STUDY COURSE ON INSOLVENCY AND BANKRUPTCY CODE (IBC)

Understanding the bankers approach towards recovery of NPA under – SARFAESI & IBC

by
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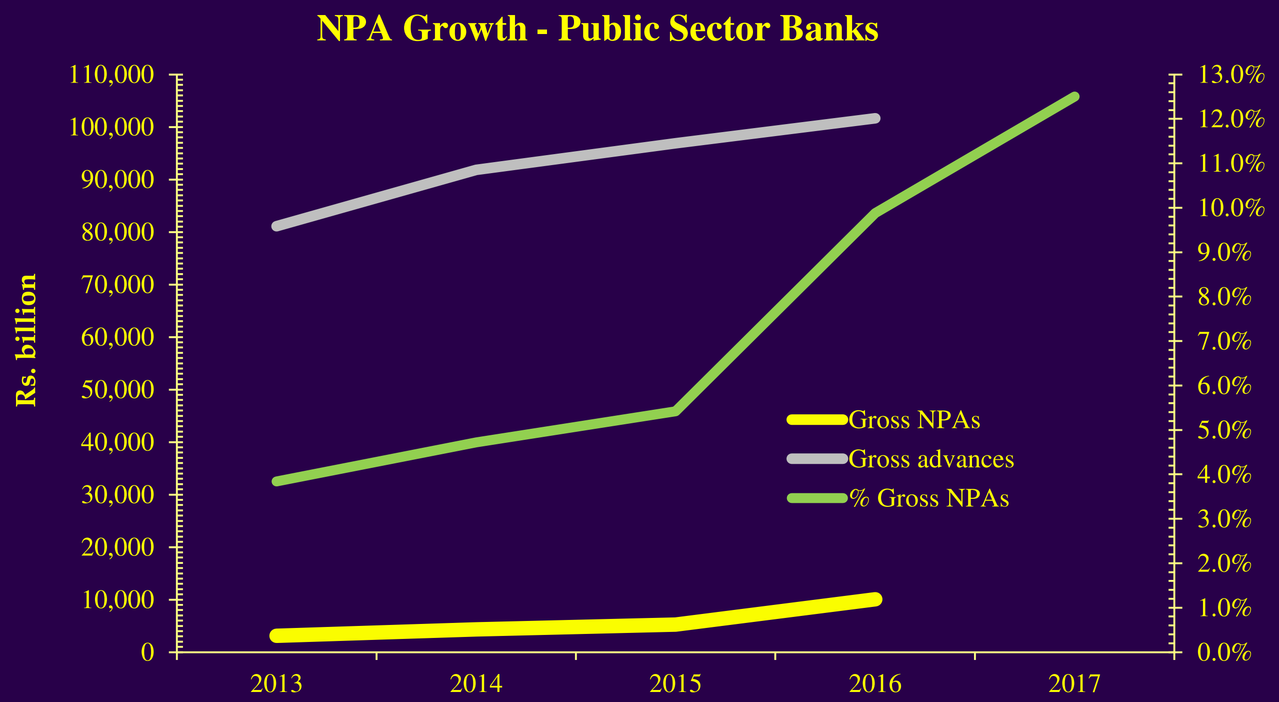
Presentation Structure

1. Introductory remarks - The NPA Problem
2. Recovery V/s restructuring: RDDBFI / SARFAESI Acts and IBC-2016
3. Varying approaches: Public sector and Private sector banks
4. India's constraints and way forward
5. IBC – The great value adder
6. Discussions

