Asia Pacific Guide to Lending and Taking Security - India

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# Background

## Background

India has an exchange control regime. The inflow and outflow of foreign currency is regulated by the Foreign Exchange Management Act, 1999 and the rules and regulations framed under it. All loans and credit facilities made available by a foreign lender to an Indian borrower are governed by that act. An external commercial borrowing (ECB) is a commercial loan raised by an eligible resident entity from a recognized nonresident entity. An ECB is required to conform to several parameters, including amount, minimum average maturity, end use and all-in-cost ceilings.

The framework in relation to ECBs is contained in the "Master Direction on External Commercial Borrowings, Trade Credits and Structured Obligations" dated 26 March 2019, as amended ("**ECB Guidelines**"), issued by the Reserve Bank of India (RBI).

Under the ECB Guidelines, ECBs can be made available either in a foreign currency or in Indian rupees.

# When considering whether to lend

## 1. Is it necessary or advisable for any lender, arranger, facility agent or security agent to be licensed, qualified or otherwise entitled to carry on business in this jurisdiction: (a) by reason only of its execution, delivery or performance of the finance documents; or (b) to enable it to enforce its rights under the finance documents?

No. However, depending on the nature of the security created to secure the ECB, an offshore security agent would need to have a digital signature to file certain forms with the Registrar of Companies (ROC) or have a dematerialized account with a depository in India. If it does not have either of these, it may be necessary to appoint a security trustee in India.

## 2. Will any lender, arranger, facility agent or security agent be deemed to be resident, domiciled, carrying on business or subject to tax by reason only of the execution, delivery, performance or enforcement of the finance documents?

No.

## 3. Are there any regulatory reporting requirements that lenders must observe in connection with those transactions?

Depending on the nature of the security created in relation to the ECB, the lender or the security agent may be required to sign certain forms with the ROC, make certain filings with the Central Registry of Securitization Asset Reconstruction and Security Interest (CERSAI) or assist with the registration of the security documents with the relevant land registry. Further, if a pledge or any other encumbrance is created over shares of a listed company, it may need to be disclosed by the lender or the security agent to the relevant stock exchange in accordance with the regulations issued by the Securities and Exchange Board of India (SEBI).

## 4. Is it necessary to establish a place of business in your jurisdiction in order to enforce any provision of the finance documents?

No.

## 5. Is a foreign bank/financial institution permitted to approach local entities for business?

A lender that is eligible to provide an ECB may approach Indian borrowers in relation to ECBs.

# When lending to borrowers

## 1. Are there any restrictions in relation to the type of borrower who may borrow foreign currency or in relation to the term of foreign currency and/or the amount of foreign currency borrowed by local entities?

Yes. The ECB Guidelines (see "Background") prescribe the categories of entities to which an ECB can be made available and also limit the amounts that the entities may borrow without the RBI's approval.

**Entities to which ECBs may be made available**

A foreign currency-denominated ECB may be made available to all entities eligible to receive foreign direct investment in India, port trusts, units in a special economic zone, the Small Industries Development Bank of India and the Export Import Bank of India.

An ECB denominated in Indian rupees may be made available to all entities eligible to borrow foreign currency ECBs as well as to registered entities engaged in microfinance activities, entities that are registered not-for-profit companies, registered societies/trusts/cooperatives and nongovernmental organizations.

**Term of ECBs**

Generally, an ECB must have a minimum average maturity of three years. However, depending on the end use of an ECB, the ECB Guidelines prescribe the following minimum average maturities:

ECB raised by manufacturing companies up to USD 50 million or its equivalent per financial year: 1 year.

ECB raised from a foreign equity holder for working capital purposes, general corporate purposes or for repayment of Indian rupee loans: 5 years.

ECB raised for working capital purposes or general corporate purposes or on-lending by nonbanking financial companies (NBFCs) for working capital purposes or general corporate purposes: 10 years.

ECB raised for repayment of Indian rupee loans availed domestically for capital expenditure or on-lending by NBFCs for the same purpose: 7 years.

ECB raised for repayment of Indian rupee loans availed of domestically for purposes other than capital expenditure or on-lending by NBFCs for the same purpose: 10 years.

**Limits on the amount of ECBs**

Eligible borrowers are permitted to borrow up to USD 750 million or the equivalent by way of ECBs each financial year. Any borrowings exceeding the above amounts require the RBI's prior approval.

## 2. Are there any restrictions on the rate of interest or default interest that may be charged?

The ECB Guidelines prescribe an all-in-cost ceiling of 500 basis points above the benchmark rates for foreign currency ECBs. For ECBs in Indian rupees, the ECB Guidelines prescribe an all-in-cost ceiling of 450 basis points above the benchmark rates. The benchmark rate in the case of foreign currency ECBs refers to any widely accepted interbank rate or alternative reference rate of six-month tenor applicable to the currency of borrowing, e.g., EURIBOR for euros. The benchmark rate in the case of Indian rupee-denominated ECBs is the prevailing yield of the government of India securities of the corresponding maturity. The "all-in cost" includes rate of interest, other fees, expenses, charges, guarantee fees and export credit agency charges, whether paid in foreign currency or Indian rupees, but will not include commitment fees and withholding tax payable in Indian rupees.

Default interest must not exceed 2% above the rate of interest agreed under the facility agreement. Any payment of default interest over and above that rate may require the RBI's prior approval.

## 3. Are there any restrictions on particular lenders or classes of lender entering into credit transactions with borrowers?

ECBs can only be extended by a lender that is a resident of any one of the following:

A country that is a member of the Financial Action Task Force (FATF) or a member of an FATF-style regional body; and should not be a country identified in the FATFs public statement as a jurisdiction that has strategic anti-money laundering or combating the financing of terrorism deficiencies to which countermeasures apply, or a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the FATF to address the deficiencies.

