

Strengthening Diligence for a Secure Mortgage Lending

INTRODUCTION

India's booming real estate market has fueled significant growth in real estate financing, with mortgages on immovable property becoming a preferred and most common form of collateral for both retail and corporate borrowers. Recognizing inherent property risks, lenders conduct a legal due diligence, often through external counsel, who issue a title search report (“**TSR**”) that scrutinizes the title and identifies potential issues. Scrutinizing the title is essential to ascertain the ownership of the property and to ensure that the title is clear and free from any defects, encumbrances and claims. The TSR also includes advice on necessary compliances involved in creating a valid and enforceable charge towards recovery of dues in case of a default by the borrower.

A flawed title could adversely impact the validity and enforcement of security. For instance, proceedings under the *Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002* (“**SARFAESI**”), or the *Insolvency and Bankruptcy Code, 2016* (“**IBC**”), can be impacted in terms of timelines which often leads to deterioration of asset value. Further, recovery and insolvency proceedings under SARFAESI and IBC are often stayed until the issue of title is determined by a competent civil court, leading to additional delays and a downward spiral in the value of the security.

A recent case before the Hon’ble Supreme Court of India (“**Supreme Court**”), *Central Bank of India & Anr. v. Smt. Prabha Jain & Ors.* (“**Prabha Jain**”), addressed whether a civil court is empowered to adjudicate on the determination of title of a property mortgaged with a bank, when proceedings are pending before a Debt Recovery Tribunal for the same subject property. The Supreme Court observed that a civil court has exclusive jurisdiction to determine the ownership of a property. The Supreme Court also emphasized that banks must be careful with inadequate TSRs and recommended that the Reserve Bank of India (“**RBI**”) formulate guidelines for

preparing TSRs. This note discusses the recommendations of the Supreme Court and attempts to uncover its practical implications.

BREAKING DOWN THE RECOMMENDATIONS IN PRABHA JAIN

Standardization of TSR

In *Prabha Jain*, the Supreme Court observed that RBI, along with other stakeholders, should collaborate in developing a standardized and practical approach for preparing TSRs. Hitherto, no standard format or operational guidelines have been prescribed by regulators for banks/ financial institutions regarding the preparation of TSRs. While some banks have internal policies and standard formats for their TSR that the external counsels adhere to, it is not the case with all the banks and financial institutions, and neither is there a common agreed format used by all the banks.

The Hon'ble Bombay High Court had addressed the question of the approach to be taken and contents of TSRs in *Ramniklal Tulsidas Kotak and Others v. Varsha Builders and Others* (“**Ramniklal**”) and has laid down the following norms for advocates preparing TSRs:

1. perusal of title-deeds;
2. conducting public searches;
3. issuing public notices;
4. seeking certification on whether the land is under set-back or reservations;
5. administering requisitions on title to the mortgagor and ensuring satisfaction with the responses;
6. obtaining declarations on oath from the relevant persons regarding the factual position before issuing a certificate of title.

Affixation of liability & quality control

In *Prabha Jain*, the Supreme Court further suggested that RBI should establish a framework to determine liability (including criminal action) of the officer who wrongfully approves any loan. RBI has been issuing directions on fraud risk management, classification and reporting from time to time and the existing framework could be adopted for determining staff liability in case of loans as well. Furthermore, *Prabha Jain* recommends standard guidelines for fees and costs associated with TSRs to ensure high quality. To maintain high quality, it may also be necessary to have minimum eligibility criteria for the counsels preparing TSRs and a mechanism of

reporting advocates to Indian Banks Association's caution list in case of willful negligence or fraud by the counsel, as some banks have already implemented.

