right over the security;
 - Appoint Manager to manage the security;
 - Ask any debtors of the borrower to pay any sum due to the borrower.

Source: IE