A country whose securities market regulator is a signatory to the Multilateral Memorandum of Understanding of the International Organization of Securities Commission's (IOSCO) Multilateral Memorandum of Understanding (Appendix A Signatories) or a signatory to a bilateral memorandum of understanding with the SEBI for information-sharing arrangements.

Further, the following are also recognized lenders under the ECB Guidelines:

Multilateral and regional financial institutions of which India is a member.

Individuals provided they are foreign equity holders.

Individuals provided they are subscribing to bonds or debentures listed offshore.

Foreign branches or subsidiaries of Indian banks (only for foreign currency-denominated ECBs).

## 4. Are there any exchange controls that will apply to payments to be made in foreign currencies or to foreign lenders?

Yes, see "Background." Further, the ECB Guidelines contain restrictions in relation to the following:

The amount of ECBs that can be raised (see the answer to question 1 of this section).

The amount of interest and fees that can be paid on ECBs (see the answer to question 2 of this section).

The assets that can be provided as security for an ECB (see "Regulatory approvals" in the answer to question 10 of the "If taking security" section).

The prepayment of ECBs (any proposed prepayment that does not comply with the stipulated minimum average maturity, as mentioned in the answer to question 1 of this section, requires the RBI's prior approval).

Indemnity payments by an Indian borrower to a person resident outside India (these require the RBI's prior approval).

## 5. Is there any requirement to deduct or withhold tax from any amounts to be paid or repaid to a lender (whether domestic or foreign)? If so, at what rate must tax be deducted and from what kinds of payment?

Withholding tax is payable on payments of interest in relation to ECBs by Indian borrowers to foreign lenders. Currently, the rate is 5% where the loan agreement in relation to the ECB is entered into before 1 July 2023 subject to the satisfaction of certain conditions notified by the government of India. For interest payments by an Indian company on money borrowed or debt incurred in foreign currency on or after 1 July 2023, the rate is 20% plus surcharge and cess, while in other cases, a 40% rate plus surcharge and cess would apply. This is subject to the availability of tax treaty benefits and compliance with the requisite conditions for availing such benefits.

## 6. Are there any “thin capitalization” or other rules that may limit the extent to which interest payments may be deducted for tax purposes?

The thin capitalization provisions impose limitations on the deduction of excess interest incurred by way of interest or payments of a similar nature by an Indian company or a permanent establishment of a foreign company ("**PE**") to its nonresident associated enterprise in respect of debt borrowed. Excess interest is an interest amount exceeding 30% of the earnings before interest, taxes, depreciation and amortization (EBITDA) of the Indian company or PE.

These rules are only applicable where the interest, or payments of a similar nature, amount exceeds Indian rupees 10 million. Further, the interest expense that is disallowed against income will be allowed to be carried forward and allowed as a deduction against profits and gains of any business or profession carried on for up to eight assessment years, subject to the limits mentioned.

The thin capitalization rules are also applicable in instances of interest payments to third-party lenders that provide a loan on the basis of an associated enterprise, either providing an explicit or implicit guarantee to such third-party lender or depositing a corresponding amount with such lender.

Thin capitalization provisions are not applicable to Indian companies and PEs engaged in the banking or insurance business or notified NBFCs. These provisions are also not applicable with respect to interest paid in respect of a debt issued by a lender that is a PE of a nonresident that is engaged in the business of banking (for example, where the lender is the branch of a foreign bank in India).

## 7. Are there any registration, notarization, translation or reporting requirements in relation to the loan documents?

A facility agreement is not required to be registered or notarized with any authority. However, the details of the ECB are required to be reported to the RBI through the authorized dealer category-I bank in the form prescribed under the ECB Guidelines. The said report has to be made in English.

No specific translation requirements apply if the documents are in English.

See the answer to question 11 of the "If taking security" section for the requirements in relation to security documents.

## 8. Are there any stamp, documentary, registration, notarization or other taxes, duties or fees chargeable in relation to the loan documents? If yes, what are the amounts and when are they payable?

There are no taxes, duties, fees or other charges payable to any governmental authority or the RBI for using foreign currency loans.

However, stamp duty must be paid on credit agreements, guarantee deeds and security documents. The stamp duty payable on the documents varies from state to state. Usually, it is the obligation of the borrower, guarantor or security provider (as the case may be) to pay the stamp duty.

Stamp duty is paid prior to, or at the time of, execution of a document in India. Payment of stamp duty is often a determinative factor in choosing the location for the execution of documents. However, if a document is stamped in one Indian state but the original or a copy of it is brought into another Indian state that levies a higher stamp duty, differential stamp duty may be payable in the other state, depending on the nature of the document and the stamp duty laws in that state.

If a document is executed outside India, under Indian law, no stamp duty is payable on or before its execution. However, if the document or a copy of it is received in India, stamp duty may be payable on it, depending on the Indian state where the document is received and the nature of the document.

See the answer to question 11 of the "If taking security" section for the requirements in relation to fees payable in relation to security documents.

## 9. Does the law recognize the subordination of the debt that a debtor owes to one creditor to that which the debtor owes to another creditor? If yes, how is this usually effected?

Yes. Contractual subordination, by which lenders agree among themselves how the payment of debts will be prioritized, is the usual way of achieving this. It is usually documented in a subordination deed or an intercreditor agreement.

## 10. Are there any classes of unsecured and unsubordinated creditor whose claims against a debtor would rank equally with or above those of the debtor’s other unsecured and unsubordinated creditors (e.g., the claims of employees and tax authorities or the claims of creditors under particular kinds of instrument)? If yes, what classes of creditors are preferred?

See the answer to question 1 of the “If things go wrong” section.

## 11. Are there any consumer protection or similar laws that apply if credit is made available to individuals or other classes of debtor? If yes, what laws are applicable?