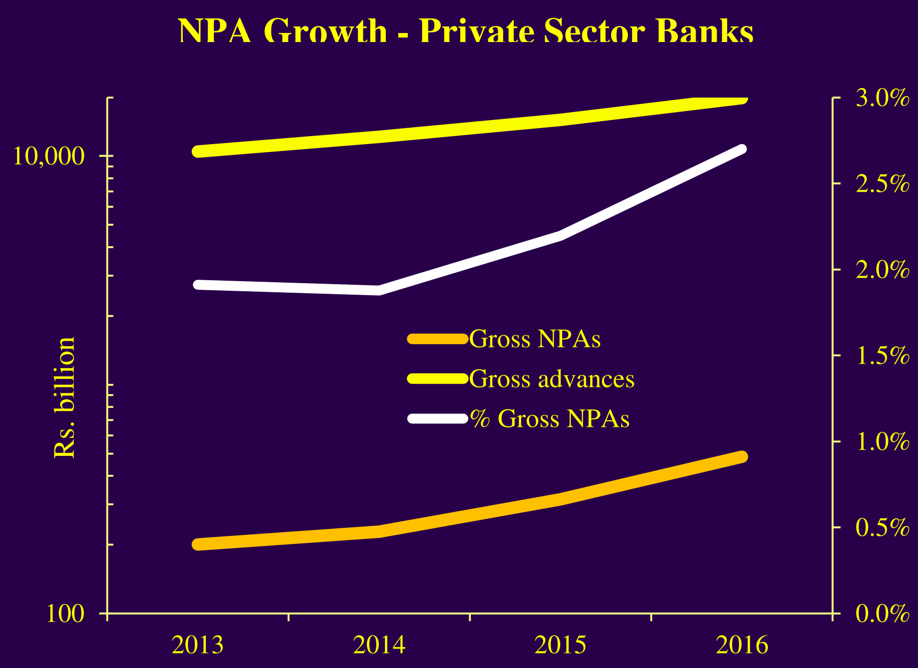
Introductory remarks - The NPA Problem

- Sudden spurt in NPA growth
- More pain ahead
- Not the result of systemic meltdown
- Result of asset overstatement and poor credit appraisal and monitoring



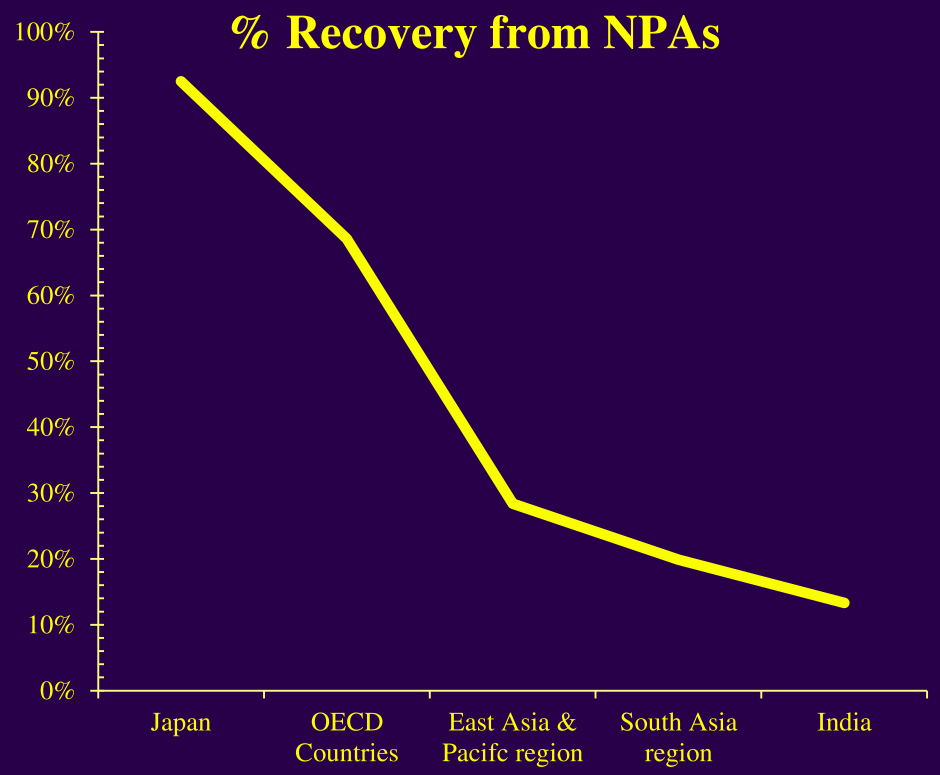
Introductory remarks - The NPA Problem

- Huge difference between public sector and private sector bank NPAs
- The NPA recovery ratio dictates NPA recovery approaches of the banks