KEY FACETS FOR PREPARATION OF A TSR

Following *Ramniklal's* precedence, we set out below are some of the of key facets of preparing a TSR:

Period of title search

While conducting a title search, *inter alia*, the title documents of the immovable property are examined and scrutinized to ensure proper and complete flow of title. As a standard practice, the title is traced for a period of thirty years. This practice has evolved due to several legal inferences including the below:

1. the limitation period for filing a suit for redemption or foreclosure of mortgaged properties is thirty years under the Limitation Act, 1963, beyond which a claimant loses the right to file the suit;
2. documents over thirty years old are presumed to be genuine and properly executed under the *Bharatiya Sakshya Adhinyam, 2024*; and,
3. the limitation period for filing a suit for dispossession by the government is thirty years, and the limitation period for filing a suit for adverse possession is twelve years under the Limitation Act, 1963. Thus, tracing the title for thirty years ensures that neither the government nor any private person has a right to dispossess the property.

However, tracing the title for a period of thirty years is not a "one-size-fits-all" approach. In some situations, an extensive scrutiny of documents executed beyond thirty years may be required to ascertain the title of the mortgagor. Each situation should be assessed on a case-by-case basis by counsel and the lender, considering the nature of the loan, the type of property, and the parties' objectives.

Documentary search

For preparing a TSR, counsels typically rely on documents such as title documents, encumbrance certificates, revenue records, property tax documents, construction permissions etc. However, it is also prudent to conduct searches in the records of the Sub-Registrar of Assurances, wherever appropriate. In states like Maharashtra, where searches are permitted, counsel or their clerk can verify the records of the concerned Sub-Registrar Office ("**SRO**") for a specified period to check any existing encumbrances. In some of the eastern and southern states of India, where searches

are not usually conducted, a 'nil encumbrance certificate' from the revenue authorities may be accepted. Wherever applicable, the title diligence should also include findings from searches with the [Central Registry of Securitization Asset Reconstruction and Security Interest](#), the [Registrar of Companies](#) and [Registrar of Firms](#) to examine the existence of any pre-existing charges over the assets sought to be mortgaged. Further, TSRs should also include details of pending litigation in courts and tribunals.

Public notice

It is also advisable to issue public notices about the mortgage in both a local language newspaper and an English language newspaper inviting objections of the public to the security provider mortgaging the property to avoid any third-party claims and to provide added strength to the legal stand of the lender in case of any future dispute. In *Ramniklal*, the court highlighted that issuing a public notice is a standard practice in title diligence.

Approvals and consents

Further, counsels also advise on the applicable laws and regulations including any reservations made by the government on the property. The land-use/ status of the property (i.e., agricultural or non-agricultural) is identified during the verification of title and necessary legal advice on the details of required approvals under law is given in the TSR. There may also be restrictions on mortgage creation based on the borrower's constitution (e.g. companies formed with charitable objects, trusts, societies) that should be addressed in the TSR. The TSR must highlight any third-party consents or no-objection certificates ("**NOC**") required for creating a valid charge over the property which must be duly obtained. Notably, in the case of *Bikram Chatterji and Ors. v. Union of India and Ors.*, the Supreme Court had invalidated a mortgage because the required NOCs were not obtained before the creation of mortgage.

Risks and compliance aspects

TSRs may sometimes include adverse findings that are often overlooked during lending. However, such issues can pose significant risks to security enforcement and loan recovery in case of default. Lenders should exercise caution in ensuring that all adverse findings in the TSR are addressed, either by correcting them, or by incorporating necessary provisions in transaction documents. Additionally, TSRs should cover all such aspects that can affect the title of the property that can hinder enforcement of the security such as issues related to succession, family disputes, stamp duty, registration charges, payment of revenues, and confirm the security

provider's title, the validity of the proposed mortgage, and the type of mortgage to be created.

CONCLUDING REMARKS

A flawed title of a security on which charge has been created not only poses a risk of delaying the process but can also lead to courts invalidating the charge itself. Legal due diligence plays a crucial role in risk assessment and mitigation with respect to creation and enforcement of a valid charge over the property of a borrower. By implementing the recommendations of the Supreme Court in *Prabha Jain*, the banking and financial sector will benefit from enhanced clarity, improved due diligence leading to better quality collateral and more efficient recovery mechanisms.

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