Individuals are not eligible to borrow ECBs and, therefore, consumer protection laws are not relevant to loans made under the ECB Guidelines.

## 12. Are there any prohibitions or limitations on the extent to which a company can give financial assistance for the purchase of: (a) its own shares or those of any affiliated company; or (b) assets owned by it or any affiliated company?

Under the Companies Act, 2013, a public company is not permitted to provide, whether directly or indirectly and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of, or in connection with, a purchase or subscription made or to be made by any person of, or for any shares in, the company or its holding company. However, this rule does not apply to private companies.

Further, under the ECB Guidelines, ECBs cannot be used for acquisition of shares other than acquisition of shares in an overseas entity in accordance with the guidelines issued by the RBI.

# If taking security

## 1. Are there any classes of unsecured and unsubordinated creditor whose claims against a debtor would rank equally with or above those of the debtor’s secured creditors?

See the answer to question 1 of the "If things go wrong" section, where the priority waterfall for distribution if liquidation proceeds is discussed.

## 2. May security given by a company rank in a specified order so as to secure liabilities owed to different creditors of the company in that order and, if that is not possible, is it viable for parties to enter into a contractual arrangement for the purposes of moderating this order?

Yes. An agreement between the borrower and the secured creditors prescribes the order of ranking. The lenders can also enter into an intercreditor agreement for moderating the order of priority of common security.

## 3. Does this jurisdiction recognise the concept of floating security or similar equivalent (i.e., security over a changing pool of assets that the company giving the security is free to buy, sell and generally deal with)?

Yes. Indian law recognizes the concept of a floating charge. A floating charge may be created over movable assets, receivables and current assets.

## 4. If so, are there any practical reasons why floating security is difficult to take, maintain or enforce?

If appropriate safeguards and monitoring mechanisms are implemented in the finance documents, it is not difficult to maintain and enforce a floating charge over movable assets.

## 5. May security be granted to a trustee to be held on trust for the lenders from time to time, in such a way that a change of lenders does not require new security to be taken?

Yes. These arrangements are possible as Indian law recognizes the concept of a trust. The relevant legislation is the Indian Trusts Act, 1882.

## 6. If not, are there any techniques that can be used to achieve substantially the same effect (e.g., parallel debt structures)?

Not applicable.

## 7. If an agent holds security for the lenders rather than a trustee, is it necessary to take new security on a change of lenders? If no, why not? If yes, are there ways to structure the transaction to avoid such a requirement?

Although the concept of agency is recognized in India, security is usually held by a trustee to avoid any difficulties regarding creation of security pursuant to a change of lenders.

## 8. Under the laws of this jurisdiction, is there any class of asset over which it is difficult or impossible to grant effective and perfected security, or in relation to which any security granted will be of limited effect?

The security created over assets of a project for which a concession is granted by the government (i.e., because the government owns the relevant land or has commissioned the project) may be subject to governmental approvals and terms and conditions imposed by the relevant governmental authority.

## 9. Under the laws of this jurisdiction, are there any restrictions on offshore lenders taking security over any class of asset?

The ECB Guidelines permit an ECB to be secured by immovable assets, movable assets and financial securities of an Indian company subject to obtaining the no-objection certificate of the authorized dealer bank in India. However, if any such asset constitutes a cross-border asset (such as shares of an overseas company), additional conditions may apply.

## 10. Must a company receive a corporate benefit in return for giving a guarantee or security? In particular, are there restrictions on the grant of upstream and cross-stream guarantees and security? If yes, briefly what is the effect of these laws?

The Indian Contract Act, 1872 provides that anything done for the benefit of the principal debtor is sufficient consideration for the guarantor or provider of security. However, the guarantor or security provider must be empowered under its constitutional documents to enter into a guarantee or grant security (as the case may be).

Where a third-party Indian company provides the guarantee or security, shareholders' approval of that company (by way of a special resolution) is required if certain prescribed thresholds (in terms of paid-up capital and free reserves) are exceeded. However, the approval is not required if the guarantee or security is provided in respect of financing made available to its wholly owned subsidiary company or joint venture company.

Please note that under the Companies Act, a company ("**lending company**") cannot grant a loan, provide security or extend a guarantee to, or on behalf of, any other company that has common directors with the lending company if certain conditions are met, unless the loan, guarantee or security has been approved by the lending company's shareholders and such loan is used for the  principal business activities of the borrower. This is subject to certain exceptions, such as the following:

Any guarantee given or security provided by a holding company in respect of a loan made to its wholly owned subsidiary if that loan is used by the wholly owned subsidiary for its principal business activities.

Any guarantee given or security provided by a holding company in respect of a loan made by any bank or financial institution to its subsidiary company if that loan is used by the subsidiary for its principal business activities.

If the lending company, in the ordinary course of its business, provides loans, guarantees or security for the due repayment of a loan and, in respect of that loan, interest is charged at a rate no less than the rate of the prevailing yield of 1 year, 3 years, 5 years or 10 years government security closest to the tenor of the loan.

## 11. What type of security interests does your jurisdiction recognise, e.g., pledge, charge, mortgage, hypothecation? In relation to each type of security interest, please state the formalities required to create and perfect that security.

**Modes of security creation**

**Immovable property**

Security over immovable property, such as land and buildings, is taken in the form of a mortgage. The Transfer of Property Act, 1882 ("**TOP Act**") primarily governs the creation of mortgages. The most common forms of mortgage are an English mortgage (a registered mortgage), a simple mortgage (a registered mortgage) and an equitable mortgage (a mortgage created by depositing the title deeds with the lender or security trustee).

Under the TOP Act, a mortgage (other than an equitable mortgage) for repayment of money exceeding Indian rupees 100 must be created by way of a registered instrument. The instrument must be signed by the mortgagor, attested by two witnesses and registered with the land registry where the mortgaged immovable property is situated.