Introductory remarks - The NPA Problem

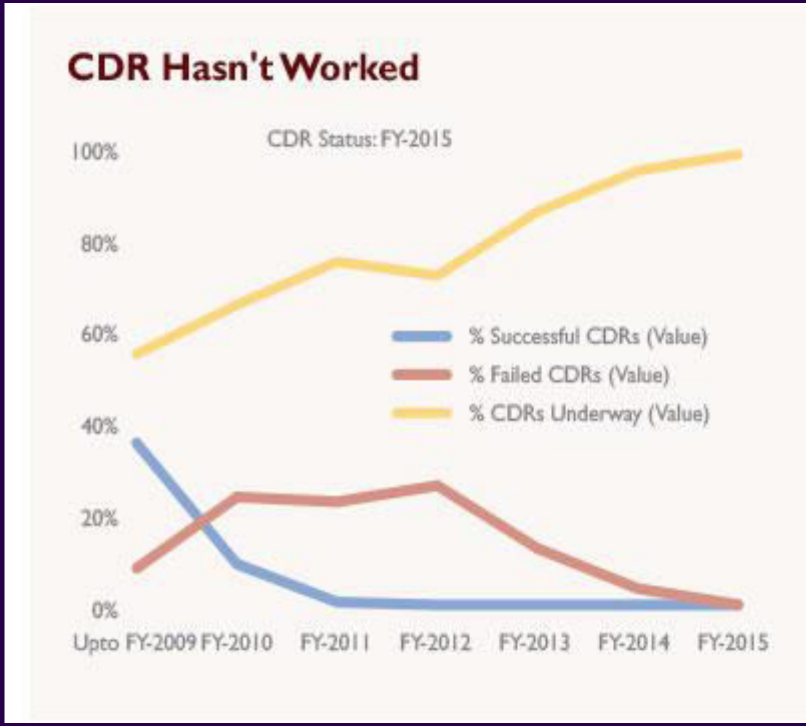
- According to World Bank study, India's NPA recovery ratio is among the poorest



- This impacts the choice of resolution / recovery approach of the banks

Recovery V/s restructuring: RDDBFI / SARFAESI Acts and IBC-2016

- **RECOVERY: BANKS' APPROACH**
  - **Maximum recovery**
    - Restructuring based on robust bottom approach only can guarantee this
    - Restructuring schemes launched since 2001 have not met with success



- The experience with JLF / 25%-50%, 5/25, SDR and S4A schemes for restructuring has been similar
- The 12 large companies brought under IBC in terms of RBI's circular of May 5, 2017 went through the process of restructurings under one or more of these schemes
- Reason for failure has been low value of assets relative to book values – validated by lowest recovery from Indian NPAs
- This means predominance of recovery

Recovery V/s restructuring: RDDBFI / SARFAESI Acts and IBC-2016

- **Minimum recovery cost**

  DRT: RDDBFI Act / SARFAESI Act

  - Average cost of adjudication per account: Rs. 5 to 10 lakhs
  - Average time: 5 years: Loss of real interest: 40% or more (of the realised asset value)
  - Impairment of assets: Substantial
  - Enforcement / security costs: 2% to 5% (of the realised asset value)
- **IBC-2016**
  - Decision to liquidate can be done in 1-2 months. IRP / RP fee: Rs. 10 to 20 lakhs
  - Liquidator and assets being under control of the CoC, speedy and efficient sale happnes
  - Liquidator's fee: 0.25% to 5% in different slabs. Weighted average < 5%
- **CONCLUSION:**
  - **Recovery under IBC is very efficient**
  - **IBC wins hands down: It is excellent RECOVERY CODE**

Recovery V/s restructuring: RDDBFI / SARFAESI Acts and IBC-2016

- **Provisioning issues**

  IBC-2016

  - IBC entails 50% provisioning each of 2 years
  - If the asset valuation is very low, higher provisioning is necessary

  RDDBFI Act / SARFAESI Act

  - The debt is written off in 4 years

  CONCLUSION:

  - Higher provisioning under IBC is an issue with banks
- **CVC issues**
  - Fear of substantially lower asset values relative to book values
  - Applicable both in RDDBFI-SARFAESI Acts and IBC-2016
  - Hence banks do not speed up asset sales
  - This also triggers sale to ARCs
  - RBI's Sept. 2016 guidelines on sale of distressed assets are a dampner

Recovery V/s restructuring: RDDBFI / SARFAESI Acts and IBC-2016

- **RESTRUCTURING: BANKS' APPROACH**
  - Provisioning issues
    - Provisioning has been progressively tightened by RBI. It is still benevolent
    - A good bottom up approach can ensure restructuring with maximum recovery and reduced provisioning
    - The restructuring schemes of RBI: CDR / JLF-CAP / 5-25 / 25-50% / SDR and S4A have not succeeded
    - The result is migration to IBC
    - IBC's restructuring is highly flexible – Practical difficulties