In the case of an equitable mortgage, the mortgagor or its authorized representative deposits the title deeds in relation to the immovable property with the lender or security trustee and provides a declaration, at the time of the deposit, that records that the title deeds were deposited by that person with the lender or security trustee with the intention of creating a mortgage. The lender or security trustee records the deposit of title deeds by way of a memorandum of entry.

**Shares and other securities**

Security over shares and other securities is typically created by way of a pledge. There is no prescribed form under Indian law for the creation of a pledge of shares. However, a pledge agreement or deed is usually entered into between the pledgor and the pledgee to create and record the pledge. The pledgor also usually issues a separate power of attorney to the pledgee that allows the pledgee to deal with the pledged shares/securities in case of an event of default and take other actions on behalf of the pledgor.

**Movable property**

Movable property, such as cash deposits, bank accounts, receivables, plant and machinery and stock, is usually secured by way of hypothecation. Under Indian law, hypothecation generally means a charge over any movable property, existing or future, created by a borrower in favor of a creditor without the delivery of possession of the movable property to that creditor. The charge created by way of hypothecation may be a fixed charge over identifiable assets or fixed assets and is usually a floating charge over current assets and stock-in-trade.

The security provider executes a deed of hypothecation in favor of the lender or security trustee. The deed of hypothecation is usually a standalone document and covers all terms and conditions, powers and provisions to safeguard the interests of the lender/creditor. The security provider also usually issues a separate power of attorney to the lender or security trustee that allows the lender or security trustee to deal with the hypothecated assets in case of an event of default and take other actions on behalf of the security provider.

**Corporate authorizations**

If the security provider is a corporate entity, its constitutional documents must permit the creation of a mortgage over its immovable property. If the security provider is a company, it may need to obtain board and shareholder resolutions to approve the creation of the security, which must be in accordance with the requirements of the Companies Act.

**Perfection requirements**

In India, the perfection of a security occurs through registration. The type of security and the type of property determine where a security must be registered. While some securities do not require registration, others must be registered at more than one registry.

**Registration under the Indian Registration Act, 1908**

Any mortgage of immovable property, other than an equitable mortgage created by way of deposit of title deeds of the mortgaged property, must be registered in accordance with the Indian Registration Act, 1908 ("**Registration Act**") within four months of the execution of the mortgage deed. All Indian states require this type of mortgage to be registered. If the mortgage is not registered, it is invalid. However, where the mortgage is an equitable mortgage of immovable property created by way of deposit of title deeds of the mortgaged property, the document recording the deposit of title deeds is only required to be registered under the Registration Act in some Indian states.

No registration is required for any instrument creating any title or interest in, or right to, movable property under the Registration Act. Deeds of hypothecation and share pledge agreements are not required to be registered under the Registration Act.

**Registration with CERSAI**

A mortgage (by way of deposit of title deeds or otherwise), hypothecation (of plant and machinery, stocks, a debt (including book debt or receivables) and a security interest (in intangible assets, i.e., know-how, a patent, copyright, a trademark, a license, a franchise or any other business or commercial right of a similar nature, or on an under-construction residential or commercial building or its part by an agreement or instrument other than by mortgage) are also registered with CERSAI. This registration must be done by the lender or the security trustee with CERSAI.

**Filing with the ROC**

A mortgage, lien, charge, pledge, hypothecation or any other security interest created by an Indian company over its assets located in India or abroad must be registered with the relevant ROC within 30 days from the creation of the security interest. The ROC issues a certificate of charge. A charge created by an Indian company will not be taken into account by the liquidator or any creditor of the company unless it is registered with the ROC and a certificate of registration of the charge is issued by the ROC. The security provider company is also required to maintain a register of charges recording the details of the charge.

**Intellectual property, ships and aircraft**

Security over intellectual property, ships and aircraft must also be registered with the relevant government authority.

**Registration and filing fees**

Registration and filing fees vary according to the type of security and are payable at the time of registration. Some Indian states have a fixed registration fee, while others have a percentage-based fee. The amount of the registration fee for registering a mortgage of land with the land registry depends on the Indian state in which the property is located.

Registration fees for registering security documents with the ROC are nominal.

**Regulatory approvals**

**Approvals from tax authorities**

Creating a charge over certain types of assets (land, buildings, machinery, plant, shares, securities and fixed deposits in banks), to the extent to which those assets do not form part of the stock-in-trade of the taxpayer's business, may also need the income tax authorities' permission. If any proceedings are pending against the security provider under the Income Tax Act, 1961 where the amount of tax or other sum payable or likely to be payable exceeds Indian rupees 5,000, any mortgage or charge over assets of that type that are valued at more than Indian rupees 10,000 would be held to be void to the extent of any claims of the income tax authorities arising out of those proceedings. Further, as per the provisions of the Central Goods and Services Act, 2017 ("**CGST Act**"), if a company creates a charge over its assets after amounts under the CGST Act are due from such company and with an intention to defraud the government revenue, such charge will be void against any claim in respect of any tax or any other sum payable by the company. It is therefore, advisable for a lender to require that the security provider obtains the permission of the assessing officer under the Income Tax Act, 1961 and the proper officer under the CGST Act before creating any mortgage or charge in the lender's or security trustee's favor. However, this may delay the completion of the financing, as obtaining permissions from the income tax authorities and authorities under the CGST Act may be time-consuming.

**Consents of the authorized dealers for ECBs**

In the case of ECBs, the RBI has permitted authorized dealers (i.e., banks in India that have been given special licenses to deal with foreign exchange) to grant permission in relation to the creation of security over movable property, immovable property and financial securities in accordance with the ECB Guidelines.

**Other formalities**

**Immovable property**

As a matter of practice, a title search is conducted in relation to immovable property to ensure that the mortgagor is the legal owner and entitled to mortgage the property and to check whether any prior charge or mortgage exists over the property. The title search is conducted at the land registries in whose jurisdiction the immovable property is situated. Note that an equitable mortgage does not appear in the land registry's records unless registered with the relevant land registry. Therefore, it is advisable to also initiate a search with the ROC to check whether any equitable mortgage has been registered there.

**Movable property such as bank accounts and contracts**

In the case of a hypothecation over bank accounts or contracts, notices should be issued to the banks or the counterparties to the contracts informing them of the charge created. Often the bank will be the chargee and therefore know about the hypothecation. If the bank is not the chargee, however, and the notice is not issued, the chargee may find that the money in the relevant bank account is withdrawn and the charge is worthless.

**Shares or other securities**

Where the shares are in dematerialized form, certain forms have to be filed with the depository participant to mark a pledge over these shares in the shareholder's beneficial account.

## 12. Are there any registration, translation or notarization requirements in relation to security, guarantees, subordination or intercreditor documents?

In relation to registration requirements for security documents, please see the answer to question 11 of this section. Guarantees, subordination deeds and intercreditor documents are not required to be registered under Indian law.

There are no specific translation requirements that apply if the documents are in English.

## 13. Are there any stamp, documentary, registration, notarization or other taxes, duties or fees chargeable in respect of security, guarantees, subordination or intercreditor documents? If yes, what are the amounts and when are they payable?

Please see the answer to question 8 of the “When lending to borrowers” section.

# If things go wrong

## 1. Please provide a brief description of the insolvency regime. In particular what rights and duties do unsecured and secured lenders have on the insolvency of a debtor? Are there any other matters of concern?

The insolvency regime for a company is governed by the Insolvency and Bankruptcy Code, 2016 ("**Code**"). The insolvency resolution process of corporate persons (CIRP) is governed by Part II (Corporate Insolvency Resolution Process) of the Code and the regulations made under it. The adjudicating authority in relation to any matters relating to the CIRP of a corporate person is the National Company Law Tribunal (NCLT). No civil court or any other authority has jurisdiction in relation to insolvency matters of companies. Under the Code, prepackage insolvency resolution is currently only permitted with respect to companies classified as micro, small and medium enterprises.

**Insolvency resolution process**

**Commencement of process**

The CIRP of a corporate person under Part II of the Code can be commenced when a corporate debtor has committed a default in relation to the payment of a debt of at least Indian rupees 10 million owed to a financial creditor or an operational creditor. Part II is applicable to companies (except for financial service providers) and limited liability partnerships.

To commence a CIRP, an application must be filed before the NCLT in the form prescribed, informing the NCLT of the details of the default and suggesting an insolvency resolution professional.

The Code prescribes a 14-day timeline for the NCLT to admit or reject the application (although this has been interpreted to be recommended and not mandatory). The CIRP commences from the date of admission of the application by the NCLT ("**Insolvency Commencement Date**").

Under the Code, a public announcement must be made by the insolvency resolution professional at the time of the commencement of the CIRP in relation to the company. The public announcement, among other things, is required to notify the last date for the submission of claims by all the creditors of the company.

The CIRP is to be completed within 180 days from the Insolvency Commencement Date. The above time period may be extended by the NCLT for a period of 90 days if an application to do so is made by an insolvency professional (acting pursuant to a resolution of a committee of creditors passed by a vote of 66% of the voting shares). Further, the Code prescribes that in any event, the CIRP must be completed within a period of 330 days from the Insolvency Commencement Date, including any extension of the period of the corporate insolvency resolution process granted and the time taken in legal proceedings in relation to such resolution process. However, this time period has been extended by the courts and tribunals on a case-by-case basis.

**Moratorium**

The Code prescribes that from the Insolvency Commencement Date until the completion of the CIRP or the passing of a liquidation order (whichever is earlier), a moratorium will be imposed in relation to the company as follows:

No suits or proceedings are permitted to be instituted against the company.

No security is permitted to be enforced.

The company is not permitted to transfer or encumber any of its assets.

**Interim resolution professional**

An interim resolution professional must be appointed by the NCLT on the Insolvency Commencement Date. That resolution professional must be registered with an insolvency professional agency under the Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016 and be an independent party in relation to the company. From the date of appointment of the interim resolution professional, the management of the company's affairs will vest with the interim resolution professional.

The insolvency resolution professional is vested with the power to collate claims against the corporate debtor and, on the basis of claims received, constitute a committee of creditors. The form and manner, including the relevant documents that are required to be submitted by a financial creditor, operational creditor or a worker/employee in relation to their respective claims, must be in accordance with the applicable regulations. Please note that, in relation to any debt in foreign currency, such debt will be valued in Indian rupees at the reference rate published on the RBI's website on the Insolvency Commencement Date.

**Creditors' committee**

The insolvency resolution professional identifies the financial creditors and constitutes a creditors' committee. Operational creditors above a certain threshold are permitted to attend committee meetings but have no voting power. Depending on the item to be decided on, the creditors' committee can approve matters by a 51%, 66% or a 90% majority vote (depending on the type of matter). Decisions of the creditors' committee are binding on the corporate debtor and all its creditors.

The creditors' committee considers proposals for the revival of the debtor and must decide whether to proceed with a revival plan or liquidation within 180 days (subject to extensions as mentioned above). Any interested party may submit a revival proposal but it must provide for the payment of operational debts to the extent of the higher of the amounts that the operational creditors would have received had the company been liquidated and the amounts that the operational creditors would have received had the proceeds of the resolution plan been distributed as per the prescribed liquidation waterfall. Further, a plan must also provide for financial creditors who did not vote in favor of the plan to be paid a minimum of the amounts that they would have received had the company been liquidated.