India's constraints and way forward

- **CONSTRAINTS**
  - Comparison with the best insolvency & recovery code makes this cleat
  - The UK bankruptcy code:
    - Creditor friendly: Over 50% of the distressed companies are sold as going concerns and over 40% of the companies are liquidated piecemeal
    - The liquidation process gets concluded in less than 1½ years
    - Recovery of about 75% with recovery cost of just 15% of the asset value.
    - Overall, 75% of the distressed assets undergo bankruptcy and the balance are restructured, reflecting the lenders' preference for restructuring viable businesses.
  - In India:
    - Lower recovery – 13.3% reflects substantial asset overstatement – Many examples
    - This means deployment of IBC predominantly for liquidation – The best way
    - Nascent code & infrastructure issues

Varying approaches: Public sector and Private sector banks

- **Private Sector Banks**
  - Adopt speedy restructuring / recovery action
  - Targetted approach: NPAs must be disposed off speedily
  - Significantly lower infrastructure / project financing which has caused bulk of NPAs
  - Have not faced much asset overstatement
- **Public Sector Banks**
  - Bogged down by substantially lower realisable asset values relative to book values
  - Decision making impaired due to accountability / CVC issues
  - Had to be prodded by RBI
  - RBI initiative will lead to spurt

IBC – The great value adder

- Epoch making: Debtor in possession to Creditor in possession / control
- Excellent Resolution Code: Flexible resolution. Rigidities surrounding existing restructuring schemes eradicated
- Government dues: No longer a dampener – the big one that it has been so far
- Decision making vests with Committee of Creditors i.e. the people who understand commercial / financial aspects – no longer a subject of adjudication
- Adjudication relates only to the questions of law
- Pre-cursor to spurt in acquisitions
- Proper price discovery and rectification of historical blunders

IBC – The great value adder

Challenges

- IRPs / RPs need to forge teams of domain experts to understand business, adopt a bottom up approach and come up with realistic enterprise value
- Go beyond the necessaries in the Information Memorandum in terms IBC-2016 and CIRP Regulations
- Add sufficiency criteria
- Produce effective Information Memoranda u/s 29 of IBC-2016 and facilitate speedy due diligence by Resolution Applicants - Let's see CIRP regulations to comprehend this

IBC – The great value adder

Clause 36 of CIRP Regulations:

Information Memorandum: Necessary requirements

- Audited financial statements for the last 2 years, and recent provisional statements till 14 days before the insolvency application date
- Assets and liabilities as on the insolvency commencement date.
- Details of creditors: Names, amounts claimed and security details
- Related party details / dues
- Details of members / partners holding stake of 1% or more, along with the stake
- Details of guarantees as security for the corporate debt: including from related parties
- Details of material litigation
- Liquidation value including relating to operational creditors
- Other relevant information as the resolution professional (IRP for short) may decide.

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Clause 37 of CIRP Regulations:

Resolution Plan

Asset sale

- Transfer of all or part of the assets of the corporate debtor to one or more persons;
- Sale of all or part of the assets whether subject to any security interest or not;
- Issuance of securities of the corporate debtor for cash, property, securities, or in exchange for claims or interests, or other appropriate purpose; and

Stake sale

- Substantial acquisition of shares of the corporate debtor, or the merger or consolidation of the corporate debtor with one or more persons

Security for the debt

- Satisfaction or modification of any security interest;

IBC – The great value adder

- Sufficiency criteria in Information Memorandum (IM)
  - Capture clearly the due diligence aspects: Technical, financial / accounts, contractual / legal & regulatory and business
  - Add enterprise value
  - Calls for thorough bottom up approach
  - Calls for collaborative approach among RPs
  - Catalyze acquisition bids through competitive Resolution Plan
  - Let’s look it more precisely

IBC – The great value adder

An effective **IM** must contain:

- Necessary and sufficient information, data, and analysis to facilitate decision making by Committee of Creditors (CoC)
- In other words, the IM must facilitate formulation of
  - Precise RP options, or
  - Liquidation
- Necessary information:
  - Details mentioned in Clause 36
  - Inferential analysis of financial position and performance
- Sufficient information:
  - Business viability
  - Management & organisational bandwidth
  - Operating cost and capex requirement / phasing
  - Peer comparison
  - Comments on viability potential and requisite steps in case of resolution, and anticipated realisation from asset liquidation

Discussions

- Let's discuss matters

Thank you