If the resolution plan meets the requirements of the Code, the resolution professional will submit it to the creditors' committee for its consideration. Once a resolution plan is approved by the creditors' committee (by a 66% majority), the resolution plan will be submitted to the NCLT for its approval. A resolution plan approved by the NCLT is binding on all stakeholders, including employees, creditors, joint venture partners, members, partners of the corporate debtor and governmental authorities.

**Liquidation**

Under the Code, liquidation may be initiated against the corporate debtor in the following scenarios:

A 66% majority of the creditors' committee resolves to liquidate the corporate debtor at any time during the CIRP.

The creditors' committee does not approve a resolution plan within 180 days (or within the extended time periods as mentioned above).

The NCLT rejects the resolution plan submitted to it on technical grounds.

The corporate debtor contravenes the NCLT-approved resolution plan and an affected person makes an application to the NCLT to liquidate the corporate debtor.

In the case of liquidation, the priority waterfall for distribution of liquidation proceeds, prescribed under the Code, is as follows:

The costs of the insolvency resolution (including any interim finance) and liquidation.

Secured creditors (that are not enforcing their security outside the liquidation) together with worker dues for the preceding 24 months, on an equal basis.

Wages and any unpaid dues owed to employees other than workers for the 12-month period preceding the liquidation commencement date.

Financial debts owed to unsecured creditors.

Amounts payable to the central and state governments for the preceding 24 months, and unrealized dues of secured creditors outside the liquidation on an equal basis.

Any remaining debts and dues.

Preference shareholders, if any.

Equity shareholders or partners, as the case may be.

On liquidation, a secured creditor may choose to realize its security and receive proceeds from the sale of the secured assets as first priority. If the secured creditor enforces its claims outside the liquidation, it must contribute any excess proceeds to the liquidation trust. Further, in the case of any shortfall in recovery, the secured creditors will be junior to the unsecured creditors to the extent of the shortfall.

## 2. Is it possible to obtain a moratorium before insolvency?

**Code**

See the "Moratorium" paragraph in the answer to question 1 of this section in relation to the moratorium under the Code.

**Prudential Framework for Resolution of Stressed Assets**

The RBI issued the Reserve Bank of India (Prudential Framework for Resolution of Stressed Assets) Directions, 2019 ("**RBI Prudential Framework**") dated 7 June 2019. The RBI Prudential Framework applies to banks and financial institutions, as well as large nonbanking financing companies, and also requires asset reconstruction companies to adhere to the relevant resolution framework. The RBI Prudential Framework does not apply to foreign ECB lenders as they would not fall under the above category. However, such ECB lenders may voluntarily agree to participate in the resolution process and be bound by it (if the lenders that are bound by such a framework are agreeable).

Under the RBI Prudential Framework, upon the occurrence of a default (i.e., a day-one nonpayment) the lenders have to decide a resolution strategy within a review period of 30 days. A timeline of 180 days after the end of the review period is provided under the RBI Prudential Framework for preparing and implementing the resolution plan. Additional provisioning norms apply after 180 days.

To implement the resolution strategy, during the review period the lenders are required to sign an intercreditor agreement (ICA) to provide for basic rules for the finalization and implementation of the resolution plan. A resolution plan has to be agreed to by 75% of the creditors by value and 60% by number for it to be binding on all the creditors, and an ICA has to be entered into by the creditors for them to be bound. The resolution plan may, among other things, provide for a one-time settlement of the debt, a restructuring of the debt, a moratorium on principal and interest payments and/or conversion of some of the debt into equity/other instruments. It may also provide for a change of ownership. Further, resolution plans should provide for payment no less than the liquidation value (i.e., the estimated realizable value of the relevant borrower's assets, if such borrower were to be liquidated on the date of commencement of the review period) due to the dissenting lenders.

A resolution plan under the RBI Prudential Framework is not binding on creditors that do not sign the ICA. It is not mandatory for foreign ECB lenders to sign the ICA. However, if foreign ECB lenders sign the ICA, their dues will be paid or restructured per the resolution plan.

Please note that the ICA provides for a standstill period of 180 days within which no security can be enforced against the company, nor can an insolvency resolution process be commenced by the lenders that are signatories to the ICA.

**State-specific legislation**

Special state-specific legislation such as the Maharashtra Relief Undertakings (Special Provisions) Act, 1958 (applicable to Maharashtra), the Rajasthan Relief Undertakings (Special Provisions) Act, 1961 and the Karnataka Relief Undertakings (Special Provisions) Act, 1977 can also provide a veil of protection to debtor companies from claims by creditors on express notification by the debtor company as a relief undertaking by the respective state government.

## 3. When a company is the subject of a formal insolvency procedure, can the company’s pre-insolvency transactions be set aside?

**Preferences**

If the liquidator or the insolvency resolution professional is of the view that the corporate debtor has given a preference to any person, they may apply to the NCLT to seek a declaration that any preferences that occurred at the relevant time are void and that their effect be reversed.

Under the Code, a corporate debtor is deemed to have given a preference if the following conditions are met:

There is a transfer of property or an interest in the property of the corporate debtor for the benefit of a creditor or a surety or a guarantor for or on account of an antecedent financial debt or operational debt or other liabilities owed by the corporate debtor.

That transfer has the effect of putting the creditor or a surety or a guarantor in a better position than it would have been in had the distribution of assets been made in accordance with the Code.

However, a preference does not include the following transfers:

A transfer made in the ordinary course of the business or financial affairs of the corporate debtor or the transferee.

Any transfer creating a security interest in property acquired by the corporate debtor to the extent that the following conditions are met:

The security interest secures new value and was given at the time of, or after, the signing of a security agreement that contains a description of that property as a security interest and was used by the corporate debtor to acquire that property.

The transfer was registered with an information utility (i.e., a depository of financial information registered with the Insolvency and Bankruptcy Board of India pursuant to the Code) on or before 30 days after the corporate debtor receives possession of that property.

"Relevant time" means:

The period of two years preceding the Insolvency Commencement Date in relation to a related party (other than by reason only of being an employee).

The period of one year preceding the Insolvency Commencement Date in relation to any other person.

**Undervalued transactions**

Additionally, the Code provides that the liquidator or the appointed insolvency resolution professional may make an application to the NCLT to seek a declaration that any undervalued transactions are void and that their effect be reversed. An undervalued transaction is a transaction that is not in the debtor's ordinary course of business and one where the corporate debtor does either of the following:

Makes a gift to a person; or

Enters into a transaction with a person that involves the transfer of assets by the debtor for consideration that is significantly less than the consideration provided by the corporate debtor at the time of acquisition of those assets.

An undervalued transaction may be declared to be void and be reversed if made with a related party within a period of two years preceding the Insolvency Commencement Date or with any other person within a period of 1 year preceding the Insolvency Commencement Date.

Separately, the Code provides that the NCLT must make an order restoring the position as it existed before the transaction and protecting the interests of persons who are victims of the transactions if the corporate debtor has deliberately entered into an undervalued transaction to do either of the following:

Keep the debtor's assets beyond the reach of any person who is entitled to make a claim against the debtor.; or

Adversely affect the interests of such a person in relation to the claim.

However, any order of this type will:

Not affect any interest in property that was acquired from a person other than the corporate debtor and was acquired in good faith, for value and without notice of the relevant circumstances, or affect any interest deriving from such an interest; and

Not require a person who received a benefit from the transaction in good faith, for value and without notice of the relevant circumstances, to pay any sum unless they were a party to the transaction.

**Extortionate credit transactions**

Further, the Code also provides the liquidator or the insolvency resolution professional with the power to make an application for the avoidance of any extortionate credit transaction entered into by a corporate debtor within a period of two years preceding the Insolvency Commencement Date. Under the regulations under the Code, a transaction is considered an extortionate credit transaction where one of the following conditions is met:

The terms require the corporate debtor to make exorbitant payments in respect of the credit provided; or

The terms are unconscionable under the principles of law relating to contracts.

## 4. When can a lender enforce its security? Can security be enforced out of court following an event of default (or other contractual trigger event), or is a court order required? Are there any restrictions that apply before a lender may enforce its security?

The terms and conditions of the security documents govern enforcement of security. Generally, a lender may enforce its security on the occurrence of an event of default. The process to be followed for enforcing the security is briefly set out below. (See the answer to question 11 of the "If taking security" section for the different types of security interest referred to below).

Except in the case of an equitable mortgage, a court order is generally not required for the enforcement of security. However, if the security provider objects to, or disputes, the enforcement and makes an application to the court, the dispute must be resolved through a court process.

**Immovable property**

If the mortgage is an English mortgage, the mortgagee has the power to sell the mortgaged property without the court's intervention, subject to certain notification requirements. Where the mortgage is an equitable mortgage, the mortgagor must apply to the court for a decree to sell the mortgaged property to recover the debt.

**Movable property**

The rights and remedies of a hypothecatee (that is a foreign lender or a security trustee for a foreign lender) are entirely regulated by the terms of the deed of hypothecation between the hypothecator and hypothecatee. A deed of hypothecation can be enforced by either compelling the delivery of the movable property or by selling or obtaining a decree for sale of the movable property if that is stipulated in the deed of hypothecation. If the deed does not specify the manner in which the hypothecated property may be dealt with, the remedy open to the creditor would be to obtain a money decree declaring its lien on the property and the right to sell that property.

**Pledge over shares**

A pledgee may enforce a pledge and sell the pledged shares by giving reasonable notice of enforcement to the pledgor. The pledgee does not need to obtain a court order to sell the pledged shares. If the pledged shares are held in physical form, the pledgee must submit to the company whose shares are being pledged the executed share transfer forms held by the pledgee. The company will then need to approve the transfer of shares in the name of the lender or third-party transferee at its board meeting. If the company refuses to approve the transfer of shares, the lender or third-party transferee will need to approach the competent courts and tribunals to challenge the refusal.

## 5. Do any limitation periods apply in relation to bringing an action to enforce security?

Any proceeding in court for the enforcement of security must be brought within the relevant limitation period. For example, a suit ordering the sale of the mortgaged property must be brought within 12 years from the date on which the money sued for becomes due, and a suit ordering a sale of charged or pledged property must be brought within three years from the date that the cause of action arises.

## 6. Is there any particular way in which secured assets must be liquidated on enforcement (e.g., by auction or court sale)?

No. The process is governed entirely by the terms of the security documents. However, please note the following stipulations under the ECB Guidelines (see under "Background") in relation to enforcement of security over relevant assets:

In the case of the invocation of a pledge, any transfer of financial securities must be in accordance with the extant foreign direct investment policy, including provisions relating to sectoral cap and pricing, as applicable in accordance with the Foreign Exchange Management Act, 1999 and rules and regulations framed under it.

In the event of the enforcement of a mortgage, immovable assets must only be sold to a person resident in India and the sale proceeds must be repatriated to liquidate the outstanding ECB.

Charged movable assets may be taken out of India by a lender to the extent of the lender's claim, subject to obtaining permission from domestic lender(s), if any.

## 7. Are there any particular legal or practical difficulties or delays in enforcing security?

If the security provider contests enforcement action in relation to the security (which generally is the case), the enforcement process is time-consuming. It could take several years to obtain a judgment in India. The timeline depends on the facts and the relief sought, as well as the backlog of cases at the time of enforcement. However, it may be possible to obtain interim relief in a shorter time frame.

## 8. In relation to enforcement, are there any specific requirements to be borne in mind if the lender is a foreign entity?

Yes. The RBI's prior approval may be required to repatriate to an offshore lender from India any amounts recovered on enforcement of a judgment of a court that is not an Indian court.

## 9. Is there any reason why you think that arbitration rather than litigation might be advantageous in resolving disputes under the finance documents, and if so, why? Please outline the relative merits of arbitration and litigation, including the ease of enforcement of foreign judgments and foreign awards from different jurisdictions. Is it possible to rely on a hybrid enforcement provision that allows the lenders to opt for either arbitration or litigation as they see fit?

It is not very common for a loan agreement between an Indian borrower and a foreign lender to select arbitration as the dispute resolution mechanism as it may be quicker to obtain a judgment in a foreign court rather than to appoint (after the dispute) an arbitral tribunal and have the dispute heard by arbitration.

Any judgment that is a money decree obtained from a superior court of any reciprocating territory notified under the Code of Civil Procedure, 1908 of India will be recognized and enforced by the courts in India, subject to certain statutory provisions, without re-examining the issues. The UK and Singapore have been declared reciprocating territories, and certain courts in those jurisdictions have been declared superior courts for the purposes of the Code of Civil Procedure.

India is a signatory to the New York Convention for the Enforcement of Foreign Arbitral Awards, 1958. Awards handed down by an arbitral tribunal whose seat is in a country that is a signatory to the New York Convention will be enforced in India as a "foreign award" under Part II of the Arbitration and Conciliation Act, 1996, without the need for any retrial and the award will be deemed to be a decree of an Indian court. However, there are certain grounds for objection to the enforcement of a foreign award governed by the New York Convention. These include the following:

The parties to the arbitration agreement were, under the law applicable to them, under some incapacity, or the agreement is not valid under the law to which the parties have subjected it or under the law of the country where the award was made.

The party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitral proceedings or was otherwise unable to present its case.

The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration.

The composition of the arbitral authority or the arbitral procedure was not in accordance with the parties' agreement, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place.

The award has not yet become binding on the parties or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.

The subject matter of the dispute is not arbitrable under the law of India.

The enforcement of the award would be contrary to Indian public policy.

However, even if the arbitration takes place at a venue outside India, the parties are entitled to obtain interim relief in Indian courts against the Indian entity while the arbitration proceedings are still pending.

Under Indian law, there must be a clear intention and obligation under the contract to arbitrate. If an option is given to one party to arbitrate or litigate, Indian courts have, to date, largely held that there is no clear obligation to arbitrate on both the parties. While there are arguments to suggest that a hybrid enforcement provision does not mean that there is a lack of intention and obligation, the possibility of an Indian court ruling that such an arbitration or litigation provision is invalid and, therefore, the award or judgment is not enforceable cannot be ruled out.

## 10. Are asymmetrical jurisdiction clauses enforceable? (By this we mean clauses that allow the lenders, but not the borrowers, to make certain choices in relation to choice of jurisdiction and how to litigate. These types of clauses allow the lenders, but not the borrowers, to commence proceedings in any court they choose, but restrict the borrowers to commencing proceedings in one jurisdiction only. This may also allow the lenders, but not the borrowers, to choose whether to litigate the finance documents before a court or to submit to arbitration in relation to them, but restrict the borrowers to either litigation or arbitration, as specified in the agreement).

Yes, asymmetrical jurisdiction clauses are generally recognized by Indian courts.

# Working digitally

## 1. Is it possible for documents to be executed electronically (whether by the manual insertion of a digital signature or the use of an e-signing platform) under the laws of this jurisdiction? If so, is this limited to only particular types of finance documents?

The validity of an electronically signed contract is recognized in India as long as such a contract satisfies the essential elements of a valid contract, including offer and acceptance, presence of a lawful consideration and lawful object, free consent of the parties, competency of the parties to contract, intention of the parties to create a legal relationship, the certainty and possibility of performance as intended, etc. The conclusion of electronically signed contracts on the satisfaction of these essential elements of a contract has also been recognized by Indian courts.

The Information Technology Act, 2000 ("**IT Act**") recognizes electronically signed contracts and provides that where a contract is expressed in electronic form or by means of an electronic record, such contract will not be deemed to be unenforceable solely on the ground that such electronic form or means was used for the purpose. The IT Act also provides for the type of signatures that can be used for the authentication of electronic records, namely (i) digital signatures and (ii) electronic signatures. Digital signatures issued by licensed certifying authorities (CA) are reliable and are legally valid in a court of law as per the IT Act, as they employ private and public keys that are unique to the subscriber and constitute a functioning key pair for authentication of a document.

While legal recognition has been provided to electronically signed contracts, as per the IT Act, the following documents cannot be signed electronically:

A negotiable instrument (other than a check, demand promissory note or a bill of exchange issued in favor of or endorsed by an entity regulated by the RBI and other prescribed authorities) as defined in Section 13 of the Negotiable Instruments Act, 1881.

A power of attorney as defined in Section 1A of the Powers of Attorney Act, 1882 (except when such power of attorney empowers an entity regulated by the RBI, SEBI or other prescribed authorities to act on behalf of them).

A trust as defined in Section 3 of the Indian Trusts Act, 1882.

A will as defined in Clause (h) of Section 2 of the Indian Succession Act, 1952, including any other testamentary disposition called by whatever name.

## 2. Where the witnessing of a signing is contemplated, is it possible for the witness to verify the signature over a live video call?

Documents that are mandatorily required to be witnessed cannot be witnessed over live video calls.

## 3. Is it possible to register/perfect security electronically without wet ink signatures?

Security over movable assets may be registered and perfected without wet ink signatures. However, security over immovable assets where registration with a land registry is mandatory would need to be executed by wet ink for the purposes of the registration process.

## 4. Are there any other legal restrictions that may prevent the parties from executing a finance transaction electronically?

Please refer to our response to question 1 of this section.

# Contributors

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